

BUDGET IMPACTS OF CHANGES IN CHILD CARE TAX BENEFITS

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Executive Summary

Introduction

In February 2005, the House of Representatives Standing Committee on Family and Human Services (“the Committee”) resolved to conduct an inquiry into Balancing Work and Family. As part of this inquiry, the Committee is now looking at the issue of child care support and commissioned Econtech to analyse the impact on the federal budget of two alternative policy options relating to child care services. The first policy option is:

- a) replacing the current 30 per cent rebate for child care with a general tax deduction;
and
- b) extending the current Fringe Benefit Tax (FBT) exemption on employer funded child care so as to:
 - i. include all types of formal child care; and
 - ii. remove the “business premises” requirement for this exemption.

By removing the business premises requirement on the FBT exemption, this new policy would make all formal child care provided by employers FBT exempt.

The second policy option is:

- All the current child care assistance remains unchanged;
- Families are given the option to choose a general tax deduction or the Child Care Tax Rebate; and
- The current FBT exemption is extended so that all formal child care provided by employers becomes FBT exempt.

Importantly, Econtech was not commissioned to analyse changes to the current Child Care Benefit (CCB) arrangements. Therefore, this study assumes that the current CCB arrangements remain unchanged.

Further, Econtech was only commissioned to estimate the budget effects of alternative child care arrangements. However, the alternative child care policies being analysed by the Committee would have important behavioural and distributive effects that also need to be considered when making a decision on whether to change the current policies. The analysis of these behavioural and distributive effects is outside the scope of this study.

Whilst being as detailed as possible considering the time and information available for the preparation of this report, the calculations presented in this study are broad estimates of the effect of alternative child care arrangements on the Government budget and should only be taken as a broad indication of the likely budget effects of the alternative child care arrangements being analysed. When making the decision to implement a specific policy, more detailed estimates of the budget effects should be produced.

Current Government Child Care Assistance

The current financial supports for child care in Australia are:

- Child Care Benefit (CCB) -The CCB assists families with the costs of approved and registered child care. The payment of CCB varies depending on family income and work status, the number of children in care, the hours of care, and the type of child care used.
- Child Care Tax Rebate (CCTR) -In addition to the CCB, a claimant may be eligible for the 30 per cent CCTR if the claimant has used approved care, received CCB and met the CCB work, training and study test. The CCTR covers 30 per cent of out-of-pocket child care expenses for approved child care, with a rebate of up to \$4,000 (indexed) per child per year. The CCTR is a tax offset that reduces the tax calculated on income when a personal income tax return is lodged and is transferable between spouses if the claimant has insufficient tax liability to claim the full amount.
- Fringe Benefits Tax (FBT) Exemption -Under the current tax laws, child care fees are exempt from fringe benefits tax if the services are provided to employees on an employer's business premises or on business premises of a related company in a wholly owned company group. Importantly, this FBT exemption is not available if the employer pays for childcare provided by another party.

Costs of the Current Government Child Care Assistance

Based on data contained in the Child Care Survey (CCS) of the Australian Bureau of Statistics (June, 2005), Econtech estimated that the costs of the current CCTR to the Government are approximately \$266.7 million per year of operation.

Additionally, based on estimates provided by the Committee on the approximate number of employees salary sacrificing child care fees, Econtech calculated that the cost of the FBT exemption for child care fees is approximately \$14.08 million per year, which represents the forgone income tax stemming from the exemption.

Literature Survey

The evidence in the empirical literature, both Australian and international, on the impact that child care costs have on employment decisions is mixed and empirical results vary considerably with the methodology used as well as with the dataset.

Some studies, such as those by Teal (1992), Vandenheuvel (1996), Cobb-Clark et al. (2000), Rammohan and Whelan (2005), and Rammohan and Whelan (2006) find that the cost of child care is not a significant deterrent to labour market activity. Although the greatest demand for formal child care arises for work-related issues, these studies found that the cost of child care is not a barrier to parents' labour force participation decisions.

In contrast, other studies from the United States, Canada, United Kingdom, Germany, France, Japan and Australia find that higher child care costs have negative effects on labour participation and hours worked. Doiron and Kalb (2005) and Anderson and Levine (1999) present a comprehensive review of international literature on this field. A summary of studies on the effects of child care costs on participation rates and hours of work is presented in the body of the report. Generally, these studies found that policies that reduce the costs of child care induce an increase in both labour supply and child-care use. Nonetheless, the

range of estimated elasticities reported for both participation in the labour force and hours of work with respect to child care costs is rather large, ranging from just over zero to almost -1.

Aside from methodological differences, some of these studies use data on all mothers, while others use single mothers, and still others concentrate on married mothers. Some focus on mothers in low-income families. Some restrict their analysis to women with pre-school age children (under age 6), while others include women with children up to age 15. Under these circumstances, pinning down the specific factors that generate the discrepancies across studies is difficult. Thus, for this report, Econtech based its estimates of the changes in labour force participation and hours worked in the estimates presented in Doiron and Kalb (2005). The reason for this is twofold. First, although there are some studies that find that the cost of child care is not a barrier to parents' labour force participation decisions, the number of studies that do find a negative relationship between child care costs and employment (regardless of the econometric technique used) greatly outweighs the number of studies that find no relationship. Second, the study by Doiron and Kalb provides estimates that are specific to the labour supply in Australia.

Impacts on Families of the Alternative Child Care Arrangements

Under the alternative child care arrangements, the subsidy that a family would get for their child care fees would depend on the effective marginal tax rate (EMRT¹) of the highest income earner in the family. Therefore, families that are currently claiming the CCTR will pay lower child care fees under the alternative child care arrangements if the highest income earner in the family faces an EMRT (which equals the new deduction rate) higher than 30 per cent, which is the rate of the current rebate.

Table 1 shows the percentage increase/decrease in child care costs compared to the existing arrangements by type of family and family income. A couple with one parent working would have lower child care cost under the alternative arrangements because those arrangements would provide them with the child care subsidy for the first time. For families where both parents are working, the alternative arrangements would provide savings in child care costs provided that the highest income earner in the family has an annual taxable income of over \$25,000.

Table 1
Increase/Decrease in Cost of Child Care by Type of Family
Compared to Existing Arrangements

Couple Family with one parent working	
Weekly Family Income	Increase/Decrease in Cost of Childcare
Less than \$400	-15.00%
\$400-\$599	-15.00%
\$600-\$799	-35.50%
\$800-\$999	-31.50%
\$1000-1199	-31.50%
\$1200-\$1399	-31.50%
\$1400-\$1999	-41.50%
\$2000 or more	-41.50%

¹EMRT refers to the effective marginal rate of tax to be paid by taxpayer including the Medicare levy and the low income tax offset.

Couple Family with both parent working

Weekly Family Income	Increase/Decrease in Cost of Childcare
Less than \$400	21.43%
\$400-\$599	21.43%
\$600-\$799	21.43%
\$800-\$999	21.43%
\$1000-1199	-20.00%
\$1200-\$1399	-7.86%
\$1400-\$1999	-2.14%
\$2000 or more	-2.14%

One parent family

Weekly Family Income	Increase/Decrease in Cost of Childcare
Less than \$400	21.43%
\$400-\$799	-20.00%
\$800-\$1199	-2.14%
\$1200 or more	-2.14%

Source: Econtech estimates using ABS data

Note: Assumes that in couple families with both parents working, each parent earns 50 per cent of the family income and that parents receive income 52 weeks a year.

Effects of Alternative Arrangements on Labour Supply

The effects on the labour supply of the alternative arrangements will depend on various different factors, namely:

- If the family currently uses child care or not;
- The type of child care they use (formal/informal);
- If they currently salary sacrifice child care fees or no;
- The working status of the parents; and
- The level of income of the highest income earner.

To facilitate the understanding of all these effects, Econtech constructed the following tables that capture the before and after situation of families currently using formal child care and families not using child care but who have children aged 0-12 years. Families currently using informal care are not included in these tables because the new arrangements would not change their current situation.

Table 2
Families Currently Using Formal Child Care

Type of Family	Support received before	Support received under new arrangements	Effect
COUPLE FAMILIES			
Both parents working and not salary sacrificing child care fees.	CCB and rebate of 30% of child care out-of-pocket expenses.	CCB and CCTD that depends on effective marginal rate of tax of highest income earner.	Depends on the income of highest earner. If EMRT > 30%, family would pay less for child care. If EMRT=30% family is same as before. If EMRT < 30%, family would pay more for child care.

Type of Family	Support received before	Support received under new arrangements	Effect
Both parents working and one salary sacrificing child care fees.	FBT exemption (support is based on their EMRT)	Same as before	No change
Only one parent working and not salary sacrificing child care fees.	CCB	Can receive FBT exemption	Child care would be cheaper than before. Second parent chose not to work before when fees were more expensive. Making fees cheaper is unlikely to increase participation.
Only one parent working and salary sacrificing child care fees.	FBT exemption (support is based on their EMRT)	Same as before	No change
ONE PARENT FAMILIES			
Parent working and salary sacrificing child care fees.	FBT exemption (support is based on their EMRT)	Same as before	No change
Parent working and not salary sacrificing child care fees.	CCB and rebate of 30% of child care out-of-pocket expenses.	CCB and CCTD that depends on effective marginal rate of tax of the parent.	Depends on the income of parent. If EMRT > 30%, family would pay less for child care. If EMRT=30% family is same as before. If EMRT < 30%, family would pay more for child care.

Source: Econtech

Notes: - Assumes that current CCB arrangements remain unchanged.

- EMRT refers to the effective marginal rate of tax to be paid by taxpayer including the Medicare levy and the low income tax offset.

Table 3
Families Currently NOT Using Child Care

Type of Family	Support received before	Effect of new child care arrangements
COUPLE FAMILIES		
Both parents working	N/A	If under current arrangements both parents are working and not using child care, the new child care arrangements are unlikely to change their hours of work.
Only one parent working	N/A	Will only use child care and join the workforce if one of the parents earn enough to be in an EMRT > 30% (i.e. to pay lower child care fees than they would pay with the current rebate)
ONE PARENT FAMILIES		
Parent working	N/A	If under current arrangements parent is working and not using child care, the new child care arrangements are unlikely to change his/her hours of work.
Parent not working	N/A	Will only use child care and join the workforce if parent can earn enough to be in an EMRT > 30% (i.e. to pay lower child care fees than he/she would pay with the current rebate)

Source: Econtech

Notes: - Assumes that current CCB arrangements remain unchanged.

- EMRT refers to the effective marginal rate of tax to be paid by taxpayer including the Medicare levy and the low income tax offset.

Based on the information contained in Table 1 to 3, Econtech estimated the increase/decrease in the number of working hours of parents currently in the workforce, the effects of the new child care arrangements on labour force participation, and the effect that these changes would have on income tax collected by the Government.

To estimate the changes in labour force participation and hours worked, Econtech used the elasticity estimates presented in Doiron and Kalb (2005).

Importantly, the new arrangements would have two main effects. First, those parents in low income brackets for whom the child care costs increase with the new arrangements will decrease their working hours. This will decrease the amount of income tax revenue that the Government will receive. Second, those parents in high income brackets for whom the child care costs decrease with the new arrangements will increase their working hours. This will increase the amount of income tax revenue that the Government will receive. The net effect will depend on the magnitude of the increase and the decrease of hours worked and the income received for those working hours.

Budget Effects of the Alternative Child Care Arrangements

The estimated cost of the new alternative arrangements (extension of FBT exemption and CCTD) to the Government is approximately \$499.2 million per year of operation. Taking into consideration the savings from removing the existing arrangements (which cost to the Government approximately \$280.7 million per year), the net cost to the government of the alternative arrangements is \$218.5 million per annum. Table 4 below summarizes the estimated effects of the alternative child care arrangements on the Government Budget.

Table 4

Direct Effects on the Government Budget (\$million, annually)

Annual cost of new arrangements	\$500.2
Increase in income tax collected	\$1.0
Cost of Alternative Arrangements to Government	\$499.2
Savings from removing existing arrangements	\$280.7
Net Cost to Government of Alternative Arrangements	\$218.5

Source: Econtech Estimates.

In summary, compared with the current arrangements, the new child care arrangements would increase the Government costs by \$218.5 million a year. The main reason for this cost increase is the extension of the child care subsidy to couple families with only one parent working. The other reason is that for most of the families, tax deductibility provides a larger benefit than the tax rebate.

Budget Effects of Second Alternative Scenario

The second alternative scenario differs from the one just considered in that it gives the family the option to choose between the CCTR and the CCTD rather than just replacing the current CCTR with a general tax deduction.

The likely effects of this second alternative scenario are as follows.

- Couple families with both parents working will choose to claim the CCTD if the highest income earner in the family is in an EMRT² (which would be the new deduction rate) higher than 30 per cent, which is the rate of the current rebate. If the EMRT of the highest earner is less than 30 per cent, families will choose to claim the CCTR.
- Couple families with only one parent working are likely to choose the FBT exemption option because they can not claim the CCTR or CCTD.
- One parent families with parent working will choose to claim the CCTD if he/she is in an EMRT³ (which would be the new deduction rate) higher than 30 per cent, which is the rate of the current rebate. If his/her EMRT is less than 30 per cent, he/she will choose to claim the CCTR.

Econtech estimated that the cost of this new scenario to the Government is approximately \$542.7 million per year of operation. Taking into consideration the savings from removing the existing arrangements, the net cost to the government of the alternative arrangements is \$262 million per annum. Table 5 shows the direct effects on the Government budget on the new scenario by program.

Table 5
Direct Effects on the Government Budget of New Scenario
(Extension of FBT Exemption and Choice of CCTR or CCTD)

Program	Cost (\$million, annually)
Child Care Tax Rebate	\$85.5
Child Care Tax Deduction	\$322.7
Extended FBT Exemption	\$136.6
Increase in income tax collected	\$2.0
Total cost of the Alternative Scenario	\$542.7
Savings from removing existing arrangements	\$280.7
Net Cost to Government of Alternative Arrangements	\$262.0

Source: Econtech Estimates.

In conclusion, the first alternative scenario (CCTD and extension of FBT exemption) would increase the Government costs by \$218.5 million a year, while the second alternative scenario (choice of CCTR or CCTD and extension of FBT exemption) would increase the Government costs by \$262 million a year. The second scenario is more costly because it gives the families the option to choose the arrangements that would provide them with the highest child care subsidy.

² Including the Medicare levy and the low income tax offset.

³ Ibid

1. Introduction

In February 2005, the House of Representatives Standing Committee on Family and Human Services (“the Committee”) resolved to conduct an inquiry into Balancing Work and Family. The Committee aims to explore how the Australian Government can better help families balance their employment and family responsibilities. Between March 2005 and August 2006, the committee has held numerous public hearings and received many submissions on this issue. As part of this inquiry, the Committee is now looking at the issue of child care support and commissioned Econtech to analyse the impact on the federal budget of two alternative policy options relating to child care services. The first policy option is:

- c) replacing the current 30 per cent rebate for child care with a general tax deduction; and
- d) extending the current Fringe Benefit Tax (FBT) exemption on employer funded child care so as to:
 - i. include all types of formal child care; and
 - ii. remove the “business premises” requirement for this exemption.

By removing the business premises requirement on the FBT exemption, this new policy would make all formal child care provided by employers FBT exempt.

The second policy option is:

- All the current child care assistance remains unchanged;
- Families are given the option to choose a general tax deduction or the Child Care Tax Rebate; and
- The current FBT exemption is extended so that all formal child care provided by employers becomes FBT exempt.

Importantly, Econtech was only commissioned to estimate the budget effects of alternative child care arrangements. However, the alternative child care policies being analysed by the Committee would have important behavioural and distributive effects that also need to be considered when making a decision on whether to change the current policies. The analysis of these behavioural and distributive effects is outside the scope of this study.

Further, whilst being as detailed as possible considering the time and information available for the preparation of this report, the calculations presented in this study are broad estimates of the effect of alternative child care arrangements on the Government budget and should only be taken as a broad indication of the likely budget effects of the alternative child care arrangements being analysed. When making the decision to implement a specific policy, more detailed estimates of the budget effects should be produced.

This report is structured as follows.

- Section 2 outlines the current Government child care assistance.
- Section 3 describes the alternative child care assistance arrangements that the Committee is analysing.
- Section 4 presents a literature review of previous studies on child care costs and labour supply.

- Section 5 describes the effects of the current child care assistance on employee remunerations and Government's costs.
- Section 6 presents the effects of the alternative child care assistance arrangements on the Government Budget.
- Section 7 presents the effects of the additional scenario of child care arrangements on the Government Budget.
- Section 8 present the references used to prepare this report.

While all care, skill and consideration has been used in the preparation of this report, the findings refer to the terms of reference of the House of Representatives Standing Committee on Family and Human Services and are designed to be used only for the specific purpose set out below. If you believe that your terms of reference are different from those set out below, or you wish to use this work or information contained within it for another purpose, please contact us.

The specific purpose of this report is to analyse the impact on the federal budget of two alternative policy options relating to child care services.

The findings in this report are subject to unavoidable statistical variation. While all care has been taken to ensure that the statistical variation is kept to a minimum, care should be used whenever using this information. This report only takes into account information available to Econtech up to the date of this report and so its findings may be affected by new information. Should you require clarification of any material, please contact us.

2. Current Government Child Care Assistance

This section outlines the current financial support for child care in Australia⁴ and it is divided in three sections. Section 2.1 outlines the child care benefit. Section 2.2 presents the child care tax rebate. Finally, Section 2.3 outlines the fringe benefits tax exemption.

2.1 Child Care Benefit

The Child Care Benefit (CCB) assists with the costs of approved and registered child care. Approved child care is provided by a child care service that has been approved to receive CCB payments on behalf of families. Most long day care, family day care, outside school care, vacation care, occasional care services, and some in house care offer approved care. Registered child care is care provided by nannies, grandparents, relatives or friends who are registered as carers with the Family Assistance Office.

To be eligible for a CCB, the following conditions must be met:

- Claimant's child attends an approved or registered child care;
- Claimant is liable for paying child care fees;
- Claimant is living permanently in Australia, is an Australian or New Zealand citizen or hold a relevant visa; and
- Claimant's child is immunised or exempt from the immunisation requirements.

The payment of CCB varies depending on family income and work status, the number of children in care, the hours of care, and the type of child care used. Importantly, from 3 July 2006, there have been changes to the number of hours a family can receive CCB for children in approved child care. These changes affect families who receive CCB as reduced fees. Families who claim CCB as a lump sum payment will be affected when they lodge their claim for the next financial year.

Depending on the family circumstances, a family can be entitled to the following care hours.

- Approved care- CCB is limited to 24 hours of care per child per week unless the work, training, study test is met. If this test is met, up to 50 hours care per child per week can be obtained. A claimant can get more than 50 hours of CCB if both the claimant and his (her) partner are both unavailable at the same time to care for their child (en) due to work, study or training commitments. CCB is only payable above 50 hours per week for the actual hours the child physically attended the child care service. The payment is subject to an income test but not an assets test.
- Registered care- CCB is limited to 50 hours per child per week if the claimant is working, training or studying at some point in time or has an exemption.

The basic CCB rates for approved and registered child care are outlined below.

- Approved care- every family using approved child care is eligible for at least the minimum rate of CCB, which is currently \$0.497 per hour (up to \$24.85 for 50 hours of approved care). The maximum rate per week for 50 hours of approved care is \$148 for

⁴ The information contained in this section is mainly sourced from the Australian Taxation Office website- www.ato.gov.au.

one non-school child (\$ 2.96 per hour per child), \$309.35 for two non-school children (\$3.09 per hour per child), \$482.84 for three non-school children (\$ 3.21 per hour per child), and an additional \$160.94 for each additional non-school child in care after the third (\$3.21 per hour per additional child). Rates for school children are 85 per cent of the above non-school rates.

The maximum rate for approved care is payable for actual annual family income under \$34, 310 or if the claimant or the claimant’s partner are receiving an income support payment (such as Parenting Payment of Newstart). As income increases above this threshold, the amount of CCB decreases. A claimant receives the minimum rate payable for annual family incomes over the following thresholds:

Number of children in care	Upper income threshold
1	\$98, 348
2	\$106 629
3	\$121 130 + \$20 221 for each child in care, after the third.

- Registered care- families using registered care can only claim the minimum rate of the CCB (\$0.497 per hour, up to \$24.85 for 50 hours of registered care) and cannot claim the Child Care Tax Rebate (explained in the following section) for any out of pocket expenses. Rates for school children are 85 per cent of these non-school rates. CCB for registered care is not subject to an income test.

2.2 Child Care Tax Rebate

In addition to the CCB discussed above, a claimant may be eligible for the 30 per cent Child Care Tax Rebate (CCTR) if the claimant has used approved care, received CCB and met the CCB work, training and study test.

The CCTR covers 30 per cent of out-of-pocket child care expenses for approved child care, with a rebate of up to \$4,000 (indexed) per child per year. Out-of-pocket expenses are paid child care fees, less CCB entitlements.

The CCTR is not a “cash in hand” refund. It is a tax offset that reduces the tax calculated on income when a personal income tax return is lodged. The CCTR is transferable between spouses if the claimant has insufficient tax liability to claim the full amount.

The CCTR payment will be received by the claimant at least 12 months after the child care costs have been incurred and the delay could be more than 2 years.

This benefit does not cover “registered care” (such as care provided by nannies, grandparents, relatives or friends).

2.3 Fringe Benefits Tax Exemption

Fringe benefits tax (FBT) is a tax paid on certain benefits employers provide to their employees or their employees’ associates. FBT is separate from income tax and is based on the taxable value of the various fringe benefits provided.

Under the current tax laws, child care fees are exempt from fringe benefits tax if the services are provided to employees on an employer's business premises or on business premises of a related company in a wholly owned company group. Business premises can include premises shared with multiple employers at a separate site used solely for child care purposes. Employers can also sponsor a child care service, reserve places in an existing service, or use an agency to find suitable child care places in the wider community. Payments made by employers to secure priority access for employees' children in an eligible child care facility may also be considered exempt of FBT. Importantly, this FBT exemption is not available if the employer pays for childcare provided by another party.

Significantly, this FBT exemption only supports employees of large organisations that can afford to establish in-house child care facilities and does not support people employed in small and medium companies or those self-employed.

3. Alternative Child Care Assistance Arrangements

The House of Representatives Standing Committee on Family and Human Services is analysing two alternative policy changes relating to the current Government support for child care services. The first policy option is:

- e) replacing the current 30 per cent rebate for child care with a general tax deduction; and
- f) extending the current Fringe Benefit Tax (FBT) exemption on employer funded child care so as to:
 - i. include all types of formal child care; and
 - ii. remove the “business premises” requirement for this exemption.

By removing the business premises requirement on the FBT exemption, this new policy would make all formal child care provided by employers FBT exempt.

Under this first policy option, the families could choose between two options:

- Claim the CCB plus a general tax deduction; or
- Salary sacrifice child care fees.

Consistent with the general philosophy of the CCTR, the child care tax deduction (CCTD) would be an eligible option only if both parents are working at the time. Single parents working full time would also be able to claim the deduction. Furthermore, consistent with the current practice of the CCTR, parents can select which one will claim the deduction. Importantly, under the new CCTD, the parent earning the highest salary (and hence facing the highest effective marginal rate of tax) would be the most likely to claim the deduction.

With respect to the FBT exemption, the new child care arrangements would imply that all child care payments provided by employers would be generally FBT exempt (i.e. this would be equivalent to removing the business premises rule). Consistent with the current practice, there would be no work test for salary sacrificing. Therefore, couple families with only one parent working are likely to choose the FBT exemption option.

The second policy option is:

- All the current child care assistance remains unchanged;
- Families are given the option to choose a general tax deduction or the Child Care Tax Rebate; and
- The current FBT exemption is extended so that all formal child care provided by employers becomes FBT exempt.

Importantly, Econtech was not commissioned to analyse changes to the current Child Care Benefit (CCB) arrangements. Therefore, this study assumes that the current CCB arrangements remain unchanged.

4. Previous Studies on Child Care Costs and Labour Supply

This section reviews a selection of studies available in the empirical literature on the relationship between child care and employment decisions. Whilst being as comprehensive as possible considering the time available for the preparation of this report, the list of studies contained in this review is by no means exhaustive. However, the studies presented in this section provide a useful source of estimated parameters relating to the effects of child care costs on participation rates and hours of work.

The evidence in the empirical literature, both Australian and international, on the impact that child care costs have on employment decisions is mixed and empirical results vary considerably with the methodology used as well as with the dataset.

Some studies, such as those by Teal (1992), Vandenheuvel (1996), Cobb-Clark et al. (2000), Rammohan and Whelan (2005), and Rammohan and Whelan (2006) find that the cost of child care is not a significant deterrent to labour market activity. Although the greatest demand for formal child care arises for work-related issues, these studies found that the cost of child care is not a barrier to parents' labour force participation decisions.

In contrast, other studies from the United States, Canada, United Kingdom, Germany, France, Japan and Australia identify a negative relationship between child care costs and labour participation and between child care costs and hours worked. Doiron and Kalb (2005) and Anderson and Levine (1999) present a comprehensive review of international literature on this field. A summary of studies on the effects of child care costs on participation rates and hours of work is shown in Table 4.1.

Generally, the studies presented in Table 4.1 found that policies that reduce the costs of child care induce an increase in both labour supply and child-care use. Nonetheless, as can be seen in the table, the range of estimated elasticities reported for both participation in the labour force and hours of work with respect to child care costs is rather large, ranging from just over zero to almost -1. These studies also found that the use of child care by employed mothers is more price sensitive than for unemployed mothers and that formal child care is also more sensitive to price and wage effects than informal care. Further, Doiron and Kalb (2005) found that males in two-parent households are hardly affected by child-care fee increases.

Table 4.1
International Estimates of Elasticities of Labour Supply to Child Care Costs

Author (s)	Country (Year)	Population (age of youngest child)	Estimated Elasticity	
			Participation rate	Average hrs worked
Anderson & Levine (1999)	US (1980–1994)	All women (<13)	-0.055 to -0.358	
Blau & Hagy (1998)	US (1989/1990)	Married & single mothers (<7)		-0.20 ^a
Blau & Robins (1988)	US (1980)	Married women (<14)	-0.38 ^a	

Author (s)	Country (Year)	Population (age of youngest child)	Estimated Elasticity	
			Participation rate	Average hrs worked
Connelly (1992)	US (1984/1985)	Married women (<13)	-0.20 ^b	
Ribar (1992)	US (1985)	Married women (<15)		-0.74 ^b or -0.64 ^a
US Government Accounting Office (1994)	US (1990)	All mothers (<13)		
		Poor	-0.50	
		Near Poor	-0.34	
		Non-poor	-0.19	
Kimmel (1995)	US (1988)	Single mothers in poverty	-0.35	
Ribar (1995)	US (1984/1985)	Married women (<15)		-0.024 to -0.088 ^a
Averett, et al. (1997)	US (1986)	Married women (<6)	-0.78	
Gelbach (1997)	US (1980)	Single mothers (<5)	-0.13 to -0.36	
Powell (1997)	Canada (1988)	Married women (<6)	-0.38 ^b	-0.32 ^b
Kimmel (1998)	US (1988)	Single mothers (<13)	-0.22	
		Married mothers (<13)	-0.92	
Han and Walsfogel (1998)	US (1991-1994)	Single mothers (<6)	-0.31	
		Married mothers (<6)	-0.21	
Powell (2002)	Canada (1988)	Married women (<7)	-0.16 ^{a, c}	
Michalopoulos & Robins (2000) ^d	Canada (1988) & US (1990)	Married mothers (<5)	-0.156 (all) ^a -0.142 (US) ^a -0.203 (Canada) ^a	
Michalopoulos & Robins (2002) ^d	Canada (1988) & US (1990)	Single parents (<5)	-0.26 ^a	
Blundell <i>et al.</i> (2000) ^e	UK (1994– 1996)	Married women: Unemployed partner	-0.075 ^a	-0.084 ^a

Author (s)	Country (Year)	Population (age of youngest child)	Estimated Elasticity	
			Participation rate	Average hrs worked
		Employed partner	-0.066 ^a	-0.048 ^a
		Single women	-0.021 ^a	-0.020 ^a
Kornstad & Thoresen (2002)	Norway (1998)	Married women (1-2)	-0.12 ^a	-0.14 ^a
Wrohlich (2004)	Germany (2002)	Married women (<6)	-0.03 (east) ^a -0.07 (west) ^a	-0.04 (east) ^a -0.09 (west) ^a
Choné <i>et al.</i> (2003)	France (1997)	Married women (<3)	-0.01 ^a	-0.02 ^a
		Married women (<7)	-0.01 ^a	-0.01 ^a
Oishi (2002)	Japan (1998)	Married women (<7)	-0.60	
Doiron and Kalb (2005) ^f	Australia (1996/1997)	Married women (<12):		
		Total	-0.020 or -0.020 ^a	-0.021 or -0.034 ^a
		Low wages	-0.023 or -0.047 ^a	-0.027 or -0.045 ^a
		Preschool child	-0.050 or -0.050 ^a	-0.048 or -0.066 ^a
		Preschool child & low wages	-0.031 or -0.061 ^a	-0.053 or -0.079 ^a
		Lone parents (<12):		
		Total	-0.050 or -0.100 ^a	-0.053 or -0.150 ^a
		Low wages	-0.038 or -0.189 ^a	-0.062 or -0.263 ^a
		Preschool child	-0.136 or -0.136 ^a	-0.175 or -0.280 ^a
		Preschool child & low wages	-0.126 or -0.000 ^a	-0.216 or -0.054 ^a

Source: Doiron and Kalb (2005) and further additions from Anderson and Levine (1999).

a Evaluated at each observation and averaged across all observations.

b Evaluated at the sample means.

c This elasticity is derived from the simulation of a decrease in the formal child-care price ('centre price') in table 4 in Powell (2002).

d This elasticity is for a price change in the base model (see table 5, p. 486).

e These elasticities are derived from tables 7-9 and 11 in Blundell *et al.* (2000).

f Both the results from doubling the gross price and doubling the net costs (largest effects) are presented.

The papers presented in Table 4.1 use different methodological approaches to study the impact of the variability of child care costs on employment decisions. Most of these studies employ a probit model to estimate the discrete employment decisions. Other studies use a structural model based on utility maximizing behaviour and specific functional form

assumptions and estimate the parameters for the model. Another methodological approach used is to estimate a maximum likelihood model that incorporates the probability that an individual's choices rest on any particular segment of their budget constraint.

Aside from these methodological differences, some studies use data on all mothers, while others use single mothers, and still others concentrate on married mothers. Some focus on mothers in low-income families. Some restrict their analysis to women with pre-school age children (under age 6), while others include women with children up to age 15. Under these circumstances, pinning down the specific factors that generate the discrepancies across studies is difficult. Thus, for this report, Econtech based its estimates of the changes in labour force participation and hours worked in the estimates presented in Doiron and Kalb (2005). The reason for this is twofold. First, although there are some studies that find that the cost of child care is not a barrier to parents' labour force participation decisions, the number of studies that do find a negative relationship between child care costs and employment (regardless of the econometric technique used) greatly outweighs the number of studies that find no relationship. Second, the study by Doiron and Kalb provides estimates that are specific to the labour supply in Australia.

5. Effects of the Current Child Care Assistance

This section presents the effects of the current child care financial assistance on employee remunerations and on Government expenses. Section 5.1 provides examples of the difference that the current Government financial supports for child care make to the total remuneration package of an employee. Section 5.2 analyses the current cost of the child care tax rebate for the Government. Finally, Section 5.3 analyses the current cost of the FBT exemption for the Government.

5.1 Effects on Employee Remunerations

Table 5.1 examines examples of the difference that the current Government financial supports for child care make to the total remuneration package of an employee. The table looks at an employee with a set \$65,000 salary package. In the first case, part of this package is access to FBT-exempt child care facilities. The second package includes child care paid by the employer through employee's salary sacrifice, but this is not provided on-site. The third package does not include any child care assistance; hence the employee has to pay for these expenses.

Table 5.1
Effects of Current Child Care Assistance on Employee Remunerations

	In-house Child Care (1)	Off-site Child Care paid by employer (2)	Off-site Child Care paid by employee (3)
Wages & salary	\$50,459	\$50,459	\$59,633
Child Care	\$10,000	\$10,000	\$0
Superannuation	\$4,541	\$4,541	\$5,367
Total Employee package	\$65,000	\$65,000	\$65,000
Income tax	\$11,244	\$11,244	\$14,134
FBT	\$0	\$8,692	\$0
Child Care Benefit	\$0	\$0	-\$814
Child Care Tax Rebate	\$0	\$0	-\$2,756
Total Taxes less rebates/benefits	\$11,244	\$19,936	\$10,565
Net Employee package	\$53,756	\$45,064	\$54,435

Source: Econtech estimates.

a CCB can not be claimed when an employee is salary sacrificing childcare fees.

b The CCTB can only be access by employees who received CCB.

c Assumes the minimum CCB rate is received.

While the total employee package is the same value in all cases, the tax treatment is quite different.

- In the first case, the employee is able to take less of his/her package as taxable salary and is thus paying less income tax. This is possible because the employer is offering an employee benefit, in the form of child care assistance, which is FBT exempt. Nonetheless, in this case the employee is not eligible to receive either the CCB or the CCTB.
- In the second case, while the package structure and the income tax component is the same, the child care assistance is subject to FBT. Although the FBT is paid by the employer, it would generally be incorporated into the employee's total package, leaving

the employee worse off under the off-site child care scenario. Also, because the employer is the person ultimately liable for the child care fees, the employee cannot get the CCB and hence cannot get the CCTB either.

- In the third case, a larger proportion of the employee's package is subject to income tax. This is because, in this case, the employee does not have the option to salary sacrifice child care assistance. Nonetheless, as the employee has to pay child care and incur in out-of-pocket expenses, he can get the CCB and claim the 30 per cent child care rebate.

As a result of all these different effects, an employee is better off in the third scenario where he/she pays for off-site child care facilities out of his/her pocket.

5.2 Cost of Child Care Tax Rebate for the Government

Econtech calculated the yearly cost of the CCTR for the Government based on data contained in the Child Care Survey (CCS) of the Australian Bureau of Statistics (June, 2005). The main inputs and assumptions used by Econtech to estimate this cost are the following.

Inputs

- Data on number of children aged 0–12 years that used formal child care by weekly cost of care. These data is presented in Table 5.2.
- Number of children in formal child care for whom the CCB was claimed: 585,600 (Source: Table 15, Child Care Survey, ABS).
- Number of children who used formal care in couple families with both parents working (includes mother working part time): 393,100 (Source: Table 21, Child Care Survey, ABS).
- Number of children who used formal care in one parent families with parent working: 96,100 (Source: Table 22, Child Care Survey, ABS).

Assumptions

- The weekly cost of care per cost bracket in Table 5.2 is assumed to be the average between the minimum and the maximum rate paid.
- The numbers of weeks paid for child care are assumed to be 52.
- Estimates do not include parents looking for work or studying/training.
- Families receive the maximum amount of rebate they can claim for their out-of-pocket expenses.
- The CCTR costs are calculated without taking into account the effect of delaying the payment of the rebate (i.e. claiming child care costs from the year 2004-05 at the end of the financial year 2005-06).

Based on these inputs and assumptions, Econtech estimated that the CCTR costs to the Government approximately \$266.7 million per year of operation.

Table 5.2
Children Aged 0–12 Years Who Used Child Care, Type Of Care By Weekly Cost Of Care (a). Australia, June 2005

	Weekly cost of care								Total
	No cost	\$1–\$9	\$10–\$19	\$20–\$39	\$40–\$59	\$60–\$79	\$80–\$99	\$100 or more	
NUMBER OF CHILDREN ('000)									
Formal care(b)									
Before and/or after school care	15.1	50.9	49.0	60.7	31.4	11.4	5.1	6.3	230.0
Long day care centre	6.4	15.6	31.1	72.1	56.1	33.1	28.3	81.9	324.7
Family day care	8.3	16.5	15.9	30.2	8.7	8.2	7.5	11.5	106.9
Occasional care centre	4.1	15.3	12.7	9.6	5.6	2.5	0.0	1.6	51.4
Other formal care	3	4.5	3.3	2.2	2.2	0.3	0.9	2.2	18.5
Children who used formal care(b)(c)(d)	34.0	96.6	106.4	166.7	105.2	57.2	40.0	105.0	711.5
Informal care									
Grand parent	640.7	1.0	3.5	7.1	3.3	4.0	0.8	0.9	661.2
Other relative (e)	289.1	0.9	1.1	5.2	3.2	2.0	0.4	2.3	304.3
Other person	146.4	3.5	8.9	16.7	9.3	9.2	0.5	12.8	207.3
Children who used informal care (d)(f)	1007.5	5.3	13.6	29.0	15.8	15.2	1.7	16.0	1104.1
Children who used formal care(b) only	24.0	59.8	67.8	110.1	64.3	34.3	21.7	67.2	449.3
Children who used informal care only	768.9	4.6	10.4	18.7	12.0	12.5	1.7	13.1	841.9
Children who used formal(b) and informal care	8.7	34.7	36.4	55.3	39.4	24.9	21.3	41.6	262.2
All children aged 0–12 years who used child care	801.6	99.1	114.6	184.1	115.7	71.7	44.7	121.9	1553.4

Source: Child Care Survey, ABS (June 2005)

(a) Net cost to parent(s) after the Child Care Benefit has been paid but does not include adjustment for the new Child Care Tax Rebate.

(b) In surveys prior to 2005, the definition of 'formal care' included preschool.

(c) All children who used formal care, including those who used both formal and informal care.

(d) Components do not add to total as children could use more than one type of care.

(e) "Other relative" includes non-resident parent, brother/sister and other relative.

(f) All children who used informal care, including those who used both informal and formal care

5.3 Cost of FBT Exemption for the Government

The cost of the FBT exemption for child care fees is shown in Table 5.3. As shown in this table, the cost for the Government is the forgone income tax stemming from the exemption. Importantly, the exact number of employees salary sacrificing for child care under the FBT exemption is not known because exempt benefits do not have to be reported to the Australian Taxation Office. Therefore, the estimates presented in Table 5.3 were based on estimates provided by the Committee on the approximate number of employees salary sacrificing child care fees.

Table 5.3
Estimated Cost of the FBT

Employees Salary Sacrificing child care (FBT exempt) ^(a)	10,000
Average annual payment for in-house child care ^(b)	\$ 6,400
Total income not taxed	\$ 64,000,000
Average income tax rate in the economy ^(c)	22%
Forgone income tax	\$ 14,080,000

Source: Econtech's estimates.

(a) Estimate provided by the Committee.

(b) Source: McMillan Shakespeare Submission to the Committee.

(c) 22 per cent is the average tax rate (total tax as a proportion of income) for a worker earning the male average wage in Australia. Source: ATO, International Comparison of Australian Taxes Report, April 2006.

6. Effects of Alternative Child Care Assistance Arrangements

This section presents the effects of the alternative child care assistance arrangements described in Section 3 and it is structured as follows. Section 6.2 presents the effects of the alternative child care arrangements on the child care costs for families. Section 6.3 describes the direct effects on the Government costs of replacing the current CCTR with a general tax deduction and of extending the FBT exemption. Finally, Section 6.4 presents effects of the new child care assistance arrangements in the hours of work for families using formal child care and the changes in participation rate for families currently not using child care.

6.1 New Cost of Child Care

The current weekly cost of care for families using formal care by type of care is shown in Table 5.2 in the previous section. This cost represents the net cost to parent(s) after the CCB has been paid but does not include adjustments for the CCTR. Table 6.1 below shows the weekly cost of care after the CCTR has been deducted.

Table 6.1
Weekly Cost of Care (Net of CCB)

Cost Bracket	Current Cost after CCB	Current Cost after CCTR
No cost	\$0.0	\$0.0
\$1–\$9	\$5.0	\$3.5
\$10–\$19	\$14.5	\$10.2
\$20–\$39	\$29.5	\$20.7
\$40–\$59	\$49.5	\$34.7
\$60–\$79	\$69.5	\$48.7
\$80–\$99	\$89.5	\$62.7
\$100 or more	\$100.0	\$70.0

Source: Econtech estimates using ABS data.

Note: Assumes that the weekly cost of care per cost bracket is the average between the minimum and the maximum rate.

Under the alternative child care arrangements, the subsidy that a family would get for their child care fees would depend on the effective marginal rate of tax⁵ (EMRT) of the highest income earner in the family. Tables 6.2 to 6.4 show the new deduction rate for families with different income. As shown in the tables, families that are currently claiming the CCTR will only pay cheaper child care fees under this new arrangements if the highest income earner in the family faces a effective marginal rate of tax (which equals the new deduction rate) higher than 30 per cent, which is the rate of the current rebate.

Table 6.2
New Deduction Rate for Couple Families with One Parent Working

Weekly Family Income	Yearly Income	Effective Marginal Rate of Tax= new deduction rate
Less than \$400	\$400	15.0%
\$400-\$599	\$500	15.0%
\$600-\$799	\$700	35.5%
\$800-\$999	\$900	31.5%
\$1000-1199	\$1,100	31.5%

⁵ Including the Medicare levy and the low income tax offset.

Weekly Family Income	Yearly Income	Effective Marginal Rate of Tax= new deduction rate
\$1200-\$1399	\$1,300	31.5%
\$1400-\$1999	\$1,700	41.5%
\$2000 or more	\$2,000	41.5%

Source: Econtech estimates using ABS data

Notes: - Assumes that the weekly income per income bracket is the average between the minimum and the maximum income and that parents receive income 52 weeks a year.

- The effective marginal rate of tax includes Medicare levy and the low income tax offset. Medicare levy is calculated based on the following low income thresholds: \$16,284 for individuals and \$27,478 for families.

Table 6.3

New Deduction Rate for Couple Families with Both Parents Working

Weekly Family Income	Yearly Income	Effective Marginal Rate of Tax= new deduction rate
Less than \$400	\$200	15.0%
\$400-\$599	\$250	15.0%
\$600-\$799	\$350	15.0%
\$800-\$999	\$450	15.0%
\$1000-1199	\$550	44.0%
\$1200-\$1399	\$650	35.5%
\$1400-\$1999	\$850	31.5%
\$2000 or more	\$1,000	31.5%

Source: Econtech estimates using ABS data

Notes: - Assumes that the weekly income per income bracket is the average between the minimum and the maximum income, that the highest income earner earns 50 per cent of the family income and that parents receive income 52 weeks a year.

- The effective marginal rate of tax includes Medicare levy and the low income tax offset. Medicare levy is calculated based on the following low income thresholds: \$16,284 for individuals and \$27,478 for families.

Table 6.4

New Deduction Rate for One Parent Families

Weekly Family Income	Yearly Income	Effective Marginal Rate of Tax= new deduction rate
Less than \$400	\$400	15.0%
\$400-\$799	\$600	44.0%
\$800-\$1199	\$1,000	31.5%
\$1200 or more	\$1,200	31.5%

Source: Econtech estimates using ABS data

Notes: - Assumes that the weekly income per income bracket is the average between the minimum and the maximum income and that parents receive income 52 weeks a year.

- The effective marginal rate of tax includes Medicare levy and the low income tax offset. Medicare levy is calculated based on the following low income thresholds: \$16,284 for individuals and \$27,478 for families.

Since only some families will face a effective marginal rate of tax higher than 30 percent, the child care costs under the new arrangements will not decrease for all the families. Table 6.5

shows the percentage increase/decrease in child care costs compared to the existing arrangements by type of family and family income. A couple with one parent working would have lower child care cost under the alternative arrangements because those arrangements would provide them with the child care subsidy for the first time. For families where both parents are working, the alternative arrangements would provide savings in child care costs provided that the highest income earner in the family has an annual taxable income of over \$25,000.

Table 6.5
Increase/Decrease in Cost of Child Care by Type of Family
Compared to Existing Arrangements

Couple Family with one parent working

Weekly Family Income	Increase/Decrease in Cost of Childcare
Less than \$400	-15.00%
\$400-\$599	-15.00%
\$600-\$799	-35.50%
\$800-\$999	-31.50%
\$1000-1199	-31.50%
\$1200-\$1399	-31.50%
\$1400-\$1999	-41.50%
\$2000 or more	-41.50%

Couple Family with both parent working

Weekly Family Income	Increase/Decrease in Cost of Childcare
Less than \$400	21.43%
\$400-\$599	21.43%
\$600-\$799	21.43%
\$800-\$999	21.43%
\$1000-1199	-20.00%
\$1200-\$1399	-7.86%
\$1400-\$1999	-2.14%
\$2000 or more	-2.14%

One parent family

Weekly Family Income	Increase/Decrease in Cost of Childcare
Less than \$400	21.43%
\$400-\$799	-20.00%
\$800-\$1199	-2.14%
\$1200 or more	-2.14%

Source: Econtech estimates using ABS data

Note: Assumes that in couple families with both parents working, each parent earns 50 per cent of the family income and that parents receive income 52 weeks a year.

6.2 Effects of Alternative Arrangements on Government Costs

Econtech calculated the yearly cost of the alternative arrangements for the Government using the information presented in Section 6.1 about the new costs of child care for families and information about the current cost of child care cost presented in Section 5.2. Also, Econtech used the following assumptions to estimate this cost.

Assumptions

- The numbers of weeks paid for child care are assumed to be 52.
- Estimates do not include parents looking for work or studying/training.
- The number of families using formal child care with both parents not working is approximately zero.
- Families receive the maximum amount of deduction they can claim for their out-of-pocket expenses.
- Couple families with only one parent working will choose the FBT exemption. The rest of the families choose the CCTD option.

Based on the inputs and assumptions explained above, Econtech estimated that the cost of the new alternative arrangements (extension of FBT exemption and CCTD) to the Government is approximately \$500.2 million per year of operation. In comparison with the current arrangements, which cost to the Government approximately \$280.7 million per year (CCTR and current FBT exemption), these new arrangements will increase the Government costs by \$219.5 million a year. Importantly, these estimates only represent the direct cost to the Government for the subsidies paid and do not include the effects that the new arrangements would have on the labour supply, and subsequently, on the income tax collected by the Government. The effects of the alternative arrangements on the labour supply of families with children under the age of 12 are presented in the next section.

6.3 Effects of Alternative Arrangements on Labour Supply

The effects on the labour supply of the alternative arrangements will depend on various different factors, namely:

- If the family currently uses child care or not;
- The type of child care they use (formal/informal);
- If they currently salary sacrifice child care fees or no;
- The working status of the parents; and
- The level of income of the highest income earner.

To facilitate the understanding of all these effects, Econtech constructed the following tables that capture the before and after situation of families currently using formal child care and families not using child care but who have children aged 0-12 years. Families currently using informal care are not included in these tables because the new arrangements do not change their current situation.

Table 6.5
Families Currently Using Formal Child Care

Type of Family	Support received before	Support received under new arrangements	Effect
COUPLE FAMILIES			
Both parents working and not salary sacrificing child care fees.	CCB and rebate of 30% of child care out-of-pocket expenses.	CCB and CCTD that depends on effective marginal rate of tax of highest income earner.	Depends on the income of highest earner. If EMRT > 30%, family would pay less for child care. If EMRT=30% family is same as before. If EMRT < 30%, family would pay more for child care.
Both parents working and one salary sacrificing child care fees.	FBT exemption (support is based on their EMRT)	Same as before	No change
Only one parent working and not salary sacrificing child care fees.	CCB	Can receive FBT exemption	Child care would be cheaper than before. Second parent chose not to work before when fees were more expensive. Making fees cheaper is unlikely to increase participation.
Only one parent working and salary sacrificing child care fees.	FBT exemption (support is based on their EMRT)	Same as before	No change
ONE PARENT FAMILIES			
Parent working and salary sacrificing child care fees.	FBT exemption (support is based on their EMRT)	Same as before	No change
Parent working and not salary sacrificing child care fees.	CCB and rebate of 30% of child care out-of-pocket expenses.	CCB and CCTD that depends on effective marginal rate of tax of the parent.	Depends on the income of parent. If EMRT > 30%, family would pay less for child care. If EMRT=30% family is same as before. If EMRT < 30%, family would pay more for child care.

Source: Econtech

Notes: - Assumes that current CCB arrangements remain unchanged.

- EMRT refers to the effective marginal rate of tax to be paid by taxpayer including the Medicare levy and the low income tax offset.

Table 6.6
Families Currently NOT Using Child Care

Type of Family	Support received before	Effect of new child care arrangements
COUPLE FAMILIES		
Both parents working	N/A	If under current arrangements both parents are working and not using child care, the new child care arrangements are unlikely to change their hours of work.
Only one parent working	N/A	Will only use child care and join the workforce if one of the parents earn enough to be in an EMRT > 30% (i.e. to pay lower child care fees than they would pay with the current rebate)
ONE PARENT FAMILIES		
Parent working	N/A	If under current arrangements parent is working and not using child care, the new child care arrangements are unlikely to change his/her hours of work.
Parent not working	N/A	Will only use child care and join the workforce if parent can earn enough to be in an EMRT > 30% (i.e. to pay lower child care fees than he/she would pay with the current rebate)

Source: Econtech

Notes: - Assumes that current CCB arrangements remain unchanged.

- EMRT refers to the effective marginal rate of tax to be paid by taxpayer including the Medicare levy and the low income tax offset.

Based on the information contained in Table 6.4 to 6.6, Econtech estimated the increase/decrease in the number of working hours of parents currently in the workforce, the effects of the new child care arrangements on labour force participation, and the effect that these changes would have on income tax collected by the Government.

To estimate the changes in labour force participation and hours worked, Econtech used the elasticity estimates presented in Doiron and Kalb (2005). These estimates are presented in Table 4.1. Additionally, to estimate the changes in labour force participation, Econtech first estimated the number of parents in the labour force with children in formal child care and the number of parents in the labour force with children aged 0-12 years that did not use child care. For this estimate, Econtech assumed that each family has, on average, 1.8 children⁶.

Consistent with Doiron and Kalb (2005) findings, it is assumed that males in two-parent households are not affected by child-care fee increases and hence will not change their working hours. Additionally, based on the explanation provided in Table 6.5, it is assumed that those parents currently salary sacrificing, will not change their working hours either.

Importantly, the new arrangements will have two main effects. First, those parents in low income brackets for whom the child care costs increases with the new arrangements, will decrease their working hours. This will decrease the amount of income tax revenue that the Government will receive. Second, those parents in high income brackets for whom the child care costs decreases with the new arrangements, will increase their working hours. This will increase the amount of income tax revenue that the Government will receive. The net effect

⁶ Australia's fertility rate in 1997 (Source: ABS). The fertility rate in 2005 is not very different from this estimate (1.81 according to ABS).

will depend on the magnitude of the increase and the decrease of hours worked and the income received for those working hours.

Based on the inputs and assumptions explained above, Econtech estimated that the effect of the new arrangements on income tax collected would be an increase in revenue of \$1.0 million per annum due to the changes in labour supply. This means that the cost of the new arrangements to the government is \$499.2 million per year. Taking into consideration the savings from removing the existing arrangements, the net cost to the government of the alternative arrangements is \$218.5 million per annum. Table 6.7 below summarizes the estimated effects of the alternative child care arrangements on the Government Budget.

Table 6.7

Direct Effects on the Government Budget (\$million, annually)

Annual cost of new arrangements	\$500.2
Increase in income tax collected	\$1.0
Cost of Alternative Arrangements to Government	\$499.2
Savings from removing existing arrangements	\$280.7
Net Cost to Government of Alternative Arrangements	\$218.5

Source: Econtech Estimates.

In summary, compared with the current arrangements, the new child care arrangements would increase the Government costs by \$218.5 million a year. The main reason for this cost increase is the extension of the child care subsidy to couple families with only one parent working. The other reason is that for most of the families, tax deductibility provides a larger benefit than the tax rebate.

7. Alternative Scenario

The second alternative scenario differs from the one just considered in that it gives the family the option to choose between the CCTR and the CCTD rather than just replacing the current CCTR with a general tax deduction. In summary, this alternative scenario involves the following:

- All the current child care assistance remains unchanged;
- Families are given the option to choose a general tax deduction or the CCTR; and
- The current FBT exemption is extended so that all formal child care provided by employers becomes FBT exempt.

The likely effects of this second alternative scenario are as follows.

- Couple families with both parents working will choose to claim the CCTD if the highest income earner in the family is in an EMRT⁷ (which would be the new deduction rate) higher than 30 per cent, which is the rate of the current rebate. If the EMRT of the highest earner is less than 30 per cent, families will choose to claim the CCTR.
- Couple families with only one parent working are likely to choose the FBT exemption option because they can not claim the CCTR or CCTD.
- One parent families with parent working will choose to claim the CCTD if he/she is in an EMRT⁸ (which would be the new deduction rate) higher than 30 per cent, which is the rate of the current rebate. If his/her EMRT is less than 30 per cent, he/she will choose to claim the CCTR.

Econtech calculated the yearly cost of this new scenario Government following the same methodology used in Section 6 and based in the following assumptions:

Assumptions

- The numbers of weeks paid for child care are assumed to be 52.
- Estimates do not include parents looking for work or studying/training.
- The number of families using formal child care with both parents not working is approximately zero.
- Families receive the maximum amount of deduction they can claim for their out-of-pocket expenses.
- People salary sacrificing are equally distributed among the different type of families and income brackets.
- Families who were salary sacrificing before the policy changes, will continue to do so.
- All couple families with one parent working will choose the FBT exemption.
- Couple families with both parents working will choose to claim CCTD if the EMRT (inclusive of Medicare Levy and the low income tax offset) of the highest earner is

⁷ Including the Medicare levy and the low income tax offset.

⁸ Ibid

higher than 30 per cent. If EMRT of higher earner is less than 30 per cent, families will choose to claim the CCTR.

Based on the inputs and assumptions explained above, and taking into account labour market changes, Econtech estimated that the cost of this new scenario to the Government is approximately \$542.7 million per year of operation. Taking into consideration the savings from removing the existing arrangements, the net cost to the government of the alternative arrangements is \$262 million per annum. Table 5 shows the direct effects on the Government budget on the new scenario by program.

Table 7.1

**Direct Effects on the Government Budget of New Scenario
(Extension of FBT Exemption and Choice of CCTR or CCTD)**

Program	Cost (\$million, annually)
Child Care Tax Rebate	\$85.5
Child Care Tax Deduction	\$322.7
Extended FBT Exemption	\$136.6
Increase in income tax collected	\$2.0
Total cost of the Alternative Scenario	\$542.7
Savings from removing existing arrangements	\$280.7
Net Cost to Government of Alternative Arrangements	\$262.0

Source: Econtech Estimates.

In conclusion, the first alternative scenario (CCTD and extension of FBT exemption) would increase the Government costs by \$218.5 million a year, while the second alternative scenario (choice of CCTR or CCTD and extension of FBT exemption) would increase the Government costs by \$262 million a year.

Importantly, whilst being as detailed as possible considering the time and information available for the preparation of this report, the calculations presented in this study are broad estimates of the effect of alternative child care arrangements on the Government budget and should only be taken as a broad indication of the likely budget effects of the alternative child care arrangements being analysed. When making the decision to implement a specific policy, more detailed estimates of the budget effects should be produced.

Furthermore, Econtech was only commissioned to estimate the budget effects of alternative child care arrangements. However, the alternative child care policies being analysed by the Committee would have important behavioural and distributive effects that also need to be considered when making a decision to change the current policies. The analysis of these behavioural and distributive effects is out of the scope of this study.

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