
8 Financing and delivery options

Key points

- Mandated paid parental leave, whether financed from general government revenue, businesses or employees, affects people's choices about investment, consumption, saving and employment. The extent to which those choices are altered is a measure of the economic or efficiency costs associated with financing parental leave.
- Direct employer financing would place most of the costs of a scheme initially on those businesses that have higher proportions of female employees, with:
 - risks of discrimination against potential parents — particularly younger women
 - significant transitional impacts on those businesses, including increased failure rates, as wages and prices cannot be changed quickly
 - long-run downward pressures on wages in female-intensive occupations, such as child care services — accentuating gender wage inequality.
- A pooled employer funding arrangement that spread the costs among all firms and (ultimately) employees would avoid the problems of direct employer financing. This would operate like a small payroll tax, with generally low long-run efficiency costs. But it would involve adverse transitional impacts to firms until future rounds of wage negotiations, a comparatively high administrative and compliance burden and goes against the principle of tax simplification.
- Parental leave savings accounts are another funding option. Such accounts would deliver much the same benefits as a common funding pool, but would be more complex to design and involve higher efficiency costs. They would also share the disadvantages of pooled funding.
- Income contingent loans used to supplement a base taxpayer-funded scheme would give families the choice of extending the time spent with young children beyond that needed to meet the primary objectives of the Commission's proposed scheme. Should the Government consider increasing the generosity of the scheme in the future, income contingent loans could provide an appropriate low cost option for doing so.
- A concessional business tax arrangement would encourage business 'top ups' of a statutory scheme, but would favour employees more likely to have access to paid parental leave, involve budgetary risks and have scope for unintended outcomes.
- While government funding is likely to involve higher efficiency costs than a pooled employer funding arrangement, the current review of Australia's tax and transfer system provides an opportunity to reduce those costs. Redirection of baby bonus and other expenditures to the paid parental leave scheme will also reduce the efficiency costs of raising additional government revenue. Administrative and compliance costs are likely to be lowest using government financing, and it spreads the cost of any scheme broadly among the community.
- Centrelink would be the most effective administrative vehicle for the scheme. Where an employee has sufficient workplace tenure, Centrelink should forward payment (in advance) to their employer, who would then pay eligible parents as part of their usual pay cycle. Other eligible parents should be paid directly by Centrelink. There is a prima facie case for employer provision of superannuation contributions, but its implementation should be deferred. It should be implemented following a review into the scheme three years after its inception, subject to consideration of its impacts at that time. Accrual of other leave entitlements could be revisited at that time.

8.1 Introduction

Explicit policies mandating the provision of paid parental leave are well-established features of employment arrangements in a number of countries. Most rely on social insurance financing that pool contributions from employees and employers. However, in some countries (for example, New Zealand and the United Kingdom), funding is provided through general government revenue sourced, ultimately, from taxpayers. And in countries like Germany, employers are required to contribute a substantial share of an employee's remuneration while on parental leave. Participants to this inquiry suggested a range of financing options, some of which involved a 'user-pays' component. Those options included employer provision (direct or pooled), portable leave savings accounts, income-contingent loans, business tax concessions and funding from general government revenue.

This chapter evaluates alternative financing options for a mandatory paid parental leave scheme in Australia. In particular, it focuses on the incidence of, and incentives created by, different models and their implications for economic efficiency, equity (or fairness) and simplicity. It also discusses the options against the backdrop of some specific issues raised by the terms of reference, namely:

- the employment of women, their workforce participation and earnings and the workforce participation of both parents more generally
- the cost-effectiveness of alternative models.

Ultimately, the choice of funding source will influence the effectiveness of a program in meeting its objectives. As such, the relative ranking of different objectives will be an important issue in choosing the best funding model. A summary table of the advantages and drawbacks of each individual funding option is presented at the end of this chapter.

8.2 Direct employer financing

In considering the desirability of alternative funding sources, an important issue is the extent to which each of those options affects the behaviour of firms, employees and taxpayers. Generally speaking, the greater the behavioural response to a specific funding alternative, the higher the associated economic or efficiency cost. However, those impacts should not be confused with the desirable behavioural change that a paid parental leave scheme is designed to elicit — primarily to extend the time parents spend with their newborn children and to strengthen workforce attachment of women. But the benefits of this intended behavioural change will need to be weighed against the efficiency costs associated with raising revenue to fund the parental leave scheme.

In the context of direct (or mandated) employer provision, the risk of unemployment looms as a major efficiency concern because employees that take parental leave will impose higher costs on firms than those who don't. As discussed in chapter 7, those costs may include expenses incurred in hiring, training and paying replacement staff, reduced productivity (from the temporary and returning employee), leave administration and the uncertainty that lengthier absences inherently involve.

The risk of discrimination (especially for younger women employed in smaller firms) was the focus of a number of participants to this inquiry in arguing against employer funding. The submission from Professor Joshua Gans outlined the nature of the problem in the following way:

... by making leave a mandated entitlement, it increases discrimination toward those who are statistically or have revealed themselves to have a preference to actually take that leave. This is because employers face costs of temporary worker turnover (something that is more likely to be an issue for smaller than larger firms) and so, in choosing which workers to hire, promote and train, there will be a commercial bias toward the non-family oriented. (sub. 24, p. 4)

The Brotherhood of St Laurence commented specifically on the skill characteristics of the women most likely to be at risk:

... requiring business to pay is likely to lead to discrimination against women of child-bearing age and adversely affect the hiring of women, particularly those with low skills. It could also adversely affect small business. (sub. 92, p. 3)

And employer groups such as Commerce Queensland highlighted the implications of employer funding for industries with a high concentration of female employment:

Existing gender demographics in the workforce would mean that the cost of paid parental leave would impact disproportionately on certain industries and businesses (sub. 172, p. 10)

In assessing the likelihood of these outcomes, the Commission notes that employer funded mandates are widely used in the United States and Europe to provide a range of *universal* employment benefits such as health and unemployment insurance, workers compensation and pension entitlements as well as *group-specific* benefits related to childbirth expenses and parental leave, which raise the cost of employing a demographically identifiable group of employees.

A range of studies have sought to determine the economic consequences of these arrangements, with the general findings being that the costs of mandates are largely, if not completely, shifted to the wages of the employees receiving them, with little impact on employment (see, for example, Gruber and Krueger 1991, Krueger 1993, Gruber 1994a, 1994b and Ruhm 1998). While this suggests the risk of job

discrimination is low (with low associated efficiency costs) from employer funding, it also means greater wage inequality — a concern raised in the submission by the Centre for Independent Studies in the specific context of parental leave:

While the relationship between wages and employment conditions is complex, this may suggest that universal employer-funded maternity leave would push women's wages down and increase the gender gap. (sub. 89, p. 9)

Over the longer term, the greatest impact on gender wage equality is likely to be felt in occupations dominated by female employees such as child-care services, health and community care, retail trade and the hospitality industries. But there would still be significant transitional impacts on firms in those industries until wages were able to adjust or prices raised (see below).

Importantly, the international evidence implies barriers to wage adjustment, such as anti-discrimination laws, relative pay norms (like equal pay for equal work) and minimum wage conditions, are not active in those countries where the research was based. But this is highly unlikely to reflect the situation in Australia for two reasons. In the United States, for example, the minimum wage is considerably lower than that in Australia and applies to a much smaller proportion of employees.¹ Secondly, the share of Australian women whose pay and conditions are set through collective agreements and industrial awards (which to the Commission's knowledge would not provide scope for employees to receive different pay rates in lieu of employment conditions for which they might prospectively be eligible) is also considerably higher than in the United States.^{2,3,4}

The different nature of Australia's industrial landscape therefore means that employers would bear at least some of the cost of providing paid parental leave and

¹ Around 10 per cent of employees are paid at the minimum wage in Australia (currently \$14.31 per hour). According to the US Department of Labour, 2.3 per cent of all hourly paid workers had wages at or below the minimum in 2007 (currently \$US5.85 per hour) though this figure does not include salaried and other workers not paid by the hour but whose effective hourly earnings may be at or below the minimum.

² According to the ABS (2007), 68 per cent of Australian female employees had their pay set either through an award or collective agreement in 2006. The remaining 32 per cent were subject to an individual agreement. The recent prohibition of new Australian Workplace Agreements will reduce the latter share in the future. According to AMMA (1999), collective bargaining coverage in the United States was less than 20 per cent.

³ As the costs of paid parental leave provisions in awards and collective agreements will be passed on to all employees covered by those arrangements (regardless of whether they benefit from such a provision), this implies that there will be larger associated efficiency costs compared to paid parental leave provisions negotiated in individual contracts.

⁴ The Commission notes recent Australian research (Edwards 2006) which found evidence of negative wage differentials associated with eligibility for maternity leave in the Australian labour market. That study did not explicitly address this issue of institutional wage rigidities.

this will increase the risk of employment discrimination against younger women. It also means that the financial viability of smaller firms and those with a high concentration of female employment could be compromised. (As discussed in chapter 7, the magnitude of the financial risk will depend on the probability of a parental leave event actually occurring.)

In summary, the Commission does not favour direct employer financing, either as a stand-alone funding option, or as a compulsory top-up to a taxpayer-funded scheme (as suggested by several participants) because it would place most of the costs of the scheme initially on those businesses with higher proportions of female employees, with:

- risks of discrimination against potential parents — particularly younger women
- significant transitional impacts on those businesses, including increased failure rates, as wages and prices cannot be changed quickly
- long-run downward pressures on wages in female-intensive occupations, such as child care services — accentuating gender wage inequality.

8.3 Pooled levy arrangements

The financial risks to employers and the potential for gender-specific discrimination from a mandated parental leave scheme would be considerably reduced through the introduction of a pooled funding arrangement. Such an arrangement, typically involving a levy on all wages and salaries, would spread the cost of providing leave across all employers and all employees irrespective of whether any employees actually took parental leave. The breadth of that levy base also means it would be a potentially efficient financing mechanism because it would require a comparatively low tax or levy rate to raise the necessary funds. Indeed, based on the Commission's estimate of a \$1.4 billion gross funding requirement per year (including the superannuation component), this represents around 0.3 per cent of total economy-wide wages and salaries in Australia in 2006-07 (ABS 2008d).⁵

A number of participants acknowledged the advantages of a pooled funding approach and some also commented on the specific form that it should take. For example, the joint submission by the Australian Catholic Council for Employment Relations and Catholic Social Services Australia said:

Pooled funding would avoid disproportionate impacts on sectors employing more women and would be an important safeguard against gender-based workforce

⁵ By way of comparison, the Medicare levy which is set at a rate of 1.5 per cent of taxable income, raised \$6.1 billion in 2005-06 (ATO 2008d).

discrimination. Employer contributions should be assessed on a measure such as staff numbers or payroll, rather than on the number of staff actually using or likely to use paid parental leave. All employers, not only those employing many women of childbearing age, should contribute towards the scheme. (sub. 225, p. 15)

The Public Interest Advocacy Centre concurred in recommending that a levy-based pool be used as a supplement or top-up to government funding. It suggested:

... that the Federal Government fund 26 weeks paid maternity leave at the minimum wage level and that employers should pay the gap between minimum wages and the worker's actual wages; this could be achieved by employers paying a contribution into a central pool, to be distributed as needed. The size of the contribution employers would be required to make would be determined by staff numbers or payroll size, thus relieving the burden on small business. Potentially, businesses deemed too small to pay payroll tax could even be exempt.

This type of arrangement, which creates a collective responsibility for funding paid maternity leave, reduces the prospect of discrimination against women of child-bearing age. (sub. 226, p. 11)

Others considered that both employers and employees could share responsibility for a pool that would supplement existing baby bonus expenditures. In that regard, the National Foundation for Australian Women (sub. 54) and Julia Perry (sub. 8) commented that as well as providing portability of benefits (which would promote workforce attachment), such an arrangement would not be administratively burdensome for employers as it could be incorporated into existing PAYG tax collection arrangements. Julia Perry suggested the scheme:

... would be funded through a levy on employers of around 0.5 per cent of the total wage bill and on all employees of around 0.5 per cent of wages. The Government's contribution would be the Baby Bonus (re-named maternity allowance) which is provided to all women giving birth regardless of previous workforce attachment and, at \$5000, is equivalent to \$192.30 a week over 26 weeks. (sub. 8, p. 4)

Some called for even more generous benefits, with Dale Key (sub. DR294) proposing that employees, employers and the Government each contribute five per cent of an employee's gross annual wage to fund a parental leave benefit equivalent to 75 per cent of that wage after five years.

Employer interests, on the other hand, argued that Australia was relatively inexperienced in the use of pooled funding arrangements (especially compared to European countries that rely on mandated social insurance schemes to finance an extensive range of welfare and other benefits). That inexperience meant their application in the paid parental leave area would be costly, problematic for administrative and governance reasons and also inevitably lead to demands for the pool to be expanded to cover additional entitlements such as long service leave and

redundancy payments. For example, the Australian Industry (Ai) Group said in this regard:

Social insurance/trust fund models pose particular problems. These include administrative costs and complexities, compliance and enforcement issues, and difficulties with meeting funding requirements particularly in the initial phase. (sub. 182, p. 24)

But this position ignores several well-established models of pooled funding used in an Australian context. Prominent examples include compulsory third party insurance arrangements that pool risk to provide benefits for individuals injured in motor vehicle accidents and workers compensation schemes that apply to those injured or incapacitated in a work-based context. In those cases, premiums are collected, pooled and managed according to specified prudential standards either by public statutory authorities or private firms in order to provide sustainable benefits to individuals injured or incapacitated on a no-fault basis.

In looking at the impact of a pooled levy arrangement, it is important to recognise that the distinction between a levy imposed on employers or employees is largely artificial because the actual burden of the levy will *eventually* fall on employees.⁶ This outcome was explicitly acknowledged by some participants to this inquiry with the Centre for Independent Studies, for example, commenting that:

... levies imposed on all businesses will ultimately be absorbed by all employees' wages ... (sub. 89, p. 9)

In the short-run, however, the fixed duration of existing collective agreements and individual contracts means that employers would bear the cost of the levy at least until those arrangements expire. Similarly, time lags involved in the review and amendment of minimum pay rates (which would take account of changes to employment costs and the capacity of employers to pay higher wages) means there would be a *de facto* increase in minimum wages in the near term. Those rigidities would place additional financial pressures on some businesses, possibly making some firms unviable.

Adjustment costs aside, the key issue in deciding whether to collect the levy from employers (through say a payroll tax) or employees (as is the case with the Medicare levy) and how those funds should be administered comes down to which option involves the lowest administrative, compliance and efficiency cost. As noted by the National Foundation for Australian Women (sub. 54), employers already have systems in place to pay a range of taxes related to their payroll. Existing PAYG withholding arrangements, for example, require employers to remit

⁶ Again, minimum wage legislation limits the extent to which wages can adjust to the levy (see the section on direct employer financing).

payments to the Australian Taxation Office (ATO) on a regular basis with the frequency depending on payroll size.

But while the PAYG system would facilitate the timely *collection* of a parental leave levy, it would involve additional compliance costs for firms and administrative costs for the ATO because, for example, Business Activity Statements, accounting and information technology systems would need to be modified to separately identify the payment and to ensure firms have complied with their obligations.

An alternative to PAYG collection involves a levy on employees as part of the annual personal income tax lodgement and assessment process in much the same way that the current Medicare levy operates. But a potential disadvantage of this approach is that taxable income is much broader than earnings from wages and salaries and includes income derived from capital sources such as dividends, capital gains and royalties.⁷ This could effectively mean an additional tax being imposed on capital with relatively high associated efficiency consequences given the mobile nature of capital flows compared with other factors of production. In addition, a range of exemptions (including a comparatively high income threshold currently applying to the Medicare levy) raise other efficiency issues related to the breadth of the revenue base.

An employee levy may also involve concerns about fairness, a point raised by the Real Estate Institute of Australia:

It would be wholly inappropriate to apply a specific ‘parental leave levy’ to all employees given that some will not have children, there will be variations in the number of children born to any one employee and that many employees will already have had children upon inception of the levy. (sub. 51, p. 4)

The scope for a pooled levy arrangement to avoid many of the problems associated with direct employer financing suggest it is worth considering as a funding option. But the Commission noted in the draft report that the introduction of what would effectively be a hypothecated payroll tax in Australia to collect a tiny proportion of wage income may not be worth its potential administrative and compliance burdens and would go against the principle of tax simplification embraced by the current review of Australia’s taxation and transfer system. Importantly, because levy funding would involve regular and ongoing administrative and compliance obligations on employers, it would be a more burdensome arrangement than one requiring payment only when a parental leave event occurs. An event-based payment is a key feature of the Commission’s proposal (see chapter 2).

⁷ The Commission acknowledges these income items are separately identified on tax returns for employees.

At the draft report hearings, Julia Perry contested the Commission's arguments against pooled funding and argued that the duration and payment level in the taxpayer-funded proposal were inadequate to meet the developmental needs of children. In terms of the key scheme parameters, she considered that:

... paid parental leave needs to be available at full wage replacement until the child is six months old. ... The Commission's proposal that this length of leave could be provided by 18 weeks worth of the minimum wage is not adequate. Low-income women are unlikely to have other leave entitlements or sufficient resources to make up the time. Higher-income women are likely to have their income locked into housing costs. (DR trans., pp. 429-430)

Noting the likely budgetary resistance to expanding the Commission's proposal, Ms Perry suggested that this furthered the case for a pooled funding model.

However, as discussed in chapter 2, the Commission considers that the proposed 18 week duration will, in combination with other current forms of leave, provide scope for nearly all primary carers to take at least six months of parental leave. Importantly, the impact of the scheme on leave duration would be greater for lower income, more financially constrained families. This outcome also reflects the setting of the payment rate at the adult minimum wage (which would be much closer to full wage replacement for lower income earners).

Moreover, discussions with the ATO since the release of the draft report have amplified rather than allayed the Commission's concerns about the administrative and compliance costs associated with collection of a parental leave levy through the PAYG withholding and BAS reporting systems (see the discussion on delivery issues below).

On these grounds, the Commission continues to view a pooled funding arrangement as a relatively less effective means of financing the proposed paid parental leave scheme.

8.4 Portable leave savings accounts

Some participants proposed the introduction of portable parental leave savings accounts similar in character to the long service leave arrangements used for building and construction workers in New South Wales since 1975. The submission from the Australian Rail, Tram and Bus Industry Union (representing a sector with a small ratio of female employment) specifically referred to the New South Wales scheme in saying it:

... supports an employer funded pooled contribution scheme designed to operate in a manner similar to the NSW Building Industry Long Service Leave Payments

Corporation, which operates a pooled levy scheme to ensure that building workers obtain paid long service leave in an industry which requires workers to move from employer to employer over the qualifying period for long service leave. (sub. 127, p. 6)

Catalyst Australia (a public policy network comprising unions, academics, individuals and other organisations) went further in arguing that Australia's existing system of parental leave was poorly aligned with the increasingly casual and part-time nature of employment, which effectively prevented many women from accessing either paid or unpaid leave entitlements.

As a remedy, Catalyst suggested the creation of a leave savings account for all employees, funded by an employer levy and supplemented by a universal parenting payment that redirected baby bonus expenditures into a fourteen week payment at the federal minimum wage. A range of novel design features to facilitate the proposed duration and payment level were also canvassed, including allowing: drawdown of accruals in advance; leave transfers between parents; incorporation of long service leave entitlements; and employer or government top-ups. Catalyst outlined the nature of, and benefits from, the proposal in the following way:

A leave account is a simple leave bank account for workers' that moves with them from job to job over the course of their working life. The account would be drawn upon to pay for a minimum of 12 weeks time off for parenting. Employers would contribute to the leave account in the same way that they contribute to superannuation accounts, ie by a small percentage quarterly payment. Leave accounts are analogous to [and would replace] existing long service leave entitlements but would begin to accrue from day one in the workforce and would be portable.

They have the added benefit of spreading the cost of funding parental leave across firms. Each employer contributes a small share that accrues into a bigger entitlement. In this way, a leave account is a savings focused scheme. It would be available to both women and men. The leave account proposal is relevant and practical to today's labour market and to the Australian employment context which has experience in administering similar arrangements for superannuation. (sub. 167, p. 3)

Importantly, the administrative and operational cost of establishing and maintaining the leave accrual register, managing the funding pool and distributing benefit payments need not be that great given the experience with the New South Wales construction industry long service leave scheme where those costs accounted for just 1.7 per cent of the pool in 2006-07 (BCILSPC 2007).

The pooled nature of the proposal would also avoid the potential for discrimination and related problems with direct employer funding noted earlier.

However, the proposal has several limitations:

-
- In its current form, the Catalyst proposal appears to remove the requirement for a given period of employer tenure as the basis for eligibility for long service leave. As in a variety of other industrial relations contexts — including unpaid parental leave — the quid pro quo for employers of a statutory requirement to give a benefit to employees is some gain in employer retention rates. Employers value higher retention rates, but they also mean that employees are more likely to get adequate training. And the desirability of mixing parental and long service leave is not clear, especially as it would increase the number of employees (and the cost to employers) eligible for long service leave.
 - As currently formulated, the scheme provides a leave bank to all employees, regardless of whether they take it as parental or long service leave. Some would see this as an advantage in that all employees, regardless of whether they had children or not, could benefit from the scheme. But its broad scope and its payment at replacement rates implies a much bigger impost on business than schemes focused on paid parental leave alone. The distortions created by taxes rise more than proportionately with higher tax rates.
 - Some of the suggested features also increase the complexity of the scheme and could lead to unintended outcomes. For example, how would an employee who does not intend returning to work be prevented from accessing an advance draw down of leave that they would not be in a position to make up?

More broadly, however, a portable leave account arrangement suffers the same limitations of the pooled funding model discussed earlier, with additional complexities and higher costs. As in the case of the pooled funding model, levy-based financing would require a new tax at a time when consideration is being given to simplifying Australia's taxation system.

Some of the disadvantages associated with employer funded leave accounts could be addressed by shifting that responsibility to the employees who will ultimately benefit from paid parental leave. Such a proposal was indeed put forward by the Centre for Independent Studies (CIS) which argued for the concessional tax treatment of savings by prospective parents as a means of funding parental leave:

In a savings scheme, individuals are required to keep their personal account at a minimum balance, which needs to be topped up through future earnings if drawn upon. Alternatively, individuals can choose to save more than the required minimum. Contributions (to a ceiling) are tax-privileged, making saving a more attractive proposition. ... Unused savings could be used to pay for school fees, put towards the purchase of a house, or rolled into superannuation (sub. 89, p. 11)

Aside from issues surrounding the potential use (or abuse) of tax privileged savings accounts for non-parental leave purposes, the CIS proposal would also provide the greatest financial benefit to high income earners (paying higher marginal tax rates)

— those likely to already have access to paid parental leave. In addition, given low income employees — the group in most need of parental leave support — would value current period income more highly than future income drawn from a compulsory saving regime, the desirability of the CIS’s proposal could be questioned on both equity and welfare grounds.

The Commission notes that a tax-preferred ‘life course saving scheme’ assisting employees to fund various types of unpaid leave (including parental, long-term care and pre-pension) was introduced in the Netherlands on 1 January 2006 with a related aim of increasing female labour force participation. That *voluntary* scheme provides a tax reduction (or credit) equivalent to 50 per cent of the statutory minimum wage for male and female employees to fund up to 13 weeks of parental leave in addition to the statutory entitlement of 16 weeks paid maternity and two days paid paternity leave. According to Moss and Korintus (2008), just 5.5 per cent of eligible employees participated in the scheme in its first year of operation and only 6 per cent of those participating employees did so to finance parental leave. This low utilisation rate may reflect a range of factors, including that low income earners can make better use of current period income.

8.5 Income contingent loans

An alternative funding option proposed by some participants involved the use of an income-contingent loan arrangement, specifically as a top-up or supplement to other parental leave funding sources. Income-contingent loans have been employed in the provision of tuition assistance for Australian university students through the Higher Education Contribution Scheme (HECS) since 1989. The key features of HECS are described in box 8.1. In a parental leave context, such loans could address the financial constraint facing (currently) low income parents around the time of childbirth by allowing them to fund parental leave (for a period beyond that provided by a base government scheme) from their future income.

A feature of this approach is that decisions regarding extensions to the duration of leave provided by base government funding and the associated income requirements are left in the hands of parents. This potentially means more efficient choices regarding employment and the optimal overall duration of parental leave (assuming parents are well informed about child and maternal welfare — see chapter 4). Another advantage is that because individuals finance at least some of the leave themselves, this reduces the efficiency cost associated with complete government financing (discussed later).

Box 8.1 **Australia's Higher Education Contribution Scheme (HECS)**

HECS provides income contingent loans from the Australian Government to students to pay for course fees for undergraduate education. It was established in 1989 and partially replaced existing taxpayer funding of higher education, therefore representing a move toward a user-pays system. The system provided around \$1.2 billion in 2005, about 30 per cent of annual recurrent university costs. It has recently been extended to cover tuition fees for all post-graduate courses, all private sector higher education institutions and a subset of vocational education and training courses (known as FEE-HELP). A large number of other countries have also adopted this approach as a means of partially financing higher education expenditures.

Loans are indexed to inflation in line with the consumer price index (CPI) and are repaid by graduates according to specific repayment rates and income thresholds. CPI indexation implies a zero real interest rate on such loans. As such, the government provides a subsidy to students the size of which depends on the long term government bond rate, the level of the debt and the time taken for repayment, if this occurs. In terms of non-repayment, the doubtful (unlikely to be recovered) debts ratio under HECS varied from around 17 to 22 per cent between 1998-99 and 2002-03.

In 2007-08, the repayment rate was set at 4 per cent of assessable income once an income threshold of \$40 000 was reached. Where assessable income falls below this amount in any given year, there is no payment required for that year. Repayments are made annually when an individual lodges their personal income return to the Australian Taxation Office. Currently, administrative expenses associated with HECS are estimated at less than 4 per cent.

Undergraduates receive a 20 per cent discount for up-front payment of the university tuition charge while FEE-HELP students (other than for post-graduate tuition) face a 20 per cent surcharge for the use of the income contingent loans system. While the surcharge can be viewed as an arbitrary form of real interest rate, which might involve a negative subsidy if the loan were repaid very quickly, a recent study has shown that the interest rate subsidies associated with FEE-HELP in the private education sector are typically in the order of 25–30 per cent (Chapman and Lounkaew 2008).

Source: Chapman, Higgins and Lin 2008.

Commenting specifically on the application of income-contingent loans in the parental leave area (as a supplement to direct government grants and employer tax credits — see below), the submission by Professor Joshua Gans said:

... because individual households fund their own leave ... it is very low cost in economic efficiency terms making it far superior to schemes that directly fund paid parental leave. (sub. 24, p. 6)

While those participants supporting this model did not propose the *stand-alone* use of income contingent loans, it is worth highlighting why that option would not be consistent with several major objectives of paid parental leave. In particular:

-
- To the extent that paid parental leave aims to address a legitimate barrier to long-term female workforce participation, the reduced level of (effective wage) subsidy in a stand-alone scheme would elicit a lower female labour supply response compared to alternative schemes involving higher wage subsidies (particularly grant-based arrangements).
 - If parents are not reasonably well informed about the impacts of greater duration of parental leave on child and maternal health and welfare (because of information asymmetries), then a system based primarily on self-financing may not deliver the best outcomes.
 - Complete self-financing fails to recognise the broader value to the community of a parent taking leave to care for children. Those social benefits (or externalities) suggest that the community has a role to play in supporting (and paying for) such arrangements.
 - Similarly, self-financing is not compatible with the view that parental paid leave should be an employment entitlement like other leave, which at least many in the community (as reflected in submissions) regard as an important norm to be reinforced.

Some participants were staunchly opposed to the use of income contingent loans as a stand-alone funding mechanism because of the financial burden it would place on women. The Australian Federation of University Women, for example, said:

We very strongly oppose any notion of an income-contingent loan. In our view this would simply be in fact creating a disadvantage for these women. We believe it would in fact probably lead to some women feeling that they would not take up maternity leave at all. Frankly we think it's an outrageous suggestion. (DR trans., p. 207)

But others voiced support for supplementing a base government-funded scheme with a loan arrangement. The Smith Family said in that regard:

In addition to the primary provisions of the parental leave scheme, The Smith Family recommends the exploration of voluntary saving schemes and personal loans to allow parents to stay at home for longer periods, and that any leave arrangements longer than 12 month should be subject to negotiations with employers. (sub. DR387, p. 6)

In line with these views, the Commission concluded in the draft report that the application of an income-contingent loan scheme to parental leave could only realistically be viewed as a supplement or ‘top-up’ to a primary funding alternative.

Should contingent loans be used as a ‘top up’?

Prima facie, there are better arguments for introducing income contingent loans as a *supplement* to a base level of government funded leave because the government

scheme could deal with the labour supply aspects, parental information asymmetries and the social issues (externalities) that would not be adequately dealt with by a stand-alone arrangement. Were there to be genuine capital market failures preventing private sector borrowing by young families, it is possible that government loans might address these.

A recent research study co-authored by the architect of the HECS system in Australia (Chapman, Higgins and Lin 2008) proposed such supplementary use of income contingent loans as an optional means of extending the leave available under a grant-based parental leave scheme funded by government. A key argument made for public provision of the loan component was that borrowing from private banks would not be possible for most families interested in financing parental leave due to a lack of collateral as security for the loan (Chapman, Higgins and Lin 2008, p. 9).⁸

A loan arrangement involving fixed fortnightly payments at the federal minimum wage to fund 26 weeks of additional parental leave (following an initial period of leave financed by taxpayers) was modelled to explore the implications for families and government of an income-contingent loan.⁹ Using several hypothetical demographic and financial scenarios of potential borrowers and detailed design parameters (with respect to coverage, duration, payment and repayment thresholds, rates and conditions), which included a debt surcharge as ‘a blunt form of applying a real interest rate’, the authors noted the results highlighted two key features:

- Median and high income earners would be deterred from participation in the scheme because the faster loan repayment combined with the surcharge resulted in a small negative subsidy for those groups. This was arguably beneficial from an equity perspective.
- Families in most financial need in their lifetimes received the highest positive subsidies. Single mothers, particularly those on low incomes, benefitted most from concessional indexation rates applied to the debt given the length of time taken for repayment (if repaid at all).

Despite those features and the conceptual elegance of the proposal, the Commission noted in the draft report that the disadvantages of such an approach (which the authors sought to address — see box 8.2) may well outweigh its advantages:

⁸ In that case, it was argued that any social spillovers from paid parental leave would not be delivered.

⁹ The authors also noted the possibility that employers could share the loan repayments with their employees conditional on the parent returning to their original employer. The benefit to the employer would be the preservation of firm-specific training investments.

-
- Contingent loans mean that people face disincentives to exceed the income threshold at which repayment occurs, reducing their incentives to work at the margin ('moral hazard') especially when the loan interest rate is subsidised. So long as the borrowed amount was capped at a reasonably low level, those disincentives would be reduced, but also would add to an already significant group of barriers to work for low-income families.
 - The loan provides the greatest subsidy to parents least likely to pay it back (households whose income will not exceed the threshold for repayment) and parents that will only be required to pay back the loan a long way into the future. Such 'adverse selection' increases the cost to government of the scheme, while probably not significantly changing the duration of parental care for babies.
 - To the extent that there is a failure in capital markets, then this would imply an income contingent loan should be available for any purchases of young families, not just paid parental leave. Moreover, there is no guarantee that prospective borrowers would use the loan to finance additional parental leave (above what they would have otherwise taken) rather than for non-parental leave purposes.
 - The externalities that might reinforce support for an income-contingent loan (in addition to the goal of addressing perceived capital market imperfections) would probably have been significantly exhausted given a base government scheme. That would imply a relatively small loan amount — but then that would raise the question of whether all the work of designing, implementing and managing a relatively complex scheme was worthwhile.
 - Finally, scheme design errors would be difficult and costly to reverse. By its nature, an income contingent loan scheme involves financial flows that potentially endure for decades. Winding up a scheme were it not to function properly, would involve a considerable period of time and administrative expense.

There are partial antidotes to some of these problems (box 8.2), and the authors of the proposal emphasised that designing an effective scheme involved many challenges:

... there are critical issues of policy design with respect to the roles played by adverse selection and moral hazard, and what these behaviours might mean for the availability, collection parameters and taxpayer subsidies of income contingent loans. All of this promotes the case for a financially cautious initial approach in the application of income contingent loans for [paid parental leave]. (Chapman, Higgins and Lin 2008)

On the grounds noted above, the Commission concluded in the draft report that it was sceptical there was a strong enough case for income-contingent loans in this area of public policy.

Box 8.2 Careful design can help mitigate the risks of an income-contingent loan scheme

As noted by Chapman, Higgins and Lin (2008), the risks of an income-contingent loan scheme may be mitigated by several safeguards including:

- putting a cap on the available loan size
- obligating repayment responsibility to both parents (in those cases where this is applicable). As long as one parent earns an income in excess of the threshold (and for a sufficient period of time), the loan is eventually repaid. In circumstances where parents separate (on either a bona fide or contrived basis), the outstanding balance remains a liability of both parties. While single (and low) income couples earning less than the threshold would still effectively receive a non-repayable grant, this might be justified for some on equity grounds
- debt-loading — setting the initial debt level at a certain percentage above the actual cash amount loaned, but otherwise increasing outstanding debt levels only by the CPI. This would deter higher income households (who are less likely to be financially constrained) from accessing the loan. This is because such households would be required to pay the loan back quickly, so that the debt loading would act like a relatively high real interest rate. In contrast, poorer, more financially-constrained, households would pay back over a longer period, and the real interest rate may then be negative. That helps target the scheme at parents whose leave duration is more affected by financial constraints
- using eligibility criteria based on past workforce attachment to discourage borrowing by parents with a low likelihood of entering or re-entering the workforce. This would reduce the demand for loans and increase the probability of repayment.

The Commission argued in the draft report that these safeguards involve their own limitations and complexities, and can only moderate some of the problematic incentives created by such a scheme. Notably, HECS suffers fewer of these limitations because higher education and working are complements.

But the proponents of this funding mechanism subsequently responded to the Commission's analysis by modelling the impact of a 10 week loan arrangement (compared to the original 26 week proposal) to demonstrate that the concerns raised in the draft report could be addressed through appropriate scheme design. In particular, they contended that:

- Given the maximum loan amount of approximately \$5500 per child (10 weeks at the minimum wage) equated to a repayment liability of just \$10 per week once the income threshold was reached — this level of financial burden was unlikely to reduce the incentive to work (especially as the repayment liability would be shared by both parents). In support of this conclusion regarding the risk of moral hazard, the designers pointed to experience with HECS (involving considerably

larger debt levels) where no evidence had been found of debtors remaining below the income threshold to avoid repayment.

- Even under highly unrepresentative modelling assumptions that would illustratively overstate the take-up by ‘high risk’ parents (the adverse selection issue) ‘... the aggregate subsidy and the scheme costs [which totalled around \$21 million] are still very manageable and negligible, even under some extreme circumstances.’ (DR trans., p. 109).
- Quarantining the loan for parental leave purposes was not a significant concern because unlike the Commission’s grant-based arrangement (which the proponents argued could be questioned on additionality grounds) the loan would eventually be repaid by the majority of borrowers.
- The role of income contingent loans as a top-up arrangement was not to address externalities but to enable access to finance that would not be provided by private firms.
- The administrative cost of the scheme (and hence the cost of winding it up) was insignificant given that parental leave debt collection would be made through the existing income tax collection system (as in the case of HECS).

As outlined in chapter 2, the Commission considers the primary objectives of its taxpayer-funded proposal (promoting child and parental wellbeing and workforce attachment) will be achieved by an 18 week arrangement paid at the federal minimum wage. Those objectives will also be delivered in a fiscally prudent manner. But the Commission is also mindful of the likely future pressures that will bear on Government to extend the duration of the scheme beyond 18 weeks and to increase the payment rate. International experience almost universally points to such pressures over time. Many participants to this inquiry also expressed the view that the Commission’s proposed duration and payment rate were either manifestly inadequate in delivering child and maternal health goals or just a first step in the journey to a longer and more generous parental leave scheme (see box 8.3).

Against that background, and in light of the persuasive supplementary input from the proponents of the income contingent loan scheme, the Commission has reconsidered its draft report conclusion (subject to the modifications below) regarding the place for such loans as an optional top-up to a taxpayer-funded base scheme. Accordingly, should the Government consider extending scheme duration and/or the payment rate at some point in the future, the Commission now believes that income contingent loans could provide an appropriate low cost option (given the efficiency costs associated with taxpayer funding) for doing so.

Box 8.3 Participants' views on scheme duration and payment level

Catalyst Australia:

There may be funding constraints around immediate introduction of a 26 week scheme. These can be dealt with by treating the 18 weeks as a starting point and increasing this incrementally over a period of two to four years. (sub. DR374, p. 2)

National Investment for the Early Years (NIFTeY):

In the strongest possible terms we argued for 12 if not 24 months' paid leave; the need for this time is acknowledged by the new Commonwealth entitlement to 2 years' unpaid parental leave. If 12 months is not to be countenanced at this time, then the very minimum should be 6 months (26 weeks), with the option of part-time employment to follow and the use of other forms of leave to extend time with the baby beyond 6 months. (sub. DR386, p. 2)

Family Day Care Australia:

... paid maternity leave should be at least 26 weeks (6 months) in duration, funded by government at the average wage and that supporting parents should be provided four weeks supporting partner leave. (sub. DR379, pp. 1–2)

Australian Human Rights Commission:

... following the implementation of the proposed paid leave scheme an independent review be carried out two years into its operation in order to make the necessary modifications and improvements and so that a second stage of paid leave measures be introduced so that in total the scheme provides for [52 weeks of paid parental leave] ... (sub. DR377, p. 6)

Office of the Anti-Discrimination Commissioner (Tasmania):

The proposal ... of 18 weeks is a good starting point and will not be a significant financial burden on businesses. The proposed duration should however be reviewed, with a view to increasing the period over time [as should the level of payment]. (sub. DR379, p. 4)

Commonwealth Public Sector Union:

... the 18 weeks recommended by the Productivity Commission [is] a good first step and will [contribute to] our aim of 26 weeks paid leave at full income replacement and usual superannuation through collective bargaining. (sub. DR376, p. 1)

Association of Professional Engineers, Scientists and Managers, Australia:

... there [should] be a staged increase of primary care giver leave to 26 weeks over five years. (sub. DR335, p. 1)

Australian Rail, Tram and Bus Industry Union:

... the Commission to review its position on the length of the proposed scheme from 18 weeks to 26 weeks [and from 2 weeks to 4 weeks for the partner]. (sub. DR326, p. 6)

Western Australian Commissioner for Children and Young People:

... I am calling for a six-month paid maternity system ... with a view to Australia moving towards a 12-month paid maternity leave system in the future. (sub. DR311, p. 1)

Independent Education Union of Australia:

... supports 26 weeks (6 months) as the most appropriate quantum for paid leave to provide support and care for mother and child. (sub. DR308, p. 1)

(Continued next page)

Box 8.3 (continued)

Tasmanian Women's Council:

... would like to see in future the possibility of extending the paid leave component beyond the 18 weeks so that most women may have the opportunity to have 1 - 2 years leave, should they choose, following the birth of a baby. The Council considers that this proposition should be considered as part of the Governments review process ... (sub. DR307, p. 10)

Finance Sector Union:

The FSU seeks, therefore, the inclusion of transitional arrangements in the Scheme to increase the quantum of leave from 18 weeks to 28 weeks (2 weeks before and 26 weeks after the birth of child) within 5 years. (sub. DR306, p. 8)

Unions NSW:

Unions NSW ... recognizes the economic necessity of getting the first stage of an evolving scheme in the 2009 Federal Budget. Nonetheless, it is important to recognize this part of the scheme as a first step that must be a stage in further action ... that will see a system of six months universal parental leave, paid at full wage replacement by 2013. (sub. DR350, p. 3)

Australian Breastfeeding Association:

We consider the proposed 18 weeks inadequate and maintain our position in recommending a minimum of 6 months paid leave after the birth of the child. (sub. DR391, p. 2)

That said, the Commission considers that the effectiveness of the income contingent loan option in the parental leave area could be improved by the following design changes:

- setting the interest rate on the loan at the current mortgage interest rate (as opposed to using a debt surcharge)
- piloting the scheme before its universal introduction.

The first of these design elements would dissuade parents from applying for a loan simply because it offered better terms than a commercially available option were that to be available (including for use in non-parental leave endeavours). Further, to the extent that publicly provided loans are viewed as an antidote to a failure by capital markets to extend credit to parents that lack loan collateral, the key objective is to provide access to such credit rather than to do so on non-commercial terms. Moreover, given the existence of a lengthy statutory scheme, arguments about providing interest rate subsidies for low income parents on equity grounds become much less forceful. Charging a commercial rate of interest will also provide a greater incentive for parents to return to work because the size of the debt will continue to rise the longer they remain outside the workforce.

Secondly, the cap on the available loan size (as suggested by Chapman et al.) could also serve as a de facto pilot scheme that limits budgetary risk (including those resulting from any scheme design errors).

8.6 Concessional business tax arrangements

While support for an income contingent loan scheme also featured in the submission by Professor Joshua Gans, he argued that because such arrangements did not reduce the (replacement and other) costs faced by employers during periods of parental leave, they would not address the issue of employment discrimination. As such:

... there is a fundamental conflict between [all] policies that create an incentive to exercise parental leave opportunities and discrimination in terms of employers having incentives to favour employees who are less likely to exercise that option. (sub. 24, p. 6)

In response, he proposed a combination of policies to deliver a set of mutually exclusive parental leave objectives. These covered:

- **Minimum-wage parental leave**, paid for by the government, for one parent (for 3 to 6 months). This element is to cover the social security element of having children and would provide incentives for parental leave to be taken in contrast to existing payments such as the Baby bonus which do not. This leave could be means-tested.
- **Income-contingent loans**, secured by the government, based on previous and future household income (for 3 to 6 months). This would address the liquidity issue associated with taking parental leave. It would promote child development but would have a minimal fiscal impact on tax-payers. Consequently, it is equitable in contrast to schemes that involve lump-sum government hand-outs.
- **Return to work tax credits**, paid for by the government to employers who have employees take parental leave and then return to work (for a minimum period). These payments would be made contingent upon criteria that demonstrated re-integration of the employee with their career in the firm. (sub. 24, p. 8)

Return to work credits would involve a tax credit provided to employers (at a suggested rate of between 150 and 200 per cent) for the wages paid to employees while on parental leave. Professor Gans argued that making the tax credit contingent on an employees' return to employment would create incentives for employers to:

- encourage employees to take parental leave
- provide employment conditions (such as flexible working arrangements) that facilitate a return to work
- encourage more highly paid employees (including males) to take parental leave.

The Commission notes the introduction of a family tax credit in France in 2004, which shares at least one of those specific aims — encouraging employers to develop family-friendly policies for their employees (Moss and Korintus 2008). The credit provides a 25 per cent tax deduction up to a ceiling for expenses related to parental and other forms of leave such as training programmes (rather than actual wages).

In the Commission's view, while concessional tax treatment would probably encourage business top-ups at the margin, it would also provide tax concessions to any of the existing negotiated parental leave entitlements. As a result a significant part of the revenue cost of the scheme would support behaviour that was going to occur anyway.

The scheme would probably also tend to favour higher-skilled and better paid employees where retention benefits to employers are highest (and who are already covered by voluntary arrangements), and tend not to increase coverage of lower-skilled or casual employees. This raises equity and efficiency issues.

In addition, the administrative costs associated with the suite of proposed funding policies proposed would be higher than alternative financing options.

Finally, the proposal could also involve a high risk to government revenue. That risk stems from the uncapped nature of the proposal; the size of the suggested tax deduction; and the incentive for some employers to act strategically in order to maximise their returns from the scheme (especially for higher income earners). In the latter case, by either reclassifying or actually shifting employee remuneration from wages to parental leave (to the extent this is possible), employers could artificially increase the value of the taxation benefit from the program without incurring any net increase in financial outlays.

There are precedents for such unwanted behavioural responses to other government programs. One example is the Research and Development (R&D) tax concession which was introduced in 1985 to stimulate private sector investment in research and development activity. It was subsequently found to have prompted some firms to reclassify certain business expenditures as R&D (such as feedstock) when those expenditures were not the specific target of the program (see Lattimore 1997). As a result, the budgetary cost of the program was much greater than anticipated and necessitated a tightening of the eligibility criteria.

Conversely, the proposal could involve costs for some firms who were encouraged to provide parental leave and other family friendly benefits only to find the employee has chosen either not to return to work or, at least, not to their previous

employer. The prospective financial benefit to an employer from a returning employee may even result in undue pressure being applied to ensure that outcome.

On all these grounds, the requisite design parameters to target employees most responsive to paid parental leave, limit budgetary risk and the scope for unintended outcomes would appear to present a significant challenge. The Commission does not, therefore, favour this funding alternative.

8.7 Parental leave financed through general government revenue

A large number of submissions across a broad cross-section of participant interests, including individual employers and representative organisations, state and territory governments, welfare and other advocacy groups, parents and non-parents, considered that taxpayers alone should bear the bulk of the funding burden of a universal paid parental leave scheme for Australia. Arguments advanced in support of taxpayer funding revolved around perceptions that this would variously:

- spread the cost of the scheme across the whole community
- involve comparatively low administrative and compliance costs
- reduce financial stress for parents (including, in some models, those not in the paid workforce and the self-employed)
- avoid an unsustainable financial burden being placed on employers (especially those with a high concentration of female employment) not currently providing paid parental leave on a voluntary basis
- lessen or remove the potential for workplace discrimination against women of child-bearing age
- increase female workforce participation.

But while there are advantages from public financing, there are several — often little appreciated — costs that need to be considered.

- The costs of raising tax revenue include the cost of compliance, enforcement and collection (the latter borne by the ATO and employers who withhold and remit taxes on its behalf), which rise in line with the complexity of the tax system, and ‘rent seeking’ costs, where one group in the community attempts to divert resources from another. While those combined costs are large in their own right, they can (depending on the nature of the tax system) be dwarfed by the disincentive or distortionary costs associated with taxation systems.

-
- Distortions arise when decisions about working, saving, investing and consuming are altered by a tax and, as a result, a less preferred (valued) choice is made to that which would have otherwise occurred. A recent study suggested that the distortionary costs associated with raising an *additional dollar* of taxation revenue from *all sources* in Australia could be between 15 and 65 per cent (Robson 2005). This implies that the return to the community from introducing a new program funded by raising additional taxation revenue must be at least 15 per cent and possibly up to 65 per cent to be economically justified.¹⁰

But not all taxes are alike. Generally speaking, the more broadly a tax is applied and the lower and more uniform the tax rate, the lesser the distortion and associated efficiency cost.¹¹ Indeed, the broad base, low rate features were a key motivation for introducing the GST in Australia and reducing personal income tax rates at the same time.

That might suggest the Commission should identify a particularly efficient tax — either new or existing — that should be the source of the funding for a paid parental leave. However, to do so would invite the question: if that is true for paid parental leave, why is it not true for other government spending? The Commission would then, in effect, be undertaking a review of the Australian tax system. However, the Australian Government has already announced a comprehensive review of Australia's tax and transfer system to be completed by December 2009. The review's goal is to set out a tax structure that enhances Australia's future economic and social outcomes (box 8.4). As noted in the terms of reference for the review:

Raising revenue should be done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and inter-generational), and minimise complexity for taxpayers and the community. (Swan 2008)

In light of the wide-ranging nature of that process, the Commission considers that it is not appropriate for it to identify a particular tax earmarked to paid parental leave.

Indeed, the discussion paper released as part of the review process attributed the current complexity of Australia's tax-transfer system, in part, to incremental policy development over time.

¹⁰ The total efficiency costs of taxation in Australia have been estimated at around 6 per cent of GDP (Freebairn 1998). According to the Australian Treasury (2008), that estimate is consistent with rules of thumb of efficiency costs of taxation in the United States.

¹¹ The actual impact will depend on the how sensitive demand and supply are to a price change and the scope for substitution. The design of some taxes also serve equity objectives with the most obvious example being the progressive nature of personal income taxes.

Box 8.4 Review of Australia's tax and transfer system

A discussion paper released as part of the review of Australia's taxation and transfer system highlighted a range of features of Australia's current tax system and compared that system with international experience. Key findings included:

- There are at least 125 taxes paid by Australians every year. Just 10 of those taxes collected 90 per cent of the \$320 billion in total tax revenue in 2006-07. Personal income tax, company tax and the GST dominate revenue collections (68 per cent of the total). There were around 40 cash transfers paid by the Australian Government in 2006-07 costing over \$70 billion. Around \$18 billion (or 26 per cent) of that total was paid to families and children.
- The tax and transfer systems are separate but combine to affect the disposable income of individuals and families, and their incentives to work, save and invest (including in skills). There are different bases of assessment between and within the two systems, including the definition of income, the unit of assessment, the period of assessment and the basis of eligibility. These differences largely exist to achieve a targeted system, but the result is the system as a whole is complex.
- All taxes are ultimately borne by individuals on the earnings from three factors of production: labour, capital and land. Individuals end up paying taxes in a range of ways, including as consumers through higher prices, as employees through lower wages, or as shareholders through lower profits. All taxes affect choices by encouraging individuals to shift from higher taxed to lower taxed goods and services or activities, and by lowering their available income.
- The legal incidence of a tax (the person required to pay) can be quite different to the economic incidence of that tax (the person who ultimately bears the burden). Taxes can be shifted from one person to another through changes in the prices of inputs to the production process, the price of goods produced or through the distribution of returns to economic activity. Taxes will tend to be shifted to goods or factors of production of which the demand or supply is relatively less sensitive to price changes, has fewer available substitutes or is less mobile.
- Compared with other OECD countries Australia has a low share of tax revenue from labour income. This reflects the significant use of social security contributions in other countries which are levied on wages, salaries and similar income. Australia has the greatest reliance on tax revenue from capital in the OECD — a result highlighted as surprising given the mobility of international capital flows.
- The level of complexity of Australia's tax-transfer system is likely to be greater than the optimal level for society as a whole. This is due to the incremental development of tax-transfer policy over time, based on partial assessments of the associated benefits and costs, and income maximising behaviours of taxpayers and transfer recipients. Broad reforms provide an opportunity to take a systemic view of the tradeoffs between simplicity and other policy objectives (economic efficiency and equity).

Source: Australian Treasury 2008.

Given the relatively modest cost of the Commission's leave proposal and the problem associated with earmarking, it considers that general government revenue should form the basis of funding, at least until the new tax landscape is in place. This cautious approach and the need to consider parental leave funding as part of the broader tax-transfer review was supported by the submission from CPA Australia:

We consider that if a mandatory paid parental leave scheme is to be introduced, it should be publicly funded from government revenue and that it should be paid by way of a transfer payment rather than through the tax system. Given this view, we recommend that a mandatory paid parental leave scheme should be considered as part of Australia's Future Tax System Review, so that it can be examined as a potential component of all the support the Government provides to families, rather than looked at in isolation. (sub. 157, p. 1)

That said, in the absence of any new revenue initiatives, and given the deterioration in the Australian Government's budgetary outlook as a result of the global financial crisis, this implies funding paid parental leave from general revenue would likely require the redirection of expenditure from an existing program. Importantly, the opportunity to use funds allocated to an existing policy measure in a more targeted and effective manner provides scope to reduce the efficiency costs associated with general government revenue funding.

Redirecting expenditure from an existing program

The obvious candidates for redirection of funding from existing programs are the baby bonus and, in part, family tax benefit B, since these are already used to provide support for parents of newborn babies but have several deficiencies. While the baby bonus is administratively simple and involves low compliance costs, several social and economic commentators (see, for example, Guest 2007) have argued that it also:

- lacks clear objectives
- is poorly targeted
- involves a high cost to government revenue relative to the benefits.¹²

On that basis, a redesigned program provides the scope to reduce the economic costs associated with achieving the policy aims of the baby bonus. As of 1 January 2009, the baby bonus provides a means-tested grant of \$5000 for new parents, paid

¹² The total cost of the program was around \$1.2 billion in 2007-08 and is expected to rise to \$1.4 billion in 2008-09 (FaHCSIA 2008a).

in 13 fortnightly instalments.¹³ This is equivalent to 14 weeks (the funding duration sought by many participants) at 65 per cent of the adult minimum weekly full-time wage in Australia. In terms of objectives, the Australian Government recently remarked that the baby bonus payment:

... recognises the extra costs associated with birth or adoption of the child, including the loss of income while on unpaid maternity leave. (FaHCSIA 2008a)

In that context, the baby bonus shares one of the mooted objectives of paid parental leave (alleviating a potential liquidity constraint). Indeed, at least one submission to this inquiry considered that the baby bonus and the policy initiative that preceded it (the maternity allowance) were explicitly designed as a social security alternative to private sector provision of paid maternity leave. In chronicling the historical development of these policies, that participant, Dr Hazel Moir, commented:

The Australian Baby Bonus parallels the social security provision of paid maternity leave in some European countries, except that in many European countries the level of payment is earnings-related ... The very substantial increase in the amount of maternity leave payment means that currently it provides the equivalent of over 18 weeks' income, albeit at the level of social security income. To suggest, as many do, that Australia does not currently have paid maternity leave is to ignore the very substantial outlay by Australian taxpayers providing a sum equivalent to over 18 weeks' income for all mothers of new babies. (sub. 158, p. 5)

The ACTU corroborated this view of the baby bonus (and its predecessor) as a 'de facto' paid parental leave scheme:

Our campaign history includes advocacy for paid maternity leave in the early nineties which resulted in the maternity allowance in 1993 and support for HREOC report "Time To Value" which resulted in the Baby Bonus in 2005. (sub. 69, p. 2)

While some participants said the baby bonus payment should be quarantined from, and therefore additional to, paid parental leave, many considered it should form the basis of a new parental support program. For example, the Ai Group and the ACTU commented respectively:

Options to offset the fiscal impact of a government-funded model should be explored. Ai Group's preferred approach is for the Baby Bonus to be abolished. (Ai Group, sub. 182, p. 25)

Given the existing commitment to the current Baby Bonus, the Australian Government is now in a unique position to convert that budget expense into a paid maternity leave scheme that reflects international standards and sets a sound policy base on which to build future improvements. (ACTU, sub. 69, p. 31)

¹³ From 1 July 2009, families earning in excess of \$75 000 in the six months following the birth or adoption of a child will be ineligible for the program.

Unions NSW (sub. 181, p. 38) went further in drawing attention to the offsetting savings for its proposed scheme from expenditure on both the baby bonus and other family support payments.

The National Foundation for Australian Women similarly viewed the baby bonus as a component of a composite funding model that included employer and employee contributions. It said:

The funding arrangements proposed by this model include a contribution from the Commonwealth government equivalent to the Baby Bonus which will be \$5,000 from 1 July 2008. This proposal therefore involves no extra funding commitment from the government. The remainder of the maternity and paternity leave payments would be funded by pooled funds from an additional payroll tax levy on employers and an income tax levy on employees earning more than \$10,000. (sub. 54, p. 34)

The current form of the baby bonus also conflicts with a number of desirable objectives of a paid parental leave scheme. These include that the payment is:

- unrelated to leave duration and therefore to the optimum length of absence in terms of maternal and child health (although the additional income would encourage at least some women in work to take longer periods of leave)
- not employment-related or contingent on women returning to work and therefore does little to encourage workforce attachment
- viewed as welfare rather than a work-based entitlement, like other leave, that legitimised the dual role of working and caring for children.

As discussed in chapter 2, amalgamating the baby bonus and family tax benefit B expenditures into the Commission's preferred model for paid parental leave would address some of these drawbacks for the group that would be eligible. Those not eligible would still be able to claim the baby bonus (subject to its recently-introduced means test). Family tax benefit B would also continue to be paid to that group, but not to parents accessing paid parental leave during the period of that leave.

8.8 Delivery options

Although taxpayers would provide the funding base, an important administrative issue is deciding how those funds should be delivered. Currently, most child-related income support payments are made directly through the Australian Government's Family Assistance Office (FAO).¹⁴ The main exceptions are family tax benefit payments, which families have been able to claim through the Australian Taxation

¹⁴ The FAO is a virtual office encompassing the ATO, Centrelink and Medicare.

Office (ATO). However, from 1 July 2009, the taxation system will no longer be an available payment option for family tax benefit payments.

Aside from issues of comparative administrative efficiency, the choice of public sector delivery agency can also have a bearing on the way the payment is viewed by recipients and the broader community. For example, the fact that parental leave payments in New Zealand are made via the Inland Revenue Service rather than a social welfare department has been argued (by the program's administrator) to have removed the stigma of the payment being labelled welfare.¹⁵

That said, some participants to this inquiry disputed whether a payment ultimately sourced from taxpayers would ever be viewed as anything but welfare or government assistance (see, for example, Julia Perry sub. DR309, p. 4 and Chamber of Commerce and Industry Western Australia, sub. DR316, p. 2).

The Commission noted in the draft report that to the extent this feature is viewed as important, it is likely to be an even stronger 'framing device' if the taxpayer-funded payment were actually made by employers. That delivery option (which is also the approach used in countries like Singapore, the Philippines and the United Kingdom) was favoured by a number of participants to this inquiry on the grounds that it would also:

- signal the payment as a normal work-related entitlement
- encourage greater employee loyalty
- improve workforce and workplace attachment.

Qualified support for the paymaster function came from employer representatives such as the Motor Trade Association of South Australia (MTA SA) which said it recognised:

... that employers must play a role in the provision of paid parental leave. Generally employers support the scheme, as it encourages retention of quality staff and female participation in the labour market. MTA SA supports the employer obligation to act as paymaster and guarantee employment. (sub. DR339, p. 1)

Ai Group voiced conditional support provided '... the employer and employee agreed to the employer acting as paymaster (which might well be common in practice, at least for larger firms)' (sub. DR363, p. 15).

Some individual firms also backed the paymaster feature, with GM Holden, for example, supporting the broad features of the Commission's scheme subject to the condition:

¹⁵ New Zealand Department of Labour (personal communication).

That employers pay these leave payments initially to employees and seek reimbursement from the government, via a workable method of speedy reimbursement as described [in the draft report]. (sub. DR388, p. 3)

Tadpoles Early Learning Centres — an employer of around 260 female staff (85 per cent of whom are aged between 20 and 40 years) — concurred:

Despite functioning with a small administrative team and only one payroll officer we believe that we will be able to act as ‘paymasters’ for the government-funded scheme on the condition that the proposed reimbursement mechanism is a credit to ‘pay as you go’ withholding payments to the Taxation Office. (sub. DR334, p. 1)

However, a number of employer groups disagreed. Many were opposed on the grounds of the perceived administrative burden involved. Examples included the combined submission from the NSW Business Chamber and Australian Business Industrial:

... any ‘normalcy’ benefit, derived from having business as the administrator and paymaster, is outweighed by the significant administrative and cash-flow burdens this will cause. (sub. DR 340, p. 4)

Similarly, ACCI argued that the Commission’s proposed scheme should use existing public sector administrative and payment processes as they would avoid:

... the confusion inherent in employers continuing to pay “wages” or some quasi wage-like payment on behalf of government to employees who are no longer working for them in a daily or active employment relationship. (sub. 135, p. 50)

The Australian Mines and Metals Association also considered the paymaster function would be administratively complex:

Not only would the identification of employers’ responsibilities be time consuming and costly, the process of actually making the payments would involve immense administrative complication, with the potential to increase organizational costs and administrative pressures for employers. (sub. DR348, p. 9)

Others called for compensation to be paid to employers for taking on the paymaster function. For example, the Chamber of Commerce and Industry Western Australia said:

In the event that the scheme cannot be administered by the government, employers must be reimbursed for incidental costs, such as upgrades to payroll systems, training of staff or the greater time spent on payroll functions. (sub. DR316, p. 3)

And the Canberra Business Council called for assistance to small firms in particular:

If the Government wants to transfer administration costs of the proposed scheme to businesses acting as paymasters then it must reimburse small business ... and ensure

that reimbursement is received promptly and that compliance documentation is minimal otherwise it will simply add yet another layer of red tape. (sub. DR341, p. 1)

On the issue of compensation, the Commission notes that agency roles have often been assigned to firms and even individuals to act on the Government's behalf (collection of income tax being a prominent example) without any recompense for the costs involved. Those arrangements typically reflect the most cost-effective means of achieving a particular policy objective. While the payment of compensation in the case of paid parental leave would not be that expensive (given the low likelihood of parental leave absences), it would open the door for similar claims across a whole raft of agency arrangements — and that would be prohibitively expensive. The Commission also considers that the administrative burdens on firms delivering taxpayer-funded parental leave need to be weighed against the retention benefits that the proposed scheme will deliver to many, if not most, employers not currently offering paid parental leave voluntarily.

More broadly, as the Commission said in the draft report, the kinds of arguments raised in opposition to the paymaster function ignore the role already played by employers in the provision and/or administration of a range of employment related entitlements including annual, long service, sickness, voluntary paid and statutory unpaid parental leave.¹⁶ Indeed, it is arguable whether there would be any material addition to administrative costs, not only for large employers with access to sophisticated payroll and human resource management systems, but also for smaller firms because (as acknowledged by some participants) the probability of an employee actually being on parental leave at any point in time would be quite low (see chapter 7). The National Foundation for Australian Women supported this assessment as part of its proposal for a pooled levy arrangement (discussed earlier):

The potential administrative burden seems over-stated. ... Employers already pay recreation, sick and long service leave entitlements to employees. The potential addition would be in reclaiming the funds from the Commonwealth Agency, and this should be made as efficient as possible. (sub. 54, p. 7)

But the Chamber of Commerce and Industry Western Australia took issue with this assessment:

The argument ... that employers already play a large role in the “provision and/or administration of a range of employment related entitlements”, does not recognise that the scheme proposed would not form part of the contract of employment or part of the employment relationship and as such is significantly different to other leave entitlements such as sick leave, annual leave or long service leave. (sub. DR316, p. 2)

¹⁶ The exception may be for those casual employees that would be eligible for parental leave but who are not currently entitled to provisions such as annual leave, long service leave and unpaid parental leave.

All that said, the dissenting groups did not quantify the cost associated with the paymaster function, nor did they take issue with evidence presented in the draft report suggesting relatively low administrative costs for employers from the operation of the United Kingdom's *Statutory Maternity Pay* (SMP) program. As the Commission noted, recent analysis of the impact of potentially moving from employer payment to a direct government payment system found that the administrative cost to the 85 000 employers paying SMP is around £2.8m (about £9 per employee recipient), of which about 40 per cent is borne by small firms. That analysis also found substantially higher costs from direct government delivery with an estimated establishment cost of as much as £75m and annual operating costs of £50m (HMRC 2005).

Furthermore, it is worth noting that public sector delivery can still be very costly, even when a new payment is added to existing administrative and payment frameworks. For example, removing administrative responsibility for family tax benefit processing from the Australian Taxation Office (which represented around only seven per cent of total claims activity) is expected to provide a budgetary saving of around \$100 million over four years (FaHCSIA 2008b).

Nevertheless, the efficiency with which the payment from government is made to employers will be critical to avoiding potential cash-flow problems and other risks. This is especially the case for smaller firms employing eligible part-time and casual workers earning less than the minimum wage (the payment rate under the Commission's proposed parental leave model).

The Commission noted in the draft report that allowing employers to reduce their regular PAYG withholding remittances to the ATO by the amount of the parental leave payment (with credits available where parental leave payments exceeded the amount of tax otherwise owing) was potentially the most efficient method of reimbursing employers acting as paymasters. That option was favoured by those employer groups not opposed to the paymaster function. In addition to the comments from GM Holden and Tadpoles Early Learning Centres noted above, Ai Group said:

Reimbursement through a credit to 'pay as you go' withholdings would be greatly preferable to a system of cash reimbursement, which in practice could take many months. A requirement that only those businesses making at least monthly repayments would also lessen the cash flow implications of being required to act as paymaster. (sub. DR363, pp. 15–16)

However, following the release of the draft report the Commission held detailed discussions with both the ATO and FaHCSIA in relation to delivery issues, which included the establishment and ongoing administrative costs associated with the proposed scheme, monitoring and compliance safeguards and the administrative

impact of specific scheme design elements (the paymaster function, in particular). As a result of those discussions, it became clear that the operational framework used by the ATO is not well suited to either the delivery logistics of the proposed scheme or to ensuring satisfactory risk management outcomes in this specific area.

Specifically, the ATO uses a self-assessment model that does not typically involve routine checking or verification of the eligibility status of individual or business clients. Nor does it reconcile payments not separately listed on Business Activity Statements (which would be the case here without changes to those reporting systems) — at least until financial year end. The ATO’s approach to risk management also focuses on auditing potential high cost outcomes (as opposed to vetting all claims) and, unlike agencies such as Centrelink, the ATO does not make regular periodic payments to its clients. While the ATO’s systems could be modified to accommodate the more effective delivery of the Commission’s proposed scheme (including through amendments to BAS reporting requirements), this is likely to involve a considerable cost and meet with significant opposition from the business community.

Centrelink, on the other hand, operates in a manner that appears suited to delivering the Commission’s proposed scheme in a way that best manages potential compliance risks. Centrelink checks/verifies the eligibility status of individual clients, makes regular periodic payments to those clients and its major role in administering other family benefit payments, such as family tax benefit B and the baby bonus (both of which would cease while an individual was on statutory paid parental leave), means that consolidating delivery to that one agency would streamline the delivery of statutory paid parental leave. Centrelink’s ability to collect and cross-match personal and income details of parents as a combined family unit (rather than as separate individuals in the case of the ATO) will also reduce the potential for scheme abuse (such as cases where both parents might apply for primary carer status).

Moreover, the Commission’s discussions with FaHCSIA suggest that the:

- administrative costs of implementing and delivering the proposed scheme would be likely to comprise a relatively modest share of total scheme costs, and so need not in themselves present a barrier to a cost-effective scheme
- ongoing costs of implementing the paymaster function will not vary significantly from those involved with direct payment — in effect, both involve a similar process for payments — just with different destinations. There will, however, be significantly greater setup costs associated with the paymaster function, though not of a scale that make it uneconomic to include this feature in the scheme.

The precise administration costs associated with the proposed scheme will need to be determined by the Government, and will ultimately depend on its final design, degree of risk management and extent to which clients seek information about (or need assistance in applying for) the scheme.

The issue of prompt payment to employers remains critical to addressing at least the cash flow concerns of firms (see chapter 7). Accordingly, the Commission recommends that fortnightly *prepayment* of statutory parental leave instalments be made to employers by Centrelink. These payments would commence around the time of commencement of statutory paid leave (usually, but not always, at the birth of the child) and be triggered by the same processes that lead to payments to parents of the baby bonus. The employer would then pay eligible parents as part of their normal pay cycle.

With respect to those employees eligible on the basis of their overall workforce attachment, but with less than 12 months service with their current employer, the Commission continues to consider that direct government payment is the most efficient delivery option because of the administrative costs an employer would face in tracking employment history. Direct government payments would also be made to the self-employed, including contractors.

In terms of the administration of direct government payments, the earlier discussion regarding Centrelink's comparative suitability as the delivery mechanism suggests that it should also be responsible for administering direct payments. The documentary evidence needed to determine eligibility for employees with less than 12 months service at their current workplace (such as payment summaries) and the self-employed (such as taxation returns) are also typical features of the verification requirements employed by Centrelink for a range of payments administered by that agency.

Finally, Centrelink would also be responsible for dispute resolution and the imposition of penalties for compliance breaches associated with the proposed scheme.

Overall, the Commission continues to consider that the administrative and signalling benefits from assigning payment responsibility to employers are sufficient to favour that approach over direct government payment in most cases. This view is reinforced by the fact that such assignment will only add to compliance burdens on firms when a parental leave event actually occurs. But there will be other compliance issues facing firms from the Commission's proposed scheme (see chapter 7).

Related employment entitlements

In many instances, employees are entitled to ancillary benefits apart from wages — including employer contributions to superannuation and various kinds of paid leave (including annual, long service and sick leave) as well as unpaid leave. Several participants in this inquiry emphasised the need for paid parental leave to be given the status of a normal workplace entitlement. As a consequence, they argued for provision of such entitlements — particularly superannuation — while on a statutory paid parental leave scheme.

Superannuation

On the superannuation front, several submissions argued that the compulsory superannuation guarantee (currently nine per cent) be included on top of the actual leave payment. Most suggested that employers be given responsibility for funding that component to reflect, in part, the benefits that would accrue to firms from an initiative that strengthened workforce and workplace attachment. In addition, some argued that the provision of superannuation while on parental leave was important because it would go some way to addressing the inequity between male and female retirement savings due to the traditional role of mothers as primary care givers. For example, the ACTU said that:

... this is an important equity measure, and would address in part the disadvantage that women face in saving for their retirement. While women live longer than men, their retirement savings are significantly less than men's savings. This is due to lower salaries, broken employment, and high levels of part time employment. (sub. 69, p. 27)

On the specific question of gender equity, it is clear that a woman's lifetime earning potential from bearing children is often reduced because of the loss of human capital associated with lengthy absences from the paid workforce. But the link between that and the adequacy of retirement savings is less straightforward because married women currently have equal rights in law to the superannuation balances of their spouses (including upon death, divorce or bona fide separation) and legislation currently before the Australian Parliament aims to extend those rights to de facto and same-sex relationships.

More broadly, however, given low income earners — the group in most need of financial support and for which paid parental leave would have the greatest impact — are likely to value current period income much more highly than a payment quarantined until a distant future preservation age, the desirability of providing superannuation (as opposed to a cash equivalent) for low income earners could be questioned on a number of grounds.

That point was echoed up by the Master Grocers Association:

... it is difficult to comprehend how the payment of superannuation contributions into an employee's superannuation fund by the employer could be seen as providing a financial benefit to an employee, at a time when actual financial support is most required. A female employee, whose age could range approximately between 18 years and 40 years, cannot access a superannuation fund until retirement age. Therefore, there is no immediate benefit or value to an employee who is absent from the workforce, in having superannuation entitlements paid into a fund. (sub. DR324, p. 4)

The Hair and Beauty Association similarly contended at the draft report hearings:

... we support fully that immediate need to provide some financial assistance to mums and their children and the rationale between trying to make a link between the employer and the employee. But superannuation is effectively looking towards when this person is 60 and we have very few people who are employed in our industry - or any industries - [for] who the superannuation would have some benefit to that immediate cause. (DR trans., p. 497)

Putting that issue aside for the moment, the Commission noted in the draft report that there was currently no statutory requirement under the *Superannuation Guarantee (Administration) Act (SGAA) 1992* for employer superannuation contributions to be made during periods of paid or unpaid parental leave. So in a statutory sense, superannuation contributions have not been a normal workplace entitlement (though this has not precluded employers offering voluntary paid parental leave from providing such benefits customarily). But the Commission also said that the SGAA could be amended to make superannuation contributions during all paid parental leave absences mandatory, and therefore, normal.

Indeed, subsequent to the release of the draft report, the Australian Taxation Office issued a Draft Ruling (ATO 2008c) which, if reproduced in the final ruling, would make employer superannuation contributions during privately negotiated paid parental leave absences obligatory — effectively elevating the status of such leave to a normal workplace entitlement. However, the spirit of the Draft Ruling (and the accrual of other types of leave during parental leave absences) was opposed by employer interests, primarily on the grounds that the Commission's taxpayer-funded proposal should not be regarded as normal in an earnings context. Business SA said in that regard:

... the obligation on employers to pay superannuation contributions is applicable to 'ordinary time earnings'. Business SA would not see any Government funded PPL scheme as 'earnings' and therefore attracting any employer contributions.

Business SA also raises concerns on any unintended consequences falling from any PPL scheme on employers. For example, Business SA would not support the ongoing accruals of leave entitlements including annual leave, sick leave and long service leave during such absences. (sub. 139, p. 3)

Similarly, the Australian Federation of Employers and Industries said:

Entitlements to paid leave and superannuation are determined by the hours worked and earnings of employees while they are employed. The entitlement to parental leave is not derived from the employee's work but from a statute conferred right to be absent from work. (sub. DR339, p. 3)

The Commission, however, considers that broadening entitlement to superannuation benefits to cover statutory parental leave payments would be consistent with the goal of making the statutory scheme mirror, as much as reasonably possible, leave arrangements more generally. It would emphasise that the statutory scheme is a work-based benefit (with potential retention benefits) and that a period of caring for children while employed is a commonplace feature of employment. Accordingly, the Commission considers that there is a *prima facie* case that the Australian Government amend the SGAA to mandate superannuation contributions on statutory paid parental leave payments for the relevant group of eligible parents.

The Commission estimates the gross cost to employers of providing superannuation entitlements would be around \$85 million a year (chapter 2). The draft report argued that while this could be considered a modest contribution by employers compared to the overall size of the taxpayer funded component, it is important to recognise that those employer costs would *eventually* be borne by employees through slower wage growth where barriers to wage adjustment were not binding. In support, it cited the head of government relations at a private sector financial services provider, who recently remarked with respect to the superannuation guarantee (SG):

Small business employers who are obligated to pay the SG suffer a form of sticker shock when they calculate the 9% they must pay below their wages line ... [but] were it not to exist, their actual wages bill would be commensurately higher. (Dowling 2008)

But the Australian Federation of Employers and Industries disputed this contention on the grounds that it was a:

... theoretical argument, and assumes that labour market conditions will allow this outcome, including that there will be no employee resistance to the implicit reduction in disposable income. (sub. DR339, p. 8)

In contrast, the Commission's theorising was supported by another participant — Angela Budai — a finance industry employee with access to voluntary paid parental leave. She provided an insight into how the trade-off between pay and entitlements such as superannuation plays out in the real world:

I work under a union enterprise agreement that in the last round of negotiations we were able to achieve an increase to our superannuation from 13% to 15%. This benefit was gained at the expense of other things including a more generous across the board pay increase. (sub. DR329, p. 2)

However, for those women at or near the minimum wage, these additional employer costs would increase the risk of discrimination. That risk would be reduced by requiring income for superannuation contribution purposes to continue at an employee's regular wage level for employees earning less than the minimum wage and be limited to the minimum wage for all other employees (consistent with the ceiling on paid parental leave). Nevertheless, this would require modifications to automated and manual payroll systems (typically used by smaller firms) and add to the compliance burden on employers. For instance, firms paying above the statutory contribution rate (currently nine per cent) would have to split contributions into the statutory component and other rate in their accounting systems.

Such compliance burdens resonated strongly with business interests, with the Australian Metals and Mining Association, for example, arguing that:

The compulsory provision of capped (9% of the minimum wage) superannuation contributions will not only impose an additional cost on employers (which would not be reimbursed), but also cause administrative complexities for business. For example, the difference between the employee's usual salary and paid parental leave payment will require a re-assessment of employee's earnings in order to alter their superannuation contributions. (sub. DR348, pp. 7–8)

The NSW Business Chamber and Australian Business Industrial were more specific noting that:

... requiring additional superannuation contributions imposes an administrative burden, especially for small businesses that are often reliant on off-the-shelf accounting software packages to do the day-to-day running of their business. These systems automatically calculate payments, such as superannuation, and use these to generate key reports such as payrolls, profit & loss and general ledgers. But under the proposed scheme some superannuation payments would need to be calculated manually and the accounting system overridden. Many small businesses would be left needing to consult with expensive accounting professionals in order to understand how the manual overrides should be accounted for and entered. (sub. DR340, p. 8)

And Ai Group said the additional obligation on employers would compound the adjustment costs related to the move to the new industrial relations environment (under the National Employment Standards):

As Ai Group pointed out in its previous submissions, employers will need to adjust to a new system of obligations and rules under the NES, including some which are highly relevant to this area (eg. the right to request flexible working arrangements and to extend the parental leave period by an additional 12 months). Introducing additional obligations on employers, especially those involving a direct cost, is not warranted. (sub. DR363, p. 18)

But again employer interests did not estimate (even indicatively) the size of the administrative cost burden that would be imposed by the superannuation obligation.

And while the Commission accepts that the new industrial relations landscape will involve some level of adjustment, the legislative changes (including those in the specific parental leave area) have been flagged well in advance.

However, there are several concerns associated with the immediate inclusion of mandated employer-financed superannuation contributions in a statutory paid parental leave scheme. Most particularly, the Commission is concerned not to add unduly to the compliance burdens experienced by employers (particularly small firms) during the scheme's establishment phase and at a time of considerable economic uncertainty (chapter 2). Those considerations suggest that the immediate introduction of an additional direct cost to firms would not be prudent. Accordingly, the Commission proposes that the government defer the introduction of mandated employer-financed superannuation contributions until after a three-year review of the scheme. Employer superannuation contributions on statutory paid parental leave should then be implemented, by amending the *Superannuation Guarantee (Administration) Act 1992*, but subject to:

- a final tax ruling by the ATO determining whether the payment of superannuation on privately negotiated parental leave is mandatory and therefore would become 'normal' practice
- reconsideration of the impacts on business or legal and other administrative problems for government that may be involved. At present, these do not seem to be significant.

Deferring the superannuation component of the scheme will also have the advantage of allowing firms time to adapt to their additional obligations and the new industrial relations environment. In addition, off-the-shelf payroll software incorporating parental leave calculators dealing with the specific obligations associated with the scheme should be available well before the additional direct financial cost of superannuation was imposed (provided sufficient notice is given to deal with the administrative obligations associated with the scheme).

The detailed arrangements for paying the superannuation contribution could also be considered after the three year period, including whether it would be feasible to provide (lower income) employees with the option of taking the entitlement as a cash payment to meet their immediate financial needs or as a standard superannuation contribution.

Finally as a point of clarification, some participants questioned how the Commission's proposal for capped superannuation entitlements would affect defined benefit superannuation schemes. For example, the Finance Sector Union was 'concerned about the potential impact of a reduced contribution level for those employees who are members of Defined Benefits Funds' (sub. DR306, p. 4).

Similarly, GM Holden sought clarification about the interaction of the proposed scheme with that firm's defined benefit scheme:

The majority of our employees are covered under a defined benefits superannuation scheme — where the employee contributes 5% of gross income and the company contributes a supplementary 4%. Following 10 years employment, the company matches the employee 1:1. We are seeking clarification from the Productivity Commission about the impact, if any, of the proposed superannuation payments for the statutory leave periods would have on this defined benefits scheme. (sub. DR388, p. 8)

In response to these specific concerns, the Commission advises firstly that the 'capped' superannuation component of its proposed leave scheme is not intended to impose a mandatory ceiling on any current superannuation arrangement (defined benefit or otherwise). Employers would be free to contribute amounts above the cap should they choose to do so.

More broadly, by their very nature, defined benefit arrangements require employers to periodically make contributions at a level (determined on an actuarial basis) that will meet a fixed financial liability (that is typically expressed as a proportion of an employees final salary) at some point in the future. Any requirement under a statutory paid parental leave scheme for employers to make additional contributions into a defined benefit fund would not provide any benefits to employees as the employer would offset that contribution level against the actuarial contribution requirement. The Commission does not favour any change in the defined benefit schemes to address this since that would entail considerable complexity and compliance costs.

Accordingly, the Commission considers that for employees of defined benefit superannuation funds, contributions during periods of statutory paid parental leave could be either placed in an accumulation style fund of the employee's choosing, or the employee could be given the option of cashing-out the superannuation component. As discussed in chapter 2, both of these options could be examined as part of the review of the broader paid parental leave scheme three years after its introduction.

The Commission notes that the marked (and ongoing) shift away from defined benefit to accumulation style super schemes over the last two decades means that very few employees in the key childbearing age cohort are likely to be covered by defined benefit arrangements, though what happens in relation to these funds is still of importance to those that are covered.

Accrued leave entitlements

Dealing with accrued leave entitlements is more problematic. Currently, long service leave provisions are governed by specific legislation enacted in most jurisdictions that differ in terms of their entitlements, rates of accrual, qualifying periods and eligibility conditions.¹⁷ Parental leave absences do not count as service for long service leave accrual purposes (except for paid parental leave in Victoria).

Entitlements typically accrue on the basis of hours worked and are paid at the ordinary pay rate when long service leave is taken.

The Commission argued in the draft report that, consistent with the ceiling on paid parental leave under its proposal, long service accrual for the period of paid parental leave would need to be capped at the relevant hourly equivalent of the minimum wage for each individual. This would be in breach of statutory requirements (unless they were changed). It would also require the establishment of an ongoing dual accrual and payment system for each affected employee, with compliance burdens on most employing businesses. Notably, as leave often carries across several years, firms would need to keep track of such leave entitlements, even in years where no staff member has a child. The alternative, an uncapped scheme, would resolve many of these compliance burdens, but would add considerably to the cost of the scheme and the risk of discrimination. Similar arguments could be mounted against sick and annual leave accrual.

In addition, the Commission said that while it recognised the value of paid parental leave being seen as being like other leave, there is no single set of commercial and legislative requirements for entitlements on current forms of leave — so that it is not easy to gauge what is ‘normal’. And, particularly with respect to mandating the accrual of leave entitlements while on parental leave, there would be a significant financial and (ongoing) compliance cost imposed on employers and legislative burden placed on Governments in order to amend the relevant industrial relations legislation (potentially with other broader consequences). Accordingly, the Commission expressed the view that this would preclude leave accrual being considered a practical component of its proposed scheme. However, the Commission also said that if evidence emerged that those obstacles could be overcome in a cost-effective manner, it would have cause to reconsider its position.

Business interests responded by arguing that the design of the Commission’s scheme made leave accrual an impractical proposition. Ai Group, for example, noted that the complexities associated with leave accrual would compound the adjustment costs associated with moving to the new industrial relations landscape:

¹⁷ A uniform national system of long service leave is currently being developed.

Imposing a payment rule based on the [Federal Minimum Wage] for the period of leave accrued during paid parental leave would be problematic and confusing. It would introduce unwarranted complexity into the accrual and payments rules for other types of leave and, as the Commission notes, would require amendment of the NES. These new complexities would come at a time when employers and employees will be adjusting to a range of new entitlements and rules under the NES. (sub. DR363, p. 20)

Some were concerned about the additional costs that would be imposed on employers, particularly given the actual payment rate for the accrued entitlements. The Chamber of Commerce and Industry Western Australia said:

The result is the accrual of around 3.4 days of personal leave and around 6.8 days of annual leave, to be paid out to the employee at the employees' *current* rate of pay, which is highly likely to create the anomalous situation of exceeding the minimum rate at which they accrued the hours. (sub. DR316, p. 7)

The South Australian Wine Industry Association estimated that:

Employees would be entitled to additional 96 hours of paid leave, at their rate of pay at the time of taking the leave (which may be significantly higher than the paid parental leave rate of \$544 per week). This cost is borne by the employer and is not subject to any productivity improvement. The minimum additional cost to an employer, based on an employee receiving the adult minimum rate of pay of \$14.31 per hour would be \$1,374 per employee. Costs will be higher for employees receiving higher rates of pay in line with higher classifications, grades or non award covered employees.

And Hair and Beauty Australia voiced particular concerns about small firms:

... if other leave entitlements [accrued], that would devastate the small business industry let alone our industry which has quite a few small businesses. It is just our position that the benefits are greatly outweighed by the burden on the industry in relation to the continuing accrual of other leave entitlements. (DR trans., p. 500)

Other employer advocates suggested that the Commission's deliberations on this issue were academic because under both current legislation and the proposed National Employment Standards, unpaid leave (from the employer's perspective) does not and will not count as service for the purposes of leave accrual. The combined submission from NSW Business Chamber and Australian Business Industrial said in this regard:

The proposal to consider accrual when on the proposed national paid parental leave scheme overlooks/does not appreciate/misunderstands the fact that the employee will be on unpaid leave from their employer, given that the Federal Government is the payer in the scheme. As the NES are currently drafted, no other type of unpaid leave (except community service) allows employees to keep accruing other leave entitlements while on leave. (sub. DR340, p. 13)

But the Australian Federation of Employers and Industries was less certain:

It is also possible that, with changes in the substantive legislation and the introduction of the 10 National Employment Standards on 1 January 2010, periods of unpaid parental leave will also count as “service” for the accrual of other forms of leave. This raises issues of the rate of pay at which leave will be accrued - the rate immediately prior to taking leave, or the rate of payment while on leave. (sub. DR339, p. 10)

In turn, the ACTU argued that the uncertainty surrounding the issue could be clarified by simply changing the unpaid leave provisions of the NES and specific State-based long service leave legislation so that periods of *unpaid* parental leave were counted as service for leave accrual purposes.

Amend the National Employment Standards and long service leave legislation to provide that unpaid leave for the purposes of taking statutory parental leave is counted as service for the purpose of accrual of annual leave, sick leave, and incremental salary progression. (sub. DR365, p. 9)

Formal written advice received from the Department of Education, Employment and Workplace Relations pointed to a similar potential antidote:

To avoid any uncertainty, it would be desirable for legislation establishing the scheme to be clear whether a period of leave for which a payment is made counts as service. (personal communication)

Based on that advice, the legislative hurdles to accrual of other leave entitlements during statutory paid parental leave do not appear that onerous (particularly if a uniform national long service leave system is implemented). But the Commission has not been swayed from its view that the initial compliance burden on firms would be too heavy given the design features of its proposal (though this may change in the future). Moreover, in line with the discussion on superannuation above, the imposition of an additional direct financial burden on employers during the establishment phase of the scheme and at a time of considerable economic uncertainty would be imprudent.

Therefore, the Commission recommends that the issue of accrued leave entitlements be revisited as part of the review of the scheme three years after its introduction. This would allow for a reassessment of business compliance costs which, at this time, provide the strongest argument against the inclusion of this component in the proposed statutory parental leave scheme.

Table 8.1 Pros and cons of alternative financing options

<i>Option</i>	<i>Features</i>
Direct Employer Funding	<p><i>Advantages</i></p> <ul style="list-style-type: none"> • Involves lower efficiency costs compared to other alternatives <p><i>Disadvantages</i></p> <ul style="list-style-type: none"> • Risk of discrimination against women • Significant transitional costs on firms • Increased gender wage inequality
Pooled funding	<p><i>Advantages</i></p> <ul style="list-style-type: none"> • Potentially lowest efficiency cost compared to other alternatives • Reduces risk of discrimination and accentuation of gender wage gap • Spreads cost broadly <p><i>Disadvantages</i></p> <ul style="list-style-type: none"> • Some transitional costs for firms • Comparatively high administrative and compliance burden • Increases complexity of the tax system
Portable leave/savings accounts	<p><i>Advantages</i></p> <ul style="list-style-type: none"> • Same as for pooled funding • Decisions regarding parental leave duration left in the hands of parents <p><i>Disadvantages</i></p> <ul style="list-style-type: none"> • Same as for pooled funding • Broader scope of proposal involves higher efficiency cost • Diminishes the retention benefits from long service leave
Income contingent loans as a supplement to government-funded base scheme	<p><i>Advantages</i></p> <ul style="list-style-type: none"> • Reduces efficiency costs of full government revenue financing • Decisions regarding parental leave income and duration left in the hands of parents • Low-cost option for increasing the generosity of a base taxpayer funded scheme <p><i>Disadvantages</i></p> <ul style="list-style-type: none"> • Detailed design requirements • Involves some risk to government revenue
Concessional tax arrangements	<p><i>Advantages</i></p> <ul style="list-style-type: none"> • Decisions regarding parental leave duration left in the hands of parents • May encourage business top-ups <p><i>Disadvantages</i></p> <ul style="list-style-type: none"> • Provides tax concession to existing schemes • Favour employees likely to already have access to paid parental leave • Incentives for employers to act strategically • Involves some risk to government revenue
General government revenue	<p><i>Advantages</i></p> <ul style="list-style-type: none"> • Administrative machinery for collection already exists • Avoids problems of discrimination and greater gender wage inequality • Spreads cost broadly <p><i>Disadvantages</i></p> <ul style="list-style-type: none"> • Potentially high efficiency costs