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## 9 Interaction with social welfare payments

### Key points

- The suite of family benefits currently provided in Australia is relatively generous by OECD standards (including most countries with paid parental leave schemes).
- The Commission has recommended folding some of the existing family benefits into the proposed paid parental leave scheme.
  - Parents ineligible for the statutory paid parental leave scheme will continue to have access to existing family payments (including the baby bonus if they meet the baby bonus means test).
  - Eligible parents will have the choice of either the statutory paid parental leave or existing family payments — so the introduction of the proposed scheme should make no family be worse off.
- The Commission is also proposing that statutory parental leave payments would not be counted as income when determining eligibility for income support payments (primarily parenting payment).
  - Of the families who could be eligible for the proposed paid parental leave scheme, as many as one-third may also access parenting payment while the mother is on unpaid leave.
  - If statutory parental leave payments were counted as income for parenting payment, it is possible that these families would be financially better off not taking the proposed paid parental leave pay.
- Under the proposed parental leave scheme, budget costs would increase by around 1.2 per cent of existing government outlays on family assistance measures.
- Payments under the proposed paid parental leave scheme should be taxed. As such:
  - low income earners would receive greater benefits than middle income earners and most high income earners
  - however, some families previously ineligible for the baby bonus would also receive relatively large net benefits
  - taxing the proposed payment assists in offsetting the disproportionate gain that some high income families would receive
  - a taxed scheme would also encourage additional leave to be taken compared to an untaxed scheme with a comparable budgetary cost

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There are several substantive interactions between the tax and welfare system and the proposed parental leave scheme. This chapter explores these interactions and examines their implications for the design of the proposed paid parental leave scheme and for some existing welfare payments.

The chapter does not provide a detailed explanation of the Australian tax and transfer system. Rather, it examines how the proposed parental scheme will interact with the elements of the tax and transfer system that are particularly relevant to families with new children. This information enables the Commission to identify changes to existing arrangements that are required to improve the effectiveness of the proposed paid parental leave scheme. Additional information on these social welfare policies is provided in appendix F.

## 9.1 Interaction with other government payments

Families with young children may be entitled to a number of government payments, including the baby bonus, family tax benefit (A and B), parenting payment, the child care benefit and the child care tax rebate. These payments are generally subject to means testing, so not all families qualify.

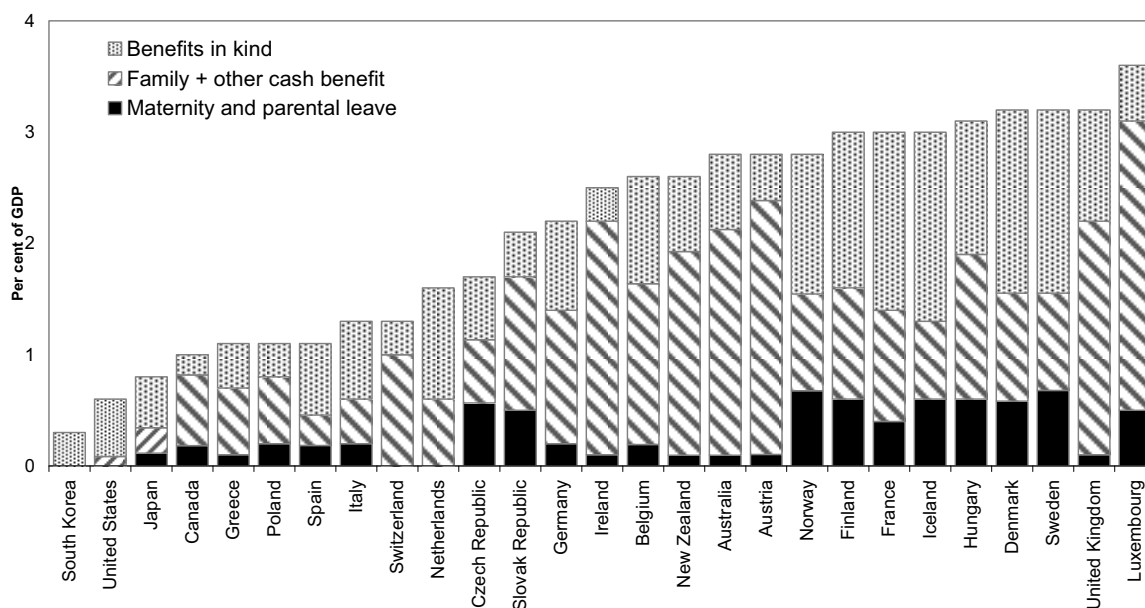
International comparisons suggest that, family payments in Australia are relatively generous by OECD standards (figure 9.1).<sup>1</sup> And, the statistics for most other OECD countries include government outlays on paid maternity or parental leave schemes.

Australia currently spends around \$25 billion on family assistance (figure 9.2). The proposed paid parental leave scheme is likely to increase family related payments made by the federal government by around 1.2 per cent. Overall, the proposed scheme will have a net cost to taxpayers of around \$310 million a year (appendix B). While raising the budget outlays that Australia makes on family related payments, the proposed paid parental leave scheme is unlikely to change Australia's ranking among OECD countries.

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<sup>1</sup> The family payments data also includes in-kind provision of services. The largest component of the in-kind provision of family services is child care. In many European countries, governments directly fund child care centres, so those payments are not treated as a monetary transfer to families but a service provided to families. For Australia, both the child care benefit and the child care tax rebate are considered direct transfers to families.

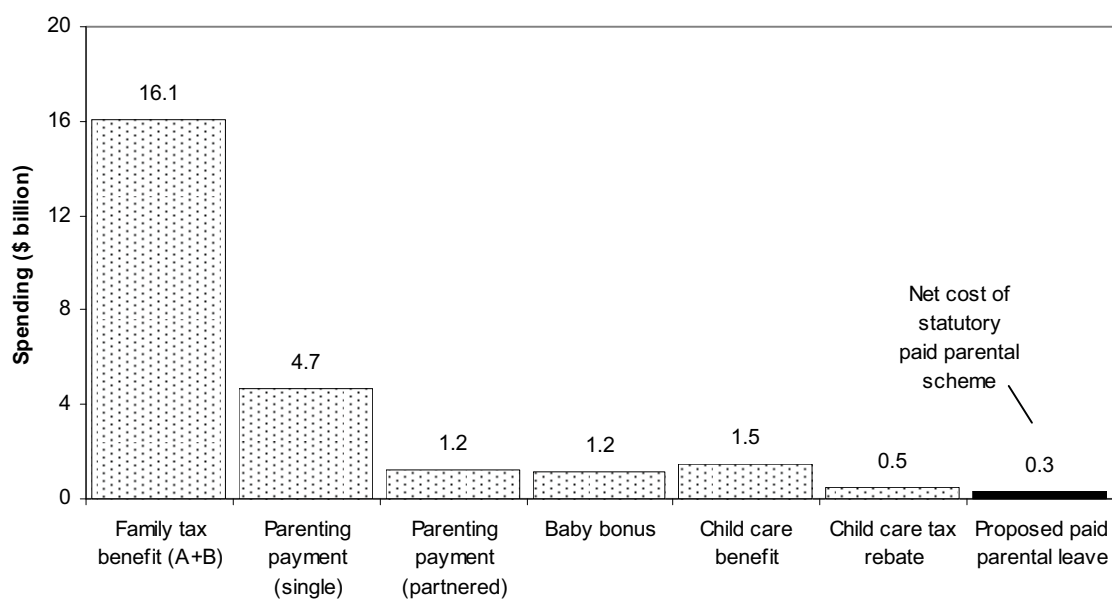
Figure 9.1 Family payments as a share of GDP in 2005<sup>a</sup>



<sup>a</sup> Family payments include family allowances, maternity and parental leave, other cash benefits and benefits in kind (which include transfers to subsidise child care).

Data source: OECD.

Figure 9.2 Budgetary outlays on main family benefits in Australia  
Outlays in 2006-07



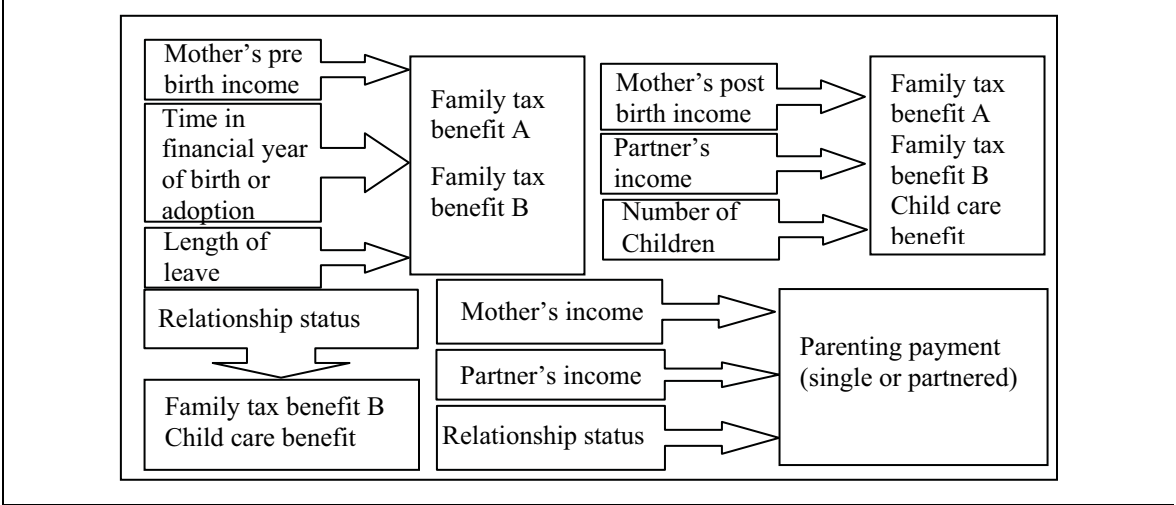
Data source: FaHCSIA 2008, *Pension Review Background Paper*, August and Productivity Commission calculation.

While family payments are available to most Australian families, the amount of support to each family differs. The factors that influence the extent of payments to families around the birth or adoption of a child include:

- the mother’s income before birth or adoption
- the mother’s income after birth or adoption
- whether they are a sole or partnered parent
- the partner’s income
- the number of children in the family
- when during the financial year the birth or adoption occurs
- the length of leave taken.

A graphical representation of the factors that determine eligibility for these key family payments and for parenting payment is provided in figure 9.3. These seven family characteristics influence the eligibility for support and/or the amount of payment each family actually receives (see appendix F for more detail).

**Figure 9.3 Factors affecting family payments**



The set of family policies discussed here provide the context in which the proposed paid parental leave scheme will operate. Most of the existing payments are directed at specific groups and designed according to their needs. Similarly, paid parental leave is, by definition, aimed at assisting certain groups in society — primarily women in paid employment who have a baby. The needs of other groups, such as families where one partner has exited the labour market for a number of years in order to become a primary carer, are more appropriately addressed by policies explicitly targeted towards them.

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## Scale of existing government payments

A key objective of a paid parental leave scheme is to encourage parents to extend their time off work. One of the main means of achieving this objective is to provide families with additional financial assistance around the birth or adoption of a child. In order to place the scale of the proposed parental leave payments into context, it is useful to understand the scale of existing government payments.

McDonald (2008) provides an illustrative example for a couple with two children. He examines the levels of lifetime family assistance associated with different patterns of workforce participation. He considered four cases:

- ‘stay at home mum’ — the mother provides full-time care and the father works full-time
- ‘one and a half incomes’ — the father works full-time while the mother works part-time until the youngest child turns 13 and then full-time after that
- ‘equal sharing’ — both mother and father work three quarter time until the youngest child turns 13 and then both work full-time after that
- ‘two incomes’ — both mother and father work full-time.

McDonald notes that the stay at home mum couple benefited most from family tax benefits A and B. The equal sharing couple benefited most from family tax benefit A. Both the one and a half incomes couple and the two incomes couple benefited most from the child care benefit and child care rebate.

The stay at home mum couple were the largest recipients (\$168 000 by the time the youngest child turns 18), which is largely due to their lower overall income and eligibility for family tax benefit B. Interestingly the two incomes couple receive a relatively high amount (around \$113 000), which is almost entirely driven by the unusually high use of subsidised child care (50 hours per week for the first five years of both children’s lives) assumed in McDonald’s example.

The one and a half incomes couples and the equal sharing couples — which McDonald suggests more accurately portrays parents’ preferences — receive more modest entitlements, of around \$45 000 and \$42 000 respectively, by the time their youngest child turns 18 years old.

Another way of looking at the scope of existing family payments is to estimate the payments that some actual families would receive. The LSAC database provides sufficient information to estimate the level of family assistance for about 1700

families had their child been born or adopted in 2008-09 (table 9.1).<sup>2</sup> The estimated payments reflect family income, the timing of birth and the amount of leave taken by parents. The evidence shows that the size of payments are strongly related to family income:

- A family where the mother's pre birth annual income was below \$20 000 and her partner's annual income was below \$30 000 received, on average, just under \$44 000 in government payments. These amounts include payments both in the year the baby was born and in the following financial year.<sup>3</sup>
- In contrast, for families where the partner earns \$90 000 or more a year and the mother has an annual pre birth wage of \$50 000 or more, the family would receive less than \$5 000 in government benefits over two years.

**Table 9.1 Payments to families with newborn children**  
Average payments to families who would be eligible for the proposed scheme

		<i>Mother's annual pre birth income<sup>b</sup></i>		
		Below \$20 000	\$20 000 to \$49 999	\$50 000 +
Partner's annual income	Below \$30 000	\$43 988	\$34 472	\$23 890
	\$30 000 to \$59 999	\$25 088	\$15 810	\$8 504
	\$60 000 to \$89 999	\$18 560	\$10 965	\$7 379
	\$90 000 +	\$15 857	\$7 309	\$4 716

<sup>a</sup> The payments include the baby bonus, family tax benefit (A and B) and parenting payment (single and partnered). Payments are the sum of payments received in the year of birth and the following financial year. The calculations assume no behavioural change from the introduction of the proposed paid parental leave scheme.

<sup>b</sup> The income is equivalent to 52 weeks of each mother's pre birth weekly wage.

Source: Productivity Commission calculations using LSAC database.

<sup>2</sup> There are 1716 families in the LSAC database where the mother would be eligible for the proposed paid parental leave scheme and where there is sufficient information to determine the value of family payments they would be entitled to if they had a child in 2008-09. As the LSAC income information relates to the 2003-04 financial year, the income has been adjusted by the growth in the consumer price index to reflect changes in income that have occurred between 2003-04 and 2007-08 (the latest complete year of inflation data).

<sup>3</sup> For around a third of families, the proposed paid parental leave scheme will be paid over two financial years. As the family tax benefit payments and tax liabilities are based on financial year income, it is necessary to examine the financial impact on families of the proposed paid parental leave scheme across the year in which the birth or adoption occurred as well as the subsequent financial year.

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In fact, the value of government payments indicated in table 9.1 is understated because child care related assistance has not been included.<sup>4</sup>

The existing generous levels of family welfare payments have to be considered in designing any statutory paid parental leave scheme. In particular, a statutory paid parental leave scheme must provide a sufficient gap between the payments received while on welfare and those received while participating in the scheme, so that parents are encouraged to take leave while maintaining a longer-term link to the workforce. Such a gap could be achieved by continuing to pay existing welfare benefits and supplementing these with an additional modest statutory leave payment.

Alternatively, the same gap could be achieved by reducing access to some welfare payments for those taking statutory paid parental leave and paying a more generous statutory payment. The latter approach — which the Commission proposes — is more consistent with the goal of making the leave payment like other work-based entitlements, rather than a conventional welfare payment (chapter 6). Moreover, the latter approach penalises the early return to work by a person on statutory paid parental leave to a greater degree, helping to facilitate the longer leave durations that are important for child and maternal welfare (chapter 4).

While, in theory, it is the gap between welfare and in-work payments that provide the most important motivation for remaining attached to the labour force, the absolute size of the statutory payments and their timing may also be important considerations, potentially encouraging higher long-term labour force participation by women (chapter 5).

Some financial assistance currently provided to families is not available immediately. For example, part of the family tax benefit A and B is paid in the following financial year. If a family chooses to participate in the statutory paid parental leave scheme then they will lose some family tax benefits. The reduction will influence both the fortnightly family tax benefit payments and the end of year supplementary payments. Many parents may not know exactly how much family tax benefits they will ultimately receive by the end of the financial year. In contrast, all of the proposed paid parental leave would be paid within an 18 week period.

Given the greater certainty and timeliness of statutory paid parental leave payments, families are more likely to use the money to extend their leave. Accordingly, a family may still change their leave behaviour even if they receive benefits under the

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<sup>4</sup> Child care benefit and child care tax rebate have not been included in this analysis because the LSAC database has insufficient information to estimate the benefits families receive.

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proposed paid parental leave scheme equivalent to those arising from current tax and welfare arrangements.

The following section assesses what changes to existing family assistance may be necessary for families to benefit from the proposed paid parental leave scheme. Based on advice received from a number of government departments on the draft report proposal, the Commission has modified the proposed approach. Most notably, the interaction between the proposed paid parental leave scheme and income support payments — especially parenting payment — has been substantially altered.

### **Existing policies that assist families with new children**

The Commission is principally interested in increasing the length of leave parents take around the birth or adoption of a child. However, given the wide range of existing policies that influence parents of new children, it has also been necessary to examine any indirect impacts that access to existing payments could have on the effectiveness of the proposed paid parental leave scheme.

#### *The baby bonus*

The baby bonus provides families with a \$5000 tax-free payment, regardless of their workforce status. Since January 2009, a means test has been applied to the baby bonus. Only families who will earn a combined income below \$75 000 in the six months after the birth or adoption of a child are eligible for the baby bonus. In addition, since January 2009, the baby bonus is paid in 13 fortnightly instalments to eligible families.

While many families already use the baby bonus to finance some of their parental leave, this is not the case for all families. As such, the Commission looked at ways to design a scheme that:

- did not diminish the ability of families to finance some of their leave through government support, but
- also provided an incentive for families to use government support for financing an extension of their leave where they are not currently doing so.

A way of achieving these two objectives is to fold the existing baby bonus into the proposed paid parental leave scheme for eligible parents — with parents only receiving the parental leave payment if they take time off work.

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### *Family tax benefit B*

The Commission proposes that families using statutory paid parental leave would lose access to family tax benefit B payments while they were on statutory leave.<sup>5</sup> This would partly finance the scheme, while helping to maintain the gap between welfare and an in-work benefit that is necessary to achieve the objectives of the scheme.

The Commission could have adopted the alternative strategy of leaving intact the existing family tax benefit B arrangements, and making budget savings as the additional income from statutory paid parental leave reduced parents' family tax benefit B entitlements. Under this scenario, were the Government to pay parental leave at the federal minimum wage then under the current family tax benefit regulations, most families would lose all of their family tax benefit B payments while receiving the proposed parental leave payment. However, a significant minority of families — particularly single parents — would remain eligible for a significant level of family tax benefit B payments while on statutory paid parental leave. Consequently, a statutory paid parental leave scheme structured so that parents would still be potentially eligible for family tax benefit B would be more expensive. That additional cost might have been justified if it had significant positive effects on the leave and labour force behaviour of the relevant group of parents who would continue to get family tax benefit B payments. However, we do not believe that to be the case.

### *Parenting payment*

There is a reasonable likelihood that families currently accessing parenting payment during unpaid leave would not be financially better off under the proposed statutory paid parental leave scheme. As a result, these families could be expected to opt out of the scheme and into welfare, potentially weakening the positive impacts of a statutory paid parental leave scheme on women's lifetime workforce participation. While the Commission is uncertain of the number of affected families, we believe it to be a more significant number than initially estimated in the draft report (box 9.1). For this reason, the Commission is now recommending that payments from the proposed parental leave scheme not count as income for determining eligibility for either parenting payment — single or partnered.

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<sup>5</sup> Currently, while the mother is on unpaid parental leave, nearly all families are eligible for the maximum rate of family tax benefit B (currently \$125.02 a fortnight).

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### Box 9.1 Who gets parenting payment while on leave?

There is considerable uncertainty about how many mothers receive parenting payment during any period of parental leave.

Centrelink administrative data supplied to the Commission by FaHCSIA indicates that 24 per cent of families with a child aged under one year old were in receipt of parenting payment in late November 2008. It is likely that additional families with newborn children would have accessed parenting payment at some time during the year — but not on that date. As such, we would expect more than 24 per cent of mothers with newborn children to receive parenting payment during the first year of their child's life. Unfortunately, the Centrelink administrative data only relates to specific points in time, and accordingly, cannot identify how many of those families would have a mother eligible for the proposed paid parental leave scheme.

Using data from the LSAC database, 26 per cent of all families with newborn children reported receiving parenting payment at a point in time. In comparison, just 10 per cent of families where the mother would be eligible for the proposed paid parental leave scheme reported receiving parenting payment when they were interviewed. And, most of these families were only eligible for part of the parenting payment. Based on this information, in the draft report the Commission did not recommend changes to the eligibility provisions for parenting payment.

However, according to the income and leave data available in the LSAC database, as many as a third of families where mothers would be eligible for the proposed paid parental leave scheme could qualify for parenting payment some time in the first twelve months after the birth of their child. Most of these families would only be eligible for parenting payment while the mother was on unpaid leave.

In fact, it is likely that less than a third of mothers who would be eligible for the proposed paid parental leave scheme would receive parenting payment for any part of the first year after the birth or adoption of a child. This is because:

- some of these families will not meet the asset test for the parenting payment
- some parents who are eligible for parenting payment will not apply for it.

As such, we do not know how many parents eligible for the proposed paid parental leave scheme will actually receive parenting payment, nor the rate of payment or its duration. However, it is likely to be considerably higher than the initial 10 per cent figure estimated by the Commission in the draft report.

More generally, the Commission is recommending that the proposed parental leave payments should not count as income for any allowances or pensions ('income support' as defined under section 23 of the *Social Security Act 1991*). This can be operationalised by including any statutory paid parental leave payments in taxable income, but excluding them from the calculation of 'ordinary income'. This will result in the paid parental leave not influencing a mother's entitlement to parenting

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payment or in her partner's entitlement to such arrangements as newstart or the disability support pension.

### *Child care benefit and child care tax rebate*

While most of the tax transfer system in Australia discourages labour force participation by new mothers, child care assistance actually encourages parents to return to work. Child care assistance encourages labour force participation by lowering the costs families face when returning to work.

Child care assistance can both undermine and complement the objectives of the proposed paid parental leave scheme:

- if assistance with child care encourages parents to return to work during the first six months of a child's life, it works against the objectives of child and maternal wellbeing
- but, if it encourages parents to return to work at a later time, it can complement the workforce participation objective of a paid parental leave scheme.

An examination of the use of child care by Australian families with a new baby gives some insight into whether child care assistance could undermine the effectiveness of the proposed paid parental leave scheme.

Assistance with child care is provided by two payments, a child care benefit and a child care tax rebate.

- The child care benefit is typically taken as a reduction in the fortnightly fee charged by 'approved' or 'registered' child care providers for eligible families.
  - the maximum hourly subsidy for 'approved' child care is between \$3.47 and \$4.63 an hour
    - ... the maximum hourly subsidy varies depending on the number of children in care and the weekly hours of care
  - for most types of registered care, the current maximum rate is less than 60 cents an hour.
- The child care tax rebate reimburses parents each quarter for half of the out of pocket expenses for 'approved' child care — up to a maximum of \$7500 a year per child (FAO 2008c).

The combined effect of the child care benefit and the child care tax rebate is that most families with a child under the age of one year who use 'approved' child care services are likely to have at least half their child care costs subsidised through the

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child care benefit scheme and the child care tax rebate. Lower income families will receive even higher subsidies.

Based on LSAC data, only 2 per cent of babies are placed in long day care or family day care — the predominant providers of ‘approved’ care — before six months of age. While around a quarter of mothers who return to work in the first six months do utilise formal child care, this is a very small group of children.

Most parents still bear part of the cost of ‘approved’ child care. As such, families with children in family day care or long day care must spend part of their net income on child care costs. If the primary carer extended their leave, the family could save money by not having their children in care. The amount of compensation those families will need to encourage the primary carer to extend their leave is likely to be less than for a family on the same income without child care costs.

Of the families with babies under six months of age using long day care or family day care for work purposes, it is estimated that three quarters would financially benefit from the introduction of the proposed parental leave scheme.<sup>6</sup> In addition, all those families who would benefit from the scheme are estimated to take the entire 18 weeks of paid parental leave. As such, the current level of child care subsidies is unlikely to negate the incentives offered by the proposed paid parental leave scheme. However, further increases in child care subsidies for children under six months old would work against the central objectives of the proposed paid parental leave scheme.

Most of the remaining mothers who would not be financially better off taking the proposed parental leave payment are earning high incomes.<sup>7</sup> As such women are less likely to respond to the proposed paid parental leave scheme generally, it is unlikely that the child care assistance they receive would undermine the objectives of the proposed paid parental leave scheme.

Throughout our inquiry, a number of participants indicated that gaining access to a preferred child care provider can alter the planned return to work date (for example Ms Roberts NTEU, transcript p. 219 and A Harris, sub. 201 p. 3). Parents typically need to register their interest in using a child care centre, and when they have reached the top of the waiting list and a place becomes available, they are offered that place. If they wish to accept the child care place, they must begin to pay for the care within a given period. If a child care place is offered at a preferred centre

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<sup>6</sup> Appendix G provides details on the approach used for estimating the benefit from the proposed paid parental leave scheme.

<sup>7</sup> But not so high that that they would be ineligible for the baby bonus if they did not use statutory paid parental leave.

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before the intended return to work date, it is likely that the family will accept child care placement and the primary carer will then return to work. It is unlikely that a parental leave payment will alter this behaviour.

Child care assistance may also alter the timing of return to work for families who already have at least one child in care when a parent begins parental leave. In those circumstances families may:

- keep the older child in care during parental leave — typically with reduced hours
- withdraw the older child from care, but at the risk of having no care place for the older child if the parent returns to work.

For those families who choose to pay for child care while the parent is on leave to guarantee ongoing access to a care position, there is an incentive to return to work earlier.

Nevertheless, overall it can be expected that parents currently using formal child care would extend their time off work under the proposed parental leave scheme. Consequently, there is likely to be a reduction in very young children in ‘approved’ child care. However, it is not clear that there would be a long-term reduction in child care use or an associated budget saving. Part of the objective of the proposed scheme is to increase the lifetime workforce attachment of women (see chapter 5), which could partly or completely offset short-run budget savings.

#### *Interaction with other government programs*

The proposed parental leave payment will also affect eligibility for other welfare payments including family tax benefit A and carers allowance.

More families with children under two years of age receive family tax benefit A than receive family tax benefit B. Around 70 per cent of families with children under the age of two years receive family tax benefit A, compared to 62 per cent for family tax benefit B. The maximum payment rate for family tax benefit A (per child) is around \$20 a fortnight higher than the (per family) maximum payment of family tax benefit B.

The interaction between the proposed parental leave scheme and family tax benefit A is likely to be less critical for the design of the proposed scheme than the interaction with family tax benefit B. This is because:

- eligibility for family tax benefit A is based on both parents’ combined income for the entire year, rather than just the income of the primary carer

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- unlike family tax benefit B, there is no quarantining arrangement<sup>8</sup> for family tax benefit A, so there is a less direct link between the duration of leave taken by the primary carer and the amount of family tax benefit A paid
  - reductions in family tax benefit A payments only occur in specific income ranges, so some families will not lose any family tax benefit A payments if they receive the proposed parental leave payment.

Given the nature of these interactions, the Commission is not recommending any changes to the family tax benefit A arrangements. The entire tax and welfare system is currently being examined by the *Australian Future Tax System Review Panel*, hence the Commission has only recommended changes to the welfare system that are considered essential for the effective operation of a paid parental leave scheme. It may be necessary to alter the design of the proposed paid parental leave scheme after the completion of the tax and welfare review to ensure that the interaction between the schemes would still deliver the desired outcomes.

The carer allowance is a means tested payment, with benefits declining at relatively low income levels (FAO 2008c). As such, recipients of the carer allowance who are eligible for the proposed parental leave scheme were among those most at risk of being worse off by accepting the proposed parental leave scheme from the draft report. As the Commission is recommending that the parental leave payments not be included for the means testing of income support payments, families where the mother or partner are receiving the carer payment are more likely to benefit from the proposed parental leave scheme.

## 9.2 Interaction with the tax system

Ultimately, the tax paid by a person depends on their annual income. However, in any given period, the ATO withdraws tax based on the income at that time. Consequently, at the end of the financial year, it is often necessary to reconcile the actual amount of tax paid and the appropriate tax liability. This is especially true for mothers who have interrupted income flows around the birth of their children, with the result that they are usually due a tax refund.

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<sup>8</sup> Quarantining is explained in appendix F. It allows one parent in a family to be paid the maximum amount of family tax benefit B for a continuous period of unpaid leave, subject to some additional conditions. Usually, access to family tax benefit B is based on income over a full financial year. The quarantining provision treats the unpaid parental leave as a separate period. This reduces the scope for families to incur a family tax benefit liability if the mother earns more money when she returns to work than has been expected.

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The pay-as-you-go tax withholding system would apply to the proposed parental leave payment. For each recipient, \$120 of the payment would be withheld each fortnight,<sup>9</sup> but the ultimate tax liability each mother would incur would depend on her income throughout the financial year.

For most mothers who would receive the proposed parental leave payment, the increase in their tax liability for the year would exceed the amount of tax withheld from their parental leave payment, reflecting the fact that their income for the rest of the year would be higher on average than that received while on paid parental leave. The outcome for most mothers would be a smaller tax refund than if there was no paid parental leave scheme. The overall size of their ultimate tax liability would be influenced by:

- when during the financial year the child was born or adopted
- how much paid leave the parent is entitled to
- how long a period off work they choose to take.

There would also be a small group of mothers who would not be liable for additional tax at the end of the year. Using the LSAC database, around 8 per cent of mothers who would be eligible for the proposed parental leave scheme would not be liable for additional tax if the government introduces the proposed scheme. For these mothers, \$120 of each of the proposed fortnightly parental leave payments would still be withheld, and these parents would receive the withheld tax back at the end of the financial year.

Because the tax implications depend upon the specific circumstances relevant to each family, the following section uses household level data to assess how the proposed paid parental leave scheme will interact with the existing tax and welfare system.

### **How much new money will be provided?**

While the Commission's proposed parental leave payment is for 18 weeks, it also involves the repackaging of some existing payments, increased tax liabilities and some loss of government benefits. Taking all of that into account, on average, the additional new money eligible families would receive from the parental leave component would be around \$1750.<sup>10</sup>

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<sup>9</sup> Based on 2008-09 tax tables, assuming that the person is eligible for the full tax free threshold.

<sup>10</sup> This is the net benefit after annual tax liabilities are considered. Families may also receive some benefits from the paternity leave component of the proposed scheme and, if this feature is introduced after the mooted three year review of the proposed scheme, from employer

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### *Who we expect to opt into and out of the scheme*

Based on an analysis of the financial impacts of the proposed scheme, around 86 per cent of families are expected to opt into the parental leave component of the scheme. There are two groups with a particularly high expected opt in rate:

- every family in the sample that was not eligible for the baby bonus is projected to opt into the scheme. These families need to receive a payment for only a small number of weeks to obtain a benefit from the scheme
- 90 per cent of eligible families having their first child are projected to opt into the scheme.

Some of the factors that increase the likelihood of families opting out of the scheme include:

- families with a larger number of children
- being eligible for large amounts of government payments such as family tax benefits and the baby bonus.

While most eligible families are expected to opt into the proposed paid parental leave, families with combined incomes between \$40 000 to \$80 000 are expected to be the most likely to opt out of the proposed scheme. Typically, these families would not opt out because the proposed parental leave is insufficient, but because they already receive substantial government assistance that they could lose. On average, families in this income range would currently receive over \$25 000 in government benefits across the financial year of the child's birth or adoption and the following financial year.

### *Average benefits for those opting into the scheme*

The average net benefits from those expecting to *use* the statutory paid parental leave scheme (some 86 per cent of eligible families) is estimated to be \$2042 per family. As shown in figure 9.4, the replacement of the baby bonus for parents eligible for the paid parental leave scheme will fund nearly nine weeks of the scheme at the federal minimum wage.<sup>11</sup> The equivalent of nearly six weeks of the paid parental leave payment would be lost because of additional tax liabilities or reduced family tax benefits. Therefore, the average family who would benefit from

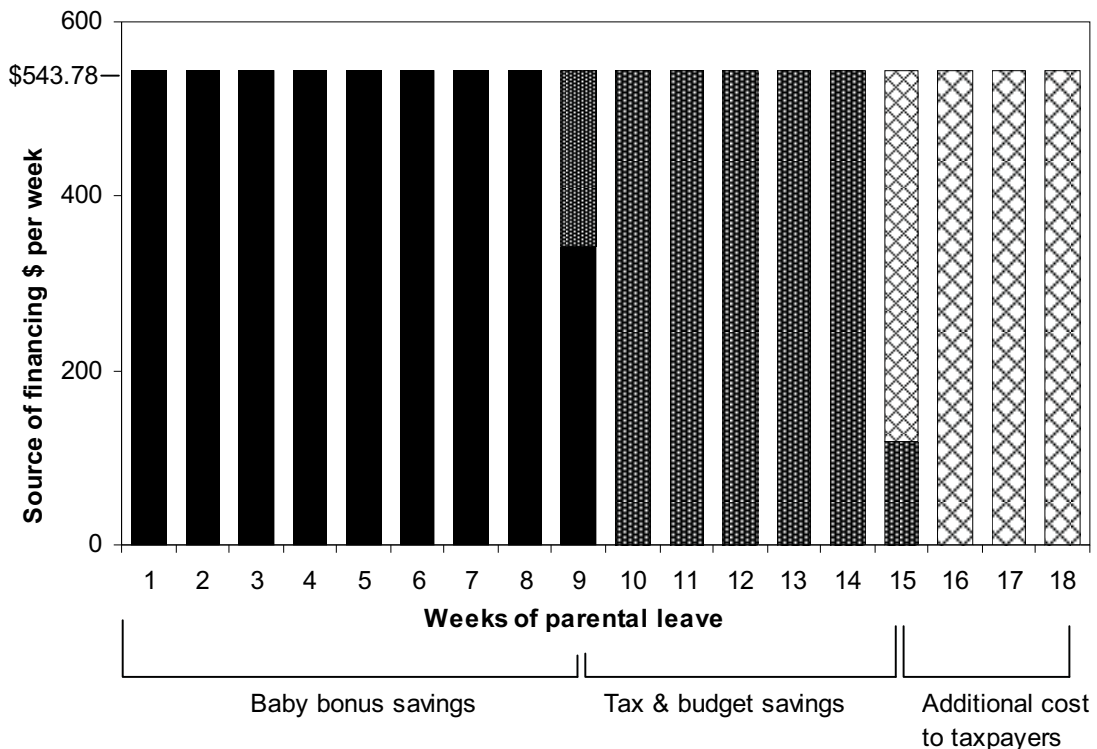
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superannuation contributions on statutory leave payments (chapter 2 and appendix B). In the remaining part of this chapter, 'net benefit' refers only to the net gains from parental leave payments, and so does not incorporate all the benefits families may gain from using the scheme.

<sup>11</sup> Figure 5 in the overview shows a similar chart, but also depicts the paternity leave component of the scheme.

the scheme would receive slightly under four weeks worth of new money — that is, money in addition to what they would have received in the absence of the paid parental leave scheme.

**Figure 9.4 How much of the parental leave payment is new money?**  
18 week parental leave payment<sup>a</sup> — average for families who receive a benefit



<sup>a</sup> This figure is based on the average for mothers who opt in to the proposed paid parental leave scheme. However, it is projected that only 17.95 weeks of paid parental leave will be used on average by mothers who opt into the scheme. To represent the averages over an 18 week period, each component has been increased by approximately 0.23 per cent.

Data source: Productivity Commission calculations.

### How do different families fare?

A key objective of the proposed scheme is to extend the length of leave that families take immediately after the birth or adoption of a child. The main means of achieving this objective is by providing families with sufficient financial incentives for them to change their leave behaviour. For this reason, we are interested in the magnitude of benefits that the scheme provides to different families.

As the proposed paid parental leave scheme will interact with the tax and welfare system, the actual benefits received by any family will often vary from the average.

Using the information in the LSAC database, it is possible to indicate how the benefits from the proposed 18 week parental leave scheme will vary by income (table 9.2). We have calculated the average net benefits only for families projected to benefit from the scheme (as other families will choose not to use the scheme). The average benefits are presented for ranges of the pre-birth incomes of mothers and families.

**Table 9.2 Net financial benefit of the proposed scheme**

Average net benefit to families who opt into the proposed scheme by mother's pre-birth annual income<sup>a</sup> and family's pre birth income<sup>b</sup>.

<i>Mother's pre birth income</i>	<i>Average benefit</i>	<i>Family's income</i>	<i>Average benefit</i>
\$1 to \$10 000	\$2419	up to \$30 000	\$2021
\$10 001 to \$20 000	\$2239	\$30 001 to \$60 000	\$1869
\$20 001 to \$30 000	\$2018	\$60 001 to \$90 000	\$1695
\$30 001 to \$40 000	\$1958	\$90 001 to \$120 000	\$1709
\$40 001 to \$50 000	\$1888	\$120 000 plus comprising:	
\$70 001 plus	\$2172	- those eligible for baby bonus <sup>c</sup>	\$1709
		- those not eligible for baby bonus	\$6490
		- all families with this income	\$2833

<sup>a</sup> The income data for mothers relate to the pre-birth income — as such, they are not affected by the proposed payment. In the LSAC database, a mother's income is in income ranges. As such, there are no observations for mothers' incomes between \$50 000 and \$70 000. <sup>b</sup> The father's income is pre-birth income from the LSAC database. <sup>c</sup> Eligibility for the baby bonus depends on family income earned in the six months after birth — income for determining eligibility for the baby bonus does not include the proposed statutory parental leave payments.

Source: Productivity Commission calculations utilising LSAC wave 1 and 1.5 data.

For most income ranges, the average benefits are of a similar magnitude, ranging from \$1695 to \$2419. The Commission's recommendation that income from statutory paid parental leave not be included in income testing of parenting payments and other income-support payments increases prospects for net benefits from participation by lower-income families. However, inevitably, the interaction between the tax and welfare system can result in some people losing most of any additional income earned. The extent to which this occurs is considered in appendix L.

It is notable that those families not eligible for the baby bonus (around 5.5 per cent of eligible families) tend to receive an average benefit of \$6490 — higher than the average for other families. It is important to explain why this outcome occurs and how to interpret its significance.

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### *Families ineligible for the baby bonus*

A small group of higher-income families are ineligible for the untaxed \$5000 baby bonus payment and are also generally ineligible for family tax benefits A and B. As a result, if such families use statutory paid parental leave, they could not lose access to any welfare payments. Under the proposed scheme, they would receive a net benefit equal to the proposed 18 weeks of parental leave payments, but taxed at the mother's marginal tax rate. The overall implication is that this particular group of families would be likely to receive a larger net benefit in *absolute* terms than most other families (table 9.2).

The only way of avoiding the relatively high absolute benefits for this small group of families would be income-tested access to the statutory paid parental leave scheme. This would be markedly at odds with several of the main objectives of the scheme:

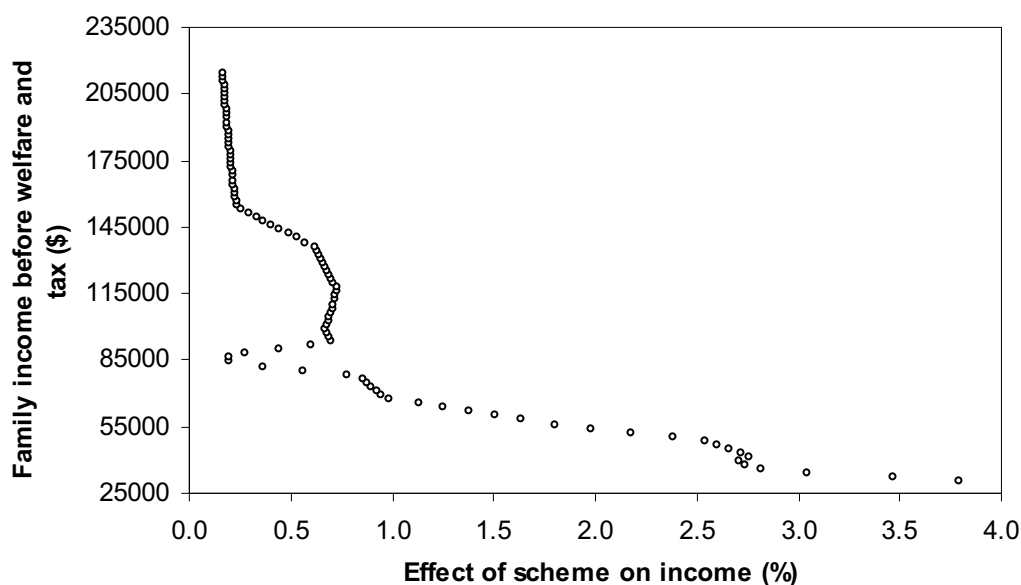
- as part of the social policy goals articulated for a statutory paid parental leave scheme, it is intended that the scheme functions as a work-based entitlement, like recreation leave, rather than as a conventional welfare payment. Work-based entitlements are not income-tested. Notably, statutory paid parental leave schemes around the world generally recognise this goal and are not subject to such tests. Indeed, many of these overseas schemes involve payment at replacement wages, which would increase even further the benefits gained by high-income families
- a major goal of the scheme is to promote child and maternal welfare benefits by encouraging longer leave durations for families. This rationale for a scheme applies to families regardless of their income level.

As emphasised throughout this report, the objective of the scheme is not income re-distribution, but rather behavioural change. Income distributional goals are best achieved through other policy measures. That said, even when the distributional issues are considered, the story is much less clear cut than may first be apparent:

- The absolute dollar benefits associated with any policy measure are a poor guide to its underlying distributional impacts. Higher-income families face both higher average tax rates and pay significantly higher absolute amounts of tax over their lifetimes. Since the proposed statutory paid parental leave scheme is taxpayer-financed, such families will bear a disproportionately greater responsibility for financing the scheme than lower-income families. As such, seen in lifetime terms, the real net benefits that high-income families receive will be considerably less than those suggested by the snapshot analysis shown in table 9.2.

- The benefits from a statutory paid parental leave scheme are much lower as a share of family income for higher-income families than lower-income families (figure 9.5).

Figure 9.5 **The *relative* impacts of the scheme by family income**



**a** The figures relate to a family having their first child and shows the effects of a statutory paid parental leave scheme on the net benefits they receive as a share of family income (before any welfare payments or taxation) as income is progressively increased.

*Data source:* Productivity Commission calculations.

## Should the parental leave payment be taxed?

In developing the proposed paid parental leave scheme, a key objective was to limit the overall cost of the scheme. Had the scheme been untaxed, it would have been necessary to either reduce the duration of the scheme or the payment rate in order to maintain a similar budget. Some benefits of taxing the proposed parental leave payment include:

- those on the lowest incomes are likely to be most responsive to the scheme and will be less affected by taxing the payment than higher income earners. Therefore, taxing the payment makes the scheme more effective in delivering longer leave periods around the birth of a child, and greater lifetime workforce attachment than an untaxed payment
- taxing the payment reduces the disproportional benefit that some higher income families receive — particularly those families not eligible for the baby bonus.

- it is then consistent with the tax treatment of other forms of paid leave, increasing the desirable perception that this is a leave payment, not welfare.

We can compare what impact taxing the proposed paid parental leave scheme would have on the distribution of benefits by comparing it to an untaxed scheme that provides a similar average benefit. An untaxed scheme of 14 weeks of paid parental leave is estimated to provide an average benefit of \$1939 for those families who opt in to the scheme and can be used for comparison.

As illustrated in table 9.3, taxing the proposed paid parental leave scheme would be expected to result in women with a pre-birth income under \$40 000 receiving substantially larger benefits than they would under an untaxed scheme with a similar average benefit. Conversely, women with pre birth incomes over \$100 000 would gain an even higher benefit from an untaxed scheme.

**Table 9.3 Distribution of benefits under taxed and untaxed paid parental leave schemes that provide a similar average benefit<sup>a</sup>**  
By mothers' pre-birth income

	<i>Average benefit under 14 week untaxed payment</i>	<i>Average benefit under 18 week taxed payment</i>
\$1 to \$10 000	\$1008	\$2419
\$10 001 to \$20 000	\$1440	\$2239
\$20 001 to \$30 000	\$1450	\$2018
\$30 001 to \$40 000	\$1730	\$1958
\$40 001 to \$50 000	\$2070	\$1888
\$70 001 to \$80 000	\$2392	\$2419
\$100 001 plus	\$3403	\$2631

<sup>a</sup> The figure compares the distribution of benefits of a taxed paid parental leave scheme of 18 week duration (average benefit of \$2042) with a 14 week untaxed paid parental leave scheme (average benefit of \$1974).

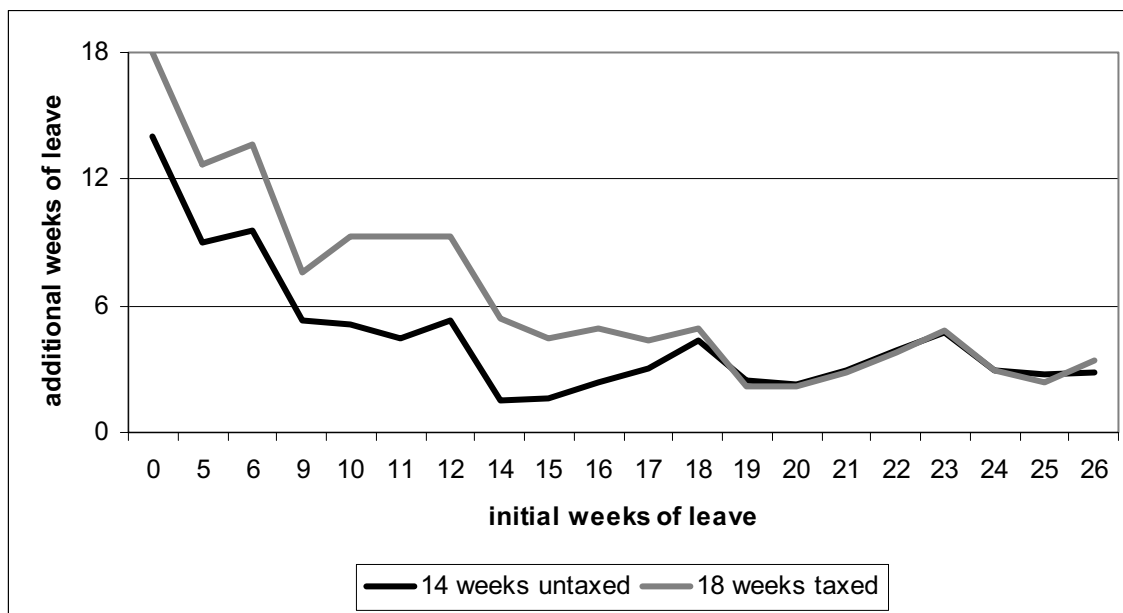
Source: Productivity Commission calculation utilising LSAC data.

Implementing a taxed paid parental leave scheme would also be expected to increase leave by more than an untaxed scheme with the same average benefit. This difference in additional leave is most notable among mothers who initially took less than 26 weeks of leave (figure 9.6).<sup>12</sup>

<sup>12</sup> In addition to the initial length of leave data contained in the LSAC database, the Commission has included an estimate of the increase in leave families would take following the introduction of the baby bonus. The methodology for this adjustment is outlined in appendix G.

**Figure 9.6 Difference in estimated additional leave for taxed and untaxed schemes<sup>a</sup>**

Average initial and additional weeks of leave for mothers who are projected to benefit from the proposed parental leave scheme



<sup>a</sup> The figure illustrates the estimated increase in leave from a taxed paid parental leave scheme of 18 week duration (average benefit of \$2042) and a 14 week untaxed paid parental leave scheme (average benefit of \$1974). Only mothers with an initial length of leave of 26 weeks or less are illustrated.

Data source: Productivity Commission estimates.

As such, a taxed paid parental leave scheme is expected to better meet the objectives for such a scheme than an untaxed scheme with the same average benefit. In particular, taxing the paid parental leave scheme is expected to result in greater benefits flowing to lower income families — those most likely to respond to the additional assistance. As such, a larger increase in leave would be expected among people currently taking less than 26 weeks of leave — a key target group given the objectives of the scheme.

### 9.3 The bottom line

While Australia does not have a statutory paid parental leave scheme, by OECD standards, it already provides relatively generous levels of family payments — in some instances exceeding the benefits offered by countries with paid maternity leave schemes. The proposed paid parental leave scheme will increase the value of Australian Government assistance to families by just over one per cent.

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The Commission is proposing to incorporate some existing payments into the statutory paid parental leave scheme, as well as adding sufficient additional benefits to encourage parents to take leave around the birth or adoption of their children. The Commission is proposing that families who receive the proposed parental leave scheme not be eligible for the baby bonus or receive family tax benefit B while receiving parental leave payments. This will require some changes to the baby bonus and family tax benefit B regulations.

To minimise the risk of families being disadvantaged by the proposed scheme, parents would still be able to opt out of the scheme and receive the family benefits they are currently eligible for.

On average, families eligible for the proposed paid parental leave scheme would benefit by an average additional \$1750 per family. In general, lower income families will receive higher benefits than higher income families.

Given the current review into the tax and welfare system in Australia, the Commission has attempted to make minimal suggestions for changes to existing tax and welfare arrangements. However, at the conclusion of the tax and welfare system review, it may be necessary to revisit the proposed parental leave scheme to ensure that it will still achieve the desired objectives.