

## **Long overdue**

# **The macroeconomic benefits of paid parental leave**

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## Summary

Despite decades of campaigning, Australia is one of only two OECD countries that do not provide comprehensive paid parental leave. As Deputy Prime Minister Julia Gillard said in October last year: 'This is an issue that's been neglected for a long period of time'. In responding to the release of the recent Productivity Commission (PC) draft report into paid parental leave, Prime Minister Kevin Rudd stated: 'This Australian Government believes the time has come to bite the bullet on this and we intend to do so'. He did not however commit to addressing the issue before the 2009 Federal Budget.

Despite these comments, in recent months the Rudd Government has begun to suggest that the arrival of the global financial crisis could delay the introduction of a paid parental leave scheme. The argument for delay is based on the slowing rate of economic growth and declining government revenue, which ostensibly make paid parental leave less affordable.

This paper argues that the opposite is true. Given that the objective of recent stimulus measures is to inject additional money into the economy, it is contradictory to suggest that saving measures must now be found in the 2009–10 Budget.

In fact, spending money on paid parental leave is a highly efficient way to stimulate the economy due to the higher-than-average propensity of young families to spend any money they receive, to spend it on locally-produced goods, and to spend it across Australia rather than in specific regions as is the case with big infrastructure projects. The PC estimated the net cost of its proposed scheme at \$450 million. Multiplier effects would generate additional GDP of \$0.9 billion, creating 8 900 new jobs and reducing the net cost of the scheme to \$225 million.

Just as importantly, women who have access to paid parental leave spend longer in the paid workforce than women who do not. Consequently *paid parental leave will pay for itself over the course of a woman's working life* because the extra tax revenue associated with the increased workforce participation of these women is estimated to be significantly greater than the cost of their parental leave payments. The long-run supply side effects of the increased participation by women in the workforce should increase GDP by around \$2.5 billion and generate additional tax revenue of \$625 million. This is significantly more than the \$450 million net cost estimate of the PC's scheme.

## Introduction

Australia has been discussing the need for a paid parental leave scheme for decades. Paid parental leave would provide an important foundation for both high-quality early childhood development and female workforce participation. But, despite broad community support, Australia is one of only two OECD countries not to have implemented such a scheme, the other being the US. As Deputy Prime Minister Julia Gillard said in October 2008, 'This is an issue that's been neglected for a long period of time'.<sup>1</sup> On 29 September 2008, the PC released a draft report into paid parental leave to which the Prime Minister Kevin Rudd responded by saying: 'This Australian Government believes the time has come to bite the

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<sup>1</sup> Radio interview with The Hon. Julia Gillard MP, Deputy Prime Minister and Minister for Education, Employment and Workplace Relations, 1 October 2008, at [http://www.deewr.gov.au/Ministers/Gillard/Media/Transcripts/Pages/Article\\_081003\\_123331.aspx](http://www.deewr.gov.au/Ministers/Gillard/Media/Transcripts/Pages/Article_081003_123331.aspx).

bullet on this and we intend to do so'. He did not however commit to addressing the issue before the 2009 Federal Budget.<sup>2</sup>

The PC proposed that the federal government should fund a total of 18 weeks of paid postnatal leave for eligible mothers, with an additional two weeks of paid paternity leave reserved for a father (or same-sex partner). The government-funded entitlement would be set at a level equivalent to the adult minimum wage (currently \$543.78 a week) with employers contributing nine per cent superannuation. The scheme would attract tax like any other form of income and is estimated to cost the taxpayer around \$450 million per year. The model advanced by the PC was a conservative one compared to many existing and proposed models (for example the widely-supported Swedish social insurance scheme funds 18 *months* of paid parental leave)<sup>3</sup> but it received general community support.

The response of many peak groups to the proposal was broadly positive. The Australian Council of Trade Unions (ACTU) welcomed the PC's draft report but proposed some significant changes, including replacing income at levels higher than the minimum wage to ensure that the necessary incentives to take leave and to work remain in place.<sup>4</sup> The Business Council of Australia (BCA), representing the chief executive officers of 100 of Australia's leading companies, was also supportive of the PC's proposal, saying that it was a 'well-focused scheme for only a modest increase in government outlays'.<sup>5</sup> The Australian Chamber of Commerce and Industry (ACCI) considered that the PC's proposal placed too much of a burden on small business, but the Council of Small Business Organisations of Australia (COSBOA) welcomed the proposal wholeheartedly.<sup>6</sup>

There is also compelling evidence for widespread public support for a paid parental leave initiative with an Auspoll survey conducted in April 2009 finding that 'two out of three Australians clearly want the Federal Government to use the next federal budget to fund the scheme'. Although women were particularly in favour, the survey findings also show that a majority of Australian men also support the timely introduction of paid parental leave.<sup>7</sup>

But despite this backdrop of a well-costed, conservative but broadly supported proposal for paid parental leave, the global financial crisis now appears to have raised new doubts in the minds of policy-makers. The Finance Minister has given the strongest indication yet that Cabinet may postpone the introduction of the scheme until 2010 at the earliest. On 5 April 2009, Lindsay Tanner said that the primary budget focus would be on constraining spending and that paid parental leave was part of that consideration.<sup>8</sup> It is not clear how these comments are consistent with the government's stated goal of stimulating the economy through public spending in response to the global economic slowdown.

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<sup>2</sup>The Hon. Kevin Rudd MP, Prime Minister, quoted in 'Rudd backs paid maternity leave but won't commit to 18 weeks', *The Australian*, 29 September 2008, at <http://www.theaustralian.news.com.au/story/0,25197,24418877-601,00.html>.

<sup>3</sup>Ray, Rebecca, 2008, A Detailed Look at Parental Leave Policies in 21 OECD Countries, Center for Economic and Policy Research, September. Note that the Swedish and other European social insurance models are funded by contributions from employers and employees.

<sup>4</sup>Australian Council of Trade Unions, 2008, ACTU Submission in Response to the Productivity Commission Inquiry Draft Report, Paid Parental Leave: Support for Parents with Newborn Children, November.

<sup>5</sup>Business Council of Australia, 2008, 'BCA Supports Productivity Commission Parental Leave Proposal', 29 September.

<sup>6</sup>ABC Radio, *PM*, at <http://www.abc.net.au/pm/content/2008/x2377396.htm>, 29 September 2008.

<sup>7</sup>National Foundation for Australian Women, UnionsNSW, NSW Commission for Children and Young People, the Young Women's Christian Association and Catalyst Australia Incorporated, 2009, 'Australians clearly want paid parental leave in next budget', media release, 9 April.

<sup>8</sup>The Hon. Lindsay Tanner MP, Minister for Finance, at [http://www.financeminister.gov.au/transcripts/2009/tr\\_20090405\\_sunday.html](http://www.financeminister.gov.au/transcripts/2009/tr_20090405_sunday.html), 5 April 2009.

This paper argues that paid parental leave should be seen as providing both a short-term and long-term stimulus to the Australian economy, contributing immediate and equitable stimulatory effects across the economic landscape and a significant long-term boost to overall productivity and workforce participation. A paid parental leave scheme presents a win-win-win situation for families, businesses and the Australian economy.

## The Productivity Commission model

On 17 February 2008, the PC inquiry into paid parental leave was announced jointly by the Treasurer Wayne Swan, the Deputy Prime Minister Julia Gillard and Jenny Macklin, the Minister for Families, Housing, Community Services and Indigenous Affairs.<sup>9</sup> The PC subsequently developed its own model for a taxpayer-funded paid parental leave scheme,<sup>10</sup> which involved paid postnatal care for 18 weeks together with an additional two weeks of paid paternity leave. Payment would be made at the rate of the adult minimum wage, currently \$543.78 a week.<sup>11</sup> Other important features were:

- All employees would be eligible, as would the self-employed, contractors and casuals.
- Non-conventional family types would be eligible.
- Businesses would continue to provide superannuation contributions.
- The payment would be treated as taxable income.
- Recipients of paid parental leave would not be eligible for other payments from government such as the baby bonus and family benefits.

The gross cost of the PC scheme is estimated to be \$1.5 billion, of which \$110 million is the cost to employers, leaving approximately \$1.4 billion as the cost to government. Against that, the PC notes there will be savings through lower baby-bonus payments. If the savings on other family benefits (for example childcare rebates and family tax benefits) are also taken into account along with the tax payable on the paid parental leave, the net cost to the government is estimated by the PC to be around \$450 million per annum. As the following analysis demonstrates, there is an unavoidable degree of uncertainty that surrounds any such estimate.

There are approximately 285 000 live births in Australia each year, of which around 175 000 are to mothers who were employed prior to giving birth. Of this group, the PC claims that around 140 000 have sufficient employment tenure and hours of work to qualify for its proposed paid parental leave scheme, with take-up estimated to be 98 per cent of the eligible population. In addition, full-time equivalent take-up of paid paternity leave is assumed to be up to 25 per cent.

The cost to the budget of providing paid parental leave is uncertain, mainly because of the difficulties faced in predicting the number of probable beneficiaries. The PC's assessment of a gross cost of \$450 million is based on its estimate that 140 000 women a year will be

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<http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/010.htm&pageID=003&min=wms&Year=2008&DocType=0>

<sup>10</sup> Productivity Commission, 2008, *Paid Parental Leave: Support for Parents with Newborn Children, Draft Inquiry Report*, Canberra.

<sup>11</sup> The Australian Fair Pay Commission is currently holding the 2009 Minimum Wage Review and is likely to increase the minimum wage by two or three per cent.

eligible for paid maternity leave. However, the assumption that virtually all women who are eligible (98 per cent) are going to use the scheme seems very high for a number of reasons.

- There will be pressure on women from some employers to return to work early or not to avail themselves of the scheme.
- Some people may prefer to remain at work and rely on child-care arrangements; for example, the 30 per cent of parents of children under one year old who presently rely on child care.<sup>12</sup>
- Many women earn a great deal more than the minimum wage and so would be reluctant to take paid parental leave at the lower rate of pay. Note that full-time adult female employees earn on average \$1094.60 per week<sup>13</sup> or just over twice the minimum wage.

Further, the assumption of a 25 per cent take-up of paid paternity leave looks somewhat arbitrary, although this component would represent only a minor part of the costs of the scheme. The PC does not give any guidance about how this estimate was reached and it would appear to be on the high side when compared with the assumption of a very high take-up rate among eligible women. However, it is convenient to use the 25 per cent figure as it is in common usage and there is no reliable way of forecasting the actual numbers.

The PC scheme is based on the minimum wage and so provides less than a 50 per cent income replacement for full-time adult females on average weekly earnings. A flat rate seems appropriate for a government payment and is consistent with the view that government payments should not discriminate between recipients. It should be noted that European schemes for paid parental leave and other benefits<sup>14</sup> do offer income support based on previous income. However, while they usually rely on government regulation, those schemes are based on employer and employee contributions. When the paid parental leave scheme is introduced, initiatives to enhance it may re-open the debate about aligning payments to previous income, perhaps with a market-related component funded by employers.

## **Why paid parental leave is a good mechanism for stimulating the economy**

Several initiatives have already been introduced and others are being considered by the Rudd Government and the Reserve Bank of Australia in order to stimulate the economy, including reductions in interest rates, new infrastructure spending and the 2008 and 2009 stimulus packages. Some of these measures, especially the infrastructure projects, will have long lead times and require complex approval processes. The impact of paid parental leave, on the other hand, is likely to be felt across the economy at a much faster rate. Further factors indicating that paid parental leave, along with other government benefits, will deliver a strong stimulatory effect include:

- 1) The recipients of paid parental leave are geographically distributed across the country and the introduction of this leave will deliver a significant increase in income support to even the smallest communities. By contrast, large infrastructure projects will have the greatest direct impact in areas where they are being constructed and on specific industries such as building materials. In comparison to

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<sup>12</sup> ABS, 2008, *Child Care, Australia*, June 2005 second reissue, Cat no 4402.0.

<sup>13</sup> ABS, 2009, *Employee Earnings and Hours, Australia, Preliminary August 2008*, Cat No 6305.0.55.001

<sup>14</sup> Other benefits include unemployment insurance, retirement incomes and sick pay.

measures such as tax cuts, paid parental leave is likely to have a positive impact on lower-income areas.

- 2) Families with young children have a low 'propensity to save'. Lifecycle studies show that the young family is in fact likely to be saving very little or even dis-saving (i.e. borrowing), with their incomes tending to the low point in their lifecycle while their needs are relatively high. Compared to the average Australian, young families are inclined to spend any increase in their resources in the short term rather than to save it or pay down their mortgages. In addition, there is evidence from overseas that families with children will forgo spending on luxuries to meet the increased demand for other goods and services due to the children's presence.<sup>15</sup> Australian evidence shows similar trends and also confirms that families with children tend to sacrifice income from work in order to care for their children.<sup>16</sup> Again, this helps to ensure that the benefits of increased government expenditure flow rapidly into the rest of the economy.
- 3) Households eligible to receive paid parental leave are also inclined to have a low 'propensity to import'. A portion of any government spending will 'leak' overseas in the form of expenditure on imports and overseas travel but families with new children are significantly less likely to buy imported cars or go on overseas holidays than the community at large. Hence the macroeconomic benefits of injecting money into the economy through paid parental leave may be superior to the benefits of other forms of expenditure.

Overall, the spending and living patterns of young families combine to create a strong economic case for introducing paid parental leave. The equity benefits of doing so make the case even more compelling.

## **The likely macroeconomic impacts of paid parental leave**

The macroeconomic impact of the stimulus associated with the introduction of paid parental leave has some important flow-on implications. First, the net effect of the spending on the Commonwealth deficit is much smaller than the budgeted amount due to the likely impact of the stimulus on GDP and, in turn, on government taxation receipts. Making some reasonable assumptions about the Australian economy and using a multiplier of two, the net impact on the budget deficit will be an increase of \$50 million following each \$100 million stimulus.<sup>17,18</sup>

On that basis the PC scheme with a net cost of \$450 million should generate additional GDP worth \$0.9 billion, which is likely to create around 8900 new jobs in the long term.<sup>19</sup> Job

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<sup>15</sup> Douthitt, R. A. and Fedyk, J. M., 2005, 'The influence of children on family life cycle spending behaviour: Theory and evidence', *Journal of Consumer Affairs*, Vol 22(2).

<sup>16</sup> ABS, 1998, *Australian Social Trends 1998* Cat No 4102.0.

<sup>17</sup> With a multiplier of two, the \$100 million stimulus will generate additional GDP of \$200 million, which is assumed to be taxed at 25 per cent, just under the average tax share of GDP over the past decade. Hence the \$100 million stimulus will generate tax revenue of \$50 million giving a net impact of increasing the budget deficit by \$50 million.

<sup>18</sup> American estimates for the value of the multiplier following transfers to persons range between 0.8 and 2.2. See Congressional Budget Office, Letter to Hon. Judd Gregg, 4 February 2009. However, the true figure will likely be much higher in the context of accommodating macroeconomic policy. Therefore the assumption of a multiplier equal to two should be a reasonably conservative assumption when monetary and other policy is also stimulatory.

<sup>19</sup> This estimate is based on GDP per worker in the December quarter and assumes that the marginal jobs to GDP ratio will be the same as the average albeit with a lag. The employment response to any change in stimulus is likely to be slow, especially where changes are small.

creation of this magnitude would generate additional tax revenue of around \$225 million, further reducing the net cost of the scheme to \$225 million.<sup>20</sup>

In addition to the standard stimulus, further macroeconomic effects associated with paid maternity leave are likely. The PC estimates that the average leave duration would increase by nine weeks, which should have the effect of increasing the demand for labour by a similar amount in the short to medium term. As estimated by the PC, 140 000 mothers would take up paid parental leave each year, thus generating an additional demand for approximately 24 000 people.

Based on its review of overseas experience, the PC estimates that the introduction of paid parental leave would increase lifetime employment by an average of six months per woman. Greater attachment to the labour force suggests that, in the long run, the scheme will pay for itself due to the higher incomes generated and the higher taxes collected. The supply side impact of increasing labour supply by an average of six months per woman would boost the total female labour supply by at least one per cent or just under 50 000 women on today's figures. This is consistent with an increase in GDP of around \$2.5 billion per annum,<sup>21</sup> which is significantly larger than the on-going cost of the scheme at \$450 million per annum.<sup>22</sup>

Even from the narrow perspective of the effect on the Commonwealth budget, in the long term paid parental leave should generate \$625 million more tax per annum for the Australian Government,<sup>23</sup> which more than covers the annual \$450 million cost of the scheme. In other words, in the long term, paid parental leave will more than pay for itself, both in community benefits and budgetary terms.<sup>2425</sup>

Paid parental leave is, therefore, an ideal budgetary measure under present circumstances, even from the point of view of its macroeconomic implications. In the short term, it will stimulate the economy just as Australia is suffering the impact of the global economic crisis and in the long term, when the scheme matures, it will more than pay for itself by improving the supply side of the economy.

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<sup>20</sup> The Australia Institute understands that government departments that sponsor initiatives are not permitted to put up cabinet submissions claiming tax or other benefits that depend on behavioural assumptions such as those used here to calculate multiplier effects. Such a process does not, however, negate the existence of such benefits.

<sup>21</sup> This estimate is based on a one per cent increase in the female labour supply as at February 2009. It is assumed that all additional female workers earn only the minimum wage and that they work in industries that, on average, have the same wages share of value added as does the rest of the workforce. The average Commonwealth tax take is assumed to be 25 per cent of GDP, just under the average over the last decade or so.

<sup>22</sup> If we could assume that all the additional employment will be remunerated at the average weekly earnings rate for females (as opposed to the minimum rate), the above estimate should be roughly doubled. Thus the estimate of a boost to GDP of \$2.5 billion should be regarded as a very conservative estimate.

<sup>23</sup> It is assumed that the Commonwealth tax take is 25 per cent of the increase in GDP; 25 per cent of the \$2.5 billion additional GDP is \$625 million.

<sup>24</sup> The figures here are based on present data. Both the benefits and costs would be expected to grow in the future as the economy grows.

<sup>25</sup> The calculations reported here could be used to argue that a revenue-neutral long-run change could involve:

- increasing parental leave from 18 to 25 weeks or
- increasing the level of income support by 39 per cent or
- some combination of the two.

## **Conclusion**

Australia remains one of only two developed countries that do not have a paid parental leave scheme. Although opinion polls indicate that most Australians support the introduction of such a scheme and both the Prime Minister and Deputy Prime Minister have stated that Australia has waited too long for one, senior members of the government have recently suggested that Australia may not be able to afford paid parental leave in the 2009–10 Budget.

As this paper has argued, the opposite would appear to be the case. Paid parental leave provides an excellent conduit through which fiscal stimulus can be passed through to the rest of the economy. In the long term, the scheme will fund itself due to increased workforce participation on the part of women and associated increases in tax revenue. In both the short and long term and in addition to the benefits it will confer on the Australian economy, the introduction of such a scheme will clearly improve equity and enhance the wellbeing of young families.