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Productivity Commission
Inquiry into early childhood education and care
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6 February 2024

A path to universal early childhood education and care

KPMG Australia (KPMG) welcomes the opportunity to provide a submission in response to the Productivity Commission's draft report *A path to universal early childhood education and care* (draft report) as part of its inquiry into the early childhood education and care (ECEC) sector in Australia.

KPMG supports the Productivity Commission's ambition for a universal, affordable system of ECEC and agrees that the reform agenda set out in its draft report provides a pathway to a universal system. We also support the Productivity Commission's proposal that Australian, state and territory governments should negotiate a new National Partnership Agreement on ECEC, setting out shared objectives in ECEC and each government's roles and responsibilities.

The Productivity Commission has stated that findings from the Australian Competition and Consumer Commission's (ACCC's) Childcare inquiry will inform and support its own inquiry.[1] In that regard, we refer the Productivity Commission to KPMG's submission and recommendations to the ACCC's inquiry.

KPMG Gender Equity series

KPMG has been analysing the childcare system in Australia for several years and making recommendations for reform as part of the firm's Gender Equity series. This includes:

- Ending workforce discrimination against women
- The cost of coming back: Achieving a better deal for working mothers
- Unleashing our potential: The case for further investment in the childcare subsidy

[1] ACCC Childcare Inquiry Final Report, December 2023

- The childcare subsidy: options for increasing support for caregivers who want to work

- Towards a more equal sharing of work

In an early report, KPMG developed the concept of a Workforce Disincentive Rate (WDR) for recipients of the Child Care Subsidy. The WDR is the percentage of any extra earnings that is lost to a family after taking into account additional income tax paid, loss of family payments, loss of Child Care Subsidy payments and increased out-of-pocket childcare costs.

Analysing the Child Care Subsidy introduced in 2018 to replace the Child Care Benefit and the Child Care Rebate, KPMG found WDRs of 75-120 per cent. These punitive rates for mothers are much higher than the top personal tax rate for men of 47 per cent.

KPMG proposed various reforms to the Child Care Subsidy that would greatly reduce these high WDRs. In its 2020 report *The childcare subsidy: options for increasing support for caregivers who want to work*, KPMG proposed an increase in the Child Care Subsidy to 95 per cent of the hourly rate cap for all families and the elimination of the annual per-child cap. As an interim step, KPMG proposed an increase in the maximum Child Care Subsidy rate to 95 per cent of the hourly rate cap and commencement of the family income-based reduction in the subsidy at $80,000 per annum.

KPMG's modelling of proposals for reform of the Child Care Subsidy has suggested that the benefits to GDP would far outweigh the budgetary cost. The Australian Government subsequently announced reforms to the Child Care Subsidy in its 2021-22 Budget which benefited around 270,000 families.

Further reforms were introduced from 1 July 2023 that increased the Child Care Subsidy for 1,260,000 families, which is almost every family using it. Under the *Cheaper Childcare* policy, WDRs were reduced for almost all families.

Updated KPMG analysis, which factors in the most recent tax rules, has found that since these reforms were introduced WDRs have decreased for many families to between 45 and 65 per cent. However, in most cases they remain above the highest marginal tax rate of 47 per cent.[2] The recommendations contained in the Productivity Commission's draft report could apply further downward pressure on high WDRs encountered by Australian working mothers.

Universality

[2] KPMG submission to ACCC Childcare inquiry, October 2023

KPMG has advocated a gradual move to a universal Child Care Subsidy, pointing out that:

> _"Not all government payments are means tested. Medicare, for example, is a universal system. Making the CCS universal … could be justified on the grounds of both equity and economic efficiency."_[3]

KPMG's submission to the ACCC's Child Care Inquiry notes that formal schooling is not means tested and, in several states, preschool is being made universally available. KPMG agrees with the Productivity Commission's view that, for many children – especially those experiencing disadvantage and vulnerability – attending ECEC can have positive effects on their achievements at school and later in life. However, children who would likely benefit the most from ECEC are attending less than average or not at all.

The Productivity Commission's draft report agrees with universality:

> _"Reflecting on those children who are unable to access ECEC, the Commission considers a universal system would enable all children to access services that support their development by addressing current availability gaps"._

In KPMG's view, a universal system of ECEC would make a vital contribution to reducing intergenerational inequity by giving all children access to quality education and care.

Affordability of ECEC

KPMG notes the Productivity Commission's conclusion that most studies in Australia and overseas find that the benefits of ECEC for children – and in some cases, their families – are greater when parental income or education is lower.

KPMG agrees with the Productivity Commission's findings that the Child Care Subsidy results in relatively high out-of-pocket expenses for the lowest-income families, that ECEC is relatively more expensive for those who can least afford it and that this is likely contributing to lower participation rates in ECEC for lower-income earners.

KPMG agrees with the Productivity Commission's recommendation that:

- Up to 30 hours or three days a week of quality ECEC should be available to all children aged 0-5 years;

[3] The cost of coming back: Achieving a better deal for working mothers

- In persistent ‘thin’ markets or communities with complex needs, the Australian Government should supply additional funding to support the establishment of appropriate services and, where necessary, ensure their ongoing viability through block funding;

- The Australian Government should raise the maximum rate of Child Care Subsidy to 100 per cent of the hourly rate cap for families on incomes up to $80,000, covering about 30 per cent of all families with young children; and

- Governments should remove impediments to the provision of flexible services, such as wrap-around care in dedicated preschools, and improve incentives for services to operate during non-standard hours. The Australian Government should fund support for families experiencing significant barriers to access, such as lack of transport.

The activity test

KPMG’s submission to the ACCC’s Child Care Inquiry recommends the removal of the Child Care Subsidy activity test for people accessing Commonwealth support payments since the activity test most heavily affects families in low-socioeconomic communities and is contributing to those households using a disproportionately large number of unsubsidised hours, leading to both access and affordability problems.

KPMG notes that the Productivity Commission’s draft report refers to an evaluation of the activity test, finding that: *“Changes in employment and other activities were small and not necessarily attributable to the activity test”.*

KPMG further notes the Productivity Commission’s estimates that relaxing the activity test for low-income families would lead to an increase of 12 per cent in the hours of ECEC children attend, *with about two-thirds of the increase in hours attributed to families who were not previously using ECEC*. In other words, relaxing the activity test for low-income families would elicit a strong increase in the use of ECEC for children in low-income families.

KPMG agrees with the Productivity Commission’s view that the Child Care Subsidy activity test should be relaxed so that it is not a barrier to any family wishing to access up to 30 hours or three days a week of ECEC services.

KPMG looks forward to working with the Productivity Commission on this important matter and would be willing to assist with information requests, including those relating to potential modifications to the activity test, the Child Care Subsidy taper rate and the level and indexation of the hourly rate cap.

Yours sincerely

Adam Norden

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