Research Note: Modelling of the 2022 Coalition and Labor Child Care Policies

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Contents

Introduction 3

Methodology 3

Policy Changes 4

Results 5

Conclusion 9

References 10

Introduction

Child care policy has taken on great importance as a policy lever for alleviating cost of living pressures for younger Australian families with young children. The push for greater affordability in child care is also often linked to increasing female labour force participation and to improve educational outcomes for young children as they progress through child care to primary school and beyond.

The Coalition and the Labor Party take to the 2022 Federal Election with important differences in their child care policies. The Coalition early in 2022 altered their 2018-19 designed Child Care Subsidy (CCS) by making the subsidy more generous for families with more than one child in formal long day care and removing the cap on the subsidy that applied to high income earners.

The Labor Party proposal incorporates these already legislated changes and provides larger subsidies across a wider income range.

This paper considers the distributional impact of the two policies compared to the previous CCS. The ANU microsimulation model of the Australian tax and transfer system estimates both the fiscal impact of the two policies and how the two policies impact households by the income distribution.

Methodology

Thiis paper uses the ANU PolicyMod microsimulation model of the Australian tax and transfer system to estimate, at the income unit level, the financial impact of current and alternative policies. The model develops a detailed database using the ABS Survey of Income and Housing 2017-18 (SIH) of disposable income for each person, income unit and household including modelling the vast majority of the personal income tax and transfer systems.

The model updates the 2017-18 survey data to the latest financial year and future years using a range of inflation measures such as CPI and wage growth. Population totals and demographics are also altered to reflect the current population and expected future population. For past and the most recent financial year the model is benchmarked to detailed demographic statistics for most transfer payments and also the distribution of taxpayer taxable incomes from the Australian Taxation Office.

This paper focusses on modelling changes in child care subsidy policy. The ABS SIH includes detailed information on the use of formal child care including hours used, type of care and the cost of that care. The data is at the income unit level and requires some significant adjustment to shift to the more detailed child level where the child care subsidy policy operates. PolicyMod updates the 2017-18 SIH data using detailed aggregate administration data from the Department of Social Services (DSS) which covers the number of children in care, prices charged, the type of care and subsidies received by the families of those children. We also use detailed aggregate distributional data on hours used and prices paid by parents from DSS. The paper does not include any behavioural change. Our estimates are based on static or 'day-after' impacts of policy change.

Policy Changes

The child care subsidy (CCS) is a relatively complicated subsidy system. The base year for this research is the 2022-23 financial year and for that year the old system would have provided an 85 per cent subsidy for families with an adjusted taxable income below about $71,000 per year. For those with an income up to around $183,000 per year that rate tapers down to 50 per cent. For incomes beyond about $268,000 the subsidy rate tapers down from 50 per cent to 20 per cent by an income of $364,000 and for incomes beyond about $370,000 there is no subsidy. In addition, there is a $10,750 cap per child on the subsidy for those with an income beyond about $200,000 per year. There are also limits on the prices for which a subsidy is applied ($12.50 per hour for long day care) and a limited activity test that ensures those who receive the subsidy are working, studying or volunteering in some form[1].

The Coalition Government altered the CCS earlier this year and their new policy is now implemented. This new policy provides a more generous subsidy for families with 2 or more children in formal child care (not including outside school hours care). The new policy also removes the $10,750 per child cap on higher income earners. The subsidy for the subsequent children is increased by 30 percentage points up to a maximum subsidy of 95 per cent.

The Labor Party proposed policy change is to increase the subsidy rate from a current maximum of 85 per cent to 90 per cent for those families earning up to $80,000 per year. The subsidy would taper away to a 0 rate by a combined family income of $530,000 per year. This means that families with an adjusted family income between around $370,000 and $530,000 would now receive a subsidy where they currently do not. The subsidy is larger than the old CCS and the new subsidy offered by the

[1] While PolicyMod has good quality data on hours worked and education status there is no information regarding volunteering. Given that the activity test impacts only a very small share of child care families we have not included the test in our modelling. We don't expect this to alter the overall conclusions of the research.

Coalition across the income distribution. The Labor policy incorporates the Coalition's additional 30 percentage point subsidy to families with more than one child in formal day care where the child is not of school age.

Results

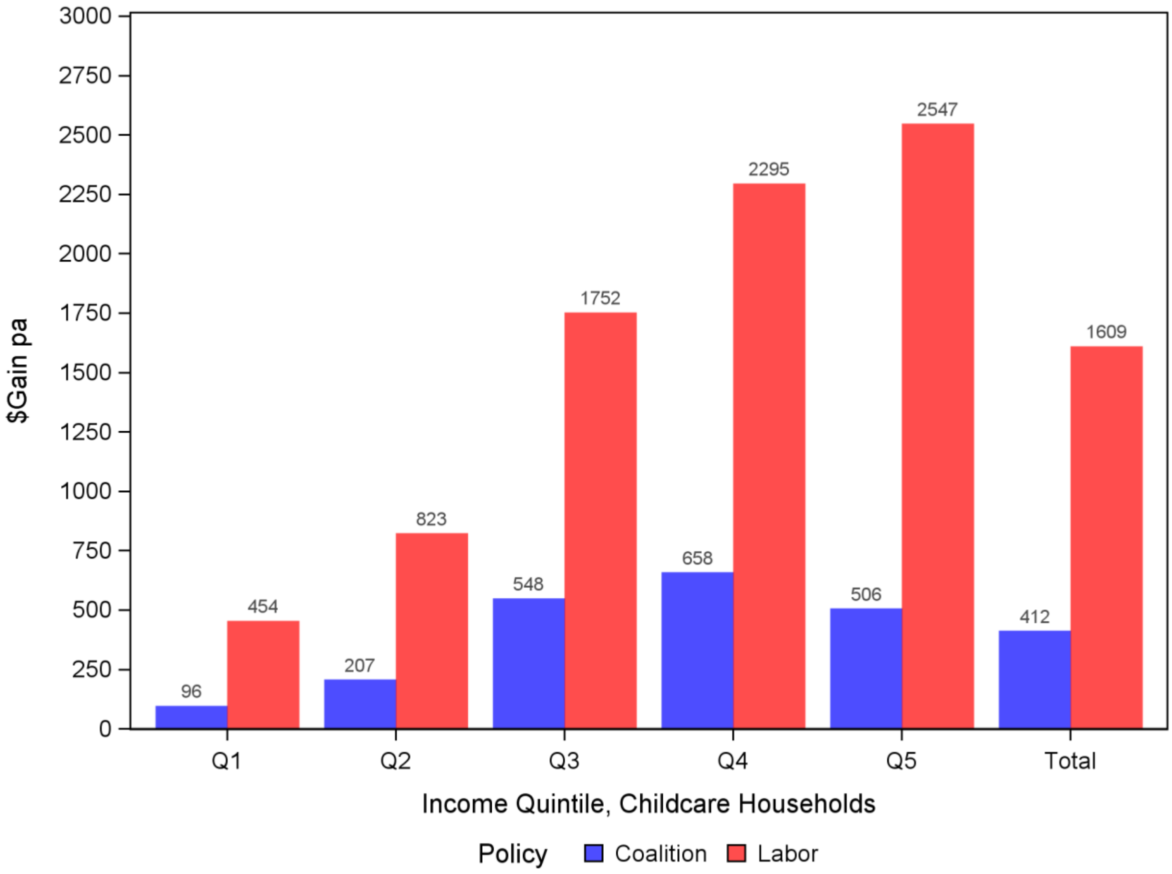
There are various alternative ways to compare affordability of child care for different policies. One approach is to consider the share of income devoted to child care costs once subsidies are deducted from the gross cost of child care. This measure is calculated for the old policy (if it were still in place in the 2022-23 financial year) and compared with that same measure for the alternative policies – Coalition and Labor.

While the overall average for all households is of interest it is also useful to consider the results by income level. For child care it is likely that the impact of policy is arguably more important for lower and middle income households since these families are more likely to be financially constrained compared to higher income households. To understand the impact by income level income quintiles are constructed and the affordability measure compared for these quintiles. An income quintile distribution splits the households according to the bottom 20 per cent (ranked by income) and then subsequent 20 per cent groups up to the top 20 per cent[2].

Figure 1 shows the average gains across all households using formal child care. The results are estimated for each income quintile. The results show a clear pattern for the Labor policy where the policy change benefits households with higher incomes in a greater absolute sense relative to lower incomes. The Labor policy provides a much more significant benefit across the income distribution. The largest average gains for Labor are for the top 20 per cent of households who benefit by $2,547 per year and for the Coalition $506 per year. The pattern is less clear for the Coalition where the greatest gains are for middle income households, peaking at $658 per year for the second top income quintile. The Coalition policy has a more muted impact on the top income quintile as their policy cuts out families with income above $370,000 per year whereas the Labor policy cuts out at $530,000.

[2] To account for differences in household size and composition disposable incomes are divided by an equivalising factor so that income is on a 'per adult' basis. The OECD modified method was used.

Figure 1 Household Average $ Gains pa by policy compared to base world, 2022/23

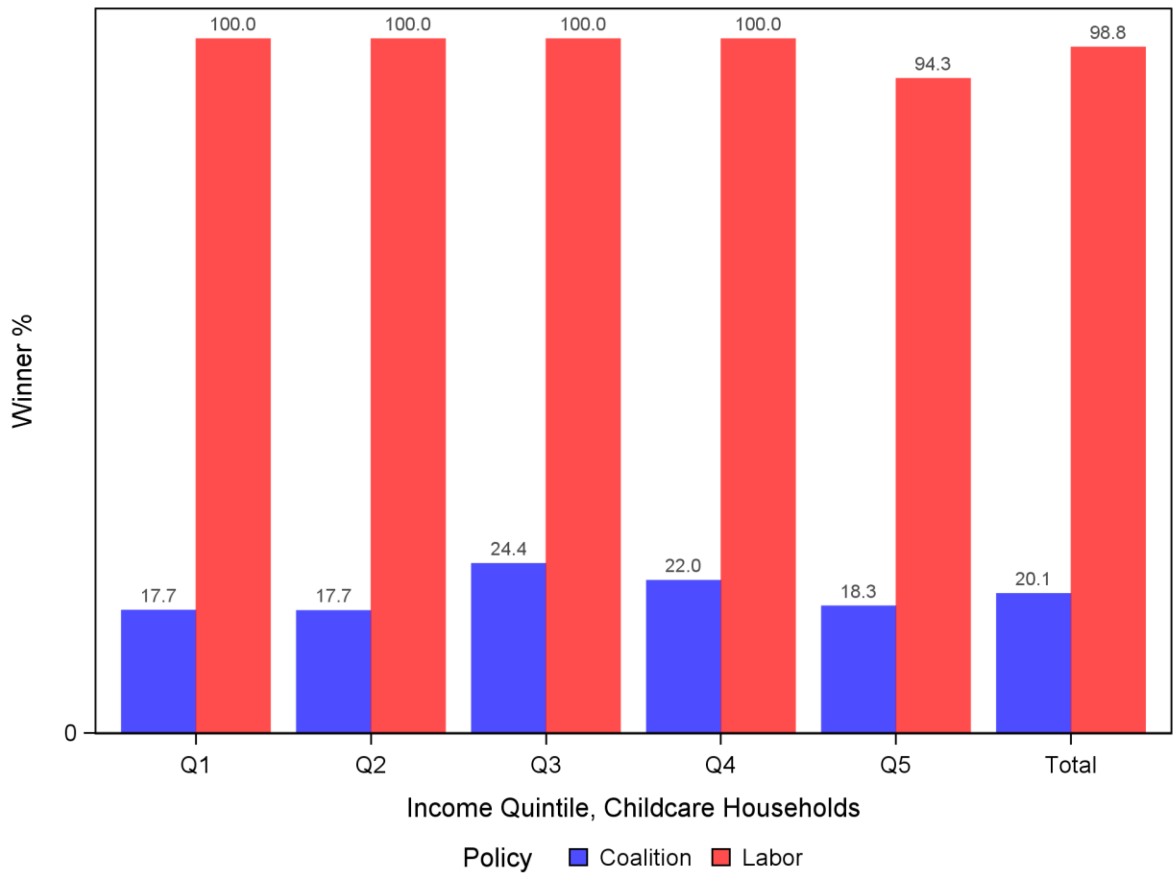


While the Labor policy clearly advantages a broader range of households including many very high income families this will have the impact of lowering effective tax rates. Applying means testing over a broader range of income lowers effective marginal tax rates. High marginal tax rates have been identified as a policy priority particularly for incentives for secondary earners returning to the workforce (Grattan 2020).

Figure 2 shows the share of households who are 'winners' in that they are better off under the policies modelled. Households who don't win are almost entirely expected to receive the same subsidy as per the base or old child care subsidy. The modelling does not find any household that is worse off from either the Labor or Coalition policy.

Under the Labor policy almost all households are better off with only the top income category below the 100 per cent 'winner' rate. The Coalition policy is a significnatly lower cost policy (estimated to be around $0.5 billion compared to Labor at $1.9 billion) and targeted mostly towards families with more than one child in formal child care. The share of 'winner' households varies across the income distribution with middle income households most likely to gain (24.4 per cent) and the lower two income quintiles the least likely at 17.7 per cent.

Figure 2 % Winner Households by policy compared to base world, 2022/23



Overall, the modelling shows that around 241,000 child care households are better off under the Coalition's policy compared to 1.18 million households (98.8 per cent) under Labor. The Labor policy also advantages 1.18 million households compared to the Coalition policy.

Figure 3 shows the average gains relative to household disposable income. Such a measure is helpful in identifying the progressivity or regressivity of the respective policies. Again, it is estimated that the Labor policy is more financially more favourable but both policies tend to favour higher income households. For Labor, bottom income quintile households gain by only 0.66 per cent of income while the top income quintile households gain 1.17 per cent and the gains are largest for quintile 4 households at 1.65 per cent of disposable income. The Coalition relative gains are largest for middle and upper middle income households.

The results here show a regressive impact from the policy changes but this is clearer for the Labor policy. Both policies provide more assistance in both absolute and relative terms for higher income households. To some extent this result is to be expected with higher income households tending to use more child care in terms of hours used. It is also the case that the original CCS policy provides more generous subsidies to lower income households so there is less room to shift the subsidy rates up for lower income households.

Figure 3 Household % Gains relative to base policy relative to disposable income

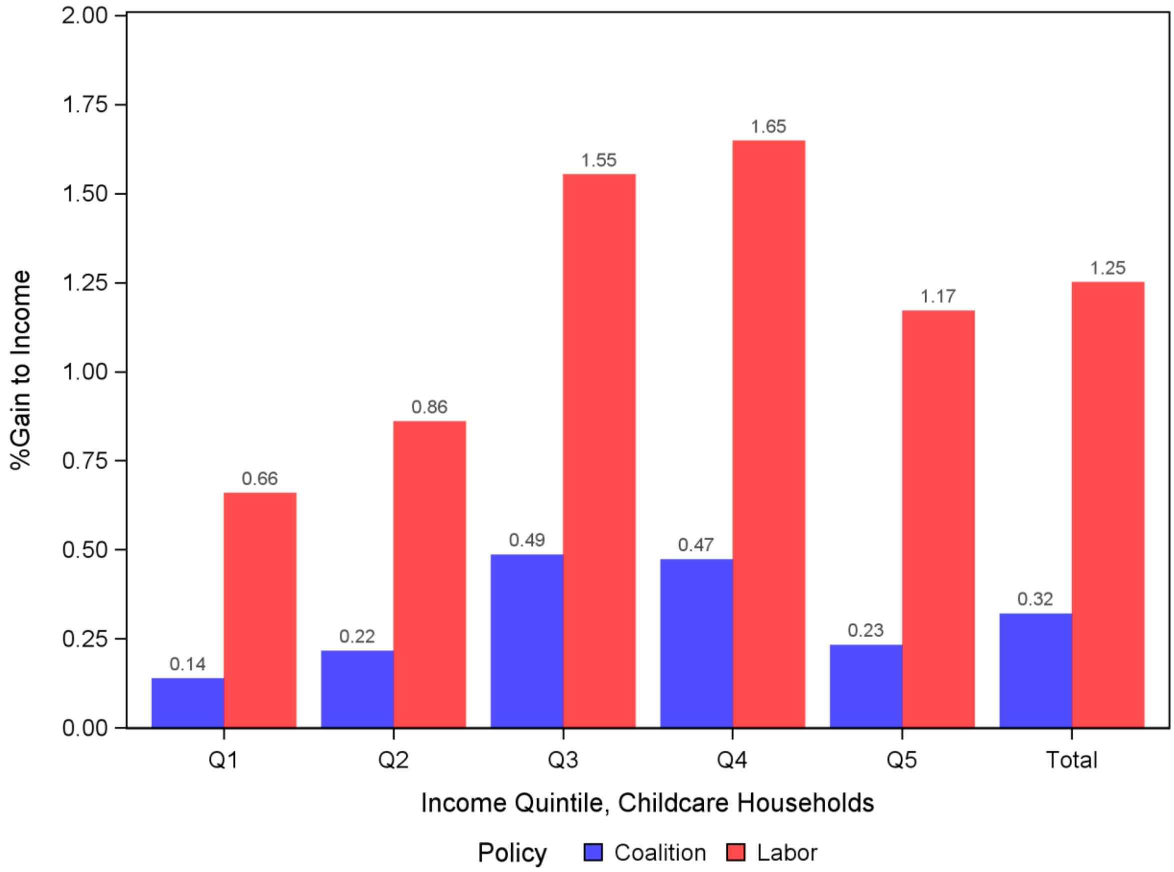
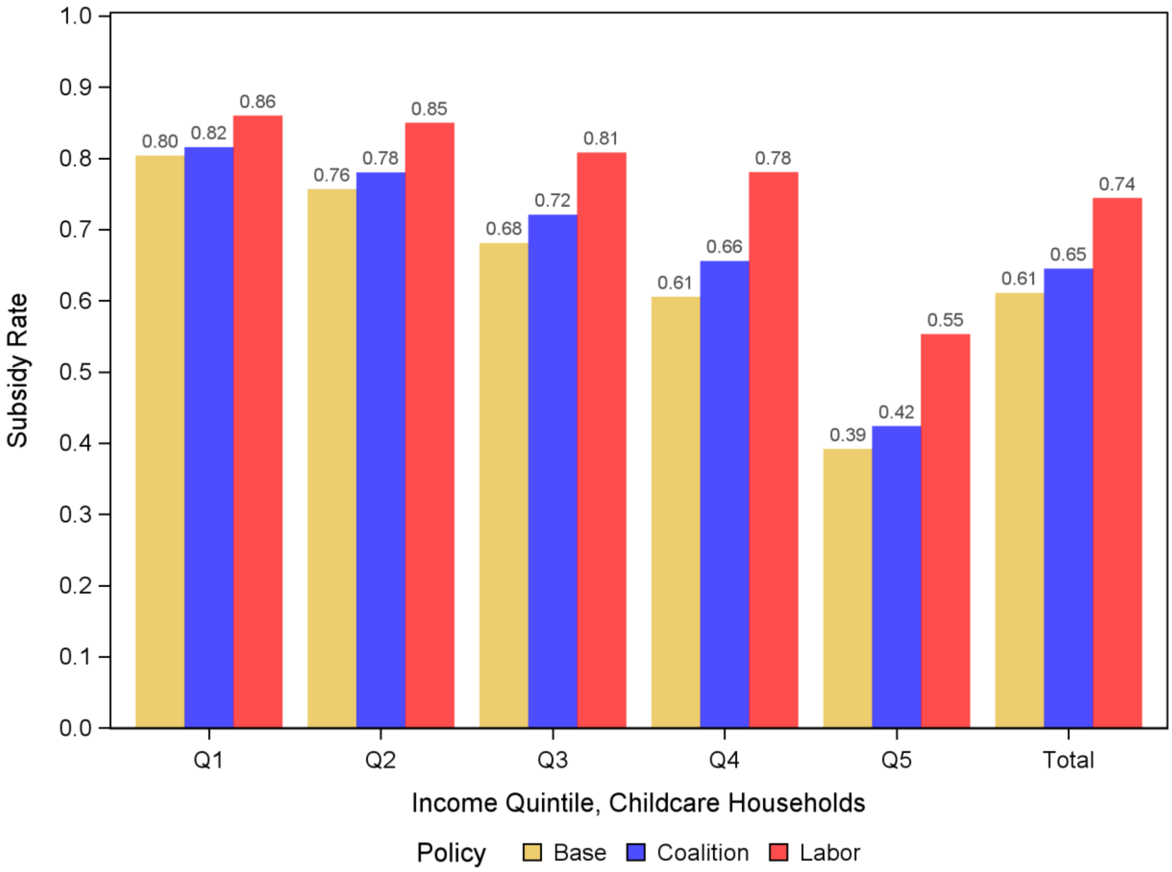


Figure 4 Shows the subsidy rates under the base (old policy) compared to the Coalition and Labor policies. Under the old policy the subsidy rate tapers away from 80 per cent for the lowest income quintile down to 39 per cent for the top quintile. The Coalition and Labor policies also taper away as incomes increase however the extent of tapering is somewhat less under Labor than the old policy or under the new Coalition policy. The Labor policy subsidy rate is 55 per cent for the top income group compared to the old policy at just 39 per cent and the Coalition subsidy rate is 42 per cent. The Labor policy, in line with our earlier results, appears to provide the most additional assistance to higher income households. A similar story applies to the Coalition subsidy rate, albeit more directed toward middle and upper middle income households.

Figure 4 Household Average % Subsidy Rate



Conclusion

The Labor and Coalition child care policies expand the original CCS (2018) policy through more generous subsidies. The Labor policy provides a very significant expansion of the CCS with an additional $1.9 billion invested per year (modelled for 2022-23) compared to the Coalition at $500 million per year.

The Coalition policy focussed on those families with more than one child in formal day care under school age and also those families who previously reached the CCS cap. Labor's policy adopts both these changes but also substantially increases the subsidy across almost all of the income distribution.

Compared to the old CCS system the Labor policy lowers out of pocket costs for households by an average of 34 per cent compared to the Coalition policy at 9 per cent. With the exception of the brief period of free child care through the COVID period in 2020 the Labor policy would be the single largest reduction in the cost of child care services since the ABS first included child care in the CPI in 1982.

The Labor policy does substantially favour higher income child care households with 62 per cent of gains flowing to the top 40 per cent of child care households but only 15 per cent to the bottom 40 per cent of child care households.

The Coalition policy also overwhelmingly is distributed amongst higher income child care households with 14 per cent to the bottom 40 per cent and 58 per cent to the top 40 per cent of households ranked by income.

The modelling does show that both the Labor and Coalition policies will, at least in the short term, improve affordability of child care. The Labor policy is much more generous and improves affordability more broadly relative to the more targeted Coalition policy. Both policies, but particularly the Labor policy improve affordability more substantially for higher income households than lower income households.

References

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