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Million Dollar Babies: Paid Parental Leave and Family Policy Reform

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EXECUTIVE SUMMARY

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In February 2008, the federal government asked the Productivity Commission to recommend a national paid maternity, paternity, and parental leave scheme. In September, the commission released its draft report, calling for eighteen weeks of parental leave and two weeks of paternity leave. Mothers who did not qualify for parental leave would be eligible for a maternity allowance equal to the existing Baby Bonus. The commission will make its final recommendation in February 2009.

Paid parental leave has become an important symbolic issue for many women, and support for its introduction has been so vocal that rather than being a means to an end, paid parental leave has become the end itself. The result is that the Productivity Commission has been limited by the inquiry's narrow terms of reference. Rather than being given a set of objectives and a brief to design policy to meet them, the commission has been asked to design a set of objectives that justify the desired policy.

This paper critiques the Productivity Commission's draft recommendations and evaluates how well the stated objectives will be met. It argues that:

- The evidence in favour of a paid maternity leave scheme is most compelling in regards to improving child and maternal health, but it doesn't necessarily follow that such a scheme will achieve this objective better than the existing system of a cash payment plus unpaid parental leave entitlements.
- Women's workforce participation may be more effectively increased by reforming existing family payments to remove disincentives for mothers to work.
- Requiring employers to participate in the scheme puts an unnecessary strain on business and 'crowds out' employer-paid entitlement schemes.
- The proposed scheme would add another layer of complexity to the family payments system, and contribute to tax-welfare 'churn.'
- Rather than being designed to promote a particular social goal, family policy should enable individuals to make choices about work and family based on their own situation and preferences.

To best achieve its stated objectives within a simple and equitable framework, any parental leave policy needs to be considered within the context of the entire system of family payments and family taxation. The upcoming 'Henry Review' of the tax-transfer system is the appropriate place for this.

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Introduction

In February 2008, the federal government announced that it had asked the Productivity Commission to undertake an inquiry into ‘improved support for parents with newborn children.’ Specifically, the terms of reference asked the commission to ‘identify the economic, productivity and social costs and benefits of providing paid maternity, paternity and parental leave.’¹ The commission is required to report its final recommendations to the government in February 2009.

After a public consultation process, the Productivity Commission released a set of draft recommendations in September 2008, seeking further public comment.² The commission recommended eighteen weeks of parental leave, paid at the federal minimum wage, to all women who had been in the workforce for an average of ten hours a week or more during the year leading up to the birth. Taxpayers would fund this. Women could opt to transfer the leave entitlement to their spouse or partner if they also meet eligibility requirements. Employers would act as paymaster and would also be required to contribute 9% superannuation during the paid leave period.

Women who did not meet eligibility requirements would be instead eligible for a maternity allowance—essentially a rebadged Baby Bonus—and would continue to receive other family benefits. All fathers or same-sex partners would be eligible for two weeks of paternity leave, regardless of the mother’s eligibility for parental leave.

The commission argued that the introduction of this policy would meet three key public policy objectives. First, it would enhance maternal and child health and well-being by enabling mothers to recover from childbirth, breastfeed, and provide one-on-one care for their infant. Second, it would enhance workforce participation by providing an incentive for women to be in the workforce prior to giving birth, and increase the likelihood that they would return to their workplace after the parental leave period. Third, it would promote gender equity and work–family balance by normalising the idea that many men and women have simultaneous work and care roles.

The commission estimates that its proposal would cost around \$530 million annually, on top of existing family policy spending. Of this, taxpayers would contribute around \$450 million while business would contribute around \$75 million.³

The public reaction to the commission’s proposal was mixed. The commission had been expected to recommend fourteen weeks of parental leave, and many proponents of paid parental leave welcomed the more generous eighteen-week proposal,⁴ while others maintained that the commission should have recommended a scheme that provides up to six months of paid leave.⁵

Other criticisms of the proposal were that it would place an unfair burden on small business,⁶ would be inequitable between working and non-working mothers,⁷ and would add another layer of complexity to an already complex family payments system.⁸

This paper evaluates how adequately the proposal would achieve its stated objectives, and explores some criticisms of the proposal. It concludes that while the commission’s proposal is flawed, these problems largely stem from the narrow terms of inquiry. To best achieve its stated objectives within a simple and equitable framework, any parental leave policy needs to be considered within the context of the entire system of family payments and family taxation.

Maternal and child health and well-being

The evidence presented in the commission’s draft report is most compelling in regards to maternal and child health and well-being. Research strongly indicates that a child enjoys optimal health and development outcomes if they are provided with exclusive parental

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care for at least the first six months of life. Some evidence suggests that longer periods, of nine months to one year, are also beneficial. Exclusive breastfeeding is recommended by the World Health Organisation until a child reaches six months of age, and some studies indicate that the length of time women spend away from work can have an effect on breastfeeding duration. Women who return to work sooner than twelve weeks after giving birth face a higher risk of depression and anxiety.⁹

While some women choose to return to work soon after birth, some submissions provided to the commission indicate that other women return to work sooner than they would like. Women may return to work early because they are ineligible for unpaid parental leave, or because they are unable to afford to remain on unpaid leave. The commission proposes that a paid parental leave scheme would overcome the latter problem by giving these women the financial means to remain on leave. It argues that the proposed policy 'would, on average, increase employed mothers' absence from work by between five and nine weeks or up to 50 per cent of the proposed length of statutory paid leave.'¹⁰

This suggests that paid parental leave will improve the health and well-being of new mothers and babies by allowing employed mothers to extend their time away from work. Nevertheless, despite the arguments the commission presents, there is some evidence that is less convincing.

A key tenet of the paid parental leave proposal is that parental care is superior to childcare for very young infants. The commission's report presents evidence that shows childcare can have negative effects on children if they are less than six months of age and in long-hours care. However, data from the Longitudinal Study of Australian Children quoted in the commission's report notes that this type of care is most prevalent in households with incomes over \$100,000. In households with incomes of less than \$50,000, this type of arrangement is 'rare.'¹¹ It can be assumed that low-income households would be the most responsive to the introduction of paid parental leave by varying their time away from work, and high-income families the least responsive. Therefore, it seems reasonable to assume that the policy would only have a limited effect in reducing the number of infants less than six months of age who are placed in long-hours care.

Another area in which the evidence is less than compelling is in the commission's justification for two weeks of paid paternity leave. Research indicates that fathers' involvement in child-rearing improves both maternal and child well-being, and paternity leave is intended to persuade fathers to be active in parenting from the beginning of their child's life. However, it is not clear that two weeks of paternity leave will lead to a substantial long-term increase in fathers' involvement. The commission quotes OECD findings that 'taking a few weeks of leave after childbirth or around summer and Christmas holidays does not reflect a fundamental behavioural change.'¹² Around 75% of Australian fathers already take leave at their child's birth, usually using employer-funded paternity leave or annual leave,¹³ and it is not clear whether a statutory period of paid paternity leave would substantially increase this figure. The commission notes that 'its actual effects on fathers' behaviour are likely to be modest.'¹⁴

Overall, the evidence presented in the commission's report shows that public policy can have the greatest effect on maternal and child health and well-being if it allows families to provide continuous parental care for the first months (and possibly even years) of a child's life. However, it does not necessarily follow that a paid parental leave scheme tied to work requirements would achieve this better than the existing combination of unpaid parental leave entitlements and a flat cash payment, or better than some other policy that allows families to adequately live on one income while their child is young.

The commission itself notes that the dual objectives of paid parental leave—maternal and child health and workforce participation—are conflicting. While increased workforce participation is best achieved through short periods of paid parental leave, child health and well-being is best achieved by a much longer period of parental care. Many submissions argued that leave periods of one or even two years are necessary to ensure optimal child health and development. As Australian National University demographer Peter McDonald

notes,¹⁵ the cost of providing this would be so large that a self-funded model would be required.¹⁶ There is a danger that in trying to reach a compromise position between these two objectives, neither will be adequately met.

Workforce participation

Increasing women's workforce participation is a key objective of the commission's paid parental leave proposal, and it estimates that its model will result in a six-month increase in lifetime participation on average. Women's participation in paid work has grown markedly over the last few decades, but still follows a very different path to men's. Women's careers tend to be more intermittent and more commonly involve part-time work. Mothers earn much less over their lifetime than non-mothers. Australian workforce participation rates for women of childbearing age are lower than the OECD average, but the commission notes that this in itself is not a rationale for intervention. Regardless of policy interventions such as paid parental leave, women's participation in the workforce will continue to rise due to factors such as increased completion of higher education by women.¹⁷

In the past, countries with high rates of fertility had low levels of female workforce participation. In the last two decades, this situation has reversed, and now countries with high levels of female workforce participation also have high levels of fertility.¹⁸ This does not necessarily indicate a causal relationship, but it does seem clear that many women's preference is to now combine work and family duties. The challenge for public policy is to enable these women to work while still enabling 'home-centred' women to fulfil their preference for full-time motherhood and allowing for shifts in preferences throughout the life cycle.¹⁹

The commission notes that increased workforce participation may lead to individual benefits such as larger incomes, and to aggregate benefits such as increases in measured economic growth. However, '*by themselves*, effects of these kinds do not provide a strong incentive for promoting workforce participation.'²⁰ Women will still make decisions about their workforce participation after weighing up competing priorities—such as financial considerations or the desire to focus on parenting—and 'people generally choose the outcome that best suits their individual circumstances, so that using any government policy to change these runs the risk of producing worse outcomes.'²¹ The commission does not see the inherent desirability of workforce participation as an adequate justification for a policy intervention, but it argues that paid parental leave is still justified because it helps women overcome obstacles that may prevent them from working as much as they want to.

Whatever the merits of the model the commission eventually recommends, the narrow scope of the current inquiry precludes any discussion of whether reforming the existing system of family benefits to remove barriers to women's workforce participation would be more efficient or effective than the introduction of paid parental leave. The federal government has already commissioned a large-scale review of the tax and transfer system (the 'Henry Review').²² In light of this, the commission's report intentionally does not recommend significant changes to the existing system of family payments or comment on whether its objectives could be better achieved through other policy reform.

Reforming the current system may have a larger effect on participation

Several academics and other commentators argue that the second earner in a family, usually the mother, faces *disincentives* to work because of the existing system of family payments and its interaction with the tax system. Peter McDonald, for example, argues that the current system of family benefits favours 'stark' choices by providing incentives for one parent to stay at home full-time or for both parents to work full-time, with the greatest value obtained by one parent staying at home. Families where one or both parents work part-time receive significantly less support, despite the fact that 59% of employed mothers with children aged 0–14 worked part-time in 2006.²³ McDonald argues for a system of family payments that is 'less contingent on the work choices made by parents.'²⁴

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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.

University of Sydney academic Elizabeth Hill argues that the very high effective marginal tax rates (EMTRs) faced by second earners—who are not only taxed for their additional income but also face withdrawal of benefits as their income increases—provide a disincentive for part-time working mothers to increase their working hours. She argues that this distorts the decisions of women who may otherwise choose to work more.²⁵ Similarly, taxation expert Patricia Apps argues that families effectively face a system of joint taxation that discourages second earners from starting work or increasing their income. She argues for a return to universal child benefits.²⁶

New research from the National Centre for Social and Economic Modelling (NATSEM) found that 15.6% of families who currently receive Family Tax Benefit A (FTB A) face EMTRs of more than 50%. After the loss of benefits, they will effectively be taxed more than half of any new income earned. NATSEM's modelling shows that reducing the taper rate of FTB A would more than halve the number of families who face these extremely high EMTRs.²⁷ This type of reform to existing benefits could affect workforce participation in a more significant way than paid parental leave.

Barry Maley and Peter Saunders of the Centre for Independent Studies highlight the example of sole parents, who upon moving from welfare payments to a minimum-wage job face EMTRs of over 75%. A pay rise to a \$35,000 per annum job would entail EMTRs of over 90%.²⁸ A reduction of the Parenting Payment (Single) taper rate in 2000 from 50% to 40% resulted in a 2.5% increase in workforce participation among single parents, demonstrating the effect that a reduction in work disincentives can have in increasing participation. However, while a reduction in the taper rate will reduce EMTRs for families who are currently receiving the payment, it can also mean that higher-income families qualify for payments. The problem of high EMTRs simply moves further up the income scale.

To overcome this, Maley and Saunders propose overhauling the tax-transfer system by significantly raising the tax-free threshold, thereby reducing the need for cash payments to families. Parents would be eligible to claim an additional threshold for each dependent child, with low-income families who did not pay enough tax being given a cash payment. In effect, each child would be entitled to a universal, non-means-tested allowance that is not tied to parents' work choices.²⁹ This system of payments would be neutral between all families, removing distortions and leaving families free to structure their work and care responsibilities as best suited them, and removing the need for an additional policy to help women overcome obstacles to working.

Removing disincentives versus creating incentives

While much discussion of women's participation in the workforce rests on economic arguments, there are also ideological debates about the role of women in work and family and what role, if any, government should play in women's and families' work choices. Peter McDonald refers to the 'battle between those who argue for family policies which enable mothers to stay at home and those who argue for family policies that support the combination of paid work with family responsibilities.'³⁰

From a feminist perspective, incentives for women to work are beneficial because they ultimately improve women's economic status. From a conservative or traditionalist perspective, such incentives are detrimental, because they undermine traditional family values including women's role as mother and carer.³¹ An alternative perspective views individual families as best placed to make decisions about work and care based on their own circumstances and preferences. A system of family payments that is neutral between all family types—single earner, dual earner, one and a half, or equal sharing—and that removes disincentives for women (and men) to either participate in the paid workforce or

remain in the home, optimises families freedom of choice and fair treatment of different family types.

Impact on employers

One of the key criticisms following the release of the commission's proposal was that it would place an unfair burden on business, especially small business.³² Although taxpayers would meet most costs, employers would be required to pay 9% superannuation to employees who take leave and are ordinarily entitled to superannuation contributions. By capping the superannuation component at 9% of the minimum wage, the maximum cost to an employer will be about 3% of the employee's annual wage. However, employers will also be required to act as paymaster, with the cost of paid parental leave being refunded to them through reduced PAYG withholding remittances. Employers will face the cost of hiring and training replacement staff. However, this liability should not greatly exceed that already faced because of existing unpaid parental leave legislation.³³ The total direct contribution from business is expected to be \$75 million plus indirect costs.

Some business groups have been vocal in their criticism of the proposal. The Australian Chamber of Commerce and Industry said it would 'lobby strenuously' against the proposal,³⁴ while the Australian Retailers Association said businesses would face a 'financial burden.'³⁵ The commission argues that these costs will be balanced by the improved retention of staff who take parental leave, but also notes that submissions from the Australian Federation of Employers and Industries, the Australian Chamber of Commerce and Industry, the Australian Industry Group, and the Chamber of Commerce and Industry Western Australia 'cautioned against assuming the benefits of voluntary schemes were relevant to all firms.'³⁶ Additional costs may be faced by businesses that would not necessarily benefit. While the cost to individual businesses may be small, it could be enough to discourage small businesses from hiring women of childbearing age. The commission notes that the cost to business will be clawed back through slower wage growth, which may mean a widening of the wage differential between men and women.

Another concern about the proposal is that it would 'crowd out' voluntary schemes that many employers are already providing. The commission maintains that 'the scheme is unlikely to lead to the wholesale removal of existing paid parental leave schemes' and that crowding out may be positive if it leads employers to substitute their parental leave policies with other family-friendly benefits.³⁷ Businesses that provide voluntary paid leave do so because it gives them a competitive edge by making them an 'employer of choice,' and it seems likely that these companies will want to retain this status. However, it is possible that some of these employers will absorb the government-funded scheme into their existing schemes, so that rather than fully funding their employees' parental leave they 'top up' the government payment to full wage-replacement level.³⁸ If some employers who already provide paid parental leave decide to absorb the new payment, a sizable portion of the \$450 million of new taxpayer spending could be a 'deadweight loss'—taxpayer funding for something that business would have supplied anyway.

Complexity and 'churn'

Another criticism of the commission's proposal for paid parental leave is that it adds another layer of complexity to an already complex system of family payments. The parental leave payment will be taxed, meaning the net value will vary depending on the mother's annual income and when during the tax year the baby is born. In Sydney's *Daily Telegraph*, Sue Dunlevy painted a humorous picture of a world where all babies are born in July, with parents planning their pregnancies to maximise their parental leave payments: 'How would you schedule all those birthday parties into four weeks a year?'³⁹

The payment will count as taxable income, so it will affect families' eligibility for other means tested family benefits. High-income women who qualify for parental leave may be better off if they opt for the Maternity Allowance (Baby Bonus), which is not taxed,

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while some women who work part-time will earn more on parental leave than they do at work.⁴⁰ Peter McDonald contends that any woman who earns more than \$34,000 in the year of birth would be better off under existing arrangements.⁴¹ Peter Apps argues that the proposal will reward women who work very few hours, while those who work longer hours will be penalised by clawback of tax and other benefits.⁴² Economist Joshua Gans comments that by tying the payment to the minimum wage, the Fair Pay Commission will have to deal with a new interest group and will 'have to choose between greater unemployment and child development.'⁴³

Besides adding a new layer of complexity, the proposal will contribute substantially to the 'churn' of payments through the tax-transfer system. New research from the Melbourne Institute of Applied Economic and Social Research shows that in the 2008–09 financial year, just over 40% of families will be negative taxpayers, meaning they receive more in government benefits than they pay in tax. When only families with dependent children are considered, this figure rises to just over 55%. The institute found that for 'families with more children and for single parents, even a median wage will not make them net contributors to government revenue. This is without taking into account childcare subsidies which would make the net government revenue even lower or more negative.'⁴⁴ There is no reliable estimate of the administrative cost of this churn. However, Treasury acknowledges the costs of this complexity. The administrative cost of Centrelink—the agency that manages transfer payments—was \$2.5 billion in 2006–07, while the cost of administering the Department of Families, Housing, Community Services and Indigenous Affairs was \$1.5 billion.⁴⁵ While this doesn't give a definitive estimate of the cost of churn, it is clear that raising tax from families and then transferring it back through a complex system of payments is more costly than lowering their tax burden.

Work–family balance and gender equity

The final objective the commission outlines is the broader social goal of helping parents to achieve better work–life balance, promoting the involvement of fathers in parenting, and advancing gender equity in the home and workplace.⁴⁶ However, the commission notes that this objective is much more open to interpretation than the other two, and that 'the extent to which [these values] should be encouraged, [is] more contestable.'⁴⁷

Some participants in the public consultation process reported discrimination in the workplace due to their pregnancy or parenthood, and believed that a paid parental leave scheme would help overcome these problems by being seen as an 'endorsement by society' that combining work and family is normal and worthwhile.⁴⁸ However, it is not clear whether this endorsement would have any practical effect. Most new mothers are already eligible for one year of unpaid parental leave, and for many it is likely that the new policy will have little actual effect on their interaction with the labour market. Moreover, more than half of mothers with a child aged four or under are already in the workforce,⁴⁹ and about half of women workers are already entitled to paid maternity leave funded by their employer.⁵⁰

This suggests that a process of social change is already underway. The danger is that government policy to speed it up may have perverse effects. The commission's report notes that the introduction of similar policies in countries such as the UK, Canada, and Sweden 'entrenched the assumption that only mothers brought up children.'⁵¹ Despite these policies' professed objective of improving gender equity, the result has often been greater hurdles for women to overcome in the workplace. The commission notes that if paid parental leave has the effect of increasing women's participation in the workforce it will improve the situation of women relative to men in the labour market. However 'by itself, paid parental leave will not reduce by much the gap between male and female labour force participation.'⁵²

Views about appropriate gender roles are varied. Some argue that 'gender-split preferences for caring or "breadwinning" are socially-constructed mores that should be challenged,' while for others 'what is perceived by some as undesirable from a gender

equity viewpoint may be seen ... as the preferred way to organise their household.⁵³ These divergences reflect people's varying preferences, and none can legitimately claim to be privileged. Policy that attempts to validate one view over another is unnecessarily divisive.

Rather than being biased towards a particular choice, policy should give families maximum freedom to make their own choices. Each individual has a different idea about what will make them happy or their life good, so any attempt by government to enshrine a 'norm' will necessarily deny some families the free choice to pursue their version of happiness.⁵⁴ Instead, governments should protect the 'right' of individuals and families to choose what they see as good, rather than promote a particular a particular version of 'the good.'⁵⁵

Conclusion

The widespread and often positive media coverage generated by the commission's report indicates that paid parental leave has become an important symbolic issue for many women, who see it as providing recognition of their dual role as workers and caregivers. Support for the introduction of paid parental leave has been so vocal that rather than being a means to an end, paid parental leave has become the end itself.

The result is that the Productivity Commission has been limited by the inquiry's narrow terms of reference. Rather than being given a set of objectives with a brief to design policy to meet them, the commission has been asked to design a set of objectives that justify the desired policy. The objectives the commission outlines—improving maternal and child health and well-being, overcoming obstacles to mothers' participation in the workforce, and helping parents balance work and family—may be worthwhile, but it doesn't necessarily follow that the introduction of a paid parental leave scheme will achieve these objectives better than other alternatives that would avoid the many objections which have been described. Paid parental leave will provide a payment to working mothers to match existing payments for non-working mothers, but a 'tit-for tat' approach will not lead to sound policymaking.

The existing system of family benefits is complex and offers families many competing incentives and disincentives, which have been added on top of each other over a period of years. As Peter McDonald puts it, 'Each "bolt-on" had its ideological or political rationale in its time but the outcome by 2008 is an illogical, inefficient, complex jumble of conflicting principles.'⁵⁶ Paid parental leave is simply another 'bolt-on.'

The challenge of designing a system of family payments that is equitable, simple, and reflective of the varied circumstances of modern families, can only be met through a wholesale review of the entire system of family payments. The upcoming 'Henry Review' of the tax-transfer system is the appropriate place for this.

Any attempt by government to enshrine a 'norm' will necessarily deny some families the free choice to pursue their version of happiness.

Endnotes

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9. See Productivity Commission, *Paid Parental Leave*, chapter 4, for details of this evidence.
10. Productivity Commission, *Paid Parental Leave*, 4.45.
11. As above, 4.37.
12. As above, 4.43.
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14. As above, xxiii.
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18. OECD, *Babies and Bosses: Reconciling Work and Family Life: A Synthesis of Findings for OECD Countries* (Paris: OECD, 213); 'LFS by Sex and Age,' *OECD.StatExtracts*, stats.oecd.org/wbos/default.aspx?DatasetCode=LFS_D (accessed 12 March 2008).
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48. As above, 6.3.
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52. As above, 6.10.
53. As above.
54. Michael J. Sandel, 'The Procedural Republic and the Unencumbered Self,' *Political Theory* 12:1 (1984), 81–96.
55. John Rawls, 'The Priority of Right and Ideas of the Good,' *Philosophy and Public Affairs* 17:4 (1988), 251–276.
56. Peter McDonald, 'Family Payments.'

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