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## 5 The labour market impacts of paid parental leave

### Key points

- There are sound rationales for stimulating women's labour force participation rates due to the particular penalties imposed by the welfare and tax system on female incentives to work.
  - Some other arguments — such as those based on the inherent desirability of labour force participation, or the need to allay the labour supply impacts of population ageing have a weaker foundation.
- Existing incentives and the impacts of childbearing have marked impacts on female labour market involvement. Women:
  - experience much higher rates of part-time employment than men during the main childbearing years
  - have lower wages and accumulated superannuation balances. Forgone female earnings amount to an average of over \$300 000 in 2007 prices in a representative family with a single child
  - with young children tend to work in jobs that have flexible work arrangements, but fewer opportunities for career development.
- Changes in the economic and social environment over time have considerably increased the capacity for women to play an active part in the labour market, suggesting that labour market behaviour is responsive to environmental factors.
  - In contrast, fathers have scarcely changed their employment behaviour. The increased engagement of women in paid work has not reflected a re-assignment and broadening of male roles.
- Evidence (and theory) suggests that a statutory paid leave scheme would:
  - be likely to promote employment prior to childbirth to qualify for the benefits
  - decrease women's work in the period immediately after childbirth (an intentional outcome), but maintain their link to the labour market. A statutory scheme of 18 weeks would increase leave currently taken by around 10 weeks
  - have long-term beneficial impacts on employment. It is conceivable that an 18 week leave period could increase the average Australian women's *lifetime* employment by around half a year
  - result in a slight reduction in wage growth for females given the increase in female labour supply.

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A major claimed goal of paid parental leave arrangements is to enhance mothers' labour market prospects — whether by encouraging greater lifetime labour participation and full-time jobs, increasing wages, or improving the quality of their jobs.

While the focus of most discussion on this issue concerns women, parental leave arrangements may also affect the experiences of fathers in the labour market. This reflects the fact that they too may qualify for, and take, parental leave, and because, even if they do not, their labour market behaviour may be altered by the effects of paid parental leave on family income or the labour market participation of their partners.

Labour market impacts extend beyond parents too. For example, paid leave may affect all employees' wage rates and entail discrimination against all women of reproductive age — regardless of their actual fertility intentions — because employers are aware that female employees might have children in the future. It may also affect the labour force decisions by grandparents or substitute carers.

This chapter explores the potentially positive and negative labour market impacts of paid parental leave, taking into account the likely effects on different types of employees.

## **5.1 The dimensions of labour market impacts**

Labour markets comprise many elements. For this inquiry, the most important element is how a statutory paid parental leave scheme might affect the incentives facing employers and employees.

On the employer side, there are greater incentives for sex discrimination if statutory paid parental leave raises the costs to businesses of employing women of reproductive age. (We consider that issue in chapter 8.)

On the employee side, incentives to be inside the formal labour force, to take part-time or full-time jobs, and to choose a given occupation and employer are affected by the various costs and benefits of these choices. These costs and benefits need not take a monetary form:

- People undertaking caring or domestic tasks 'outside' the formal labour force are nevertheless in a job, and get benefits from being so. They are eligible for more welfare transfers and receive value from the (untaxed) work that they do. But they may be socially and economically marginalised.

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- People ‘inside’ the (paid) labour market get wages, but they also get benefits from leave entitlements, childcare rebates, the workplace social environment or other aspects of job quality. On the other hand, they may find it stressful balancing continuing caring and domestic work with paid work.

People weigh up these respective benefits and costs when making their choices. By altering the balance of these benefits and costs, social change (such as a greater willingness by men to take on child caring roles) or new policies, such as statutory paid parental leave or income-tested family welfare benefits, can alter people’s choices.

The labour market impacts of statutory paid parental leave also depend on:

- existing labour market regulations, and in particular, the role of legislated arrangements for unpaid parental leave
- how a scheme may change social attitudes to combining caring and working (chapter 6)
- the extent to which wages fall for females of reproductive age or for workers in general — which will fundamentally be affected by how a statutory paid parental leave scheme is financed (chapter 8)
- the tendency for a person to remain in the same labour market state rather than another (‘state’ dependence). So, if a person is outside the labour force, they are more likely to be still outside the labour force next month than they are to be in, or actively looking for, a job. This is important because it means that changing a labour market decision can have prolonged impacts on a person’s labour market outcomes
- the long-run consequences of people’s choices, some of which may not be fully anticipated. For instance, while paid parental leave decreases the time spent working around the birth of a baby, it may actually increase the *lifetime* employment of women. These employment effects have implications for skills too. Greater lifetime employment helps to build up paid-work skills. On the other hand, an associated impact may be greater erosion of skills that relate to unpaid work (for example, child-rearing skills). Similarly, hours worked in the formal market will tend to crowd out hours spent in unpaid work that is important to the community at large, such as volunteering.

It is particularly important when thinking about the labour market effects of family policies — such as paid parental leave — to see unpaid activity as a job too, with its own qualities, social value and ‘employee’ costs and benefits. In that sense, paid parental leave alters the mix of jobs in the economy, rather than creating or destroying jobs per se.

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## 5.2 The female labour market experience

Unlike men, women currently accommodate family life through prolonged absences from the workplace and by working reduced hours. As a result, women have both lower attachment to the formal labour force (figure 5.1) and, when employed, a greater tendency to have part-time jobs (figure 5.2). As noted by the APESMA (sub. 204, p. 13), survey evidence of professional women found that around 80 per cent thought they would need to downgrade their career ambitions in order to start a family.

Mothers' lifetime earnings are significantly lower than non-mothers. For example, Breusch and Gray (2004) find that a woman of middling education forgoes around 31 per cent of their potential income for a first child, an additional 13 per cent for a second child, and a further 9 per cent for a third child. In 2007 prices, forgone earnings amount to over \$300 000 on average for a single child (Lattimore and Pobke 2008). Such lower lifetime income stems from several aspects of mothers' labour market experiences. Mothers:

- are absent for long periods from the labour market
- tend to choose occupations that are more flexible so that they can combine work and family responsibilities, but these occupations (such as aged care and retailing) tend to pay less than many other occupations
- experience punctuated careers, which reduces the wage premium associated with job experience and leads to lower quality jobs (less autonomy, training, diversity, power and entitlements).

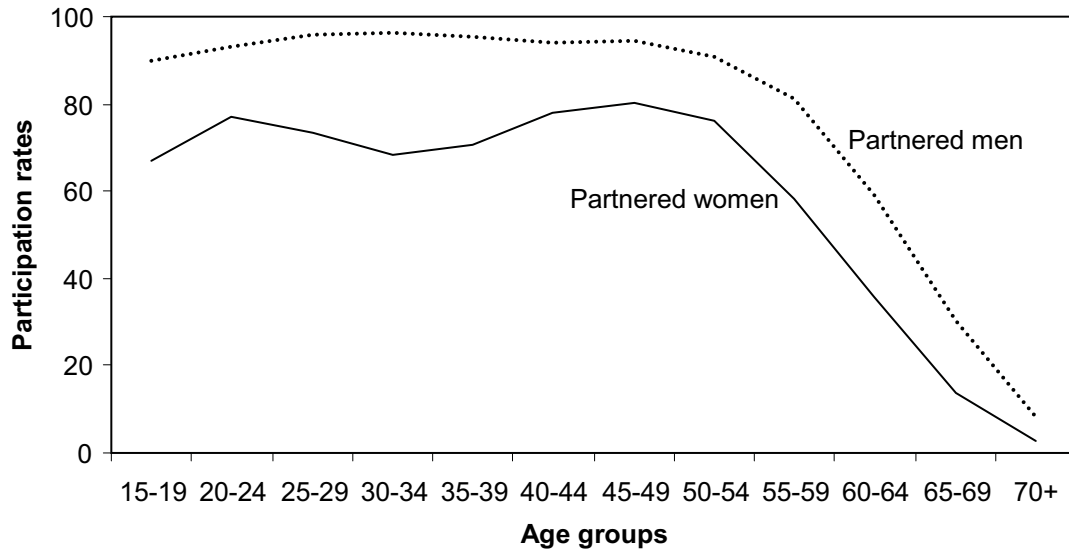
Often women say that they prefer these patterns of labour market involvement, given their role in caring for children, but that is set against a background where other choices may be limited. For instance, fathers continue to play a weak role in direct care of children and, indeed, in domestic work generally.

Moreover, a mother's often tenuous attachment to the labour market when her children are young can affect her wages and prospects for the rest of her life. Among other things, this can make her more economically vulnerable if her relationship breaks down, even when that occurs years after the birth of her children. Women's lower lifetime earnings also mean that their superannuation entitlements are significantly lower than men's (Kelly et al. 2001 and Nielson 2008, p. 14).

An often-mentioned goal of a statutory paid parental scheme is to help address these lifetime economic impacts of mothers' childbearing and caring roles. For instance, many participants in this inquiry have urged the inclusion of superannuation

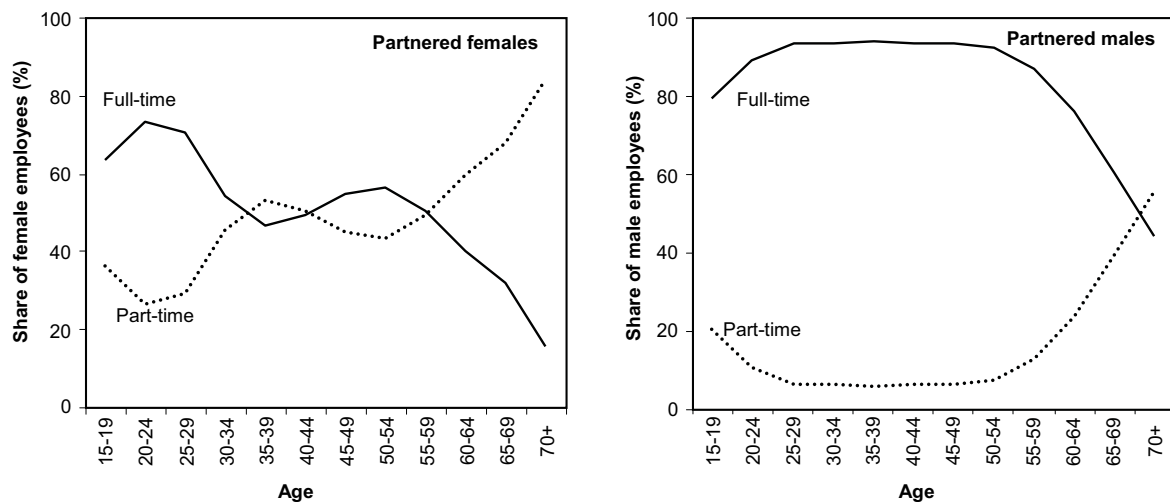
benefits in a paid parental leave scheme to increase women's retirement earnings. (We discuss this issue in chapter 8.)

**Figure 5.1 Labour participation rates are lower for women**  
Partnered men and women, 2007-08



Data source: ABS (*Labour Force, Australia, Detailed - Electronic Delivery*, Jun 2008, Cat. no. 6291.0.55.001, July).

**Figure 5.2 Women's child rearing affects their work patterns**  
Part and full-time employment shares, partnered women and men, 2007-08



<sup>a</sup> Partnerships includes social marriage-like arrangements (that is, de facto) as well as registered marriages. Consequently, categorisation by partnered status is likely to identify that group of women and men most likely to have children.

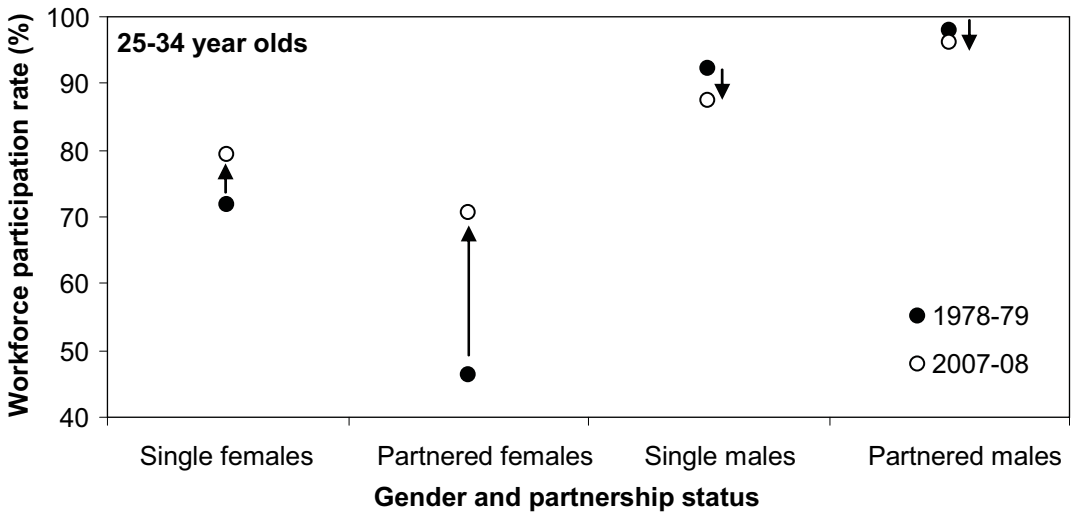
Data source: ABS (*Labour Force, Australia, Detailed - Electronic Delivery*, Jun 2008, Cat. no. 6291.0.55.001, July).

The snapshots in figures 5.1 and 5.2 only tell part of the story. Women’s labour market experiences have changed significantly over the last five decades and are likely to do so over the coming decades. These changes provide an indication of the likely relative importance of paid parental leave compared with other factors shaping labour market outcomes for females.

Female participation rates have increased dramatically over the last 30 years, testimony, among other factors, to the impacts of cultural change; greater educational attainment; the switch to a services-based economy; lower fertility rates; provision of child-care; and increased productivity in domestic chores.

In particular, those women most likely to have children (married women aged 25–34 years) have shown a particularly large increase in their engagement in the labour force (figure 5.3). And over the last 25 years, mothers of very young children (those aged 0 to 4 years old) have shown about the same percentage points increase in their employment rate as mothers of children aged 5 to 9 years (table 5.1).

**Figure 5.3 Workforce participation by partnered women has risen**  
 Female and male workforce participation rates, 1978–79 and 2007–08<sup>a</sup>



<sup>a</sup> Partnerships includes social marriage-like arrangements (that is, de facto) as well as registered marriages. Consequently, categorisation by partnered status is likely to identify that group of women and men most likely to have children. The data above only relate to people aged 25–34 years (the prime years of childbearing).

Data source: ABS (*Labour Force, Australia, Detailed - Electronic Delivery, Jun 2008*, Cat. no. 6291.0.55.001, July).

**Table 5.1 Mothers of young children increasingly work**

Employment rates, married couples, 1982 and 2006–07

	Age of youngest child	
	0 to 4 years	5 to 9 years
	%	%
Mothers 1982	28.8	50.5
Mothers 2006–07	51.0	74.8
Fathers 1982	93.1	93.8
Fathers 2006–07	93.6	94.7

<sup>a</sup> The data relate to couple families in which the youngest child is 0 to 4 years old and 5 to 9 years old. Data on single-parent families are not available on a comparable age basis for 1982. However, the share of single mothers not working in 1982 with a youngest child aged 0 to 9 years was around 74 per cent compared with 52 per cent in 2006-07, suggesting a similar increase in the propensity for working among single mothers.

Data sources: ABS (*Labour Force Status and Other Characteristics of Families, Australia*, July 1982, Cat. no. 6224.0); ABS (*Family Characteristics and Transitions, Australia, 2006–07*, (Reissue), Cat. no. 4442.0, 15 July).

Regardless of any initiatives in paid parental leave, several factors will tend to encourage further female labour force engagement, so that the picture portrayed by contemporary female labour force participation rates across ages will underestimate the true extent of female *lifetime* workforce participation:

- the same forces that historically have pushed up female participation rates are continuing
- increases in the educational attainment of women mean that a much greater proportion of recent birth cohorts of women will have tertiary training than men, with possible implications for relative wages and decisions about future child rearing roles (Lattimore and Pobke 2008)
- lower completed fertility rates imply briefer interruptions to work, and, given lower child care costs, increased incentives for carers to work
- the increasing age of mothers for their first nuptial confinement<sup>1</sup> enables women to advance further along their career path, gaining experience that secures greater long-run attachment to the labour force. Later births also mean that a woman is a mother for less of her otherwise working life. These two effects more than offset the fact that the wage costs from later childbearing are higher than earlier (Breusch and Gray 2004).

Nevertheless, during their prime reproductive ages, Australian women's participation rates are still significantly lower than many other OECD countries

<sup>1</sup> ABS (*Births Australia, 2006*, Cat. no. 3301.0), p. 23.

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(Abhayaratna and Lattimore 2006, p. 51).<sup>2</sup> For example, in 2005, labour participation rates for females aged 25–44 years were more than 80 per cent in Sweden, Iceland, Denmark and Finland, compared with less than 75 per cent in Australia. The current projections for recent birth cohorts of women suggest that this gap will close, but only partially.

### *Implications*

There are two broad lessons from the above observations:

- Fathers have scarcely changed their employment behaviour — the increased engagement of women in paid work has not reflected a re-assignment and broadening of male roles.
- Experiences over the last three or four decades show that changes in the economic or social environment can have persistent and large impacts on women’s employment patterns. That, combined with the fact that participation rates of Australian women in their prime reproductive years are comparatively low by OECD standards, suggests that there is at least scope for further cultural changes and policies, such as parental leave, to raise significantly workforce participation rates for women of these ages. Of course, by themselves, international benchmarks do not provide a rationale for increasing participation rates since what other countries do may reflect their own social characteristics, people’s personal preferences, or the outcome of poor policy settings.<sup>3</sup>

## **5.3 Labour market outcomes as a rationale for action**

Many people see more female labour participation by women and other labour market outcomes as a patently legitimate objective of paid parental leave schemes (chapter 1). There are two ways of evaluating such labour market objectives. One is to ask whether parental leave actually does promote female lifetime employment while increasing the time spent away from work around the birth of the baby. That is the subject of the analysis in section 5.5.

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<sup>2</sup> This is *after* adjusting for the fact that published statistics for many OECD countries count women on paid maternity leave as in the labour force, whereas women on unpaid leave in Australia are not.

<sup>3</sup> It is notable that even after controlling for a range of economic and environmental factors, including parental leave schemes, Jaumotte (2003) finds that different countries have inherently higher or lower participation rates than others that are likely to reflect country-specific preferences, social institutions and norms (showing up as so-called country-specific ‘fixed effects’). These are particularly important in explaining high participation rates for some countries, like the United States and Portugal.

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The other complementary question is to assess whether achieving these changes is desirable in the sense that they make the community as a whole better off. Chapter 4 provides good evidence that the short-run labour market outcomes — increased time away from work around the birth of a baby — is likely to be beneficial. But would any potential impacts of a paid parental leave scheme on lifetime workforce or workplace participation by women also be beneficial?

### **Is paid work necessarily beneficial?**

It may seem obvious that more lifetime female labour participation is always worthwhile. After all, at the individual level it usually implies greater immediate family income, more security for women, and better retirement incomes. And, at the aggregate level, it implies greater employment, national output and greater consumption — which, among other things, many see as an important antidote to the economic implications of an ageing Australia.

However, *by themselves*, effects of these kinds do not provide a strong argument for promoting workforce participation. Labour force participation (and the outputs from it that are measured in GDP) is not an end in itself, but something that usually reflects people's preferences. People face tradeoffs between work and non-labour market activities, such as leisure and the outputs from unpaid work (care for others and domestic tasks). People generally choose the outcome that best suits their individual circumstances, so that using government policy to change those choices runs the risk of producing worse outcomes. For example, few would contend that leisure in retirement was bad because it reduced labour force participation. Likewise, most Australians would not want to emulate the employment rates of the least developed countries, where people work from their early teenage years to a short period before death.

The argument that policy needs to increase labour force participation rates because of the effects of ageing on aggregate labour supply growth and its consequent implications for national output is, at best, partial.

It is true that ageing will slow labour supply growth and that this will retard economic growth per capita (PC 2005, IGR 2007). But that may not matter. The reason that ageing affects the labour supply and economic growth is because more people are in the stage of their lives when they want to work less and enjoy more leisure. Making them work more could address the aggregate economic impacts of this demographic transition, but to the extent that people's choices were individually optimal, this would actually make Australians worse off (Lattimore and Pobke 2008).

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A better reason for promoting labour force participation is that governments may not make adequate provisions for the high future costs of providing older people with health and aged care, and pensions. Inadequate provision could imply excessive taxes on workers in the future, which could affect efficiency and intergenerational equity. Raising labour force participation may help resolve this, but better designed intergenerational welfare arrangements would probably be the best-targeted policy.

Generally, arguments about the desirability of labour force participation must rest on something that adversely affects people's choices between paid work and its alternatives, rather than on the aggregate economic effects of labour participation or the apparent desirability of work for its own sake.

### **What about workplace attachment?**

Paid parental leave schemes may increase the likelihood that women stay with a given employer — 'retention' — avoiding the costs of looking for a job with another employer and allowing the employee to gain a wage premium for skills specific to their original employer. In themselves, these are valuable benefits. However, people not covered by paid parental leave arrangements are aware of these benefits too, and can decide voluntarily whether to return to their original employer or to seek a job with another employer. Presumably, at the margin those who decide to forgo the opportunity to return to their original employer believe it is not worth it for some reason. Given this, a statutory paid parental leave scheme would not pass a benefit-cost test on retention benefits *alone*.

That does not rule out consideration of the retention benefits of a statutory scheme. There would simply have to be other benefits from a scheme sufficient to make up the residual gap between benefits and costs (of the kind discussed later in this chapter, and in chapters 4 and 6).

In any case, the Commission's scheme requires workforce rather than workplace participation as the key eligibility criterion for the cash component of our scheme (chapter 2). So, in the main, our scheme does not explicitly subsidise employee retention, though as discussed later it has retention as an incidental (beneficial) effect.<sup>4</sup>

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<sup>4</sup> We have proposed a *workplace* eligibility requirement for access to the potential modest superannuation element of the Commission's scheme, but that reflects the fact that employers would be paying this.

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## Obstacles to individual work choices provide a strong argument

### *Social and gender equity arguments for greater labour force participation*

Some see raising workforce participation rates as improving gender equity. Greater labour force participation reduces the disparity in outcomes for females and males in the labour force, with resulting benefits for retirement incomes, preservation of skills and financial independence. However, people's preferences matter, and chapter 6 explores in more detail some of the complex issues that arise when considering the social and cultural implications of paid parental leave schemes.

### *Taxes and government transfers*

On the economic front, there are several reasons why decisions to take up paid work may be distorted. In particular, taxes and welfare eligibility rules may distort people's consumption choices and alter their incentives for raising income.

Unpaid activities (and leisure) are not taxed, unlike other labour market activities. At the margin, this encourages people to produce their own untaxed services, such as child care, cleaning and cooking, and home maintenance, rather than to undertake more paid work and buy services from others. All other things being equal, this reduces labour force participation rates below the level they would be were all transactions and work subject to neutral tax treatment.

Welfare eligibility rules may worsen this bias against work. Families are the recipients of various family benefits and other welfare payments. Australia, like other Anglo-Saxon countries, tends to favour transfers that are targeted at low-income groups rather than, as in most European countries, benefits that are universally applied regardless of income. As a result, in Australia, the value of welfare benefits depends on the *monetary* income of families. This is distinct from economic income, which would include the capacity to raise consumption through unpaid work.

Consequently, when a carer — typically a woman — enters the labour market, this increases household income, but requires taxes to be paid and involves reductions in welfare benefits. This lowers the returns from working for carers.

In theory, where income-contingent welfare benefits are based on family income, the disincentives to work fall on both men and women. However, in practice many jobs have fixed full-time hours, so that workers in such jobs cannot reduce their hours of work to avoid the withdrawal of welfare benefits. The greatest responsiveness to the work disincentives posed by welfare payments occurs for

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people who can exercise some control over their hours worked. These are people who can work overtime, those in casual and part-time jobs and those who are not working, but could do so. Women dominate the latter three categories. Therefore, in practice, family income-contingent benefits are mainly likely to affect the work incentives of women. In empirical work, this shows up as much greater responsiveness of women to wages (Jaumotte 2003).

Moreover, some income-contingent family transfers are based on the dependent spouse's income only (mainly the woman). In particular, while family tax benefit B may address the potential equity problems posed by the incapacity for households to income-split for tax purposes, it also creates a significant barrier to employment by a stay-at-home spouse seeking part-time or low paid work (chapter 9).

As a result, for many women (and some men), working may make them worse off because the net monetary returns from working are insufficient to compensate them for the forgone (untaxed) benefits of unpaid work and leisure. Indeed, in some cases, even the net *monetary* benefits from working can be negative if more than one dollar of ultimate income is lost for every additional dollar from working (this equates with effective marginal tax rates of above 100 per cent — appendix F).

Against this, there are also in-work benefits, such as the child care tax rebate, and concessional tax treatment of superannuation savings and fringe benefits, which tend to favour labour force participation. However, for many women, the net impact of the tax and welfare system continues to provide a disincentive to paid work.

There are tradeoffs and practical realities that constrain the capacity of policy to deal with the barriers to work posed by the tax and government transfer system. Leisure cannot be realistically taxed. If universal benefits were introduced, this would reduce high effective marginal tax rates for some, but with progressivity of the tax system, require higher marginal taxes for others. Reduced progressivity might address this, but this undermines the equity goals on which progressivity is based.

As argued by the Centre for Independent Studies, significant changes to the family welfare system could improve work incentives:

Reforming the existing system may be more effective than a paid parental leave scheme in helping mothers to overcome obstacles to greater participation in the workforce. A more flexible system may remove disincentives for parents to start work or increase their working hours. (sub. DR284, p. 6)

However, the potential for reform of this kind is largely outside the scope of this inquiry (though it is incidentally taken into account when considering the financing

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of a paid parental scheme). The Australian Future Tax System Review Panel will cover these issues.

In the absence of systematic welfare reform, policies that provide increased in-work benefits, such as paid parental leave, will partly address the current disincentives to paid work.

### *Short-sightedness and misperceptions*

People may not realise the long-term implications of their work/non-work choices. For example, a teenager having a baby may not be aware of the likely consequences for their future education and job prospects. Similarly, people who respond to the short-term disincentives to working may ignore the long-run benefits of entering the labour market. Being in a job allows a person to learn skills, develop networks, establish a positive reputation and boost their self-esteem. Such outcomes can help people to obtain better jobs later, where the payoff exceeds the benefits of forgone welfare benefits and unpaid work. If people fail to account for these dynamic effects, this may reduce workforce participation below desirable levels.

### *Prior paid employment is an appropriate pre-condition for eligibility*

Given the above, it is appropriate that a statutory paid parental leave scheme encourage workforce participation. That suggests that only parents with sufficient prior involvement in the paid workforce would be eligible for statutory paid parental leave. That raises the question of what should be ‘sufficient’ prior involvement and how the scheme should be designed to maximise its positive effects on workforce participation. That, in turn, depends on the impacts of different designs of statutory paid parental leave schemes on parents’ labour market behaviour.

## **5.4 The labour market impacts of paid parental leave**

### **The conceptual framework and its implications for scheme design**

A statutory paid leave scheme affects whether, and how long, parents stay in or out of the labour market at certain critical points in their lifetimes. As implied by the discussion above, the impacts of paid parental leave on parents’ labour supply depends, among other factors, on whether it offsets the high effective marginal taxes on working imposed by present social welfare transfers. Consequently, while it will be important to provide continued transfers to home-based carers outside the

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labour force, the net benefits of paid parental leave must exceed those that a carer would obtain were they to resign.

Where eligibility depends on attachment to the labour force for some period then it encourages women to enter work prior to the birth of a child in order to qualify for a benefit. In effect, paid parental leave acts like a wage increase, stimulating labour supply.

### *The direct effects*

The direct influence of paid leave on encouraging labour supply occupies a relatively brief period for primary carers (mostly women) and the strength of its incentive effects depends on time.

- Under the Commission's proposed scheme, parents would need to have at least 10 months of paid work in the 13 months prior to the expected date of the birth or adoption to be eligible for statutory paid parental leave. Given this, a woman would face a strong incentive to work in the months immediately prior to attempting conception (given conception is uncertain).
- Once pregnant, the incentive effects rise steeply as time to birth diminishes — the cost of resigning just before birth is very high.
- After birth, there are strong incentives to stay employed, but strong disincentives to actually work since paid parental leave is conditional on absence from work. A person returning to work early would forfeit (at least a portion of) the remaining value of their leave entitlements. In effect, early return to work is (intentionally) 'taxed' by a paid parental leave scheme to achieve the child and maternal health and welfare benefits associated with longer durations away from work. Similarly, complete exit from the labour market — through resignation — is also penalised. Even so, for some groups, employment may still increase even in the immediate period after childbirth (Klerman and Leibowitz 1997). This is because some people who would otherwise have resigned to take more leave than was previously allowed, find it worthwhile to return to work earlier to maintain the benefits of the original employment relationship (such as social links and the wage gains from firm-specific human capital).
- After the parental leave period expires, the process begins anew. If the parent wishes to have another child, there are reasonably strong incentives to return to work to re-establish eligibility for future parental leave.
- If no new children are planned, then the value of future parental paid leave is low — and accordingly, so too are the incentives it provides to supply labour. It may still provide insurance in cases of unanticipated pregnancies, but this insurance value declines with age (reflecting mounting subfecundity) and

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reaches zero at some point. However, paid parental leave may still provide labour supply incentives for older people if they aim to adopt children.

Given these various stages of influence, the expected *direct* labour supply incentive impacts of paid parental leave mainly occupy the period just before planned conception to completion of fertility (primarily between the ages of 25 and 34 years).

*Indirect effects would be more sustained*

However, paid parental leave is likely to lead to more sustained increases in labour force participation due to its indirect effects.

Probably, the most important of these is the fact that the likelihood of a transition from one labour market state to another is dependent on people's initial labour market state (the so-called 'state dependence' noted earlier). This implies that if people are in a job prior to the birth of their child and during its early caring period, then they are more likely to return to a job sometime after the birth of their child.

In part, this reflects the underlying characteristics of parents that determine their employment probability in the first place. So, a highly educated woman is more likely to have a job than a less educated one, and for that reason is also more likely to return to a job. However, it appears that there is state dependence even after controlling for such personal traits, reflecting:

- perceptions of what constitutes a 'customary' state for a person (being an employee or a parent caring for children full time)
- continued social and other links to a workplace during leave
- general employment skills<sup>5</sup> built up with prior employment increase the capacity to return to work (noting that employers value people with experience)
- given 'right-to-return' policies, the capacity to retain (and build on) the benefits of job-specific skills and knowledge, and to avoid search costs associated with finding a job with a new employer.

These indirect effects have the important implication that if a paid parental leave scheme increases attachment to the workforce *prior* to birth then it is likely to increase the chance of a return to a job. This in turn is likely to raise the parent's future wages, job security and quality, given the benefits of additional job experience in moving up career ladders.

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<sup>5</sup> Those associated with being employed in the past, and not specifically those associated with a given job or employer.

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### *Paid parental leave intentionally reduces work in the short run*

While a paid parental leave scheme encourages women to stay connected to their employer, a scheme is also *designed* to reduce the amount of paid work around the birth of a baby. A scheme achieves longer durations away from work in the early months of a baby's life in two ways.

- Paid parental leave is not paid if an employed parent on leave returns to work early ('use it or lose it'), so encouraging time away. This 'use it or lose it' feature affects people who may have otherwise gone back to work during the leave period of any statutory scheme. Given most people take time off work for at least three months, the effects of 'use it or lose it' on the time away from work probably increase with longer statutory leave periods.
- Paid leave provides income, which helps overcome some of the financial constraints of young families, allowing them to stay away longer from their job. If parents save this income then they can delay the return to work, even after the cessation of the paid leave period. These income effects depend on the magnitude of parental payments and the responsiveness of families leave decisions to additional income.

The net effects of a scheme's generosity and duration on lifetime employment are complex. On the one hand, greater generosity of paid leave increases the effective wages of women, encouraging them to get (and keep) a job prior to getting pregnant. On the other hand, more generous payments increase the length of absence away from work, as do longer durations of paid leave. At some point, the long-run employment benefits of pre-birth attachment to employment may be undermined by excessive periods of post-birth absence from work, which could erode work skills and 'normalise' being at home, rather than working. However, the empirical evidence (discussed later) suggests that this loss of skills is not likely to be a problem with leave periods under six months.

### *Women's wage growth will be a reduced a little*

If paid parental leave increases female labour supply, and labour demand is not very responsive to the cost of labour, then wages would grow less strongly for women than they would have otherwise. The effect is not likely to be large — perhaps resulting in long run wages falling by 2 per cent compared with the counterfactual.<sup>6</sup>

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<sup>6</sup> As noted later, the Commission's scheme might increase the female employment to population ratio by around 1.5 per cent. Much of this increase is likely to occur as women currently undertaking few or zero hours of work undertake at least 330 hours of work over the qualifying period. In addition, some women will stay in the labour force after the birth of their child, which will probably show up as more part-time jobs. Given this, the effect on the labour supply

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Wage growth might also be reduced if long periods of leave increase disruption costs for employers (chapter 7).

Finally, so long as duration of leave is not too long, the greater lifetime employment experience of women should build skills, enhance productivity and increase female wages, at least partly offsetting the wage depressing effects discussed above.

*People have varying labour market responsiveness to paid leave*

A paid parental leave scheme should take into account the varying responsiveness of different groups of people to its generosity and duration, as well as considering how the welfare system affects that responsiveness.

*Poorer families*

A paid parental leave scheme needs to give particular attention to lower income families:

- The beneficial employment effects of a leave scheme are most likely to be experienced by less well-educated and lower skilled females. Empirical evidence shows that higher effective wages do more to encourage these women to work than more educated, higher paid women.
- Poorer families have less recourse to savings and cannot necessarily support themselves on a low single income, hastening their return to work.
- Lower income families face the greatest barriers to work given the incentives of the welfare system.

Altogether these aspects of poorer families suggests that a statutory paid parental leave scheme must be sufficiently generous to encourage parents to be employed, and when employed, to take a sufficient leave of absence from work around the time of the birth of their babies.

Replacement wages — sometimes the basis for paid leave schemes overseas — would provide weak incentives for lower income families to work, depending on the nature of welfare payments available to those out of the labour force. For example, say that a woman worked in a casual job at \$20 an hour for eight hours a week (an

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measured in hours is likely to be less than 1.5 per cent. A back-of-the-envelope calculation suggests that an increase in the labour supply of around 1 per cent is plausible. Based on a demand elasticity of -0.5 (the middle value for all types of labour given by Lewis 2006, p. 5), a 1 per cent rise in female labour supply would result in long run wages falling by 2 per cent compared with the counterfactual. This glosses over some complexities, such as the effects of binding minimum wages on some women.

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income of \$160 weekly), and that paid parental leave paid replacement wages for 18 weeks funded from removing the baby bonus for people in work. In that case, a woman in this position would get a gross benefit of \$2880, while had she resigned she would have got the \$5000 baby bonus and family tax benefit B payments. Accordingly, simple provision of replacement wages or prorating of a fixed entitlement based on hours worked would not create the appropriate work incentives for the (probably) most responsive group of people.

Given the above, in the draft report, the Commission proposed setting the payment rate at the federal minimum wage (currently \$543.78 per week), as have past assessments of statutory paid parental leave schemes in Australia. The minimum wage typically exceeds the replacement wages of lower income parents (since many work less than full-time hours) and would have generally desirable labour market impacts:

- It would create good incentives to work for lower income females, since the payment is significantly more than the value of income support for women working in the unpaid sector.
- A payment equal to the adult minimum wage for 18 weeks would allow lower-income families to extend their leave to an adequate length, yet would avoid skill losses associated with very long leave periods. (In any case, the skill losses for lower skill jobs are likely to be small.)
- Capping of benefits at roughly the minimum wage would limit the benefits paid to well-off families who often already have access to privately negotiated paid parental leave and have a strong capacity for self-financing leave.
- Unlike means-testing of welfare payments, capping is not likely to elicit undesirable labour supply responses by women earning above the capped amount. This is because they would still earn the capped amount provided they took leave (whereas in mean-tested systems, people start to lose benefits when their income exceeds a threshold).

While the Australian Industry Group agreed that the federal minimum wage was an appropriate benchmark payment rate, it questioned its use for those earning less than this prior to the birth of their child:

Ai Group submits that it would be more logical and consistent with the objectives of the scheme for those receiving a wage less than the FMW prior to going on leave to receive the same wage on paid parental leave under the scheme and indeed would be more likely to reinforce the connection with paid employment as opposed to the perception of a welfare payment. Under the Commission's model, those receiving as little as \$143.10 per week for 52 weeks (i.e 10 hours per week at the FMW hourly rate) would be entitled to the full payment of \$9788.04 (18 weeks at the FMW of \$543.78). For an employee earning \$143.10 per week, this is equivalent to over 68 weeks at full

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replacement income. ... The recommendation that payments be made at a flat rate of the FMW therefore has cost implications for the scheme. Putting to one side the issue of the interaction with the Baby Bonus, consideration could be given to setting a 'floor' on payments where an employee's pre-birth income is lower than the FMW. (sub. DR363, p. 7)

However, as argued above, interactions with other welfare payments need to be taken into account when determining the most appropriate payment for those earning less than the minimum wage. This is exemplified by the case of juniors, who, as discussed in chapter 2, would earn considerably more from welfare payments were they outside the labour force system than from replacement wages while on paid parental leave. (It is for this reason that the Commission has reconsidered its draft position that this group should only get a proportion of the federal minimum wage and has proposed instead that they get the same benefits as other eligible parents. Equal treatment was supported by many participants.<sup>7</sup>)

The Australian Fair Pay Commission (sub. DR406) raised questions about the *general* desirability of using the federal minimum wage as the basis for payment, given its concern that it might affect the wage determination process. However, we do not consider this a substantive risk, so that on balance, we still consider that the minimum wage is the appropriate benchmark for payment for all participants in the scheme (chapter 2).

In addition to proposing an adequate level of payment in the scheme, the Commission has also recommended that statutory paid parental leave payments not be counted in means tests for eligibility for income support payments — particularly parenting payments (chapter 2 and chapter 9). This increases the attractiveness of statutory paid parental leave for lower income women.

### *Sole parents*

Sole parents face greater challenges in reconciling work and family demands in the absence of support from a partner. Around 30 per cent of sole parent mothers have less than 12 months tenure with their employer. On the other hand, *if they work*, sole parents tend to work 20 hours or more (some 94 per cent of this group).

Moreover, because of the interaction between the tax/welfare system and statutory parental leave, a sole parent with an existing child tends to receive considerably greater net benefits from a statutory paid parental scheme if they are working fewer hours. Accordingly, the work incentives associated with a paid parental leave

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<sup>7</sup> For example, Terri Butler (sub. DR273, pp. 2–3), Clair Stimpson (sub. DR362, p. 1), the National Children's and Youth Law Centre (sub. DR327, p. 3) and the ACTU (sub. DR365, p. 16).

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scheme are strongest for sole parents working fewer hours. As an illustration, for a representative single parent with one three year old, the net benefits of a statutory paid leave scheme of 18 weeks at the federal minimum wage is around \$2500 if the woman works eight hours a week prior to birth of her new child, but around \$500 if she works 24 hours a week.<sup>8</sup>

The implication is that the employment test for eligibility to a statutory paid parental leave scheme should not be set too high. Requiring that women have worked a significant number of hours per week prior to birth would limit the eligibility of precisely those sole parents whose labour participation might be most responsive to the scheme. (There is a similar, but much weaker effect for a primary carer with an employed partner.)

#### *Women who have already had one or more children*

Women who already have children tend to return to work for shorter hours to achieve a balance between work and family commitments and have lower employment tenure (appendix J). Around 30 per cent of such carers have worked less than 20 hours a week prior to the birth of their second or subsequent child compared with around 4 per cent of new mothers (figure 5.4). And while there is a less marked difference, about 20 per cent of existing mothers have worked for less than 12 months compared with under 16 percent of first time mothers (table 5.2).

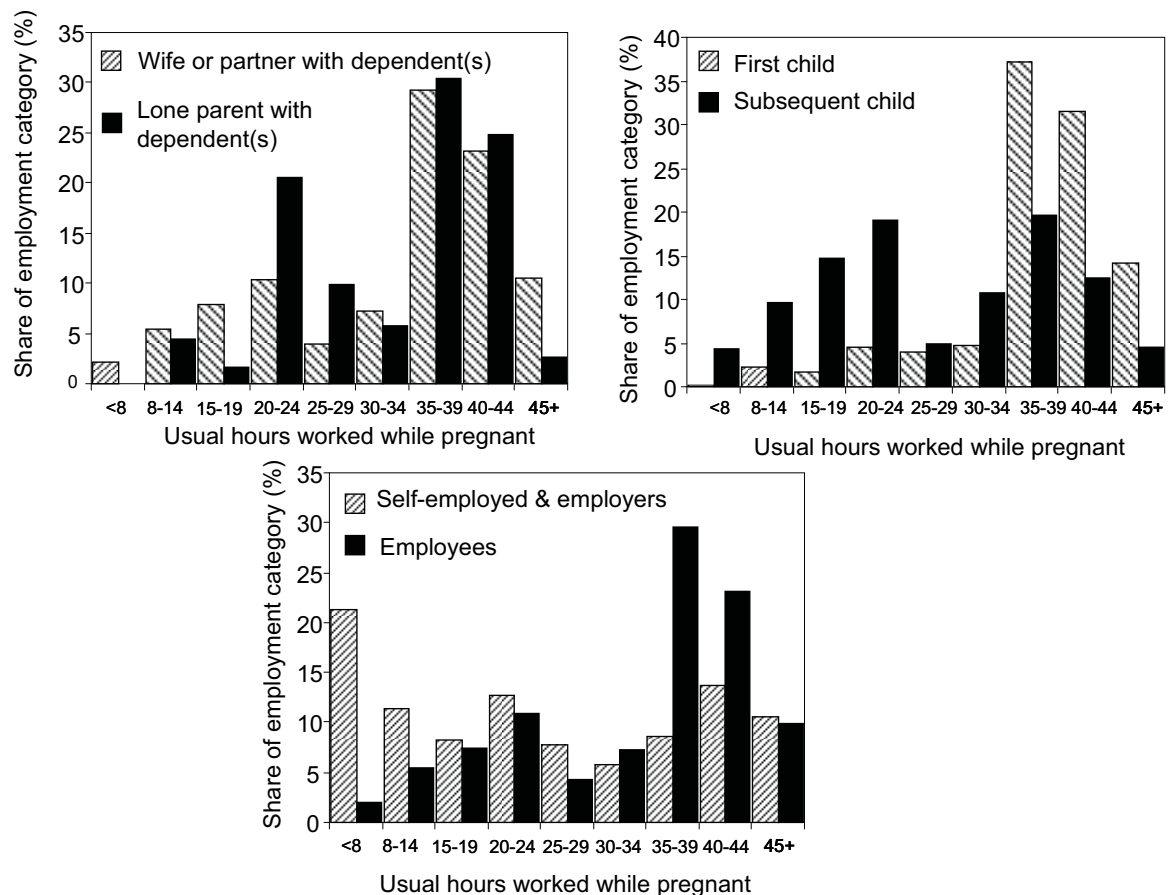
The above pattern of working for this group has implications for the employment test used to determine eligibility for the scheme. Using a high eligibility threshold for hours (say 20 hours) might encourage a greater number of mothers who already have at least one child to work more hours to re-qualify for paid parental care. However, it may also discourage existing mothers outside the labour force from attempting to qualify at all, given the large working hours commitment such qualification would entail. Encouraging greater contact with the workforce for those mothers who would otherwise be completely outside the paid labour force may be more beneficial than encouraging those who are already employed to work more hours, especially if the latter is associated with long hours of child care for infants (with its potential child welfare shortcomings — chapter 4).

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<sup>8</sup> The ‘representative’ family in this example has a woman working 8 (or 24) hours a week for \$25 an hour. The family has one three year old already. The additional child is born on 30 December 2008 and is cared for exclusively by the mother before her return to work 12 months later. The net benefits are calculated over 2008-09 and 2009-10 to account for the fact that the scheme has impacts on earnings and welfare entitlements spanning two fiscal years. If the ‘representative’ family was a couple with the father earning \$1250 a week, and identical in other respects, the net benefits of participating in the scheme were the woman working 8 and 24 hours per week prior to the date of birth would be around \$2000 and \$1500 respectively.

**Figure 5.4 Distribution of hours worked while pregnant**

For mothers who had at least 10 months of tenure with an employer<sup>a</sup>



<sup>a</sup> The ABS *Pregnancy and Employment Transitions* dataset used to undertake these calculations only had job tenure with a given employer, rather than in the workforce.

Data source: ABS (*Pregnancy and Employment Transitions, Australia, Expanded Confidentialised Unit Record File, November 2005, Cat. no. 4913.0.55.001*).

### *The self-employed*

The self-employed return to work much more rapidly than any other type of employee. For example, by the time their child is three months old, around 50 per cent have returned to work, whereas on average only around 10 per cent of all mothers have returned by this time (Baxter 2008, p. 10, p. 13). This probably reflects several factors:

- First, by definition, the self-employed do not get access to any employer-funded paid leave, whereas around half of all working women do, so the self-employed need to return to work for financial reasons.
- Second, the viability of many single-person businesses would be at risk were they to be ‘closed’ for long periods.

- Third, as noted by Baxter (2008), such businesses can often be highly flexible and can involve short hours, so enabling a parent to reconcile child rearing and working more readily than other employment types.

**Table 5.2 The tenure experiences of employed mothers**

Months tenure with employer	By family size		Employment status		By family type	
	First child	Subsequent children	Employees	Self-employed and employers	Wife or partner with dependent(s)	Sole parent
	%	%	%	%	%	%
<2	0.6	2.2	1.3	1.2	1.2	3.2
2 to <4	2.3	1.9	2.2	3.8	1.9	4.5
4 to <6	3.0	3.7	3.3	7.2	2.8	9.6
6 to <10	6.9	7.1	7.0	7.0	7.0	6.0
10 to <12	2.9	4.5	3.6	0.0	3.5	4.8
12 to <24	12.1	9.7	11.0	3.3	10.2	20.8
>=24	72.2	70.8	71.6	77.5	73.4	51.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
< 12	15.7	19.5	17.4	19.3	16.4	28.2

<sup>a</sup> Tenure relates to a given employer, rather than in the workforce.

Data source: ABS (*Pregnancy and Employment Transitions, Australia, Expanded Confidentialised Unit Record File, November 2005, Cat. no. 4913.0.55.001*).

To the extent that the first of the above factors is decisive, a statutory scheme covering the self-employed would be likely to increase their duration of absence significantly. To the extent that the latter two effects dominate, a paid leave period would not make much difference to the time away from work — it would have poor ‘additionality’. However, even in that case there are grounds for still providing leave payments to the self-employed:

- income also has an effect on infant welfare
- their exclusion could be seen as inequitable
- exclusion would reduce the incentives for entrepreneurship.

The effects of a statutory paid parental leave scheme on labour market participation for this group are also not clear cut. Reflecting the flexibility of self-employment, many more women in this employment category work relatively short hours prior to birth (figure 5.4). For example, more than 40 per cent work less than 20 hours per week prior to birth compared with less than 15 per cent of employees (and 20 per cent of the self-employed work less than 8 hours weekly compared with 2 per cent of employees). Given the capacity for flexible working hours, a statutory paid leave scheme may have relatively strong incentive effects for this group, encouraging more hours of work for those women working less than the required

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hours for eligibility to the scheme, and potentially encouraging more women outside the labour force to take up self-employment opportunities.

On the other hand, there are challenges in verifying claims made by the self-employed that they meet the employment test in a statutory paid parental leave scheme. There are clearly risks that some self-employed working less hours required by the employment test will claim that they exceed the threshold. While a business has records that can be used to objectively verify the eligibility of its employees, there is no party that is both at arm's length and informed who can attest to the eligibility of the self-employed. In New Zealand, this problem was resolved by requiring a witnessed self-declaration and verification by a chartered accountant of a self-employed person's eligibility. This issue is explored further in chapter 2.

### *Men*

Men's working hours are not as responsive to wages as women. Men already have full access to unpaid leave entitlements, so paid leave acts like an implicit wage increase. Overseas (and domestic) evidence suggests that men generally do not take advantage of the option to take paid parental leave when it is offered unless it assumes a 'use it or lose it' form. Accordingly, the expected value of most forms of paid parental leave to men would probably be small and, consequently, is unlikely to have any large effects on their labour supply. However, that need not matter for policy purposes since men's labour supply is already high.

While this is probably true for most men, it may not be for all. Some men have a weaker attachment to the labour market than their partners, and some of these may wish to assume the prime caring role for their children. Paid leave may stimulate pre-birth labour supply for this distinctive group of men.<sup>9</sup>

### *The Commission's employment test*

An employment test is necessary to reduce perverse outcomes. Were the scheme to require only minimal past employment hours or tenure, a woman planning to have a baby could secure a one-off job lasting a few hours in order to gain access to paid parental leave. Such a one-off job would be unlikely to have enduring labour market benefits, while also having no impact on the duration of home care of the baby. It would simply represent an impost on taxpayers. On the other hand, the threshold cannot be so high that women outside the labour force consider it too difficult to meet.

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<sup>9</sup> As well as including a short period of paternity leave, the Commission's scheme includes a capacity for a mother to assign all or some of her paid parental leave to her partner if he is also eligible. This may help promote labour supply by some men.

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In the draft report, the Commission proposed that to be eligible, employees must have worked 12 months prior to expected birth for an average of 10 hours a week. There is some precedence for a 10 hour test. FaHCSIA uses a 10 hour work test to trigger the so-called ‘quarantining’ provisions of family tax benefit B, which allows women to access FTB(B) in the period prior to returning to work, even if their financial year income would usually make them ineligible for benefits. New Zealand has a 10 hour, six month tenure requirement, while Canada has a 600 hour requirement in the year prior to expected birth, which on a weekly basis, constitutes a similar test (Hanratty and Trzcinski 2006).

However, a variety of participants considered that the Commission’s proposed test was overly restrictive. As one participant said:

I have no doubts that women will return to work earlier than they would like in order to qualify for paid parental leave. In order to qualify for paid parental leave a woman would need to put her child in childcare (or if she is fortunate some other arrangement) for at least 10 hours a week so that she could work at least 10 hours a week. Most childcare centres take bookings by the day, so two days of care would need to be paid for in order for the 10 hours to be worked. As referenced in appendix D, many experts have concerns about long hours of daycare (more than 10 hours per week). (sub. DR359, p. 2).

Women and Work Group also said:

The 10 hour work eligibility requirement does not recognise that many traineeships and university study programs limit work to a maximum of 8 hours per week. (sub. DR283, p. 1)

The Commission also recognises the fact that a 10 hour, 12 month test might overly limit the involvement in the statutory paid parental leave scheme of parents who already have children, undermining the scheme’s labour market and social impacts. As discussed above, women wishing to re-qualify for statutory paid parental leave for a second or subsequent birth typically work on a part-time basis and have worked for less time than women having their first child. (A 10 hour, 12 month employment test also has some other potentially undesirable effects on birth spacing — chapter 2.)

Given these concerns, the Commission has adapted its employment test. The Commission proposes that parents must have worked for at least 330 hours in 10 of the 13 months prior to expected birth, (but with no requirement that this would have to be with the same employer). The 330 hour requirement allows the eligibility of a parent who has worked an average of one conventional day a week (7.6 hours a week) for the relevant 10 months. A 330 hour, ‘10-13’ employment test appears to be neither so high as to deter workforce participation by those parents who can only manage some labour market involvement, nor so low that it encourages only

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spurious employment outcomes. The broad form of the Commission's employment test is commonplace among schemes around the world. Private voluntary schemes also usually have at least some tenure requirement.

The Commission's eligibility conditions are relatively simple to apply and exclude very few employed people (figure 5.4). Importantly, the employment test does not exclude certain disadvantaged groups, such as lone parents.

The Commission considered an alternative employment test aimed at allowing the broad involvement by parents in the scheme, while maximising its workforce incentive effects. Under this approach, all those working prior to birth would be eligible for participation in the scheme, regardless of their hours, but with perverse effects controlled through a tiered payment structure (described in appendix E). The essential idea would be to provide:

- a sufficient weekly minimum payment that people have incentives to be in work rather than receiving welfare payments outside the labour force
- *plus* a share of people's actual wages so that people find it worthwhile to work more hours rather than having the perverse incentive to be merely marginally attached.

While, in principle, a tiered payment could allow for all of these benefits, many people would find it hard to calculate the value of their entitlement, and that would then affect their labour market decisions. The Commission's proposed employment test is therefore the easiest to apply.

In addition to its tenure and hours requirements for eligibility, the Commission proposes some degree of continuity of employment to remove eligibility for a person who was dropping in and out of the labour force for long periods during the qualifying year (chapter 2). However, the Commission's approach is not intended to disqualify casuals who have reasonable continuity of employment (for example, those taking unpaid leave periods that would be commensurate with paid leave periods taken by permanent employees). The Commission's proposed eligibility requirement for work for 10 months out of 13 also would allow some interruptions to work for such casuals. As with the tenure requirement, continuity of employment could still occur if an employee worked for several employers during the year.

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## 5.5 The empirical evidence

### Some warnings

Ideally, the impact of paid parental leave would be assessed in the same way that clinical trials are used in the pharmaceuticals industry to consider the efficacy of new drugs. One randomly selected group of parents, the ‘treatment’ group, would be eligible for paid leave for a given period, while another randomly selected group of people would not be eligible (the ‘control’ group). By randomly selecting the different groups, it can be assumed that they are the same except for their access to paid parental leave. It would then be possible to consider the short and long-run impacts of paid parental leave on parent’s employment outcomes, wages, job quality and so on.

No such formal experiments have ever been conducted anywhere. Instead, various statistical techniques and so-called natural experiments (where for example, one province in a country introduces a change in policy, while another one does not) attempt to mimic such experiments to assess the impacts of paid parental leave. Any weaknesses in those statistical methods will bias the measures of the effects of paid leave. This explains some of the equivocal findings in the literature.

Moreover, that literature relates mainly to countries with different social institutions, regulations, preferences and labour markets to Australia, so it will not always be clear that the results will carry over to an Australian context. For example, Australia now has widespread voluntary provision of paid leave. The impact of mandated parental leave in that environment might well be different from those apparent in countries where the impetus for leave has long been regulation.

In addition, it is often hard to distinguish the impacts of paid leave from an unpaid leave period with a job return guarantee. In some countries, the period of paid leave and the job guarantee period coincide. This is important in the Australian context because an unpaid job guarantee period is already available. The relevant question is what *additional* labour market effects may occur if some or all of that unpaid period is now paid.

All these factors suggest that it is unlikely that the existing literature will provide a precise estimate of the employment or other labour market impacts of paid parental leave in Australia. Nevertheless, some patterns emerge.

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## Short term absences from work

The empirical evidence generally supports the view that extensions in paid (and unpaid) leave increase the duration of absence by women from work, while maintaining their connection to employment.

Women often say that they return to work when their leave runs out, so extensions in leave should promote longer work absence. Typical comments from mothers were:

I planned to return to work as soon as my paid leave ran out. If I had less long service leave and maternity leave I would have returned earlier (Angela Budai, sub. 17, pp. 1–2).

So, why after waiting so long and going to considerable lengths to have our child, did I go back to work relatively soon [7 months]. Well, the bills don't stop. (Dr K. Stephenson, sub. 189).

I think I would have had to return to work earlier if I had not been able to access paid maternity leave. (L. Jeffery, sub. 175, p. 1)

Financially, because of the unavailability of paid maternity leave and income being the primary one, I had to return to work when my baby was seven months old. This was difficult for me, not only emotionally, but also practically, because I wanted to keep breastfeeding until the baby was twelve months. (Hilary Surman, sub. 35)

Large-scale survey data show that these experiences are commonplace, even for women whose absence from work has been prolonged (table 5.3). More than 40 per cent of mothers away from work for 9–12 months felt that lack of paid maternity leave forced them to return early. This is no different from that for women away from work for less than three months. The importance of financial constraints generally is further highlighted by the fact that around 50 per cent of women said they returned to work at 9–12 months because of 'lack of money', rather than a desire per se to return to work. Consequently, by alleviating families' financial pressures, paid parental leave would be likely to extend leave periods taken.

Moreover, a special institutional feature of the Australian workplace system suggests that paid parental leave of 18 weeks will still have impacts on leave taken by women who are already taking 18 weeks or more of leave. Many Australian mothers have a job return guarantee of one year (soon to include the right to request an extension to two years) under the National Employment Standards. Accordingly, they could put aside some or all of the payments received while on the 18 weeks of statutory paid parental leave and use this money to fund a longer leave period.

The story would be different were the job guarantee to be aligned with the paid parental leave period (as is often the case overseas). In that case, many women

would be forced to go back to work at the end of the paid parental leave period to keep their jobs. The option of saving and taking leave later would vanish. This might explain why some overseas studies find that ‘short’ paid leave periods made little difference to the duration of absence from work. For example, this appeared to be the case for the initial scheme used in Canada (Baker and Milligan 2008a). Given the complementary impact of the job return guarantee, we would expect even short periods of statutory paid parental leave to increase leave absences in an Australian context.

**Table 5.3 Why did women return to work earlier than they wanted?**

<i>Months taken off work</i>	<i>Lack of paid maternity leave caused early return</i>	<i>Lack of unpaid maternity leave caused early return</i>	<i>Worries about job caused return earlier than desired</i>	<i>Returned earlier than desired because of a lack of money</i>	<i>Maintaining household income was difficult while on leave</i>
	%	%	%	%	%
0 to less than 3	44.0	7.0	22.9	45.5	37.9
3 to less than 6	60.0	2.5	16.0	58.7	34.0
6 to less than 9	60.8	1.7	7.2	60.2	40.4
9 to less than 12	43.8	4.8	5.3	51.8	45.5
12 to less than 15	34.9	19.4	5.4	24.3	43.7
15 to less than 18	32.5	7.8	14.3	26.3	31.7
Total to 18 months	47.4	8.1	9.1	45.3	40.7

Source: LSAC Wave 1.5.

Australian evidence based on LSAC shows that women able to access voluntary paid leave schemes have longer spells away from work. However, workplaces that offer paid parental leave typically do so because of the special characteristics of their employees, such as their skill levels, shortages of supply or high gains from retention. It is possible that employees with these characteristics take longer leave after birth — regardless of the existence of paid parental leave. In that case, it will *appear* that paid parental leave has an impact on leave duration when it really reflects the different characteristics of employees eligible and not eligible for paid parental leave (‘selection’ biases). The Commission undertook some econometric analysis to control for the different characteristics of the women in these two groups and still found a significant effect of paid maternity leave on the duration of time away from work. However, we were not satisfied that the results were reliable given the continued likelihood of selection biases. We were also unsure that the results would necessarily indicate the magnitude of the impacts on leave that might be anticipated from the introduction of a statutory scheme, whose design is intrinsically different from private schemes.

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Accordingly, the Commission modelled the aggregate impacts of a statutory scheme by considering the likely behavioural responses at the individual level by respondents to the LSAC survey. The results suggest that a statutory scheme of 18 weeks would increase leave taken by an average 10 weeks, but with a smaller effect for those women taking less than 26 weeks of leave already (appendix G). These are large impacts once account is taken of the fact that, under the Commission's scheme, eligible parents would be taxed on their leave pay, and lose access to the baby bonus and some other social transfers (chapter 9).

While the Commission's empirical analysis is supportive of a duration effect, it is still relatively weak evidence because it is difficult to control for all of the relevant characteristics of women that affect their access to paid maternity leave. Accordingly, the Commission looked at the impacts of *extensions* to statutory schemes overseas on leave durations (summarised in table 5.4). As natural experiments, these are less likely to be affected by the selection biases described above. The international studies generally suggest that statutory paid leave increases time off work while employed.

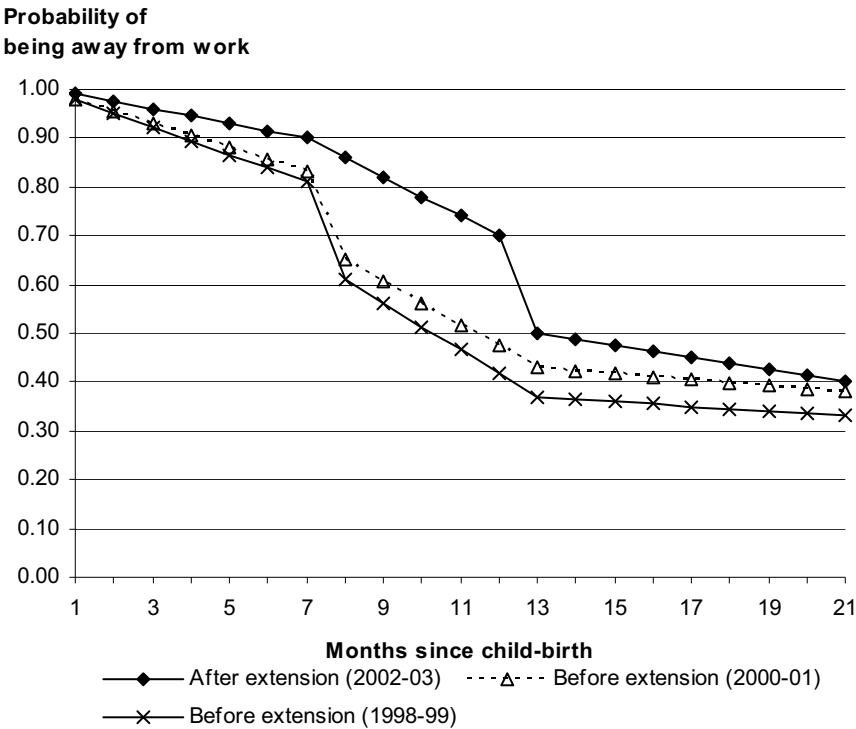
Figure 5.5 below illustrates the effect on time off work in Canada of increasing paid parental leave from 25 to 50 weeks on the probability of being absent from work. There was a large impact for the period from seven months to 12 months, with the effects rapidly dissipating in the following months, until at 21 months, both groups have a roughly equivalent likelihood of being absent from work. After controlling for other economic and demographic traits, the share of mothers remaining at home for 12 months increased from 47 per cent to 67 per cent following the change in statutory leave arrangements.

The effects vary markedly between some groups of women, with negligible impacts of extended mandates for those who did not complete high school (and who already have high probabilities of being away from work for long periods). However, it is important to note that, compared with the scheme proposed by the Commission for Australia, the Canadian system is less generous — particularly for the lowest income employees — and has more stringent eligibility requirements. Consequently, impacts on lower income employees might be expected to be greater in an Australian context.

Other recent Canadian evidence confirms the above findings, with Baker and Milligan (2008a,b) finding that the extension of paid leave beyond 25 weeks had substantial impacts on time taken off work. For example, the expansion of the Canadian leave entitlement from 25 to 50 weeks increased leave duration by more than three months.

However, Baker and Milligan (2008a) found that statutory leave entitlements of 17–18 weeks did not change the time mothers took off work, speculating that this was because mothers had recourse to private leave arrangements prior to the statutory provision. This finding may be less relevant to Australia given the complementary effects of the job return guarantee discussed above (and the fact that most women do not have access to voluntary paid parental leave of anything like 18 weeks).

**Figure 5.5 Impact of the 2000 extension to Canadian paid maternity leave on time away from work<sup>a</sup>**



<sup>a</sup> The figure shows the effect of a major extension to Canadian paid maternity leave arrangements. Two periods prior to the extension are shown to indicate that the rise that occurred is not the outcome of a general trend in leave taken. The probabilities shown above control for demographic and other characteristics, so they should reflect the impact of changes to leave mandates alone.

Data source: Hanratty and Trzcinski (2006).

**Table 5.4 Impacts of parental leave on time off work and long-run employment<sup>a</sup>**

<i>Study</i>	<i>Which country/ies</i>	<i>Impact on leave period after birth</i>	<i>Long run employment effects and job continuity</i>
<b>Women</b>			
Marshall 2003	Canada	Extension of leave from 10 to 35 weeks increased leave taken by 4 months	..
ten Cate 2003	Canada	..	An increase in mandated job-protected unpaid leave from 0 to 52 weeks led to a 2.8 to 3.6% increase in the employment rate of women whose youngest child is aged 0 to 2.
Baker and Milligan 2008a	Canada	Leave entitlements of 17–18 weeks did not change the time mothers spent away from work, but extensions beyond this did so significantly	All leave entitlements increased job continuity with the pre-birth employer
Baker and Milligan 2008b	Canada	Increase in leave entitlement from 25 to 50 weeks increased leave taken by more than 3 months	..
Rönsen & Sundström 1996	Norway and Sweden	..	Women with a right to paid leave are more likely to resume employment (3 times as fast as other women in Sweden and >2 times as fast in Norway)
Pylkkänen & Smith 2003	Denmark and Sweden	Greater compensation rates while on leave increased duration. More leave for fathers (in Sweden) decreases leave by mothers	..
Hong & Corman 2005	Sweden	Significant increase in leave taken	..
Waldfogel et al. 1998	United Kingdom, Japan and United States	..	Large impacts on job continuity (Maternity leave coverage increased the probability of returning to the same employer within 12 months of birth by 76% in Japan, 23% in the US and 16% in the UK)
Burgess et al. 2002	United Kingdom	..	Large impacts on job continuity (Maternity leave coverage increased the probability of returning the mother's previous job before seven months by 19 percentage points)
Zveglic & van der Meulen Rodgers 2003	Taiwan	..	Women's working hours increased by 4.5% and their employment rose by 2.5 percentage points. The increase in total labour input was about 7%
Merz 2004	Germany	Increased	Increase in employment to population ratio, but decrease in average weekly hours worked
Schönberg & Ludsteck 2006	Germany	Increased leave strongly when leave period increased from 2 to 6 months, but weaker effects for subsequent extensions	No long run labour supply impact (hours or participation rates). Reduces wages below counterfactual.

**Table 5.4 (Continued)**

<i>Study</i>	<i>Which country/ies</i>	<i>Impact on leave period after birth</i>	<i>Long run employment effects and job continuity</i>
Spiess & Wrohlich 2006	Germany (behavioural microsimulation model)	..	Significant positive impacts in the second year after birth (12% increase in hours of mothers and increase in participation rates from 36% to 39%)
Lalive & Zweimüller 2005	Austria	Significant increase (0.4 to 0.5 months of additional time off work for every additional month of statutory leave)	
Ruhm 1998	9 European countries	..	A 20 week paid entitlement increased the total female employment to population ratio by around 4%
Jaumotte 2003	17 OECD countries	..	Positive impacts on participation rates of women aged 25–54, but with diminishing effects after 20 weeks
Pronzato 2007	9 European countries	The right to paid leave decreases the probability of being at work by 35 percentage points when the child is between 0 and 3 years old	1 year more of leave increases the probability of employment by 4 percentage points when the child is 4–5 years old
Han et al. 2009	United States	Unpaid leave access led to a 6.7 percentage point reduction in within 12 weeks of birth	Access to unpaid leave led to a 4.7 point increase in work probabilities at 9 months after birth
Del Boca et al. 2008	15 European countries	..	Positive but decreasing effect of leave duration on the probability of working for low educated women; not statistically significant
<b>Men</b>			
Ekberg et al. 2005	Sweden	Fathers took 15 extra days of leave after 'Daddy month' leave period was introduced; mothers took 20 days less	..
Eydal 2007	Iceland	Significant effect on leave taking	..
Gíslason 2007	Iceland	Significant effect on leave taking	

<sup>a</sup> The table excludes (the many) studies from the United States because the mandated leave period is unpaid and short (12 weeks), and so probably provides less guidance about the impacts of a longer statutory paid scheme as proposed by the Commission. Baker and Milligan (B&M 2008a) summarises the United States literature, finding that there is reasonably strong evidence from a range of studies that maternity leave increases job continuity with employers. This is also supported by a study, Hashimoto (2004) (not covered by the B&M review) that finds maternity leave had significant impacts on business retention rates and a small positive impact on weeks worked, declining to zero 8 years after birth. Only two studies of the US reviewed by B&M find positive effects on leave duration. However, Han et al. (2007) (not covered by the B&M review) also finds significant impacts on leave durations in the US.

Data on job return behaviour often show spikes at the point where paid and unpaid periods end. In the latter case, this suggests the importance to women of the capacity to return to their original employer (if nothing else to exploit the benefits

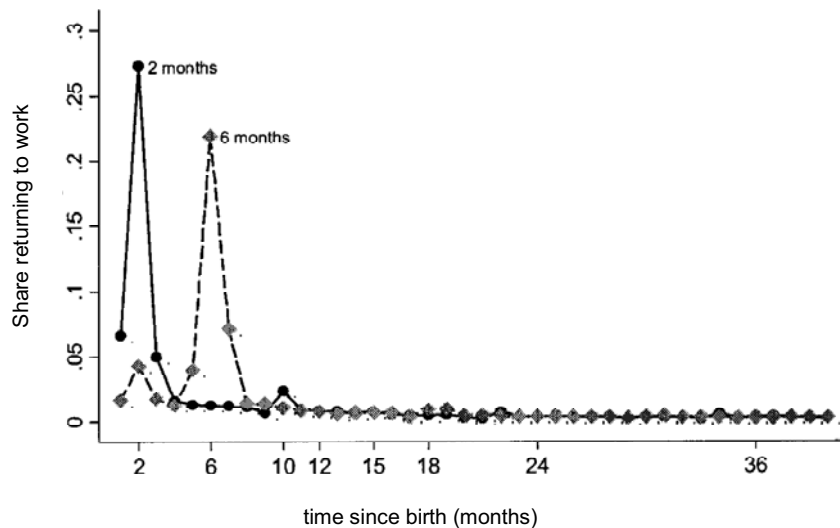
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of firm-specific human capital). In the former case, it suggests the role of financial constraints in determining period of absence — when the money runs out, people go back to work.

Spikes show up clearly in the German case (Schonberg and Ludsteck 2007). The initial scheme gave a woman two months of highly paid leave after the birth of her baby with a job return guarantee.<sup>10</sup> The subsequent scheme extended the job return guarantee by a further four months, but with a low level of pay for that supplement. The probability of returning to work under the initial scheme was highest at two months (figure 5.6). With the extension, the peak probability shifted to six months, testimony of the sensitivity of work absence to leave arrangements. The proportion of women working two months after childbirth dropped by almost 35 percentage points, from about 41 per cent for women who gave birth prior to the extension to leave to about 5 per cent for women who gave birth after the extension.

However, notably under the extended scheme there was only a small peak at two months, when paid leave rates shifted from high to low rates. Had financial constraints been the most decisive factor determining the return to work, a larger peak at two weeks would have been expected.

**Figure 5.6 Impact of extensions of the German maternity leave job-return guarantee on the probability of returning to work<sup>a</sup>**



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<sup>a</sup> This shows the effect of shifting from a 2 months post-birth (high wage replacement) paid parental leave scheme to a scheme that provides paid leave to six months (with three months of this paid at a low rate).

Data source: Schonberg and Ludsteck (2007).

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<sup>10</sup> A paid leave period of one month prior to birth was also introduced.

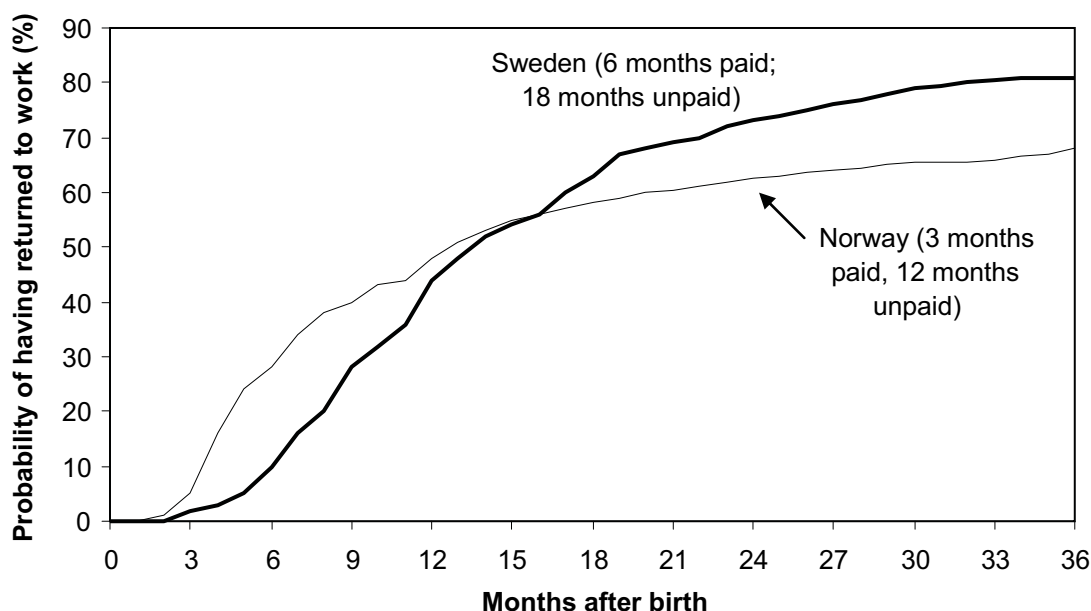
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## Longer run impacts

The initial negative effect of parental leave on labour supply is not an adverse finding — it is a major goal of such leave arrangements. The other key labour supply issue is whether women increase their labour supply prior to birth and over the long run following the early infant years of their children. Unfortunately, most studies do not examine the impacts specifically on employment prior to birth, and some that consider the post-birth employment experience of women on paid leave examine a period that may be too short to identify its ultimate impacts.

Nevertheless, the evidence suggests that there are long run impacts (table 5.4). The employment outcomes after birth in Sweden and Norway illustrate these (figure 5.7). Sweden's more generous paid parental leave arrangements lead to lower work return rates initially, as it makes staying home an affordable option for many parents. In the longer run, however, Swedish work return rates eclipse those of Norway. This is consistent with a greater share of Norwegian women resigning in the absence of longer leave provisions, which then reduces their scope for re-entry to the labour market.

Figure 5.7 **More generous leave arrangements appear to raise long-run labour force participation**  
Norway compared with Sweden



Data source: Rönson and Sundström (1996).

In part, the different outcomes may reflect differences in the characteristics and preferences of the two societies, and in the details of the parental leave schemes. For instance, at the time, Sweden had a highly flexible leave scheme that allowed

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parents to save leave until later periods, provided significantly greater access to child care, and had different eligibility criteria, all of which may partly explain the higher long-run employment rates.

Either way, parental leave in both countries prompts higher rates of return to work in the longer run. Statistical methods that control for factors like education, age and parity, amongst other factors, suggest that women eligible for paid leave resume employment around three times faster than other women in Sweden, and two times faster in Norway.

Other studies also support significant long-run leave impacts.

In the United Kingdom, Burgess et al. (2002) found that for women with similar labour force attachment, maternity leave coverage increased the share of women returning to their previous job by 19 percentage points.<sup>11</sup> However, this outcome reflected both the availability of a six month paid leave period and a job return guarantee, with the latter almost certainly an important factor. The greatest impact of paid leave was for women in lower skilled groups, while managerial and professional women tended to return later at the end of the unpaid leave period. This suggests the importance of the financial considerations for poorer families.

In Australia, there is already provision for a long period of unpaid leave. Given this, smaller retention gains are likely from the introduction of a paid parental leave scheme than observed in the UK. Increases in retention are likely to be highest for less educated and lower skilled women. While the benefits to employers from higher retention rates are lower for these types of employees than others, they may nevertheless be important.

The empirical evidence from such studies is reinforced by the personal stories of women participating in this inquiry, who resigned from work because they did not have access to paid leave. For instance,

After the birth of my daughter, I decided to quit my job as the lack of benefit made me indifferent to keeping the job. (Stella Ng, sub. 13)

It should be emphasised that retention benefits do not necessarily imply large employment effects. As an illustration, suppose that before paid parental leave 30 per cent of women returned to their original job after one year and that this increased to 50 per cent after paid parental leave — a large increase in retention. Suppose also that 60 in every 100 women returned to employment after one year

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<sup>11</sup> Also in the United Kingdom, Waldfogel et al. (1998) found that maternity leave had significant positive impacts on retention with the former employer. The probability of retention within 12 months increased by 16 percentage points.

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prior to maternity leave provisions and that this increased to 65 after paid parental leave, an increase of five percentage points. In this example, the main effect of paid maternity leave is diversion. It reduces the likelihood that a woman gains a job with another employer while increasing attachment to the original employer. The relevance of diversion appears to be borne out by other empirical analysis (below).

One of the most widely cited assessments of the long run labour market impacts of parental leave entitlements — Ruhm (1998) — considered the experiences of nine European countries from 1969 to 1993. The study found significant aggregate impacts of female employment to population ratios (table 5.5). For example, a 20 week paid entitlement increased the total female employment to population ratio by around 4 per cent. For women aged 25–34 years — the prime reproductive years — the effect is around double this.<sup>12</sup>

There are three main provisos regarding Ruhm’s results. First, in many of the countries studied, a period of absence from work while on parental leave is still classified in the official statistics as ‘employment’. Ruhm conjectures that around one quarter to one half of the employment effect shown in table 5.5 is probably a statistical illusion. Second, other employment policy initiatives — such as more family friendly policies or greater child care provision — often accompany paid leave measures, and these may have contributed to the result. Finally, other factors — such as greater female educational attainment or labour shortages — may expand female labour supply, at the same time placing political pressure for the introduction of paid leave. In the Australian context, it is evident that the large rise in the employment of professional women and their advocacy of paid leave is a major contributing factor to the decision to introduce some kind of leave scheme. The causation then is partly from employment to paid leave, and not just the other way.

Other methods of analysis also suggest lower employment responses. Taking account of the effective wage increase from the introduction of paid leave and labour supply elasticities suggests that a three month paid leave scheme would increase female employment to population ratios by around 0.4 to 1 per cent (Ruhm 1998). Longer leave schemes — such as proposed by the Commission — could have bigger effects.

To appreciate these potential effects on years worked by women, suppose that overall a scheme of the kind proposed by the Commission were to raise the female employment to population ratio by 1.5 per cent. In 2007-08, the ratio was

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<sup>12</sup> The magnitudes found by Ruhm have been broadly replicated in other settings, such as ten Cate for Canada, Zveglic and van der Meulen Rodgers for Taiwan, Pronzato for a sample of European countries, and Jaumotte for OECD countries, but not so clearly by Del Boca et al. — see table 5.4.

55.4 per cent in Australia. There are 56 years of potential work from ages 15 to 70 inclusive, which, with the present employment to population ratio, implies around 31 average years of employment per woman over her working lifetime. With the assumed parameter, the employment to population ratio would rise to 56.3 per cent under a scheme or an increase in lifetime employment of around half a year.<sup>13</sup> To put this in an historical framework, average female employment years per woman were around 22 years in 1978-79. Accordingly, 30 years of economic social change have had nearly a twenty times greater effect on employment of Australian women than the indicative impact of a paid leave scheme. That is still worthwhile, but paid leave is unlikely to be transformative. (As a comparison, the male employment to population ratio was around 70 per cent in 2007-08.)

Ruhm also found lower wages, consistent with the wage depressing effects of paid leave described earlier, suggesting that a statutory leave scheme in Australia would reduce female wage growth below its counterfactual rate (table 5.5).

**Table 5.5 Impacts of parental leave entitlements on aggregate employment and wages**  
Nine European countries, 1969 to 1993

<i>Number of weeks of paid entitlements</i>	<i>Impact on female employment to population ratios<sup>a</sup></i>	<i>Impact on female wages</i>
	%	%
10	2.8	-1.7
20	4.2	-2.8
30	4.2	-3.4

<sup>a</sup> So if the E/P ratio of women was 50 per cent, a 2.8 per cent increase in the ratio implies an E/P of 51.4 per cent (1.028 times 50) or an increase in the ratio of 1.4 points.

Source: Ruhm (1998).

Overall, the long-run studies suggest that moderate paid leave periods can stimulate female employment and workplace participation.

A final issue is the impact of leave on erosion of a woman's work skills. Long periods of absence may well reduce work-related skills (while building up others that may still be socially valuable). As noted in this inquiry:

Whilst on leave, I wasn't concerned about maintaining skills or advancing my career. I just wanted to maintain my position, so that I had an option to come back to work when I and my child were ready. However, since returning to work, I can see the importance

<sup>13</sup> This is a measure of increased numbers of employees per capita. It is not the same as hours per capita, which would probably increase by less since most of the impact would probably take the form of additional part-time jobs.

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of maintaining some involvement in paid work in order to maintain skills and networks. After being away for a year, I feel a lot of things have changed and my networks with other colleagues have been eroded. (Jane Martin, sub. 170)

Any system of paid parental leave should consider the need to assist employees to update their skill levels before they return to work. (Pharmacy Guild of Australia, sub. 245)

Ruhm (1998) finds an eventual negative impact of leave on employment, but it only occurs for very long leave periods. Jaumotte (2003) finds that the impacts of parental leave on participation rates peak at around 20 weeks and then slowly reduce, but her estimates are insufficiently precise to estimate when leave duration would actually reduce participation rates. Overall, skill depreciation is not likely to work against a (practically implementable) paid parental scheme:

- The groups of women most responsive to paid parental leave are those whose occupations tend to have lower skill requirements — which are also those that are less subject to skill loss.
- To the extent that paid leave promotes greater lifetime labour force and workforce attachment, work skills may be preserved more than they are eroded.
- Medium periods of absence are probably not realistically associated with significant skill loss. Moreover, parents also acquire skills in looking after children and the benefits of unpaid work are ignored in orthodox analysis.

Nevertheless, the Commission proposes a ‘keeping in touch’ provision, like that used in the United Kingdom, to maintain links between the employee and employer, which could reduce the erosion of skills and networks (chapter 2).

### *Men again*

The impact of paid parental leave on male labour force behaviour has rarely been explored as meticulously as that for women. Access to parental leave could affect men’s labour market decisions through several avenues.

First, some men increase their hours of work when their children are born, presumably to make up for the income lost when their partners are not in work. Paid parental leave should, in principle, reduce the income pressures on families, and allow fathers to spend more time at home.

Second, men can access paid parental leave under the Commission’s proposed scheme (as they usually can in statutory schemes abroad), so this should affect their leave behaviour after the birth of their children. However:

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- where men and women can share access to parental leave, the overseas evidence suggests that men rarely take much leave
  - where men get exclusive ‘use it or lose it’ paternity leave, such as Sweden’s ‘Daddy month’, there is evidence that they do take more time off work, but not by much (table 5.4). In the UK, apparently only around one in five men take advantage of their new paternity leave arrangements (Bennett and Ahmed 2008). Only in Iceland have very large effects been observed. Iceland has far more generous paternity leave arrangements than any other country — three months of ‘use it or lose it’ paternity leave at 80 per cent of replacement wages (and access by fathers to an additional three months of leave that can be shared with the mother). On average men take around 100 days of parental leave, far more than is apparent in contemporary Australia, or any other country for that matter (Gíslason 2007). Interestingly, increases in use of parental leave by men appears to increase labour supply responses by women, as they often return to work when the father assumes the primary care role (Ekberg et al. 2005).<sup>14</sup>

Moreover, paternity leave has not achieved the goal of increasing the long-term role of fathers in caring for children, for example, when the children were sick (Ekberg et al. 2005).

In an Australian context, the Commission’s proposal gives men a ‘Daddy fortnight’ and access to the full 18 weeks of parental leave if they pass the employment test and the mother gives consent. Given the international evidence, fathers will not generally take advantage of the parental leave component. It is harder to assess their reaction to the ‘Daddy fortnight’, but the UK experience suggests that initially a relatively small share will use it. Changing social attitudes and workplace cultures may change that over time, while having the leave available may stimulate such cultural change.

## 5.6 The bottom line

We do not know enough to be definitive about the size of the employment, labour force participation or other labour market benefits of a paid parental leave scheme. However, a reasonable judgment is that a scheme of 18 weeks would promote lifetime labour force engagement by women, while (appropriately) reducing actual work undertaken in the immediate period after childbirth.

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<sup>14</sup> A participant in this inquiry noted just such a situation, when the father’s access to (unpaid) parental leave allowed the mother to continue to work (Michelle Edmonds, sub. 68).