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19 May 2022

Senate Education and Employment Committee

Potential impacts of the Commonwealth Paid Parental Leave Scheme on small businesses and their employees

Submission from Impact Economics and Policy

Impact Economics and Policy welcomes the opportunity to contribute to the Senate Education and Employment Committee Inquiry into the potential impacts of the Commonwealth Paid Parental Leave Scheme on small business and their employees.

Earlier this year we published research (extracts attached) that highlighted the pivotal role the introduction of paid parental leave has played in increasing labour force participation of women with children aged 0-4. We have estimated that this policy increased the number of women in employment by 74,500 women in 2021-22, adding \$8.5 billion to GDP.

Australia designed its paid parental scheme very carefully by ensuring it maintained the relationship between employers and workers on maternity leave. This has had the impact of significantly improving retention and lifting female participation.

Any move to exempt small businesses from the current arrangements would weaken the relationship between employers and workers on leave, and undermine the success of paid maternity leave in lifting female participation. This would adversely impact our economy, small businesses and women.

Thank you for considering our research in your deliberations

Regards

Dr Angela Jackson
Lead Economist, Impact Economics and Policy

ATTACHMENT –EXTRACTS FROM IMPACT ECONOMICS AND POLICY (2023), CHILD CARE SUBSIDY ACTIVITY TEST: INCENTIVE OR BARRIER TO LABOUR FORCE PARTICIPATION?

FEMALE PARTICIPATION IN PAID WORK

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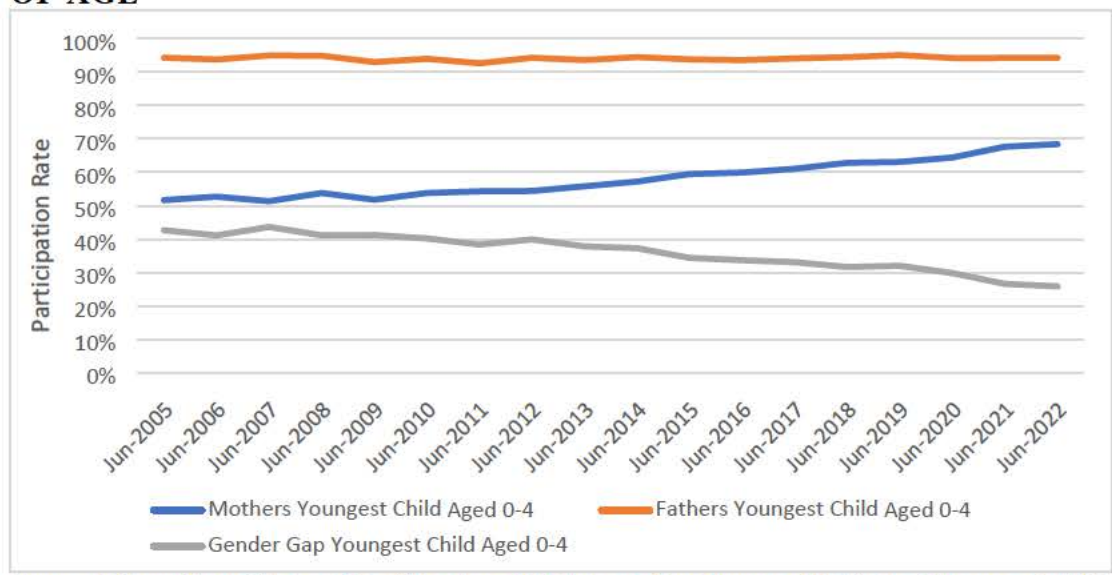


Women in Australia have similar levels of labour force participation to men, until they have children when they fall behind and never catch up.¹ The differences are most pronounced in families with children under the age of 5.

These differences are driven by the uneven distribution of unpaid caring responsibilities, that represents a major barrier to female participation in paid work. The extent to which child care is available and affordable has consistently been found to lift rates of female participation.² This is because it can increase the returns to work and is also a pre-requisite to find and undertake work.

The gap between males and females has been closing. Since the introduction of government paid maternity leave in 2011 there has been a significant increase in participation by females in families with children under 5, up from 54.3 per cent in 2011 to 68.4 per cent in 2022. There has been no corresponding decline in the participation of men with children under 5.

FIGURE 1 MALES AND FEMALES IN FAMILIES WITH CHILDREN UNDER 5 YEARS OF AGE



Source: [Labour Force Status of Families, June 2022 | Australian Bureau of Statistics \(abs.gov.au\)](#) Table 9, and author calculations

However, despite these gains Australia’s rates of maternal labour force participation remain low in comparison to other OECD countries, with Australian women having the third lowest rates of participation in full-time work across the OECD.³

If labour force participation rates for females in families with children under 5 were to increase to match male participation rates, there would be an additional 301,000 females in families with children under 5 years old in the labour force.⁴

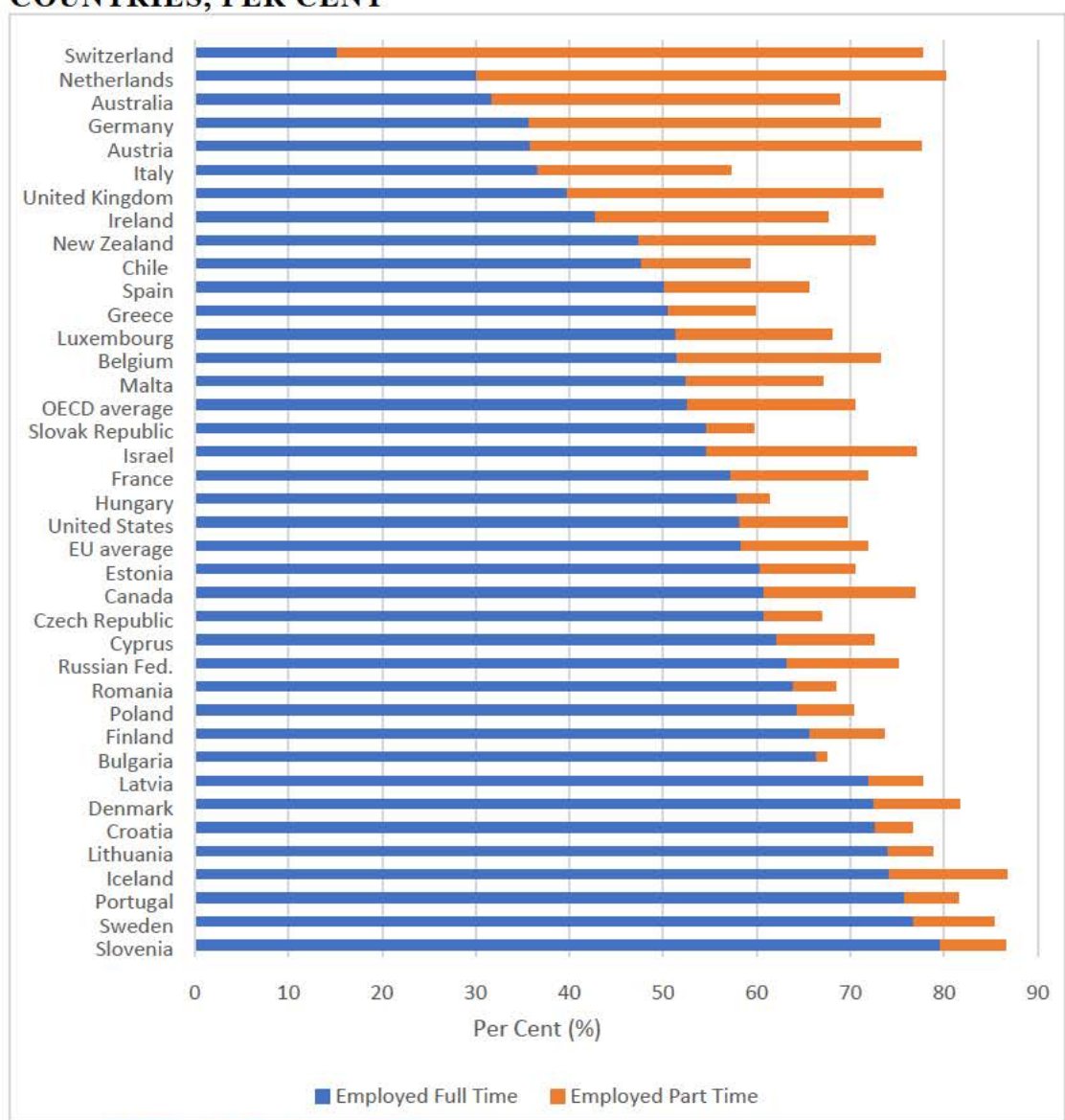
¹ The Australian Government The Treasury (2022), Treasury Round Up – Productivity Edition, Children and Gender Gap Earnings: <https://treasury.gov.au/sites/default/files/2022-11/p2022-325290-children.pdf>

² OECD (2020), Is Child care Affordable? Policy Brief on Employment, Labour and Social Affairs: <https://www.oecd.org/els/family/OECD-Is-Child-care-Affordable.pdf>

³ [OECD Family Database - OECD LMF 1.2](#)

⁴ [Labour Force Status of Families, June 2022 | Australian Bureau of Statistics \(abs.gov.au\)](#) Table 9 and author calculations

FIGURE 2 MATERNAL EMPLOYMENT RATES, FULL AND PART TIME, OECD COUNTRIES, PER CENT



Source: [OECD Family Database - OECD LMF 1.2](#)

While individual preferences and differences across countries in gender norms may explain some of these differences, there are also important differences in policy settings that are driving Australia’s poor performance.⁵

Policy Differences

⁵ Equity Economics (2021), Back of the Pack – How Australia’s Parenting Policies are Failing Women and Our Economy, December 2021

Compared to countries that perform at the top of the OECD in terms of female participation, Australia has less generous maternity and paternity leave and a higher cost of child care. The imposition of an Activity Test to access subsidised early childhood education and care does not occur feature in countries with high levels of maternal labour force participation.

TABLE 1: POLICIES COMPARED

	<i>Parental Leave</i>	<i>Use it Lose it provisions for fathers</i>	<i>Average Child Care Costs</i>	<i>Activity Requirement for Access to Child Care Subsidies</i>	<i>Per cent of women employed full time (%)</i>
<i>Australia</i>	<i>22 weeks</i>	<i>NA*</i>	<i>24 per cent of earnings</i>	<i>Yes</i>	<i>31.8</i>
<i>Canada</i>	<i>50 weeks</i>	<i>Yes</i>	<i>16 per cent of earnings</i>	<i>No</i>	<i>60.7</i>
<i>Sweden</i>	<i>68 weeks</i>	<i>Yes</i>	<i>5 per cent of earnings</i>	<i>No</i>	<i>76.7</i>

**Australians Government has indicated intention to introduce use it or lose it provisions but no such provisions have been announced.*

In order for Australia to close the gap with its international peers, and benefit from the full potential of women in the workforce it will need to take further action on each of these policy areas.

BARRIERS TO FEMALE PARTICIPATION IN PAID WORK

A number of known barriers exist to female participation in paid work, including:

- Discrimination and harassment⁶
- Low rates of pay in female dominated industries⁷
- Gender norms that women should undertake the primary carer role in the family⁸
- Lack of access to high quality and affordable child care⁹

Discrimination and harassment can influence the decision of women to work by reducing job satisfaction, placing limits on career opportunities, causing mental health issues and lowering self-esteem.

⁶ Gonzales, C et al (2015), IMF Staff Discussion Note: Fair Play – More Equal Laws Boost Female Labour Force Participation, February 2015: <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1502.pdf>

⁷ Cassells, R., Vidyattama, Y., Miranti, R., & McNamara, J. (2010). The impact of a sustained gender wage gap on the Australian economy.

⁸ Deloitte (2022), Breaking the Norm – Unlocking Australia’s Economic Potential: [file:///Users/angelahinckson/Downloads/deloitte-au-economics-breaking-norm-unleashing-australia-economic-potential-031122%20\(2\).pdf](file:///Users/angelahinckson/Downloads/deloitte-au-economics-breaking-norm-unleashing-australia-economic-potential-031122%20(2).pdf)

⁹ Gong, X, Breunig, B and King, A 2010, ‘How responsive is female labour supply to child care costs? — New Australian estimates’, *Treasury Working Papers*, 2010-03, Australian Treasury.



As noted above the decision to work and how much to work is heavily influenced by potential wage rates, and the enduring gender pay gap means women have lower returns to work than men.

Gender norms entrench the role of women as primary care givers, creating a barrier to participation.¹⁰ Caring for young children is labour intensive, and does not leave time for undertaking job search activities.

When respondents that would like to enter the labour force or work more hours are asked about the barriers that are stopping them starting in the next four weeks, 12.6 per cent (85,900) women and only 1.1 per cent (5,000) men cite caring for children as the reason.¹¹

Policies Levers to Increase Female Participation

International and Australian evidence highlights a number of policies that have been found to impact maternal participation in the labour force, including:

- Paid maternity leave which maintains the connection between women and their employer and results in women being more likely to return to work after having children¹²;
- Paid paternity leave which encourages more equal sharing of caring responsibilities between parents and increases maternal labour force participation and hours worked¹³;
- The availability and cost of child care, with an expansion in access to low-cost child care associated with increases in female participation.¹⁴; and
- Reducing effective marginal tax rates of the second earner in households.

Understanding why these policies have an impact requires first understanding how economists model participation in paid work, particularly of women with children. In the next section we explain the theory behind female labour supply, and provide an empirical example of the benefits possible from these policies using the introduction of paid maternity leave in Australia as a case study.

¹⁰ Deloitte (2022), Breaking the Norm – Unlocking Australia’s Economic Potential: [file:///Users/angelahinckson/Downloads/deloitte-au-economics-breaking-norm-unleashing-australia-economic-potential-031122%20\(2\).pdf](file:///Users/angelahinckson/Downloads/deloitte-au-economics-breaking-norm-unleashing-australia-economic-potential-031122%20(2).pdf)

¹¹ [Barriers and Incentives to Labour Force Participation, Australia, 2020-21 financial year | Australian Bureau of Statistics \(abs.gov.au\)](#) Table 5

¹² Valentova, M. (2019). The impact of parental leave policy on the intensity of labour-market participation of mothers: Do the number of children and pre-birth work engagement matter? *Journal of European Social Policy*, 29(3), 428–445. <https://doi.org/10.1177/0958928718776826>

¹³ Patnaik (2014). Reserving Time for Daddy: The Short and Long Run Consequences of Fathers’ Quotas. https://cepr.org/sites/default/files/events/papers/4576_PATNAIK%20-%20Reserving%20Time%20for%20Daddy.pdf

¹⁴ Vuri, D. 2016, ‘Do child care policies increase maternal employment?’, *IZA World of Labour*, vol. 241.

HOW DO ECONOMISTS MODEL DECISIONS TO WORK?

Economists model the decision of individuals to work using different theoretical and empirical approaches. There are generally considered two important steps in an individual's decision to work¹⁵:

- Step One** – the decision to participate in paid work
- Step Two** – the decision on how many hours to work in paid work

Both steps are influenced by education levels, wage rates, tax rates, individual preferences, and the presence of children and other dependents in the household. In addition, the first step – the decision to work – is also influenced by search costs.

Search costs involve the costs of finding and accepting a good job match, and include the time to find work, the foregone income while searching for a good job match, the costs of travelling to find work, and for women with young children the costs of childcare. The higher the search costs, the less likely individuals are to participate in job searching or persist in looking for an optimal job match.¹⁶ This can impact both the probability of working and the returns from working.

Economists have explored the relationships between various factors and labour force participation overtime, and while the size of impacts often vary depending on the countries studied and data used, the general directions are well established.

TABLE 2: DRIVERS OF THE DECISION TO WORK AND HOW MUCH TO WORK

	Decision to participate	Decision on how many hours
Education ¹⁷	Higher levels of education associated with being more likely to participate	Higher levels of education associated with working more hours
Taxation ¹⁸	Higher taxation rates associated with lower probability of participation	Higher levels of taxation reduce benefits of working and hours worked

¹⁵ Heckman, J. (1983). *A life-cycle model of family labour supply* (pp. 213-230). Palgrave Macmillan UK.

¹⁶ Turon, Helene, *The Labour Supply of Mothers*. IZA Discussion Paper No. 15312. Available at SSRN: <https://ssrn.com/abstract=4118213> or <http://dx.doi.org/10.2139/ssrn.4118213>

¹⁷ Kennedy, S., Stoney, N., & Vance, L. (2009). Labour force participation and the influence of educational attainment. *Economic Round-up*, (3), 19-36.

¹⁸ Blundell, Richard, Andreas Peichl, and Klaus F. Zimmermann (eds), *LABOR SUPPLY AND TAXATION* (Oxford, 2016; online edn, Oxford Academic, 23 June 2016), <https://doi.org/10.1093/acprof:oso/9780198749806.001.0001>, accessed 23 Feb. 2023.



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Wage ¹⁹	Higher potential wage associated with being more likely to participate	Higher wage associated with working more hours
Children ²⁰	No impact for men, but presence of children in household reduces likelihood of participation for women	No impact for men, but presence of children in household decreases hours worked for women
Child care costs ²¹	No impact for men, but higher child care costs associated with lower probability of participation for women	No impact for men, but higher child care costs decreases hours worked for women
Search costs ²²	Higher search costs reduce participation	Search costs do not impact hours worked

Any policies that impact the returns from work, the probability of those returns and the cost of searching for work, will impact decisions around labour force participation.

Decisions around child care use and work are complicated as they tend to occur simultaneously, and policy approaches need to factor in the impact on both search costs and the returns to work.

Do Mothers Caring for Children Face Lower Returns from Work?

Women returning to work face lower returns due to associated child care costs.²³ These costs reduce the probability of women working and the number of hours they choose to work.

Close to half of women caring for children aged 0 to 12 years old who were part-time workers (1.1 million), unemployed (157,000) and not in the labour force (817,000) report that access to child care and financial assistance for child care were ‘very important’ as incentives to participate in the labour force.²⁴ Policies that reduce the cost of child care and increase the availability have been found to significantly increase labour force participation.²⁵

A number of Australian studies have quantified the impact, with a range of estimates on the impact of child care costs on both the decision to work and the number of hours worked. These studies tell us how much a one per cent increase in child care costs will impact the probability of labour force participation and the number of hours worked.

TABLE 3 ESTIMATES OF IMPACT OF HIGHER CHILD CARE COSTS ON DECISIONS TO WORK

	Decision to Work	Decision on How Many Hours
NSW Productivity	A one per cent increase in costs reduces	A one per cent increase in costs

¹⁹ Card, D., & Krueger, A. B. (1993). Minimum wages and employment: A case study of the fast food industry in New Jersey and Pennsylvania.

²⁰ Heckman, J. (1983). *A life-cycle model of family labour supply* (pp. 213-230). Palgrave Macmillan UK.

²¹ Powell, L. M. (1997). The impact of child care costs on the labour supply of married mothers: Evidence from Canada. *Canadian Journal of Economics*, 577-594.

²² Michelacci, C., & Pijoan-Mas, J. (2012). Intertemporal labour supply with search frictions. *The Review of Economic Studies*, 79(3), 899-931.

²³ Turon, Helene, The Labour Supply of Mothers. IZA Discussion Paper No. 15312, Available at SSRN: <https://ssrn.com/abstract=4118213> or <http://dx.doi.org/10.2139/ssrn.4118213>

²⁴ [Barriers and Incentives to Labour Force Participation, Australia, 2020-21 financial year | Australian Bureau of Statistics \(abs.gov.au\)](#) Table 14

²⁵ Turon, Helene, The Labour Supply of Mothers. IZA Discussion Paper No. 15312, Available at SSRN: <https://ssrn.com/abstract=4118213> or <http://dx.doi.org/10.2139/ssrn.4118213>



Commission (2020)	labour force participation by 0.07 percentage points	reduces hours worked by 0.04 per cent
Gong and Breunig (2012)	A one per cent increase in costs reduces labour force participation by 0.07 percentage points	A one per cent increase in costs reduces hours worked by 0.11 per cent

Do Mothers Caring for Children Face Higher Search Costs?

Caring for children can increase search costs in a number of ways:

- The opportunity cost of searching may be higher as it reduces time spent with children.
- Finding and securing suitable child care represents an additional search cost.
- Negotiating work arrangements with an employer that allows for the balancing of work and family adds to search costs.
- Negotiating caring responsibilities with a partner that has stayed fully engaged with work represents an additional search cost.
- The cost of child care is an additional search cost.
- Limited availability of child care may limit the days that a woman can work or commit to work, making a job match more difficult and increasing the costs of searching.
- Women show a preference for jobs with closer proximity to home and child care to facilitate caring activities.²⁶

Higher search costs will reduce labour force participation, and while a number of studies have shown strong behavioural responses to reducing search costs²⁷ there is limited empirical research using real world data that can isolate search costs from other impacts. However, the introduction of universal paid maternity leave in Australia provides an illustrative example of the potential benefits.

Paid Maternity Leave – A Case Study in Reducing Search Costs and Lifting Female Participation

The provision of paid maternity leave has been found to increase rates of labour force participation in a number of studies in Australia and overseas.²⁸ This result is somewhat counter intuitive – we would expect that increasing the benefits from not working, would reduce the probability of working. However, we observe the opposite.

Paid maternity leave has been found to increase participation largely because it maintains a woman’s relationship with her employer and attachment to the labour market.²⁹ This reduces search costs for women

²⁶ Le Barbanchon, T., Rathelot, R., & Roulet, A. (2021). Gender differences in job search: Trading off commute against wage. *The Quarterly Journal of Economics*, 136(1), 381-426.

²⁷ Beam, E. A. (2021). Search costs and the determinants of job search. *Labour Economics*, 69, 101968. And Girmu Abebe, A Stefano Caria, Marcel Fafchamps, Paolo Falco, Simon Franklin, Simon Quinn, Anonymity or Distance? Job Search and Labour Market Exclusion in a Growing African City, THE REVIEW OF ECONOMIC STUDIES, Volume 88, Issue 3, May 2021, Pages 1279–1310, <https://doi.org/10.1093/restud/rdaa057>

²⁸ Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304), 80-100.

²⁹ Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304), 80-100.

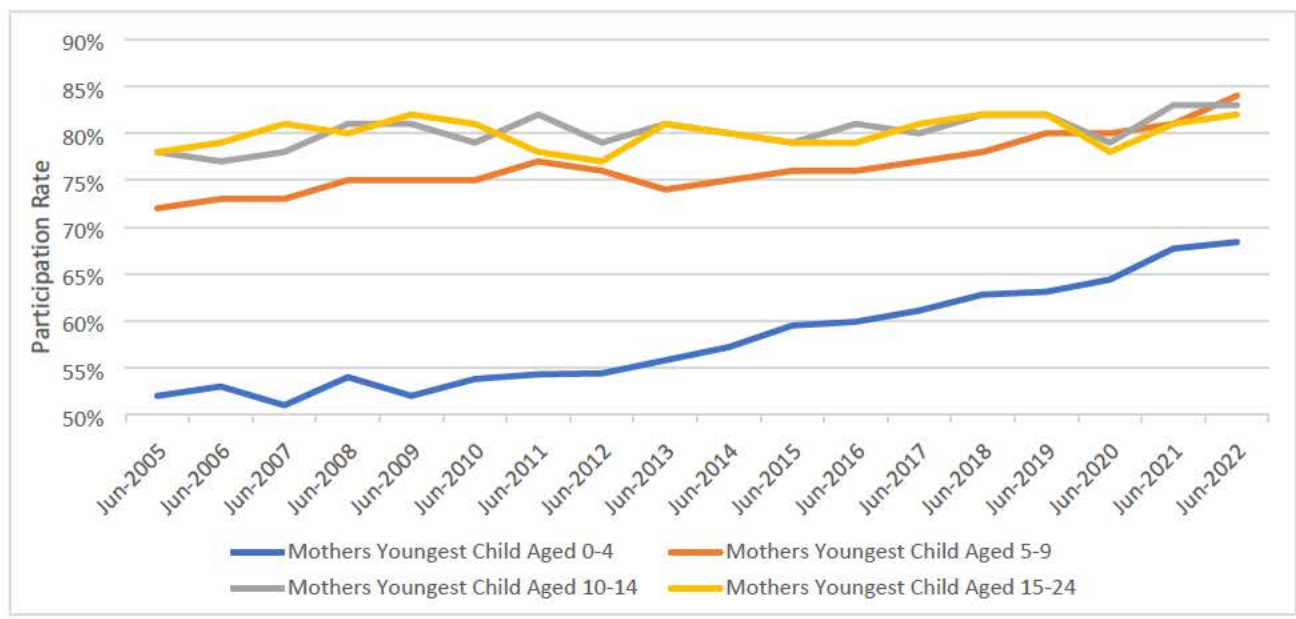


returning to work after having a child, and as a result increases participation in paid work. The design of the Australian scheme also encouraged women to stay engaged in work in order to qualify for the payment.³⁰

Australia introduced a paid parental scheme in 2011 which provided universal maternity leave, subject to a means test, and also underpinned a large increase in maternity leave provision by private sector companies. This expansion in paid maternity leave has been found to have lifted female labour force participation by studies using administrative data.³¹

Impact Economics and Policy analysis using difference-in-difference methodology (see Appendix) finds that the introduction of paid parental leave in Australia has led to a faster growth in participation amongst women with children aged under 5 compared to other cohorts.

FIGURE 34 GROWTH IN LABOUR FORCE PARTICIPATION OF MOTHER'S WITH CHILDREN AGED 0-4



Since 2011 the participation rate for mothers with children under 5 has increased by 14.1 per centage points, representing an additional 165,790 women in employment. Part of this increase reflects historical trends and can also be seen in mothers with older children. However, the rate of increase for mothers with a child aged 0-4 is higher than before the reform, and than mothers with older children during the post reform period.

Impact Economics and Policy modelling using difference-in-difference estimates finds that the introduction of paid maternity leave in 2011 has increased employment of mothers with children aged under 5 by 74,200. This represents a direct economic benefit of \$9.0 billion to GDP in 2022-23, an impressive gain for a policy

³⁰ Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304), 80-100.
³¹ Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304), 80-100.



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that costs the Australian Government \$2.7 billion a year³², excluding increased taxation revenue and reduced government payments.

While other policy changes over the period may have contributed to this increase, including the increase in child care subsidies for many families that occurred in 2018, an evaluation of the reforms found no impact on hours worked.³³ It is noteworthy that the 2018 reforms included a tightening of the Activity Test, and a large decrease in support for child care costs for women not actively engaged in the labour market. This change effectively increased the search costs for women that do not maintain a relationship with their employer, particularly women marginally attached to the labour force or in casual employment.

The impact of the introduction of paid maternity leave in Australia illustrates the importance of designing policies that reduce the higher search costs in the labour market for women with young children.

PAID MATERNITY LEAVE METHODOLOGY

In order to estimate the economic benefits of labour force participation rates were estimated for women with dependent children of various ages using data from the Australian Bureau of Statistics (ABS) Labour Force Status of Families June 2022 release.

The labour force participation rates were estimated for mothers (both in couples and single mothers), measured by the age of their youngest dependent child over the period June 2005 to June 2022 using the following age groups:

- 0 to 4 years old
- 5 to 9 years old
- 10 to 24 years old

Pre and post reform periods

In order to undertake difference in difference estimation we must define the relevant periods of pre and post reform.

Government provided PPL was introduced in January 2011, and the growth in participation is calculated for pre-reform period from June 2005 to June 2010, and the post reform period June 2011 to June 2019. The years 2020 to 2022 are excluded from the ‘after PPL’ time period so as not to bias the estimates with impacts caused by the COVID-19 pandemic.

Calculation of average growth rates

Appendix Table 1: Average annual change in labour force participation rates of mothers by age group of youngest dependent child

Before PPL 2006 to 2010	After PPL 2011 to 2019	Difference	Difference-in- difference
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³² Australian Government Department of Social Services (2022), Portfolio Budget Statements 2022-23, Budget Related Paper No. 1.14: https://www.dss.gov.au/sites/default/files/documents/10_2022/october_2022-23_social_services_portfolio.pdf

³³ AIFS (2022), Child Care Package Evaluation: Final report: <https://aifs.gov.au/research/research-reports/child-care-package-evaluation-final-report>

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0 to 4 years old	0.4%	1.0%	0.6%	
5 to 9 years old	0.5%	0.5%	0.1%	0.5%
10 to 24 years old	0.4%	0.2%	-0.1%	0.7%

Source: Impact Economics and Policy analysis of ABS 2022, Labour Force Status of Families

Treatment Group

The treatment group is the cohort with children aged 0 to 4 years old.

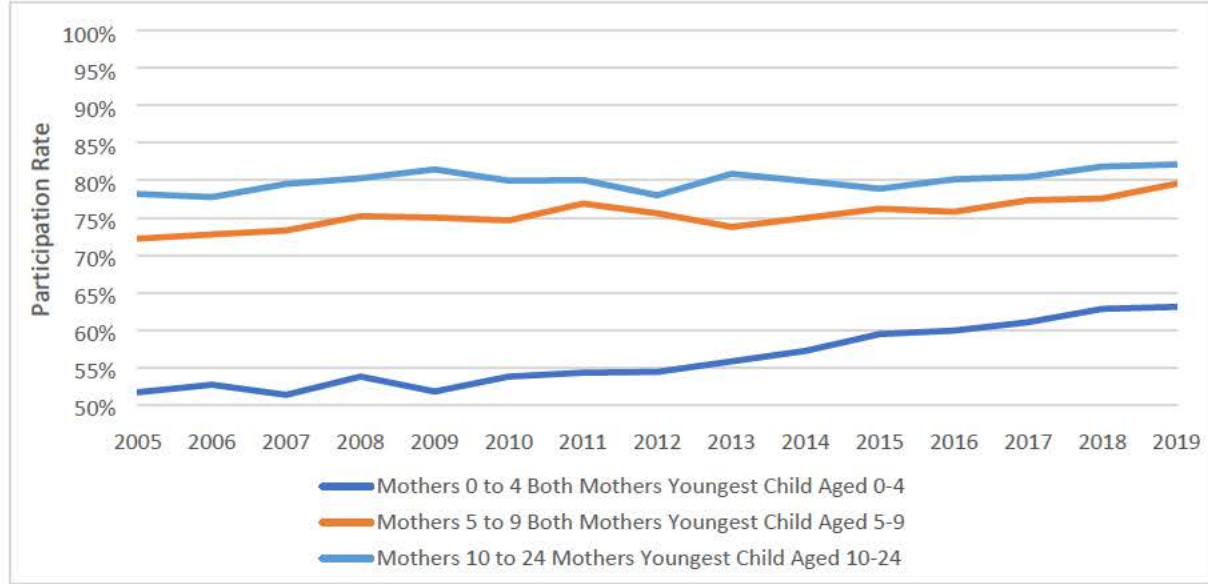
Control Group

There are two potential control groups:

- mothers with children aged 5 to 9 years old; and
- mother’s of children aged 10 to 24 years old.

Each of these control groups had similar trends to the treatment group prior to the reforms.

APPENDIX FIGURE 1: TREATMENT AND CONTROL GROUPS TRENDS IN PARTICIPATION RATES



Source: Impact Economics and Policy analysis of ABS 2022, Labour Force Status of Families

The cohort of mothers initially in the under 5 age group move into the 5-9 age group from 2016, making mothers with children aged 5-9 an inappropriate control – as women in this cohort after 2016 are also in the treatment group.

In selecting the cohort of mothers with children aged 10-24 as a control we note that other policy changes were occurring during this period, including changes to parenting payments which aimed to increase participation amongst mothers with children age 8 years and above. The extent to which this biased the results, it would result in an underestimate of the impact of the paid maternity leave reforms.

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Employment impacts

Based on the analysis described above, it is assumed that a 0.7 percentage point increase each year in the participation rate of mothers of 0 to 4 year olds, is attributable to the introduction of Paid Parental Leave (PPL) over the period 2011-2019. This is applied to the number of mothers of 0 to 4 year olds in Australia each year to estimate that by 2022-23, 76,187 mothers have joined the labour force who in the absence of PPL would have not.

Over the 2011-12 to 2022-23 period, the average employment rate of mothers of 0 to 4 year olds who are participating in the workforce has been 97.5%. Applying this rate to the estimate labour force increase, provides an estimate of 74,245 mothers of 0 to 4 year olds who are employed who would not have been without PPL.

Economic value

The next stage of the process estimates the direct economic value associated with each additional employed mother of a 0 to 4 year old. This was done by estimating the average annual value of Gross Domestic Product (GDP) generated per each employee in the labour force. This value was weighted to account for the industries in which women most commonly work. It was then weighted further by 66% to reflect that mothers of 0 to 4 year olds who are employed, tend to work 66% of the average hours worked by all employees.³⁴

This economic value produced per each additional employed mother of a 0 to 4 year old, was calculated for each year from 2011-12 to 2018-19.

These values were multiplied by the estimated number of additional employees to estimate the direct economic value generated from the uplift in employment of mothers of 0 to 4 year olds associated with the introduction of PPL. The GDP deflator was then applied to bring this value into 2022-23 \$ terms.

This method estimates that the 2011 introduction PPL generated \$9.0 billion of direct economic value in 2021-22 by enabling the employment of 74,000 mothers of 0 to 4 year olds.

³⁴ Impact Economics and Policy analysis of Household Income and Labour Dynamics (HILDA) survey data 2021.



CHILD CARE SUBSIDY ACTIVITY TEST: INCENTIVE OR BARRIER TO LABOUR FORCE PARTICIPATION?

IMPACT ECONOMICS AND POLICY

MARCH 2023

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About Impact Economics and Policy

Impact Economics and Policy brings together a group of expert economists and policy specialists with experience working for government, non-for-profits and big four consulting.

Established at the start of 2022, our mission is to partner with clients for impact through providing robust evidence, fresh analysis and strategic communication to tackle Australia's biggest public policy challenges.

This report was prepared with support of **Thrive by Five**, an initiative of the Minderoo Foundation.

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Acknowledgement of Country

We acknowledge Aboriginal and Torres Strait Islander peoples as the Traditional Owners of Country Throughout Australia and their continuing connection to both their lands and seas. We also pay our respects to Elders – past and present – and generations of Aboriginal and Torres Strait Islander peoples now and into the future.

We accept the invitation of the Uluru Statement of the Heart and support the campaign to for a First Nations Voice to Parliament to be protected by the Australian Constitution.

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INTRODUCTION

Women in families with children under the age of 5 have the lowest levels of labour force participation amongst people of prime working age. Many of these women would like to re-engage with work but cite caring for children as the main barrier to entering the job market.¹

The Activity Test limits access to subsidised early childhood education and care creating a chicken and egg dilemma for women looking to search for work. As a result, the Activity Test increases the costs to search for employment and creates an additional barrier for women looking to return to work or increase hours of work.

Under the Activity Test, access to subsidised early childhood education and care is linked to both parents' participation in labour market activities, which is contributing to 126,000 Australian children from low-income households missing out on early childhood education and care.² Early childhood education and care is known to be critically important for the development of these children, and their long term educational and labour market outcomes.³

The justification for this policy is that it enhances participation in paid work of parents, as it creates an additional incentive to wage income for them to engage in labour market activities – access to subsidised child care.

However, this justification is based on a number of questionable assumptions about decisions to use child care and decisions to participate in labour market activity. Previous analysis has also failed to account for the negative impact on labour supply from higher costs to search for employment.

Australia has recent experience of introducing a policy that reduced search costs for women returning to work after having a child, the universal paid maternity leave policy enacted in 2011. Paid maternity leave lowers search costs by strengthening the relationship between employers and new mothers and has been found to lift participation.⁴ New analysis for this report shows that as a result of the 2011 reforms:

- An additional 74,245 women with children aged under 5 are in employment, adding \$8.5 billion to GDP in 2021-22.⁵

The Activity Test is contributing to 126,000 Australian children from low-income households missing out on early childhood education and care.

1 Barriers and Incentives to Labour Force Participation, Australia, 2020-21 financial year | Australian Bureau of Statistics (abs.gov.au)

2 Impact Economics and Policy (2022), Activity Test for Child Care: Undermining Child Development and Parental Participation: https://static1.square-space.com/static/61e32e62c8c8337e6fd7a1e6/t/630de5c741a8de08ad48d593/1661855185396/Undermining+Child+Development+And+Parental+Participation+Report_FINAL.pdf

3 Vandell, D. L. et al & NICHD Early Child Care Research Network (2010). 'Do Effects of Early Child Care Extend to Age 15 Years? Results from the NICHD Study of Early Child Care and Youth Development' Child development, 81(3), 737-756

IMPACT ECONOMICS AND POLICY

In this report we explore the empirical and theoretical evidence on the decision to work of mothers of young children, and find that instead of acting as an incentive, the Activity Test is increasing the search costs for mothers of young children, and is a barrier to employment.

Impact Economics and Policy analysis shows that:

- 264,000 women in households with children under 5 are not participating in the workforce and cite child care as a barrier.⁶
- Reducing search costs for women with young children through abolishing the Activity Test could increase participation of mothers with children under 5 years of age by 39,620 and increase GDP by up to

\$4.5 billion per year.⁷

The impacts are modelled separately for low, middle and high income earners. The majority of the participation increases would be amongst women in households with incomes below \$72,000, with participation amongst this group estimated to increase by 20,790. Over 50 per cent of these gains would be amongst single mothers.

The direct costs to Government of abolishing the Activity Test are estimated at \$1,306 million in 2023-24. This is well below the gains to GDP, and would be offset by higher taxation receipts and lower government payments.

IMPACT ON UNDERLYING CASH BALANCE (\$M):

2023-24	2024-25	2025-26	2026-27
1306	1345	1379	1414

Source: Impact Economics and Policy estimates based on Centre for Policy Development (2021), *Starting Better: A Guarantee for Young Children and Families*.

The Activity Test limits access to early childhood education and care to those that have the most to gain, children from low-income families, and is acting as a significant barrier to workforce participation of mothers. Abolishing the Activity Test and providing up to three days universal access to early childhood education and care would benefit children, their parents and the economy.

⁴ Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304),80-100.

⁵ See Appendix for detailed modelling and assumptions

⁶ Estimated from Labour Force Status of Families, June 2022 | Australian Bureau of Statistics (abs.gov.au), Barriers and Incentives to Labour Force Participation, Australia, 2020-21 financial year | Australian Bureau of Statistics (abs.gov.au)

⁷ See Appendix for detailed modelling and assumptions



264,000
WOMEN WITH CHILDREN
under 5 not working
give child care
as a barrier to
participation



\$8.5 BILLION
LIFT IN GDP
due to increase
in participation
of mothers since
introduction of paid
parental leave
in 2011



\$4.5 BILLION
POTENTIAL LIFT
in GDP from
abolishing the
Activity Test and
reducing search
costs acting
as a barrier to
participation

IMPACT ECONOMICS AND POLICY

FEMALE PARTICIPATION IN PAID WORK

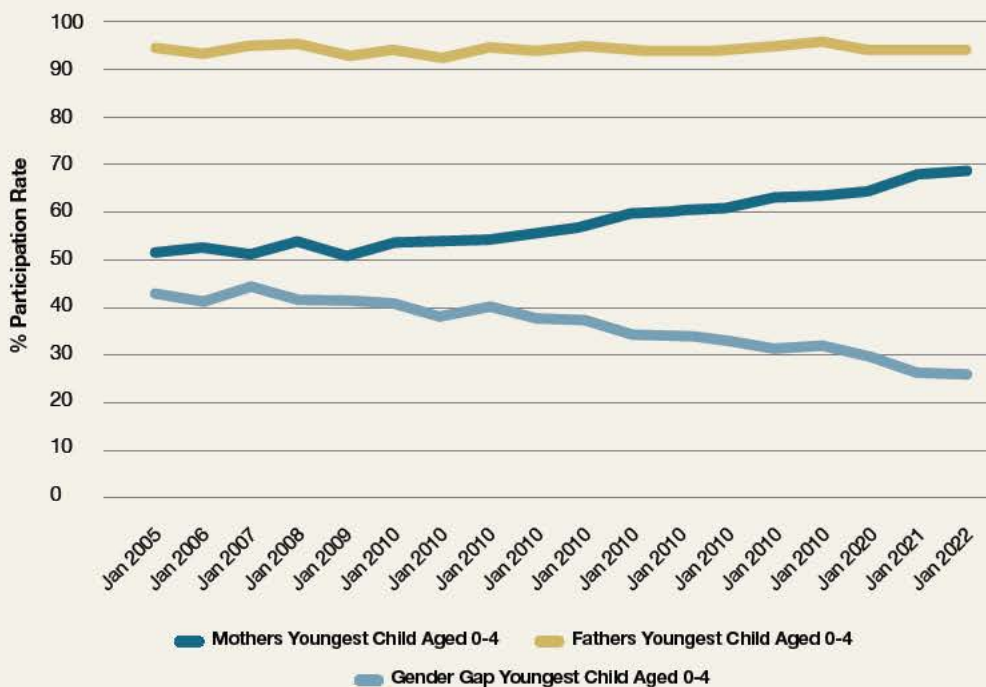
Women in Australia have similar levels of labour force participation to men, until they have children when they fall behind and never catch up.⁸ The differences are most pronounced in families with children under the age of 5.

These differences are driven by the uneven distribution of unpaid caring responsibilities, that represents a major barrier to female participation in paid work. The extent to which child care is available and affordable has consistently been found to lift rates of female participation.⁹ This is because it can increase the returns to work and is also a pre-requisite to find and undertake work.

The gap between males and females has been closing. Since the introduction of government paid maternity leave in 2011 there has been a significant increase in participation by females in families with children under 5, up from 54.3 per cent in 2011 to 68.4 per cent in 2022. There has been no corresponding decline in the participation of men with children under 5.

The extent to which child care is available and affordable has consistently been found to lift rates of female participation.

FIGURE 1 MALES AND FEMALES IN FAMILIES WITH CHILDREN UNDER 5 YEARS OF AGE



Source: Labour Force Status of Families, June 2022 | Australian Bureau of Statistics (abs.gov.au) Table 9, and author calculations

8 The Australian Government The Treasury (2022), Treasury Round Up – Productivity Edition, Children and Gender Gap Earnings: <https://treasury.gov.au/sites/default/files/2022-11/p2022-325290-children.pdf>

9 OECD (2020), Is Child care Affordable? Policy Brief on Employment, Labour and Social Affairs: <https://www.oecd.org/els/family/OECD-Is-Child-care-Affordable.pdf>

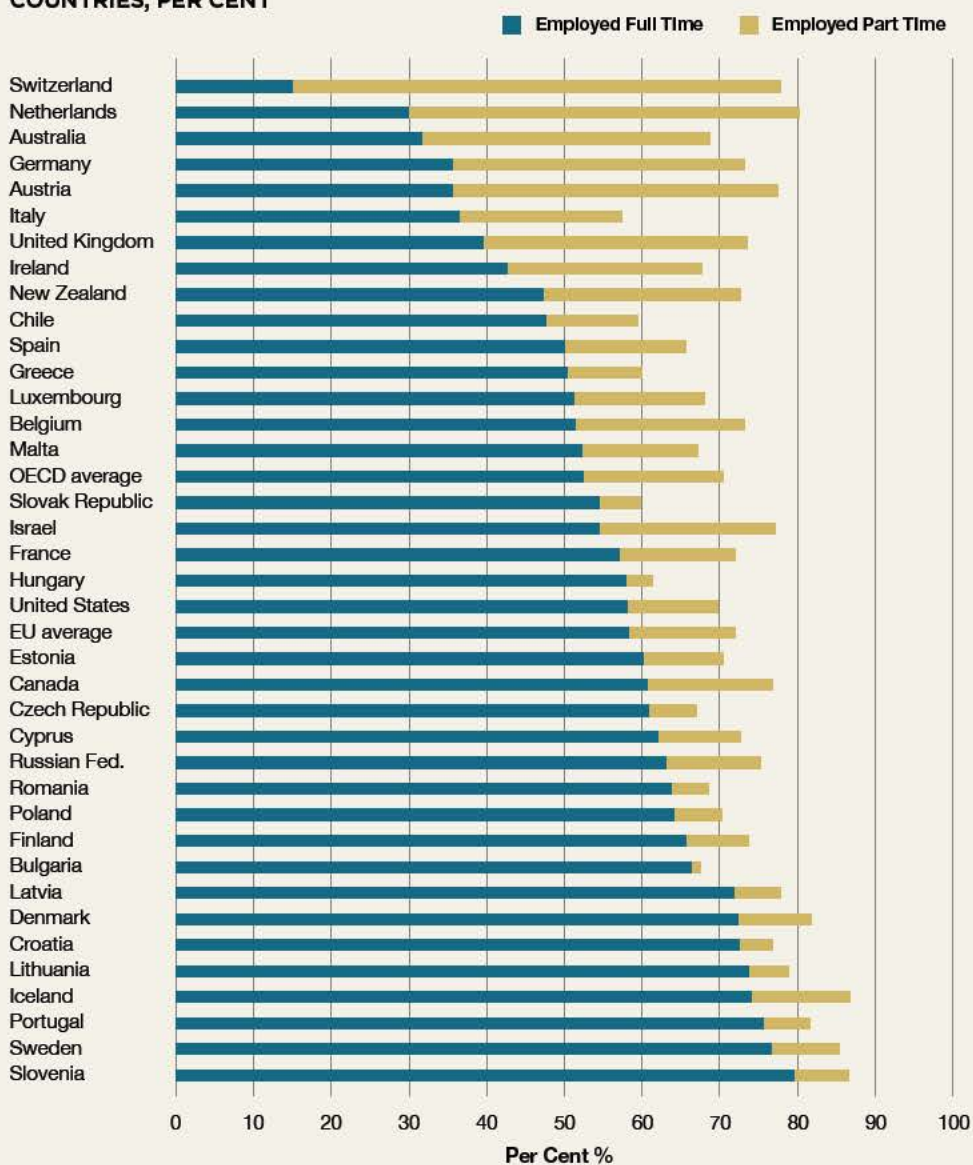
IMPACT ECONOMICS AND POLICY

However, despite these gains Australia's rates of maternal labour force participation remain low in comparison to other OECD countries, with Australian women having the third lowest rates of participation in full-time work across the OECD.¹⁰

If labour force participation rates for females in families with children under 5 were to increase to match male participation rates, there would be an additional 301,000 females in families with children under 5 years old in the labour force.¹¹

If labour force participation rates for females in families with children under 5 were to increase to match male participation rates, there would be an additional 301,000 females in families with children under 5 years old in the labour force.

FIGURE 2 MATERNAL EMPLOYMENT RATES, FULL AND PART TIME, OECD COUNTRIES, PER CENT



Source: OECD Family Database - OECD LMF 1.2

While individual preferences and differences across countries in gender norms may explain some of these differences, there are also important differences in policy settings that are driving Australia's poor performance.¹²

10 OECD Family Database - OECD LMF 1.2

11 Labour Force Status of Families, June 2022 | Australian Bureau of Statistics (abs.gov.au) Table 9 and author calculations

12 Equity Economics (2021), Back of the Pack - How Australia's Parenting Policies are Failing Women and Our Economy, December 2021

IMPACT ECONOMICS AND POLICY

POLICY DIFFERENCES

Compared to countries that perform at the top of the OECD in terms of female participation, Australia has less generous maternity and paternity leave and a higher cost of child care. The imposition of an Activity Test to access subsidised early childhood education and care does not occur feature in countries with high levels of maternal labour force participation.

TABLE 1: POLICIES COMPARED

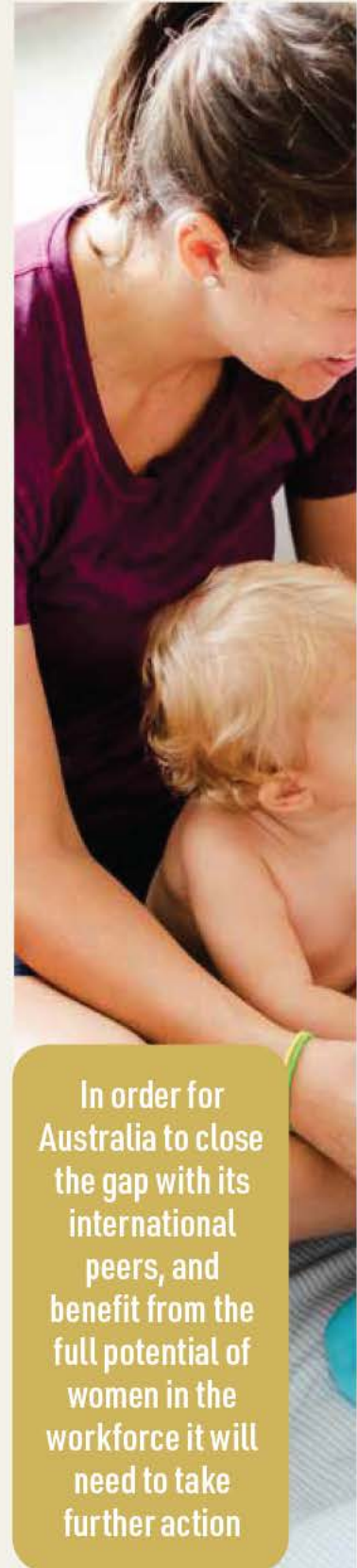
	Parental leave	Use it lose it provisions for fathers	Average child care costs	Activity required for access to child care subsidies	Per cent of women employed full time (%)
Australia	22 weeks	NA*	24 per cent of earnings	Yes	31.8
Canada	50 weeks	Yes	16 per cent of earnings	No	60.7
Sweden	68 weeks	Yes	5 per cent of earnings	No	76.7

*Australians Government has indicated intention to introduce use it or lose it provisions but no such provisions have been announced.

In order for Australia to close the gap with its international peers, and benefit from the full potential of women in the workforce it will need to take further action on each of these policy areas.

The imposition of an Activity Test to access subsidised early childhood education and care does not occur feature in countries with high levels of maternal labour force participation.

In order for Australia to close the gap with its international peers, and benefit from the full potential of women in the workforce it will need to take further action



IMPACT ECONOMICS AND POLICY



IMPACT ECONOMICS AND POLICY

BARRIERS TO FEMALE PARTICIPATION IN PAID WORK

A number of known barriers exist to female participation in paid work, including:

- Discrimination and harassment¹³
- Low rates of pay in female dominated industries¹⁴
- Gender norms that women should undertake the primary carer role in the family¹⁵
- Lack of access to high quality and affordable child care¹⁶

Discrimination and harassment can influence the decision of women to work by reducing job satisfaction, placing limits on career opportunities, causing mental health issues and lowering self-esteem.

As noted above the decision to work and how much to work is heavily influenced by potential wage rates, and the enduring gender pay gap means women have lower returns to work than men.

Gender norms entrench the role of women as primary care givers, creating a barrier to participation.¹⁷ Caring for young children is labour intensive, and does not leave time for undertaking job search activities.

When respondents that would like to enter the labour force or work more hours are asked about the barriers that are stopping them starting in the next four weeks, 85,900 women and only 5,000 men cite caring for children as the reason.¹⁸

Looking at the previous 12 months and 264,000 women with children under 5 cite child care as a reason for not participating in paid work, compared to 19,800 men.

When respondents that would like to enter the labour force or work more hours are asked about the barriers that are stopping them starting in the next four weeks, 12.6 per cent (85,900) women and only 1.1 per cent (5,000) men cite caring for children as the reason.

13 Gonzales, C et al (2015), IMF Staff Discussion Note: Fair Play - More Equal Laws Boost Female Labour Force Participation, February 2015: <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1502.pdf>

14 Cassells, R., Vidyattama, Y., Miranti, R., & McNamara, J. (2010). The impact of a sustained gender wage gap on the Australian economy.

15 Deloitte (2022), Breaking the Norm - Unlocking Australia's Economic Potential: [file:///Users/angelahinckson/Downloads/deloitte-au-economics-breaking-norm-unleashing-australiaeconomic-potential-031122%20\(2\).pdf](file:///Users/angelahinckson/Downloads/deloitte-au-economics-breaking-norm-unleashing-australiaeconomic-potential-031122%20(2).pdf)

16 Gong, X, Breunig, B and King, A 2010, 'How responsive is female labour supply to child care costs? - New Australian estimates', Treasury Working Papers, 2010-03, Australian Treasury.

17 Deloitte (2022), Breaking the Norm - Unlocking Australia's Economic Potential: [file:///Users/angelahinckson/Downloads/deloitte-au-economics-breaking-norm-unleashing-australiaeconomic-potential-031122%20\(2\).pdf](file:///Users/angelahinckson/Downloads/deloitte-au-economics-breaking-norm-unleashing-australiaeconomic-potential-031122%20(2).pdf)

18 Barriers and Incentives to Labour Force Participation, Australia, 2020-21 financial year | Australian Bureau of Statistics (abs.gov.au) Table 5



POLICIES LEVERS TO INCREASE FEMALE PARTICIPATION

International and Australian evidence highlights a number of policies that have been found to impact maternal participation in the labour force, including:

- Paid maternity leave which maintains the connection between women and their employer and results in women being more likely to return to work after having children;¹⁹
- Paid paternity leave which encourages more equal sharing of caring responsibilities between parents and increases maternal labour force participation and hours worked;²⁰

- The availability and cost of child care, with an expansion in access to low-cost child care associated with increases in female participation;²¹ and
- Reducing effective marginal tax rates of the second earner in households.

Understanding why these policies have an impact requires first understanding how economists model participation in paid work, particularly of women with children. In the next section we explain the theory behind female labour supply, and provide an empirical example of the benefits possible from these policies using the introduction of paid maternity leave in Australia as a case study.

19 Valentova, M. (2019). The impact of parental leave policy on the intensity of labour-market participation of mothers: Do the number of children and pre-birth work engagement matter? *Journal of European Social Policy*, 29(3), 428–445. <https://doi.org/10.1177/0958928718776826>

20 Patnaik (2014). Reserving Time for Daddy: The Short and Long Run Consequences of Fathers' Quotas. https://cepr.org/sites/default/files/events/papers/4576_PATNAIK%20-%20Reserving%20Time%20for%20Daddy.pdf

21 Yuri, D. 2016, 'Do child care policies increase maternal employment?', IZA World of Labour, vol. 241.

IMPACT ECONOMICS AND POLICY

HOW DO ECONOMISTS MODEL DECISIONS TO WORK?

Economists model the decision of individuals to work using different theoretical and empirical approaches. There are generally considered two important steps in an individual’s decision to work:²²

- **Step One** – the decision to participate in paid work
- **Step Two** – the decision on how many hours to work

Both steps are influenced by education levels, wage rates, tax rates, individual preferences, and the presence of children and other dependents in the household. In addition, the first step – the decision to work – is also influenced by search costs.

Search costs involve the costs of finding and accepting a good job match, and include the time to find work, the foregone income while searching for a good job match, the costs of travelling to find work, and for women with young children the costs of childcare. The higher the search

costs, the less likely individuals are to participate in job searching or persist in looking for an optimal job match.²³ This can impact both the probability of working and the returns from working.

Economists have explored the relationships between various factors and labour force participation overtime, and while the size of impacts often vary depending on the countries studied and data used, the general directions of impacts are well established.

The higher the search costs, the less likely individuals are to participate in job searching or persist in looking for an optimal job match.

TABLE 2: DRIVERS OF THE DECISION TO WORK AND HOW MUCH TO WORK

	Decision to participate	Decision on how many hours
Education²⁴	Higher levels of education associated with being more likely to participate	Higher levels of education associated with working more hours
Taxation²⁵	Higher taxation rates associated with lower probability of participation	Higher levels of taxation reduce benefits of working and hours worked
Wage²⁶	Higher potential wage associated with being more likely to participate	Higher wage associated with working more hours
Children²⁷	No impact for men, but presence of children in household reduces likelihood of participation for women	No impact for men, but higher child care costs decreases hours worked for women
Child care costs²⁸	No impact for men, but higher child care costs associated with lower probability of participation for women	No impact for men, but higher child care costs decreases hours worked for women
Search costs²⁹	Higher search costs reduce participation	Search costs do not impact hours worked

- 22 Heckman, J. (1983). A life-cycle model of family labour supply (pp. 213-230). Palgrave Macmillan UK.
- 23 Turon, Helene, The Labour Supply of Mothers. IZA Discussion Paper No. 15312, Available at SSRN: <https://ssrn.com/abstract=4118213> or <http://dx.doi.org/10.2139/ssrn.4118213>
- 24 Kennedy, S., Stoney, N., & Vance, L. (2009). Labour force participation and the influence of educational attainment. *Economic Round-up*, (3), 19-36.
- 25 Blundell, Richard, Andreas Peichl, and Klaus F. Zimmermann (eds), *LABOUR SUPPLY AND TAXATION* (Oxford, 2016; online edn, Oxford Academic, 23 June 2016), <https://doi.org/10.1093/acprof:oso/9780198749806.001.0001>, accessed 23 Feb. 2023.
- 26 Card, D., & Krueger, A. B. (1993). Minimum wages and employment: A case study of the fast food industry in New Jersey and Pennsylvania.
- 27 Heckman, J. (1983). A life-cycle model of family labour supply (pp. 213-230). Palgrave Macmillan UK.
- 28 Powell, L. M. (1997). The impact of child care costs on the labour supply of married mothers: Evidence from Canada. *Canadian Journal of Economics*, 577-594.
- 29 Michelacci, C., & Pijoan-Mas, J. (2012). Intertemporal labour supply with search frictions. *The Review of Economic Studies*, 79(3), 899-931.



Any policies that impact the returns from work, the probability of those returns and the cost of searching for work, will impact decisions around labour force participation.

Decisions around child care use and work are complicated as they tend to occur simultaneously, and policy approaches need to factor in the impact on both search costs and the returns to work.

Do Mothers Caring for Children Face Lower Returns from Work?

Women returning to work face lower returns due to associated child care costs.³⁰ These costs reduce the probability of women working and the number of hours they choose to work.

Close to half of women caring for children aged 0 to 12 years old who were part-time workers (1.1 million), unemployed (157,000) and not in the labour force (817,000) report that access to child care and financial assistance for child care were ‘very important’ as incentives to participate in the labour force.³¹ Policies that reduce the cost of child care and increase the availability have been found to significantly increase labour force participation.³²

A number of Australian studies have quantified the impact, with a range of estimates on the impact of child care costs on both the decision to work and the number of hours worked. These studies tell us how much a one per cent increase in child care costs will impact the probability of labour force participation and the number of hours worked.

TABLE 3: ESTIMATES OF IMPACT OF HIGHER CHILD CARE COSTS ON DECISIONS TO WORK

	Decision to work	Decision on how many hours
NSW Productivity Commission (2020)	A one per cent increase in costs reduces labour force participation by 0.07 percentage points	A one per cent increase in costs reduces hours worked by 0.04 per cent
Gong and Breunig (2012)	A one per cent increase in costs reduces labour force participation by 0.07 percentage points	A one per cent increase in costs reduces hours worked by 0.11 per cent

Decisions around child care use and work are complicated as they tend to occur simultaneously, and policy approaches need to factor in the impact on both search costs and the returns to work.

Policies that reduce the cost of child care and increase the availability have been found to significantly increase labour force participation.

30 Turon, Helene, The Labour Supply of Mothers. IZA Discussion Paper No. 15312, Available at SSRN: <https://ssrn.com/abstract=4118213> or <http://dx.doi.org/10.2139/ssrn.4118213>
 31 Barriers and Incentives to Labour Force Participation, Australia, 2020-21 financial year | Australian Bureau of Statistics (abs.gov.au) Table 14
 32 Turon, Helene, The Labour Supply of Mothers. IZA Discussion Paper No. 15312, Available at SSRN: <https://ssrn.com/abstract=4118213> or <http://dx.doi.org/10.2139/ssrn.4118213>

IMPACT ECONOMICS AND POLICY



Do Mothers Caring for Children Face Higher Search Costs?

Caring for children can increase search costs in a number of ways:

- The opportunity cost of searching may be higher as it reduces time spent with children.
- Finding and securing suitable child care represents an additional search cost.
- Negotiating work arrangements with an employer that allows for the balancing of work and family adds to search costs.
- Negotiating caring responsibilities with a partner that has stayed fully engaged with work represents an additional search cost.
- The cost of child care is an additional search cost.

- Limited availability of child care may limit the days that a woman can work or commit to work, making a job match more difficult and increasing the costs of searching.
- Women show a preference for jobs with closer proximity to home and child care to facilitate caring activities.³³

Higher search costs will reduce labour force participation, and while a number of studies have shown strong behavioural responses to reducing search costs³⁴ there is limited empirical research using real world data that can isolate search costs from other impacts. However, the introduction of universal paid maternity leave in Australia provides an illustrative example of the potential benefits.

Higher search costs will reduce labour force participation

33 Le Barbanchon, T., Rathelot, R., & Roulet, A. (2021). Gender differences in job search: Trading off commute against wage. *The Quarterly Journal of Economics*, 136(1), 381-426.

34 Beam, E. A. (2021). Search costs and the determinants of job search. *Labour Economics*, 69, 101968. And Girum Abebe, A Stefano Caria, Marcel Fafchamps, Paolo Falco, Simon Franklin, Simon Quinn, Anonymity or Distance? Job Search and Labour Market Exclusion in a Growing African City, *THE REVIEW OF ECONOMIC STUDIES*, Volume 88, Issue 3, May 2021, Pages 1279-1310, <https://doi.org/10.1093/restud/rdaa057>

Paid Maternity Leave – A Case Study in Reducing Search Costs and Lifting Female Participation

The provision of paid maternity leave has been found to increase rates of labour force participation in a number of studies in Australia and overseas.³⁵ This result is somewhat counter intuitive – and while employment reduces during the payment period, women are much more likely to return to their employer and work after a period of paid leave.

Paid maternity leave has been found to increase participation largely because it maintains a woman's relationship with her employer and attachment to the labour market.³⁶ This reduces search costs for women returning to work after having a child, and as a result increases participation in paid work. The design of the Australian scheme also encouraged women to stay engaged in work in order to qualify for the payment.³⁷

Australia introduced a paid parental scheme in 2011 which provided universal maternity leave, subject to a means test, and also underpinned a large increase in maternity leave provision by private sector companies. This expansion in paid maternity leave has been found to have lifted female labour force participation by studies using administrative data.³⁸

Impact Economics and Policy analysis using difference-in-difference methodology (see Appendix) finds that the introduction of paid parental leave in Australia has led to a faster growth in participation amongst women with children aged under 5 compared to other cohorts.

35 Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304), 80-100.

36 Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304), 80-100.

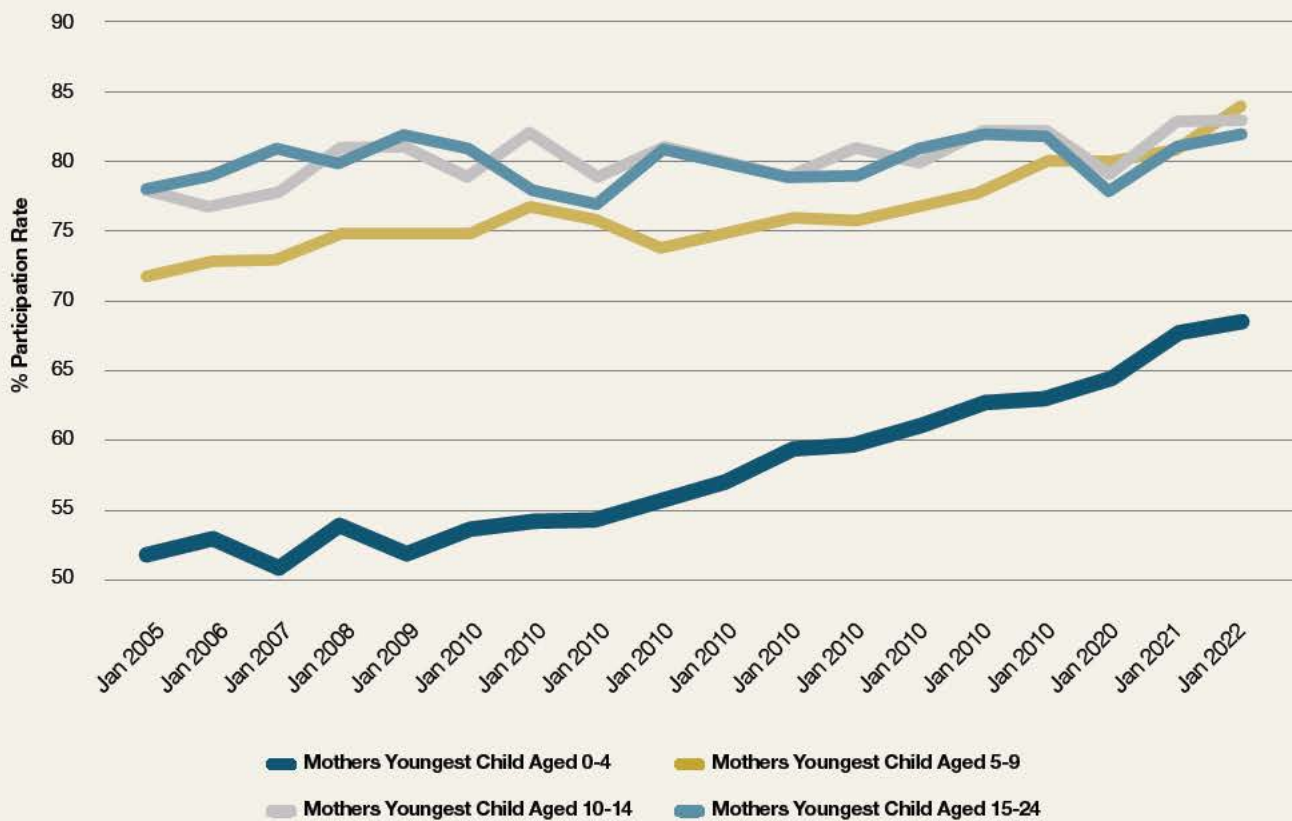
37 Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304), 80-100.

38 Kalb, G. (2018). Paid parental leave and female labour supply: A review. *Economic Record*, 94(304), 80-100.

IMPACT ECONOMICS AND POLICY



FIGURE 3 GROWTH IN LABOUR FORCE PARTICIPATION OF MOTHER'S WITH CHILDREN AGED 0-4



Source: Impact Economics and Policy analysis of ABS 2022, Labour Force Status of Families



Since 2010 the participation rate for mothers with children under 5 has increased by 14.6 percentage points, representing an additional 170,128 women in the labour market. Part of this increase reflects historical trends and can also be seen in mothers with older children. However, the rate of increase for mothers with a child aged 0-4 is higher than before the reform, and than mothers with older children during the post reform period.

Impact Economics and Policy modelling using difference-in-difference estimates, which allows us to establish causality, finds that the introduction of paid maternity leave in 2011 has increased employment of mothers with children aged under 5 by 74,245. This represents a direct economic benefit of \$8.5 billion to GDP in 2021-22, an impressive gain for a policy that costs the Australian Government \$2.7 billion a year,³⁹ excluding increased taxation revenue and reduced government payments.

While other policy changes over the period may have contributed to this increase, including the increase in child care subsidies for many families that occurred in 2018, an evaluation of the reforms found no impact on hours worked.⁴⁰ It is noteworthy that the 2018 reforms included a tightening of the Activity Test, and a large decrease in support for child care costs for women not actively engaged in the labour market. This change effectively increased the search costs for women that do not maintain a relationship with their employer, particularly women marginally attached to the labour force or in casual employment.

The impact of the introduction of paid maternity leave in Australia illustrates the importance of designing policies that reduce the higher search costs in the labour market for women with young children.

The impact of the introduction of paid maternity leave in Australia illustrates the importance of designing policies that reduce the higher search costs in the labour market for women with young children.

39 Australian Government Department of Social Services (2022), Portfolio Budget Statements 2022-23, Budget Related Paper No. 1.14: https://www.dss.gov.au/sites/default/files/documents/10_2022/october_2022-23_social_services_portfolio.pdf

40 AIFS (2022), Child Care Package Evaluation: Final report: <https://aifs.gov.au/research/researchreports/child-care-package-evaluation-final-report>

IMPACT ECONOMICS AND POLICY

HOW DOES THE ACTIVITY TEST WORK?

The Activity Test limits the number of hours parents can access subsidised child care based on the number of hours of work or other defined activity they undertake each fortnight.

Families earning under the income thresholds (<\$72,466) can access one day of child care per week without satisfying the requirements of the Activity Test. The limit of one day per week was introduced in 2018, and prior to this the limit was 2 days of child care per week and a rebate

covering 50 per cent of all out-of-pocket child care costs.⁴¹

These changes were found by an independent evaluation to have disproportionately impacted low-income families.⁴²

These changes were found by an independent evaluation to have disproportionately impacted low-income families.

Current Activity Test Requirements		
Activity test step	Hours of recognised activity per fortnight	Hours of subsidised child care per CCS fortnight –
1	Up to 8 hours + means test	24 hours (or 12 hours per week)
1a	Exemptions for preschool	36 hours (or 18 hours per week)
2	8 hours to 16 hours	36 hours (or 18 hours per week)
3	More than 16 hours to 48 hours	72 hours (or 36 hours per week)
4	More than 48 hours	100 hours (or 50 hours per week)

Source: AIFS (2022), Child Care Package Evaluation: Final report: <https://aifs.gov.au/research/research-reports/child-care-package-evaluation-final-report>

Families must update their activity regularly, and if they make mistakes in their assessment, they can face debts from Centrelink. This creates significant anxiety, and leads to families with marginal attachment to the workforce deciding against using formal child care. As a result, children miss out on the developmental benefits of early childhood and care, and parents are limited in their ability to search for and undertake work.⁴³

41 AIFS (2022), Child Care Package Evaluation: Final report: <https://aifs.gov.au/research/research-reports/child-care-package-evaluation-final-report>

42 AIFS (2022), Child Care Package Evaluation: Final report: <https://aifs.gov.au/research/research-reports/child-care-package-evaluation-final-report>

43 Impact Economics and Policy (2022), Activity Test for Child care: Undermining Child Development and Parental Participation: https://static1.squarespace.com/static/61e32e62c8c8337e6fd7a1e6/630de5c741a8de08ad48d593/1661855185396/Undermining+Child+Development+And+Parental+Participation+Report_FINAL.pdf

WHAT IS THE RATIONALE FOR THE ACTIVITY TEST?

Only providing subsidised access to early childhood education and care to children of parents that satisfy the Activity Test is done on the basis of incentivising participation in the labour market.⁴⁴ The more you participate the more hours of subsidised care you receive.

In its 2015 Report recommending a halving in the minimum hours of child care available under the Activity Test for low-income families, the Productivity Commission argued that the changes would increase participation through increasing the returns to work.⁴⁵ They found that overall hours worked would fall by 500,000 in the absence of the Activity Test, or 15,000 FTE workers, which was largely driven by those on Parenting Payment that would work 301,000 less hours per week.⁴⁶

The Productivity Commission modelling had one important omission – the cost of child care during job search. They assumed that everyone who wants to work, finds work and their modelling while including fixed costs of working, did not include search costs.⁴⁷

As noted above, the link between increasing access to subsidised child care and female labour force participation is well established, and the Productivity Commission argues in the same report that lifting the number of subsidised hours of care available to high income families will lift participation.⁴⁸



The Productivity Commission modelling had one important omission – the cost of child care during job search.

44 Productivity Commission 2014, 'Modelling the Effects of Child care Policy Changes', Technical Supplement to the Draft Report Child care and Early Childhood Learning, Canberra, October.

45 Productivity Commission 2014, 'Modelling the Effects of Child care Policy Changes', Technical Supplement to the Draft Report Child care and Early Childhood Learning, Canberra, October.

46 Productivity Commission 2014, 'Modelling the Effects of Child care Policy Changes', Technical Supplement to the Draft Report Child care and Early Childhood Learning, Canberra, October.

47 Productivity Commission 2014, 'Modelling the Effects of Child care Policy Changes', Technical Supplement to the Draft Report Child care and Early Childhood Learning, Canberra, October.

48 Productivity Commission 2014, 'Modelling the Effects of Child care Policy Changes', Technical Supplement to the Draft Report Child care and Early Childhood Learning, Canberra, October.

IMPACT ECONOMICS AND POLICY

DOES THE ACTIVITY TEST PROVIDE AN INCENTIVE OR DOES IT CREATE A BARRIER TO WORK?

There has been no empirical testing of the impact of the Activity Test on the decision to participate in work, however economic theory and empirical research on the decision to work provide evidence of a complicated relationship.

The Productivity Commission itself noted in its report recommending the introduction of the current Activity Test that: 'setting an activity test that is simple to implement and enhances rather than detracts from work incentives is challenging.'⁴⁹

What Motivates Women to Work?

Evidence indicates that women return to work after having children for a number of reasons, with over two thirds citing financial factors. Other factors also play a role including the need to maintain qualifications and fear that a longer break will harm their career. Only a very small percentage of women (3 per cent) indicate that they return to work only because they prefer working to staying at home with children.⁵⁰

FIGURE 4 REASONS FOR RETURN TO WORK, MOTHERS WHO HAD RETURNED TO WORK



The Productivity Commission itself noted in its report recommending the introduction of the current Activity Test that: 'setting an activity test that is simple to implement and enhances rather than detracts from work incentives is challenging.'

Source: Baxter, J. Is money the main reason mothers return to work after childbearing?. *Journal of Population Research* 25, 141-160 (2008). <https://doi.org/10.1007/BF03031946>

49 Productivity Commission (2015), *Inquiry Report: Child care and Early Childhood Learning*.

50 Baxter, J. Is money the main reason mothers return to work after childbearing?. *Journal of Population Research* 25, 141-160 (2008). <https://doi.org/10.1007/BF03031946>

Impact of the Activity Test on Incentives to Work

The extent to which there are benefits from early childhood education and care beyond facilitating a women's ability to re-engage in work, the provision of subsidised early childhood education and care, could act to reduce incentives to work. This is because these benefits could be accrued without needing to participate in labour market activities, and it is on this basis that the Productivity Commission found that removing the activity test would reduce participation by around 15,000 FTE workers in its 2015 Report.⁵¹

There are clear and quantifiable benefits to early childhood education and care for parents beyond providing the capacity to work including:

- improved developmental outcomes for children
- time away from children

If the Activity Test was removed and all children had access to early childhood education and care regardless of their parent's work activity, these benefits would no longer influence a women's decision to work. This could act to reduce

labour force participation, depending on the extent to which women are currently motivated to work by these factors.

However, there are also costs associated with accessing early childhood education and care that would no longer influence the decision to work if the Activity Test was abolished, because these would have already been incurred by women:

- finding a suitable child care centre
- net costs of child care after any subsidy
- the lost utility from not caring for children

Therefore, abolishing the Activity Test would only reduce the incentive to work to the extent that:

(COSTS OF FINDING CHILD CARE + NET COSTS OF CHILD CARE + LOST UTILITY FROM NOT CARING FOR CHILDREN) < (GAIN IN UTILITY FROM NOT CARING FOR CHILDREN + UTILITY FROM IMPROVED CHILD DEVELOPMENT)

In addition, the overall impact of removing the Activity Test would depend on the extent to which it adds to the search costs for women looking to return to work.

There are clear and quantifiable benefits to early childhood education and care for parents beyond providing the capacity to work

The overall impact of removing the Activity Test would depend on the extent to which it adds to the search costs for women looking to return to work.

Costs of finding child care
+
Net costs of child care
+
Lost utility from not caring for children



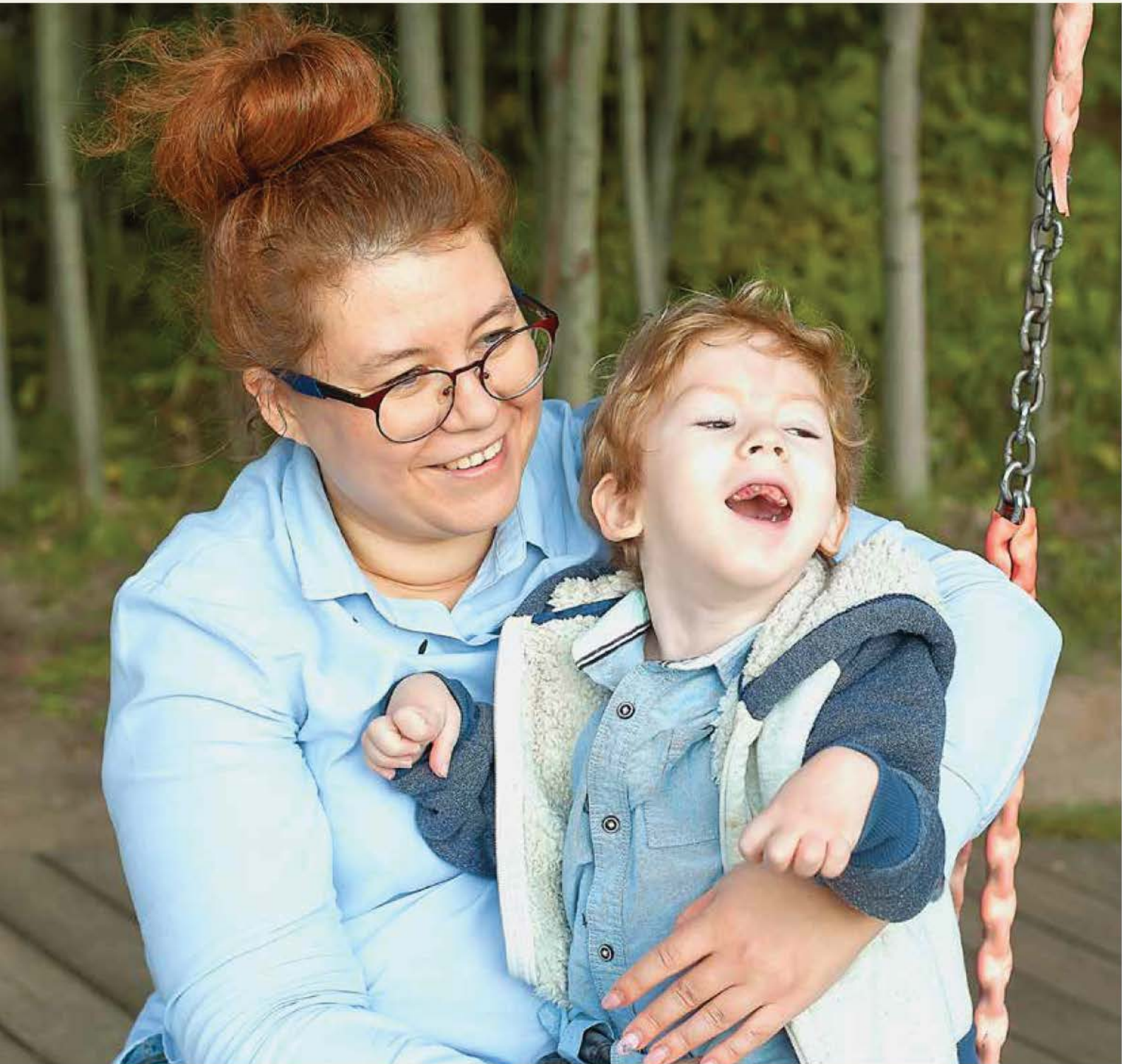
Gain in utility from not caring for children
+
Utility from improved child development

TABLE 4: THE DECISION TO WORK UNDER THE ACTIVITY TEST AND UNIVERSAL CHILD CARE

	Activity Test	Universal Child care
Step One	Individual outside labour market must incur risk and costs of child care. Job search must occur without certainty over ability to access necessary child care to work. Potential benefits from work are wages net child care costs	Individual outside labour market can access subsidised child care with no risk or potential cost. Job search can occur with certainty over access to child care to work. Potential benefits from work are wages net additional child care costs
Step Two	Individual marginal returns from work are wage less net child care costs.	Individual marginal returns from work are wages net child care costs.

51 Productivity Commission 2014, 'Modelling the Effects of Child care Policy Changes', Technical Supplement to the Draft Report Child care and Early Childhood Learning, Canberra, October

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Impact of Activity Test on Search Costs

The Productivity Commission modelling for its 2015 Report did not include search costs and assumed everyone that wanted to work could find work. This is despite evidence on the importance of search costs,⁵² particularly for women,⁵³ on labour market outcomes.

While women can in certain circumstances access one day of care a week during job search, the practical operation of the child care system means the Activity Test creates a significant barrier for women looking to return to the labour force after having a child:

- Most centres have 10 to 12 hour session times.
- Many centres require a two-day minimum for enrolment, which is often cited as a minimum for children to adjust to child care settings with three days considered optimal.⁵⁴
- New enrolments often commence in January, 4 to 5 weeks before school commences.
- Enrolment often involves an administration fee and minimum notification period to cease enrolment.

- When enrolling centres offer a set day or days per week, with flexibility to shift days based on availability.
- Even for those eligible there can be significant delays in accessing child care benefits due to delays in processing claims.

In addition to these practical barriers from the current system, that could be largely avoided with removing the Activity Test, parents are acutely aware of the risks of overpayment under the current system.

Half of parents surveyed for an evaluation of the the 2018 Child Care Package indicated they were worried that they would end up with a reconciliation debt if they did not get their details right.⁵⁵ Alongside the inability to respond to new work opportunities, this uncertainty creates an additional barrier to employment especially for women working in casual roles.

Half of parents surveyed for an evaluation of the the 2018 Child Care Package indicated they were worried that they would end up with a reconciliation debt if they did not get their details right

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- 52 The Prize in Economic Sciences 2010 - Press release - NobelPrize.org
- 53 Thomas Le Barbanchon, Roland Rathelot, Alexandra Roulet, Gender Differences in Job Search: Trading off Commute against Wage, *THE QUARTERLY JOURNAL OF ECONOMICS*, Volume 136, Issue 1, February 2021, Pages 381–426, <https://doi.org/10.1093/qje/qjaa033>
- 54 Centre for Policy Development (2021), Starting Better – A Guarantee for Young Children and Families: <https://cpd.org.au/wp-content/uploads/2021/11/CPD-Starting-Better-Report.pdf>
- 55 Centre for Policy Development (2021), Starting Better – A Guarantee for Young Children and Families: <https://cpd.org.au/wp-content/uploads/2021/11/CPD-Starting-Better-Report.pdf>
- 56 AIFS (2022), Child Care Package Evaluation: Final report: <https://aifs.gov.au/research/researchreports/child-care-package-evaluation-final-report>

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.....for many families and particularly for women at the bottom end of the labour market ... circumstances would be constantly changing ... women who are on casual rosters and on short term contracts and highly variable work arrangements, and for them to navigate the complexity of the activity test ... It was much more likely that women would think, 'Oh no, I'm not going to be able to access that subsidy because I don't have stable work. And I can't be sure that I'm always going to meet the activity test and I don't want to take the risk that one fortnight I'm going to lose it.' And so that they would rule themselves out.⁵⁶

[Child care stakeholder, November 2018]

As a result, women looking to return to work face having to meet part and potentially all of the child care costs during job search, in order to undertake job search and be available for work. This compares to pre-2018 when women could receive a subsidy of at least 50 per cent of child care costs without any Activity Test.

Unsubsidised child care costs average \$129 per day. Assuming that women require three days of care a week to work the average hours worked by women with children aged under 5, this represents potential gross cost of child care during job search of about \$387 per week. Assuming average job search duration for women in couple and single parent households this could equate to between \$3,483 and \$6,579 gross child care costs. This represents a significant barrier to job search, and for families on government support payments is unaffordable.

Phoung is a single mother with two children under four.

Having left her job as a legal clerk after her first child was born, she was keen to get back into work when her youngest turned 2 years old. She missed work and since she separated from her partner could use the additional income.

While she contacted some ex-colleagues about any opportunities available, she couldn't be sure about what days she could work or even if she could access the same days for both her children. But she didn't want to commit to child care spots for both children without knowing that she had a job secured.

Her preferred child care centre near to home only offered enrolments with a two day per week minimum, meaning that even though she qualified for one day of subsidised child care per week under the activity test she would face out of pocket costs of \$284 per week. This was too much for her to afford.

Without being able to tell her old work when she was available it was hard for them to offer her any work, but they eventually offered her two days a week. When Sarah contacted the child care centre they didn't have any spots left, and indicated she would probably have to wait three months for a spot to become available. It was all too hard, and Phoung turned down the job.

CAMEO



Casual Workers

Casual workers have the ongoing and additional risk and cost of having to pay for days of child care in the hope that they receive shifts corresponding to those days, carrying the cost if those shifts do not eventuate.

For casual workers working less than the 8 hours a fortnight, this can make taking additional shifts that may become available difficult and reliant on the ability to organise last minute care arrangements for children.

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IMPACT ECONOMICS AND POLICY

QUANTIFYING THE IMPACT OF THE ACTIVITY TEST

Quantifying the impacts of removing the activity test require estimating both the positive and negative impacts on participation. This includes making a number of assumptions regarding the elasticity of labour supply, the level of child care and the population impacted by the changes. All these assumptions and a full methodology are outlined in the Appendix, and below we summarise the results.

Positive Impacts

Removing the Activity Test and allowing all children to access a minimum of three days of child care under existing means tests would reduce the search costs for the majority of women with children. It would also provide important developmental benefits to children, the benefits of which are not quantified in this report but can be expected to lift labour force participation and productivity long term.

We restrict our analysis of search costs to the impacts on women with children under 5 as women with school aged children do not face the same search costs due to children being enrolled in full time school. However, we note that even for children in this aged bracket the costs of child care outside school hours represents an additional barrier to labour force participation.

Assuming three days of care for every child over the average duration of job

search for single and coupled mothers,⁵⁷ average costs would be reduced by between \$700 and \$4,361. We undertake analysis to show the impact this would have on a women's decision to work would depend on the time period over which they evaluated this lower cost of child care – the job search period, 6 months or 12 months.

The impacts are modelled separately for low, middle and high income earners. Abolishing the Activity Test would result in an increase in participation of between 28,500 and 101,620 women. The majority of these increases would be amongst women in households with incomes below \$72,000.

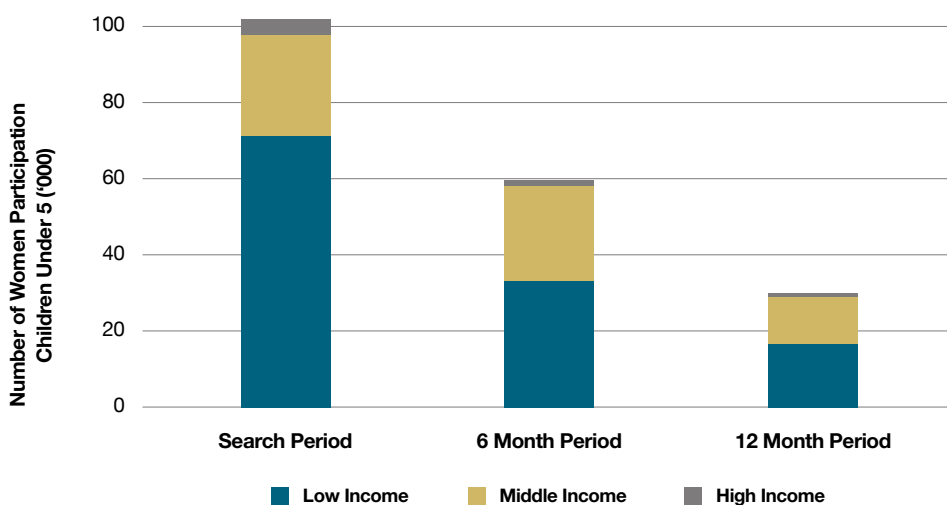
Single mothers represent 11 per cent of mothers with children aged 0-4, but would comprise approximately one third of the gains in participation. This is largely driven by single mothers on low incomes that represent over 50 per cent of the gains for this group.

Removing the Activity Test and allowing all children to access a minimum of three days of child care under existing means tests would reduce the search costs for the majority of women with children

Abolishing the Activity Test would result in an increase in participation of between 28,500 and 101,620 women.

⁵⁷ Average job search duration for coupled mother's is 9 weeks and single mother's 17 weeks according to the ABS (2023), Detailed Labour Force, Table 14b

FIGURE 5 PARTICIPATION BENEFITS FROM ABOLISHING THE ACTIVITY TEST



Source: Impact Economics and Policy Modelling (see Appendix for full methodology)

Our analysis does not include the impact of the Activity Test on women’s wages due them accepting less optimal job matches. As noted above, empirical studies have shown that women with children accept lower wages to reduce transport costs, reflecting the productivity losses incurred by women willing to accept less optimal job matches due to higher search costs.⁵⁸

Negative Impacts

Based on the findings from the 2015 Productivity Commission Report, which relates to women with children aged 0-12, and adjusting to account for average hours worked by women with children under 5, we calculate that abolishing the activity test would reduce labour force participation by the equivalent of approximately 19,940 women.

Overall Impacts

The Activity Test is likely to have both positive and negative impacts on labour force participation by women with young children, however modelling from Impact Economics and Policy finds that removing the Activity Test would result in an increase in participation of between 9,840 and 81,680 additional women.

Assuming a mid-range estimate, based on women evaluating the change in costs over a 6 month period, we find labour force participation would increase by approximately 39,620 and represent a \$4.5 billion boost to GDP in 2021-22 dollars.⁵⁹

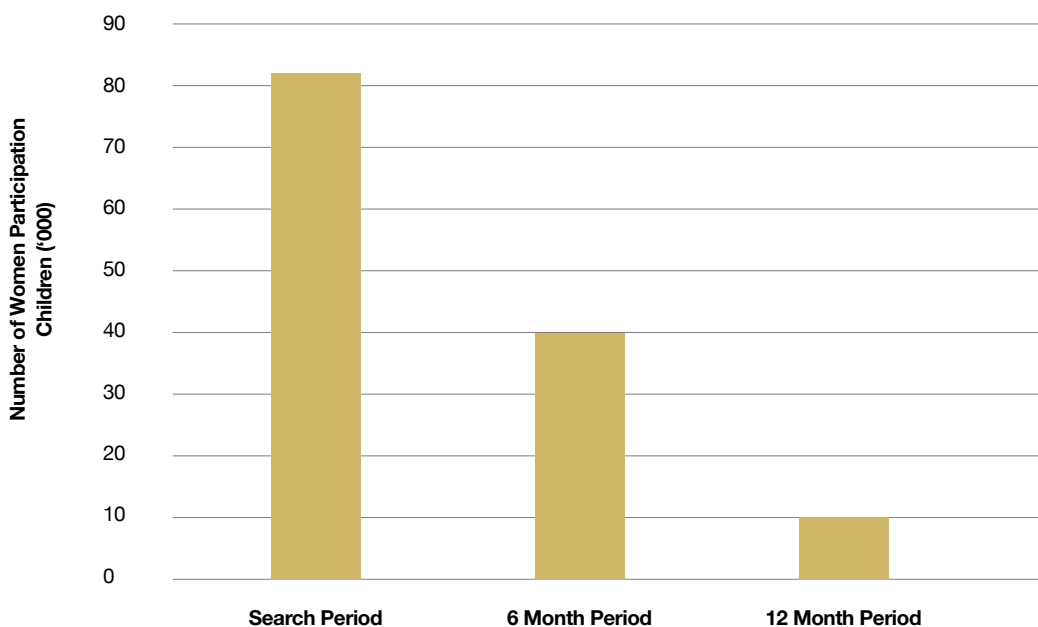
Assuming a mid-range estimate, based on women evaluating the change in costs over a 6 month period, we find labour force participation would increase by approximately 39,620 and represent a \$4.5 billion boost to GDP in 2022-23 dollars.

58 Le Barbanchon, T., Rathelot, R., & Roulet, A. (2021). Gender differences in job search: Trading off commute against wage. *The Quarterly Journal of Economics*, 136(1), 381-426.

59 See Appendix for methodology

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FIGURE 6 NET INCREASE IN LABOUR FORCE PARTICIPATION UNDER VARIOUS SCENARIOS



How Much Would Abolishing the Activity Test Cost?

There are various estimates of the cost of abolishing the Activity Test, with the Productivity Commission estimating that it would cost approximately \$972.4 million in 2014, which in 2023-24 dollars would equate to \$1,306 million.

The Centre for Policy Development has more recently costed proposals for universal provision of three days of early childhood education and care, at between \$710 and \$1730 million per year, which includes removal of means tests.

Neither costing includes the positive impacts from higher participation and GDP on the Commonwealth Budget from higher taxation revenues or lower benefit payments.

IMPACT ON UNDERLYING CASH BALANCE (\$M):

2023-24	2024-25	2025-26	2026-27
1306	1345	1379	1414

Source: Impact Economics and Policy estimates based on Centre for Policy Development (2021), *Starting Better: A Guarantee for Young Children and Families*



CONCLUSION

Australia continues to lag other developed countries in terms of the labour force participation of women, with policy settings around paid parental leave and child care undermining progress. The Activity Test, which limits access to subsidies for early childhood education and care, is one such policy that is acting as a barrier to women returning to work.

While the Activity Test was introduced to incentivise mothers' participation in paid work, this is counter to the evidence that making child care cheaper and more accessible increases participation.⁶⁰

Removing the Activity Test and providing universal access to child care subsidies to every child according to the current means test can be expected to lift labour force participation by 39,620 mothers of children under the age of 5.

In addition to the benefits that would accrue to children over their life-course from better educational and labour force outcomes, this would add up to \$4.5 billion to GDP from increased labour force participation of mothers.

The Activity Test, which limits access to subsidies for early childhood education and care, is one such policy that is acting as a barrier to women returning to work.

Removing the Activity Test and providing universal access to child care subsidies to every child according to the current means test can be expected to lift labour force participation by 39,620 mothers of children under the age of 5.

⁶⁰ Gong, X, Breunig, B and King, A 2010, 'How responsive is female labour supply to child care costs? – New Australian estimates', Treasury Working Papers, 2010-03, Australian Treasury.

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APPENDIX

PAID MATERNITY LEAVE METHODOLOGY

In order to estimate the economic benefits of labour force participation rates were estimated for women with dependent children of various ages using data from the Australian Bureau of Statistics (ABS) Labour Force Status of Families June 2022 release.

The labour force participation rates were estimated for mothers (both in couples and single mothers), measured by the age of their youngest dependent child over the period June 2005 to June 2022 using the following age groups:

- 0 to 4 years old
- 5 to 9 years old
- 10 to 24 years old

PRE AND POST REFORM PERIODS

In order to undertake difference in difference estimation we must define the relevant periods of pre and post reform.

Government provided Paid Maternity Leave (PML) was introduced in January 2011, and the growth in participation is calculated for pre-reform period from June 2005 to June 2010, and the post reform period June 2011 to June 2019. The years 2020 to 2022 are excluded from the 'after PML' time period so as not to bias the estimates with impacts caused by the COVID-19 pandemic.

Calculation of average growth rates

APPENDIX TABLE 1: AVERAGE ANNUAL CHANGE IN LABOUR FORCE PARTICIPATION RATES OF MOTHERS BY AGE GROUP OF YOUNGEST DEPENDENT CHILD

	Before PML 2006 to 2010	After PML 2011 to 2019	Difference	Differecne-in- difference
0 to 4 years old	0.4%	1.0%	0.6%	
5 to 9 years old	0.5%	0.5%	0.1%	0.5%
10 to 24 years old	0.4%	0.2%	-0.1%	0.7%

Source: Impact Economics and Policy analysis of ABS 2022, Labour Force Status of Families

Treatment Group

The treatment group is the cohort with children aged 0 to 4 years old.

Control Group

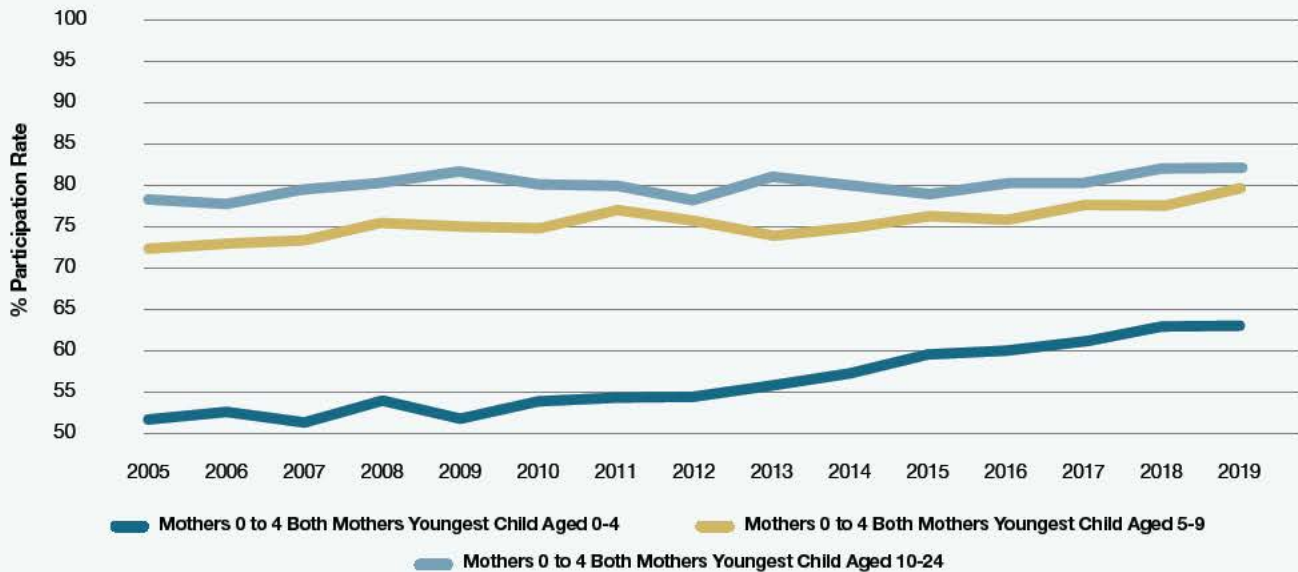
There are two potential control groups:

- mothers with children aged 5 to 9 years old; and
- mothers of children aged 10 to 24 years old.

Each of these control groups had similar trends to the treatment group prior to the reforms.

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APPENDIX FIGURE 1: **TREATMENT AND CONTROL GROUPS TRENDS IN PARTICIPATION RATES**



Source: Impact Economics and Policy analysis of ABS 2022, Labour Force Status of Families

The cohort of mothers initially in the under 5 age group move into the 5-9 age group from 2016, making mothers with children aged 5-9 an inappropriate control – as women in this cohort after 2016 are also in the treatment group.

In selecting the cohort of mothers with children aged 10-24 as a control we note that other policy changes were occurring during this period, including changes to parenting payments which aimed to increase participation amongst mothers with children age 8 years and above. The extent to which this biased the results, it would result in an underestimate of the impact of the paid maternity leave reforms.

Employment impacts

Based on the analysis described above, it is assumed that a 0.7 percentage point increase each year in the participation rate of mothers of 0 to 4 year olds, is attributable to the introduction of PML over the period 2021-2022. This is applied to the number of mothers of 0 to 4 year olds in Australia each year to estimate that by 2021-22, 76,187 mothers have joined the labour force who in the absence of PML would have not.

In 2021-22 the average employment rate of mothers of 0 to 4 year olds who are participating in the workforce was 97.5%. Applying this rate to the estimate labour force increase, provides an estimate of 74,245 mothers of 0 to 4 year olds who are employed who would not have been without paid maternity leave.

Economic value

The next stage of the process estimates the direct economic value associated with each additional employed mother of a 0 to 4 year old. This was done by estimating the average annual value of Gross Domestic Product (GDP) generated per each employee in the labour force. This value was weighted to account for the industries in which women most commonly work. It was then weighted further by 66% to reflect that mothers of 0 to 4 year olds who are employed, tend to work 66% of the average hours worked by all employees.⁶¹

This economic value produced per each additional employed mother of a 0 to 4 year old, was calculated for each year from 2011-12 to 2018-19.

61 Impact Economics and Policy analysis of Household Income and Labour Dynamics (HILDA) survey data 2021.

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These values were multiplied by the estimated number of additional employees to estimate the direct economic value generated from the uplift in employment of mothers of 0 to 4 year olds associated with the introduction of PML. The GDP deflator was then applied to bring this value into 2021-22 \$ terms.

This method estimates that the 2011 introduction PML generated \$8.5 billion of direct economic value in 2021-22 by enabling the employment of 74,245 mothers of 0 to 4 year olds.

ACTIVITY TEST METHODOLOGY

In order to quantify the potential benefits of removing the activity test we first identify the population that requires access to early childhood education and care to work, mothers with children under the age of 5 in single and coupled families.

APPENDIX TABLE 2: NUMBER OF WOMEN BY FAMILY TYPE

	June 2022 ('000)
Coupled Families	1053.8
One Parent Families	133.8
Total	1187.5

Using Data from HILDA survey these families are then broken into three cohorts, low-income, medium-income and high-income families to model the participation impacts of changes to the search costs.

APPENDIX TABLE 3: NUMBERS OF WOMEN BY FAMILY TYPE AND INCOME LEVELS

	Low Income	Medium Income	High Income
Coupled Families	158.1	642.8	252.9
One Parent Families	97.7	33.4	2.7
Total	255.7	676.2	255.6

Average child care costs per day are assumed at the national average of \$129 from the latest Department of Education statistics.⁶²

The following subsidy levels are assumed for women in each cohort based on rebate levels for the different income groups.

APPENDIX TABLE 4: SUBSIDY LEVELS BY FAMILY INCOME GROUPS

Low Income	Medium Income	High Income
109.7.1	87.1	30.6

⁶² Australian Government Department of Education (2022), Data on Usage, Services, Fees and Subsidies, March Quarter 2022: <https://www.education.gov.au/child-care-package/early-childhood-data-and-reports/datausage-services-fees-and-subsidies/march-quarter-2022-report>

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Search costs

Three days of child care is assumed during the search period, which is based on the average search time for women in coupled (9 weeks) and single parent (17 weeks).⁶³ Women are assumed to have the average number of children under 5 of 1.27 for women in couples and 1.17 for single mothers. Women are assumed to benefit from one day of subsidised child care under the current Activity Test.

APPENDIX TABLE 5: CURRENT SEARCH COSTS

	Low Income (\$)	Medium Income (\$)	High Income (\$)
Coupled Families	3170	3428	4073
One Parent Families	5517	5966	7088

APPENDIX TABLE 6: SEARCH COSTS UNDER NO ACTIVITY TEST

	Low Income (\$)	Medium Income (\$)	High Income (\$)
Coupled Families	664	1438	3373
One Parent Families	1155	2502	5869

Impact of removing the Activity Test

The impact of removing the Activity Test on child care costs is then evaluated over three periods – the job search period, 6 months and 12 months. This assumption is required to allow us to estimate the reduction in child care costs as a result of removing the Activity Test, and the impact on participation for each cohort based on estimates of the elasticity of labour supply to child care costs from the literature.

Estimates on the elasticity of labour supply from the NSW Productivity Commission and Breunig, Gong and King for pre-school children are used, which assume a 1 per cent decrease in child care costs will increase participation by mothers with pre-school aged children by 0.07 per centage points.

APPENDIX TABLE 7: IMPACT ON PARTICIPATION UNDER DIFFERENT ASSUMPTIONS ('000)

	Low Income	Medium Income	High Income
Search Period	71.5	26.2	3.9
6 Month Period	33.1	25.0	1.4
12 Month Period	16.6	12.5	0.7

Economic value

The economic value of these increases is estimated using the same methodology as for paid parental leave, resulting in an estimated direct increase to GDP of \$4.5 billion in 2021-22 dollars.

Cost of abolishing the Activity Test

The cost of abolishing the Activity Test is taken from the 2015 Productivity Commission Technical Supplement to Childcare and Early Childhood Learning Inquiry, which estimated a net weekly cost of \$18.75 million, or an annual cost of \$975 million in 2014 dollars. These costs were updated to 2022-23 figures using the GDP deflator, to give a cost of \$1,260 million in 2022-23.

⁶³ ABS (2023), Detailed Labour Force, Table 14b

