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Reform of Family Payments

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Executive Summary

The Australian system of family payments includes a number of payments to assist parents with the direct and indirect costs of children. These include Family Tax Benefit Parts A and B (FTB A and B), a range of child care subsidies, Paid Parental Leave (PPL), the Baby Bonus and Youth Allowance (YA) for older children.

Objectives of family payments

Family payments should meet a number of different objectives. The primary objective of the family payments system should be the alleviation of child poverty. To achieve this objective, payments should be designed to assist parents with the direct costs of children (housing, food, clothing, health care, education, transport and other essential items), the indirect costs of children (the living costs of the carer of a child or wages foregone due to caring responsibilities) and the costs of formal child care while also supplementing low pay and improving work incentives for parents.

The alleviation of child poverty

The alleviation of child poverty should be the primary objective of family payments. This means that higher levels of support for the direct and indirect costs of children should be targeted towards low income households, while minimising work disincentives. Australia has a relatively high rate of child poverty (at 11%), in part due to the number of children living in households without paid work, and in part to the low level of income support payments for those who need to rely on them.

An assessment of the current system of family payments suggests that, in general, assistance is fairly well targeted to low income households and relatively effective at reducing child poverty when measured in absolute terms (the percentage point reduction in poverty rates before and after taxes and transfers) and as a proportion of poverty lines. However, these general figures hide some specific inadequacies in the system, which fails to adequately meet the costs of older children or sole parenthood.

Meeting the direct costs of children

To reduce child poverty, family payments should be adequate to meet the full 'minimum' costs of raising a child in a low income family. While the family payments system comes close to meeting these costs for families with younger children, it is not responsive to the increasing direct costs of older children. Research tells us that the costs of children increase with the age of children by a ratio of between two and five (comparing the costs of a 16-17 year old and a 0-4 year old). The current system actually provides a lower level of assistance for older children compared with younger children. It is therefore poorly adapted to meeting its objective of meeting the direct costs of children in relation to older children. Further, the current system does not provide an explicit supplement to assist with the extra costs of raising a child as a sole parent, and payments which implicitly play this role also decline as children grow older.

Meeting the indirect costs of children

Support for the indirect costs of children is provided mainly to meet the minimum living costs of the primary carer of a child where no alternative source of income is available. For families with access to private incomes, it also (partially) compensates for wages foregone due to caring responsibilities. In the current system, assistance with indirect costs is provided through FTB Part B, Paid Parental Leave (PPL) and Parenting Payment. The need for Government support for parents to stay home and care for children is clearest when children are young. Some current assistance for indirect costs extends to parents of children up to 18 years of age, suggesting the system is poorly targeted in meeting this objective.

Meeting the direct costs of formal child care

Support for the direct costs of formal child care is necessary to promote the wellbeing and development of young children and to support parents to balance their family responsibilities with work participation. The current system of child care payments is complex and inequitable and should be reformed to more efficiently and equitably achieve these objectives.

Supplementing low pay and improving work incentives

Family payments are generally designed to supplement low pay and improve work incentives on the basis that the wage system is unable to take account of family size. While the current system provides fairly strong work incentives for households transitioning from being without paid work to having one adult in full-time work (with average effective tax rates among the lowest in the OECD), issues remain for second earners due to the structure of the FTB Part A and B income tests.

The structure of the family payments system

The structure of family payments should be re-designed to meet the above objectives, with a priority on the alleviation of child poverty. The system must also strike an appropriate balance between competing objectives where tensions arise.

There are a number of positive features of the current system which are well aligned with their objectives. Most importantly, the integration of FTB into a single system for families without paid work and working families has a number of important benefits for low income families. Compared to systems that divide family allowances for families without paid work and working families (like the US model of welfare benefits and tax credits), the Australian system is more equitable, simpler and provides better work incentives. However, an additional supplement which explicitly recognises the costs of sole parenthood is needed.

The current system also strikes a good balance between targeted and universal assistance through the combination of a base payment to moderate income families and a higher rate of payment to low income families.

Assistance should generally be directed to the primary carer through regular fortnightly payments. Direct payments to primary carers recognise the additional direct and indirect costs of child rearing faced by primary carers and the independence of the primary carer from her (or his) partner. Regular payments enable families to budget more easily, recognising that low income families have very limited capacity to save.

A separate payment for the direct costs of child care should also be retained, due to the specific nature of these costs. This best recognises the diversity of child care costs and enables the Government to pursue a range of other policy objectives related to early childhood education and development. But this system should be simplified, with Child Care Benefit and Child Care Tax Rebate combined into a single payment.

Payments for parents caring for children at home should be integrated with the Parenting Payment (which performs this role for low income families).

The current system of family payments should be simplified to three payment types:

1. A payment for the direct costs of children generally, currently FTB Part A. This payment should be based on minimum costs of children for a low income family, tapering down to a lower 'minimum' payment for middle income families. A supplement to FTB Part A should also be available to sole parent families (to recognise the higher direct costs of children in sole parent families - see recommendation 6). Payments for the direct costs of children should continue to go to the primary carer, mainly on a fortnightly basis.

2. A separate subsidy for child care costs should be retained but simplified into a single payment (Child Care Benefit).

3. A payment to help sustain parents while caring for children (indirect costs) should be paid separately, integrated with income support payments for adults generally (currently Parenting Payment).

Addressing problems in the family payment system

Child poverty

Two key factors contributing to child poverty in Australia are the inadequacy of support for the direct costs of older children and for sole parent families.

Payments to older children fail to adequately meet the higher cost of these children and increase the risk of child poverty. This is because, although the rate of FTB Part A increases with age up until age 15, low income families generally experience a drop in income by $14 per week once their child turns 16 years of age. The payment system should be more responsive to the increasing costs of older children, with payments increasing by age gradations of between 2 and 7 years, with smaller gradations for older children where costs increases are steepest (for example, 0-5 years, 6-12 years, 13-15 years and 16-18 years). The combination of FTB and Youth Allowance (YA) should meet the basic costs of raising children at different ages for low income families to prevent these children from living in poverty.

4. An age-based family payment structure should be developed, based on minimum costs of raising children in low income families as they grow older, with benchmarks for the adequacy of child payments taking account of age of child and family status.

5. In the interim, to reflect the costs of children as they grow older, Youth Allowance payments for dependent young people should be increased so that the maximum level of income support for a low income family rises substantially as the child grows older. The rate for 16-17 year olds should initially be set at least at the FTB Part A rate for 15 year olds, until benchmarks to the minimum costs of children are developed.

As discussed above, current levels of support to sole parents to meet the direct costs of children are inadequate, at least for those with older children. Child poverty is particularly concentrated in sole parent households, with children in sole parent households three times more likely to be in poverty than children in couple households. Sole parent families also experience high rates of deprivation and hardship. Forty-nine per cent of Parenting Payment (Single) recipients experience multiple deprivation (having to go without three or more items regarded by the community as essential, such as a decent and secure home and access to dental treatment when needed). Recent research indicates that the incidence of financial stress is some 2-3 times higher for sole parent families than other family types. This evidence on the living standards or outcomes for sole parent families indicates that the current levels of support are inadequate.

Australian and overseas research has estimated that assistance to a sole parent with one young child should be set at approximately 90% of the couple pension rate to achieve the same living standard, increasing as children get older. Under the current system, the 90% figure is reached only for children aged 0-4 years, decreasing to 69% for older children aged 16-17 years.

6. FTB Part B for sole parents should be abolished and a Sole Parent Supplement be introduced linked to FTB Part A to recognise the additional cost of raising children alone. The supplement should be fixed at either a flat rate regardless of the age and number of children or as a percentage of FTB payments for a family, whichever best reflects the additional costs of children in sole parent families.

As a result of changes made in the last Budget to the indexation of FTB, the real value of family payments will decrease over the coming years. FTB was previously indexed to the couples rate of the pension, and therefore to wages, but has recently been indexed to the Consumer Price Index (CPI). The introduction of indexation of family payments to the pension under the Hawke Government resulted in a drop in child poverty by one third over the period 1982-1995/96. The de-linking of family payments from wages (and poverty benchmarks) is a significant backward step which means that low income families are likely to fall behind community living standards, with an inevitable increase in child poverty.

7. Indexation of family payments should be benchmarked to the married couple rate of pension, based on the age based structure proposed in recommendation 4, above. This would apply to current YA payments to dependant under 18 year olds, which should be integrated into FTB Part A, as per recommendation 11.

At-home care

As noted above, support for at-home care (the indirect costs of children) is poorly targeted, with FTB Part B providing assistance to single income families right up until the youngest child is 18 years of age for full-time students. This seems unnecessary and out of touch with contemporary social norms. At the same time, support for at-home care for young children for middle income families is inadequate and should be increased. Income support for low income families should be adjusted to prevent losses.

8. *Support for the indirect costs of children in middle-income families should reflect an age-based structure, giving priority to those with younger children.*
9. *FTB Part B for couples should be replaced with a component of Parenting Payment to assist with the basic living costs of the primary carer, targeted to middle income families caring at-home for pre-school aged children. Assistance should set above the current rate of FTB Part B for young children and provided through either a base rate or by easing the income test for Parenting Payment (Partnered) for couples with young children (which currently cuts out at $40,538). Income support for low income families should be adjusted to prevent income losses.*

Targeting and work incentives

Australia has one of the highest levels of income support for low paid working families, higher than assistance in the US, despite its tax credit specifically for these families. This is due to FTB providing the same level of support for families without paid work and low paid working families, which is a simpler and more equitable model.

Reduced work incentives for second earners and high Effective Marginal Tax Rates (EMTRs) where income tests overlap should be addressed in the reform process. Features of both FTB Parts A and B have the effect of reducing work incentives for second earners. The maximum rate of FTB Part A cuts out just above the minimum wage, which has improved work incentives for families without paid work. However, as FTB Part B is income tested exclusively on the income of the second earner it has created work disincentives.

The Dependant Spouse Tax Offset (DSTO) also has a disincentive effect, discouraging married women without children from seeking employment and reflecting an outdated view of ‘dependency’. Finally, overlapping income tests for FTB Part A, Youth Allowance and Child Care Benefit create high EMTRs for affected families (over 50% for some families where FTB Part A and YA overlap). Changes should be made to ensure that taper areas apply successively and do not overlap.

10. The family income test for the Part A payment should be re-designed so that effective tax rates are shifted from second earners to primary earners in the family.
11. Changes should be made to YA to either:
   a. integrate YA into FTB Part A for dependant children under 18 years; or
   b. integrate the parental income test for Youth Allowance for dependant children under 18, where parent also receives FTB for another dependent child, with the parental income test for FTB Part A to reduce the highest effective marginal tax rates where payments overlap.
12. Income tests for FTB A and Child Care Benefit should be integrated.
13. The dependant spouse tax offset should be abolished.
14. Income estimation should be abolished, with payment levels based on income from the previous financial year (with an uplift factor and latitude to exceed this threshold by a limited amount before payment level is adjusted). A quarterly reporting option should apply for families with fluctuating incomes.

Child care payments

The current system of child care payments is complex and inequitable with different payment types for low and higher income families and fairly low levels of spending on child care overall by international standards. The Child Care Rebate (CCR) is inherently regressive as it covers part of the gap fee between income-tested Child Care Benefit (CCB) and fees charged. In addition, the level of subsidy available for low income families is generally not sufficient to finance quality care. Further inequities are created through the provision of Fringe Benefits Tax (FBT) concessions for child care services which are principally available to higher income families, more likely to have child care in the workplace.

Support for child care and education programs should be better integrated to remove the outdated distinction between childcare and early childhood education, improve equity and access (with low income families less likely to access pre-schools), develop consistency in care and education standards and balance the provision of services to under and over-fours. Finally, access to special subsidies for high-needs children should be extended to children with behavioural problems who have not received a medical diagnosis. Failing this, these children risk being excluded from early childhood education.

15. *The Child Care Rebate should be abolished and replaced with a minimum rate of Child Care Benefit (possibly paid universally for formal child care services).*
16. *The maximum rates of Child Care Benefit should be increased to better reflect the actual costs of providing quality care.*
17. *Special subsidies for children with high needs (e.g. disabilities and Indigenous services) should be retained and eligibility expanded.*
18. *Fringe Benefits Tax concessions for employer provided child care should be abolished.*

Child support

Finally, a number of issues arising from the interaction of FTB and the child support system should be addressed. FTB Part A payments are currently reduced by 50 cents for each dollar under the Maintenance Income Test (MIT) for child support payments. This often means that families receive less assistance than they did before separation. Recent changes to the child support formula, which take account of FTB payments received by parents in calculating child support entitlements, have resulted in a loss of income for around 45% of low income sole parents. These effects suggest that the interaction between these systems needs to be reviewed.

19. The Government should implement recommendation 9.3 of the Ministerial Taskforce on Child Support with a view to increasing the MIT free area (by 20%) and indexing the free area (to CPI) and reducing the taper rate to 40 cents in each dollar of child support received.

The objectives of family payments

Family payments should meet a number of different objectives, of which the primary objective should be the alleviation of child poverty. To achieve this objective, payments should be designed to assist parents with the direct costs of children (housing, food, clothing, health care, education, transport and other essential items), the indirect costs of children (the living costs of the carer of a child or wages foregone due to caring responsibilities) and the costs of formal child care while also supplementing low pay and improving work incentives for parents.

There are a number of clear tensions between these objectives. Perhaps primary among them is the tension between supporting at-home care and facilitating workforce participation for parents. The Secretary to the Treasury, Dr Ken Henry, recently described this tension in terms of the 'trade-offs' between workforce participation and 'the valuable role that parents as carers can play in developing the capabilities of our children'.[1] The debate around this policy balance pivots around FTB Part B, which is paid to single income families and has the explicit rationale of encouraging single earner households with one stay-at-home parent. The payment also benefits sole parents by supplementing income.

The alleviation of child poverty

The alleviation of child poverty should be the primary objective of family payments. This requires the direction of higher levels of assistance to low income families, particularly families without paid work and low wage earning families, while minimising the work disincentives created by targeting.

Child poverty in Australia

The current child poverty rate in Australia, based on a poverty line set at 50% of median income, is 11%, about half the child poverty rate of the late 1980s.[2] Using the same poverty line, the child poverty rate is about three percentage points higher than the general poverty rate in Australia.[3] Australia falls within the top half of OECD countries in its child poverty rate.[4]

A significant contributor to the number of children living in poverty and/or experiencing social exclusion is the large number of children living in households without an employed parent. Almost 10% of Australian working age households with children do not have an employed parent, which is double the OECD mean.[5] NATSEM figures estimate the incidence to be even higher at 700,000 children or 1 in 7 children, with one in two children in

[1] Dr Ken Henry, 'Prevention: How do we build tomorrow's capabilities today?', Speech to Australian Research Alliance for Children and Youth (ARACY) Conference, 3 September 2009 at 2.
[2] Australia Fair, *Update on those missing out*, ACOSS, 2007 at 3 and Melbourne Institute, 'A Statistical Report on Waves 1 to 6 of the HILDA Survey', *Families, Incomes and Jobs*, Volume 4, 2009 at 36.
[3] Anne Daly, 'Social Inclusion and Exclusion among Australia's Children: A Review of the Literature', Discussion Paper no. 62, December 2006 at 3.
[4] M. Corak, 'Principles and Practicalities in Measuring Child Poverty for Rich Countries', *Innocenti Working Paper 2005-01*, UNICEF, Innocenti Research Centre, Florence, Italy (2005) , cited by Anne Daly, 'Social Inclusion and Exclusion among Australia's Children: A Review of the Literature', Discussion Paper no. 62, December 2006 at 4.
[5] UNICEF Innocenti Research Centre, *Child Poverty in Perspective: An Overview of Child Well-Being*, Report Card 7, 2007.

sole parent households in households without paid work. [6] Families without paid work are about six times more likely to be in poverty than employed families.[7]

The number of families without paid work has been falling since 1998 (after increasing for most of the 1980s and 1990s) as a consequence of increasing employment among parents and a decline in the share of sole parents.[8] Despite this fall, the number of families without paid work in Australia is still among the highest in the OECD and is strongly associated with child poverty.[9] The downturn has recently caused a further increase in the number of families without paid work in Australia, rising from 11.8% to 13.9% of all families with children between the 12 months to June 2009.[10] Consistent with this trend, the number of sole parents in paid work has fallen by 5 percentage points, or for sole parents with young children, by 8 percentage points.[11]

Children in sole parent families are three times more likely to live in poverty, with around 25-30% of children in such families below the poverty line.[12] This suggests that the current level of assistance for sole parents is inadequate to protect sole parent families from poverty and enable these households to meet their essential needs. Living standards research provides another measure of the adequacy of assistance, which shows that sole parents are experiencing high levels of hardship and deprivation.

Estimating the impact of family payments on child poverty

There are a number of ways to measure the impact of family payments on child poverty.

If poverty reduction is measured in 'absolute' terms, (i.e. the percentage point reduction in poverty rates before and after taxes and transfers), then Australia is the second most effective country in the OECD in reducing child poverty.[13] In sole parent families without paid work, the effect of taxation and benefit systems reduces poverty by 31.6% (from 99.1% to 67.8% of children in poverty).[14] In families with two adults without paid work, the reduction in child poverty is even greater at 45.6% (from 93.5% to 50.8%).[15]

On this measure, Australia is particularly effective at reducing child poverty among working families, with a reduction of child poverty by 82.3% for sole parent working households and 77.1% for two parent working households.[16] These outcomes are due in large part to our family payments system, and to increases in family payments above inflation over the past

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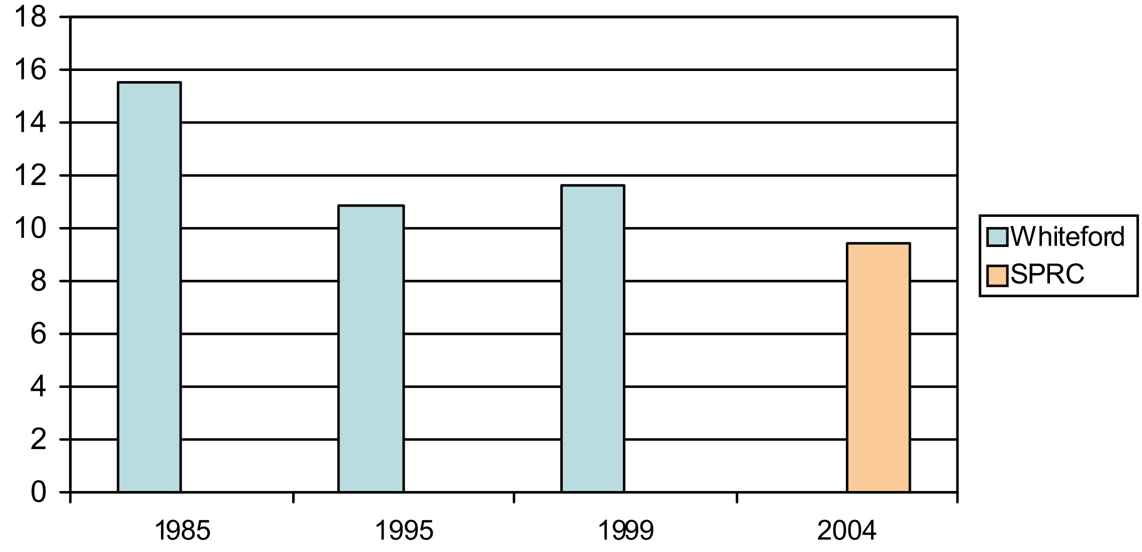
[6] Miranti, Harding, Ngu Vu, McNamara and Tanton, 'Children with Jobless Parents: National and Small Area Trends for Australia in the Past Decade', Conference Paper no. CP126, National Centre for Social and Economic Modelling, University of Canberra (2008).
[7] Whiteford, 'Social Inclusion: Family Joblessness in Australia', A paper commissioned by the Social Inclusion Unit of the Department of the Prime Minister and Cabinet, January 2009 at 60.
[8] Whiteford (2009) at 60.
[9] Ibid at 60.
[10] Australian Bureau of Statistics: Labour Force, Australia: Labour Force Status and Other Characteristics of Families, Jun 2009. Cat no: 6224.0.55.001. Website: http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6224.0.55.001Jun%202009?OpenDocument

[11] Peter Whiteford, 'Family joblessness on the rise', *Australian Policy Online*, 8 October 2009.
[12] Melbourne Institute, A Statistical Report on Waves 1 to 6 of the HILDA Survey, 'Families, Incomes and Jobs', Volume 4, 2009 at 36.
[13] Whitefold (2009) at 44.
[14] Ibid at 45.
[15] Ibid.
[16] Ibid.

20 years. However, as we argue below, they are jeopardised by the recent budget decisions to index FTB A to inflation instead of wages.

Figure 1, below, shows the effects of the two major family support packages, in 1987 and the early 2000s, on child poverty. There was a significant reduction in child poverty following each package. The 1988 child payment reforms were estimated to reduce child poverty by around one third.[17] The 1988 reforms benchmarked family payments for low income families to a percentage of the married rate of the pension, and hence to wages. However, this link was removed in a 2009 budget decision.

Figure 1: Child poverty in Australia



The 1999 and 2004 estimates are not directly comparable. Note the effects of the 1987 and early 2000s family payment packages.[18]

Meeting the direct costs of children

The direct costs of children include the costs of essential goods and services to meet children's basic needs, for example housing, food, clothing, health care, education, transport and other items. By contrast, the indirect costs of children refer to the living costs of the carer of a child or wages foregone due to caring responsibilities.

Governments support families to meet the direct costs of children for four primary reasons. The first reason is to prevent child poverty, as discussed above. This is the most important objective of the family payment system. Second, as noted above, is the failure of the wage system to take account of the number of children in a wage earner's family. In the absence of a family allowance to offset the direct costs of children, there would be significant upward pressure on wages. Government subsidies to low income families for the costs of children

[17] Ann Harding and Aggie Szukalska , 'Trends in Child Poverty 1982 to 1995/96', presented at the Australian Association for Social Research Annual Conference, 12 February 1999.
[18] Peter Davidson, 'Family payments – Australia's quiet achiever', Presentation to Australian Institute of Family Studies, August 2008.

have been justified on this basis. These subsidies also have an important alleviation of child poverty objective, as discussed above. Third, assistance with direct costs is provided in lieu of tax offsets which, in other countries, recognise the costs of children in the tax system. Fourth, assistance with direct costs has been justified as a mechanism for increasing fertility and in recognition of children as a social good and public responsibility.

There are two primary methods for calculating the direct costs of children: the Expenditure Survey approach and the Budget Standards approach.

The Expenditure Survey approach measures what households actually spend on average on children rather than what they 'should spend' or would spend if they did not have a limited budget. It does this by calculating the difference between the household expenditure of a couple with children with that of a couple the same age without children who have an equivalent standard of living.[19]

The Budget Standards approach attempts to measure what households need to spend on children to achieve a particular standard of living.[20] It calculates the costs of a given standard of living by identifying and pricing goods and services needed to achieve that standard.[21]

Despite the differences between them, both approaches reveal a number of consistent trends in the direct costs of children:

- The costs of children increase with the age of children;
- The costs of children take up a greater proportion of income in low income families;
- The marginal costs of children fall as the number of children increases;
- Child care costs are a high proportion of the costs of younger children; and
- The costs of children, as a proportion of income, are likely to be higher in sole parent families.

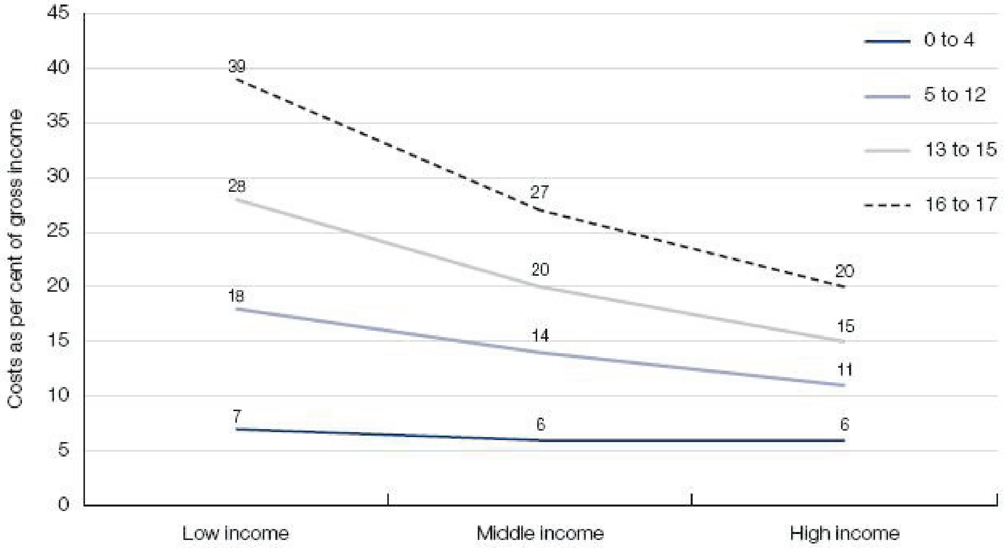
The increasing costs of older children

Expenditure survey analysis conducted for the Ministerial Taskforce on Child Support found that older children aged 16-17 years cost more than five times as much as those aged 0-4 years in low income families. This is reflected in Figure 2, below. This trend is confirmed by Budget Standards analysis also conducted for the Taskforce, which showed that the gross costs of children (excluding child care) increased with age and family income.[22] However, Budget Standards analysis suggests that the differences between the costs of children of different ages were lower than the Expenditure survey analysis. Using a budget standards approach, Henman estimated that, at the low cost standard of living, costs varied from $4,910 for a three year old per year to $7,850 for a 14 year old, the costs of an older child being less than double the costs of younger children, compared with three times the cost under the Expenditure survey analysis.[23] As a percentage of income, Henman calculated the cost of one three year old child at the 'low cost' living standard at 17.2% of disposable

[19] Report of the Ministerial Taskforce on Child Support, *In the Best Interests of Children – Reforming the Child Support Scheme* at 123.
[20] *In the Best Interests of Children* at 126.
[21] *In the Best Interests of Children* at 126.
[22] *In the Best Interests of Children* at 128, referring to P. Henman, 'Updated Costs of Children Using Australian Budget Standards' report prepared for the Ministerial Taskforce.
[23] Henman at 6.

household income and 23.3% of taxable income (excluding child care), and the cost of one 14 year old at the 'low cost' standard at 25% of disposable income and 31.7% of taxable income.[24]

Figure 2: Estimated average gross costs of a single child in couple families, by age of child and family income, 2005-06 (expenditure survey basis).



Percival R. & Harding A., 'The Estimated Costs of Children in Australian Families in 2005-06', Volume 2 of *In the Best Interests of Children* report.

This evidence tells us that the costs of children increase with the age of children by a ratio of between two and five (comparing the costs of a 16-17 year old and a 0-4 year old). The current system actually provides a lower level of assistance for older children compared to younger children. It is therefore poorly adapted to meeting its objective of meeting the direct costs of children in relation to older children.

Costs of children as a proportion of income

Expenditure survey analysis reveals that while the dollar costs of children increase with rising family income, costs as a percentage of family income decline as family income increases.

Recent Expenditure Survey analysis conducted by NATSEM and AMP, since the work for the Ministerial Taskforce on Child Support, found that while the proportion of income spent on a 0-4 year old is similar across the income bands, the increase in the proportion of income taken up by child rearing costs as they get older is steepest for low income families.[25] These trends are the same as those reflected in the graph, above, from 2005. However, using slightly different age bandwidths, the 2008 report found that a low income

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[24] Henman at 8.
[25] Percival, Payne, Harding and Abello, 'Honey I calculated the kids …it's $537,000', AMP.NATSEM Income and Wealth Report Issue 18. December 2007.

family spends an average of 9% of income on a 0-4 year old (compared to 7% in the 2005 report), 13% of income on a 5-9 year old, 25% of income on a 15-17 year old and 36% of income to 18-24 year old (due to increased recreation and transport costs, and possibly tertiary education).[26]

More than half the costs of raising children are taken up by necessities such as food, housing, health, education and clothing which represent 55% of total costs for middle income families. Food is the single biggest cost at more than 20% of total cost of raising two children for low income families.[27]

Marginal costs of additional children

Expenditure survey analysis reveals that the marginal costs of children fall as the number of children increases, due to economies of scale and as a result of budgetary constraints.[28] Budget standards results are also suggestive of decreasing marginal costs as the number of children increases.[29]

Costs of children in sole parent families

There is little recent research specifically on the costs of children in sole parent families.

The most detailed analysis of the specific costs faced by sole parents was conducted by Peter Whiteford in 1991. Whiteford sought to examine whether sole parents face extra costs which are not faced by two parent families with children, to explore the nature and quantity of any such costs and to examine the appropriateness of meeting all or part of these costs through the income support system. He noted that there were a number of alternative rationales for directing special assistance to sole parent households including high poverty rates, the high risk of hardship, responsibilities for providing a home for children, the cost of establishing a separate household and special costs arising because of the absence or a second adult due to time pressures.[30] To these arguments, one might also add recognition of the social value of parenting. Of the rationales identified by Whiteford, he considered the arguments related to hardship, the costs of separate households and the absence of the second adult most compelling.[31]

Whiteford considered direct and indirect cost issues, expenditure patterns, living standards and equivalence scales. He noted the effects of the interrelationship between direct and indirect costs for sole parents arising due to the loss of income resulting from child care responsibilities which constrains expenditure, and the savings which result from a parent performing tasks in the home (because out of the labour force) that might otherwise have been paid for (for example, housework).[32] He emphasises that 'differences in the availability of time to allocate to household production is an extremely important component of the extra costs faced by sole parents.'[33] This has a key bearing on the standard of living of sole

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[26] Ibid at 11.
[27] Ibid at 3 and 17.
[28] *In the Best Interests of Children* at 125 citing R Percival and A Harding, 'The Estimated Costs of Children in Australian Families in 2005-06', Commissioned Research Report for the Ministerial Task Force on Child Support, 25 May 2005.
[29] *In the Best Interests of Children* at 128.
[30] Peter Whiteford, 'The Costs of Sole Parenthood', *SPRC Reports and Proceedings,* October 1991, No 95 at 16.
[31] Ibid at 16-17.
[32] Ibid at 17.
[33] Ibid at 22.

parent families, with low income sole parents having limited spare time to allocate to household production and, if unable to purchase these services, likely to experience a fall in living standards.

One of the key factors contributing to diseconomies of scale for sole parent households is the cost of housing. Sole parents typically pay more for housing than childless couples, despite only having single earning capacity, due to the need for larger dwellings.[34] A 2007 Australian Housing and Urban Research Institute (AHURI) study indicated that 90% of sole parent households were experiencing rental stress, that is, paying more than 30% of income on rent.[35] Recent data shows that average rents across Australia in 2007-09 were $267 per week, with higher averages in Canberra ($337), Sydney ($327) and Darwin ($305).[36] Among Parenting Payment (Single) recipients, average rent paid per week is $216, which represents nearly 40% of income.[37] A sole parent with two primary school aged children receiving a weekly income of $550 (including Newstart Allowance, FTB Part A and FTB Part B and CRA), and paying average weekly rent of $267 per week, spends nearly 50% of income on rent each week which is well above the 30:40 housing stress ratio (and almost in housing crisis, defined as spending more than 50% of income on rent, for those in the bottom two quintiles). Based on the average rent for PPS recipients, rent still takes up 40% of income.

In his analysis of housing costs, Whiteford concluded that there was evidence that sole parent households faced similar housing costs to couples in similar income and occupancy groups with the same number of children (therefore highlighting a major diseconomy of scale for sole parents), although he did make some reservations about the appropriateness of the data on which these conclusions were based. Turning to policy responses, he suggested that ‘it is likely, however, that the appropriate policy response to the effect of housing costs on the relative position of sole parents would be in the area of housing assistance’, rather than through a sole parent payment.[38] The current rent assistance program provides the same level of assistance to sole parent and couple households with children (the maximum rate is $131.32 per fortnight for households with one or two children). However, Rent Assistance covers only a small percentage of rental costs. ACOSS has called for a review of CRA with an interim increase in the maximum rate by 30%.

Whiteford made a number of tentative conclusions based on consideration of the above factors. These conclusions were that:

- Sole parents are particularly prone to poverty;
- Sole parents are likely to have extra costs due to ‘time poverty’;
- Sole parents have the same housing aspirations as other households and are often forced into less than satisfactory housing due to their limited incomes;

[34] Terry Burke and Simon Pinnegar et al, Experiencing the housing affordability problem: blocked aspirations, trade-offs and financial hardships, *National Research Venture 3: Housing affordability for lower income Australians*, Research Paper No. 9, December 2007 at 37.
[35] Burke and Pinnegar et al at 37.
[36] Australian Bureau of Statistics, 4130.0 Housing Occupancy and Costs, Australia, 2007-08.
[37] Housing stress is generally defined as occurring when, for households in the bottom two quintiles of the income range, 30% of income or more is directed to housing costs. The data on average rents for Parenting Payment (Single) recipients is derived from the Senate Community Affairs Committee, Answers to Estimates Questions on Notice, Families, Housing, Community Services and Indigenous Affairs Portfolio, 2009-10 Budget Estimates, 1 June 2009, Hansard Page CA44.
[38] Whiteford (1991) at 45.

- Sole parents are more likely to experience hardship than other families receiving income support; and
- Equivalence scale research suggests that a sole parent with one young child should receive payment levels set at about 90% of the combined married rate of the pension.[39]

The 90% of couple pension ratio is consistent with recent work on UK budget standards by Bradshaw, which estimates the costs of sole parenthood (with one child, aged one) at the minimum income standard as 90% of the income of couples without children, excluding child care.[40]

Budget standards approaches to estimating the costs of sole parenthood have produced ambiguous results. Using the 'deductive approach', budget standards analysis compares the budgets for different household types to describe costs arising due to changes in household composition.[41] In 1998, the Social Policy Research Centre published indicative budget standards for Australia. The SPRC budget standards research compared the costs of sole parents with a range of household types in an attempt to calculate the costs of sole parenthood. Comparisons with households containing a single adult, a couple with the same number of children and a same sized two adult household were made, as well as with the cost of the second adult in a couple household.[42]

The SPRC's analysis of the costs of sole parenthood made a number of findings (all figures are in 1998 dollars):

- Comparing costs for a sole parent with one child with those for a single female, a six year old child adds $78 per week, two children add $192[43];
- Comparing costs for a sole parent with one child with those for a couple with one child, the additional costs of children for sole parents was estimated to be less than that for couples (by $16) due to lower transport, leisure and energy costs, in part as a result of eligibility for pensioner concessions[44]. This comparison also under-estimates energy costs (see below);
- Comparing sole parent and couple households of the same size, the sole parent with one child has lower costs across a range of commodities than a couple without children but this is almost outweighed by the increase in housing costs, sole parents having to rent larger dwellings[45];
- Comparing costs between one-child sole parent and couple households, or the cost of the second adult, shows that, although overall costs of an additional adult are considerable, there is little increase in expenditure on household-based commodities (for example, housing).[46]

The SPRC make a number of very important reservations about the results. Importantly, they note that one of the key challenges involved in the budget standards approach is

[39] Ibid at 72.
[40] Bradshaw, J., Middleton, S., Davis, A., Oldfield, N., Smith, N., Cusworth, L. and Williams, J., 'A minimum income standard for Britain: What people think', Joseph Roundtree Foundation (2008) at 41.
[41] Saunders, Chalmers, McHugh, Murray, Bittman and Bradbury, *Development of Indicative Budget Standards for Australia,* SPRC Research Paper Number 74 (1998) at 574.
[42] Ibid at 573 and 600.
[43] Ibid at 599.
[44] Ibid at 601.
[45] Ibid at 301. The SPRC budget comparison was based on households in private rental.
[46] Ibid at 602.

controlling for differences in living standards between household types. It is very difficult to ensure that the standard of living remains fixed as household composition changes, giving rise to uncertainly as to whether a comparison is being made between different households with the same standard of living, or different households with different standards of living.[47] The authors particularly emphasise these limitations in relation to their analysis of sole parents, noting that the estimated budgets for a sole parent and a single female reflect different norms and patterns of behaviour, due to assumed lifestyle differences between these households (resulting, for example, in a much higher entertainment budget for single females). This does not take account of financial constraints in informing spending patterns. This led the authors to state that they 'do not feel fully confident that the estimates of the costs of sole parenthood … are as valid (or accurate) as some of the other cost estimates.'

Other reservations which the authors make in relation to their analysis of the costs of sole parenthood include:

- the inclusion of concessions for energy and transport which made the net costs of sole parents appear lower than couples, even though children add to energy costs[48];
- the exclusion of many indirect costs of sole parenthood and the effects of time constraints[49]; and
- the failure to take into account the implications of the forced exit from the paid labour market and the impact of separation on unpaid work time[50].

The authors concluded that 'the BSU Budget Standards do not provide an adequate basis for estimating the costs of sole parenthood' on the basis that 'calculating the costs of sole parenthood by comparing the difference in costs between a sole parent household and a single female household and between a childless couple household and a couple with children household is fundamentally flawed. Put simply, there is no guarantee that the method is comparing households with the same standard of living.'[51]

Recent expenditure survey analysis conducted by NATSEM suggests that sole parents spend a slightly higher proportion of their income on the costs of children than couple families. However, this could be affected by budget constraints, a limitation of the expenditure survey approach (i.e. an inability to spend money on non-essentials, e.g. recreation). The NATSEM report suggests that this may be attributable to the cost of supporting an additional adult in couple families, thereby reducing the amount that may be spent on the child.[52]

Trends in the costs of children related to age and the number of children are broadly consistent in sole parent and couple families. [53] As in the case of couples with children, the costs of children increase as children get older, and additional children cost less than the first.[54]

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[47] Ibid at 574.
[48] Ibid at 602.
[49] Ibid at 604.
[50] Ibid at 605.
[51] Ibid at 605-6.
[52] *In the Best Interests of Children* at 126.
[53] Ibid at 125.
[54] Ibid at 125.

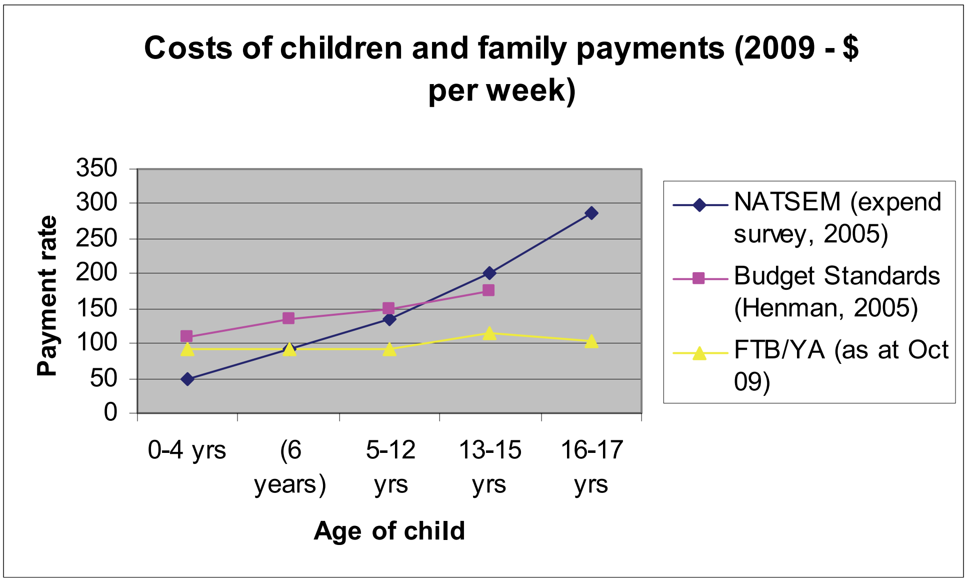
While there is debate in the research about the costs of children in sole parent families, sole parents are consistently identified as experiencing high levels of hardship, deprivation and financial stress. This is discussed below in the section 'Inadequate support to sole parents'.

FTB and the costs of children

In their study of financial stress in Australian households, Breunig and Cobb-Clark highlight the concentration of financial stress in households with children.[55] Households with children are much more likely to suffer from hardship than households without, at 17% compared to 12%.[56] The results become even more exaggerated once they are equivalised for household income. They suggest that these results raise questions about the 'adequacy of the tax and benefit system in protecting children from negative financial events'.[57] They remark: 'Based upon these results, family tax benefit and the various parenting payments do not sufficiently compensate households for the extra cost of children'.[58]

However, the adequacy of family payments varies depending on the age of the child. Research suggests that maximum rates of FTB are close to the minimum direct costs of raising a pre-school child, excluding child care costs. This is confirmed by recent research by NATSEM and AMP which finds that for some of low income families, the Family Tax Benefit partially – or perhaps fully- covers the costs of children.

Figure 3:



Note: NATSEM and Henman figures have been indexed to CPI as at June 2009. Henman's estimates do not include 16-17 year olds.

However, as Figure 3 above shows, this is not the case for older children because the increasing costs of older children are not reflected in the structure of family payments. Unlike FTB payments, Youth Allowance payments for dependent young people fall well

[55] Robert Breunig and Deborah Cobb-Clark, 'Understanding the Factors Associated with Financial Stress in Australian Households', Social Policy Evaluation Analysis and Research Centre, The Australian National University, (2004).
[56] Breunig and Cobb-Clark at 19.
[57] Ibid at 19.
[58] Ibid at 19.

below their minimum costs. Many low income families therefore experience a reduction in income support once their youngest child reaches 16 years and they switch from FTB to Youth Allowance.[59]

Supplementing low pay and improving work incentives

Since child endowment was introduced in the 1940s, family payments have been used as a form of low wage supplement for working families. This recognises the impracticality of wage rates taking account of the number of children in a household and reflects a view that, in lieu of this, Government should step in to support the families of low wage earners. By supplementing low pay, family payments also improve incentives for families without paid work to seek employment.

However, in all systems of family payments there is a tension between targeting low income families and work incentives, especially for the main carers of children (usually mothers). In theory this tension can be resolved by making family payments universal by removing income tests. In practice universal family payments are generally set at very low levels, well below the minimum cost of raising a child, so such a system could lead to an increase in child poverty.

The 'family allowance supplement' introduced in 1987 to target poor families was carefully crafted to ensure that low paid working families received the same level of payment as a similar family without paid work, to maintain incentives for families without paid work to seek at least one low paid fulltime job. FTB Part A maintains this basic structure. As a result, average effective tax rates (AETRs) for parents moving from being without paid work into part-time work at one-third of the average wage are around 40%, among the lowest in the OECD.[60] In other countries such as the USA, earned income tax credits have been introduced to supplement low pay. These payments are targeted towards low paid working families and deliberately exclude families without paid work, with a view to improving work incentives. Although FTB Part A also extends to families without paid work, it offers a higher level of public income support for a typical low paid working family than do overseas earned income tax credits. In this way it helps strengthen work incentives while at the same time preventing poverty among families without paid work.

Effective marginal tax rates (EMTRs) offer another way to measure the impact of the tax and transfer system on work incentives. Effective marginal tax rates measure the proportion of each additional dollar of income retained after income tax is deducted and means-tested Government support is withdrawn.[61] High EMTRs are disincentives to work and can create 'poverty traps' or obstacles to low income families increasing their earnings.

Means testing necessarily creates high EMTRs as government assistance is withdrawn as private income increases. This is particularly so when means tests for a number of programs overlap and/or there is also a liability for income tax.[62] Changes introduced by the

[59] Families who are not eligible for YA and remain on FTB Part A also experience a decline in income, by $77 per week.
[60] Whiteford (2009) at 54.
[61] NATSEM, 'Trends in effective marginal tax rates 1996-97 to 2006-07', AMP.NATSEM Income and Wealth Report Issue 14. September 2006 at 1.
[62] Ibid at 4.

previous Government to reduce the severity of means tests (introducing more gradual taper rates, and removing sudden death provisions) were partly designed to reduce EMTRs.[63]

From the standpoint of work incentives and EMTRs, the main problem with the way in which FTB is targeted is that it discourages two-income families, especially in the family income range from about $45,000 to $95,000. One reason for this is that the family based income test in Part A applies just above a low full time wage (at around $40,000). The second reason is that the Part B payment, which is deliberately targeted towards single income couples, imposes an additional income test on the second earner. If the same family also faces other income tests (e.g. YA) then this can lead to high EMTRs for second earners in middle income families.

To deal with this problem, the family income test for Part A has been substantially eased, from a taper rate of 50% in 1987 to 20% today. This occurred at the expense of targeting the payment to low income families and a higher cost to the Budget. The overall cost of FTB rose from $8 billion to $18 billion over the decade of the Howard Government, due mainly to the easing of income tests. A family with two children on the median family income currently receives part of the maximum rate.

The targeting of the Part B payment for couples is particularly controversial, due to the special income test applied to the second earner. The former Government argued that the payment was designed to assist a parent to care for a young child at home, but the payment extends to children up to 18 years of age. A further objective of the Part B payment was to reintroduce a form of 'income splitting' within the tax-transfer system, on the grounds that single income families miss out on the benefits of two tax free thresholds.

The main challenge for policy makers in improving work incentives through reform of family payments is that further easing of income tests would be costly (since it would affect large numbers of middle income families), and is likely to shift high effective tax rates further up the family income scale. It would also further weaken targeting of FTB to child poverty.

Meeting direct child care costs of children

There are two kinds of child care costs – the direct costs of formal child care and the indirect costs of caring for a child 'at home', which mainly comprises foregone wages.

The policy rationale for providing assistance to families to meet the direct costs of child care is two-fold: promoting the wellbeing and future development of young children and supporting parents to balance their family responsibilities with participation in the workforce. The latter objective recognises that child care costs can be a barrier to parents (mostly women) re-entering the workforce after having children.

Government intervention also plays an important role in improving the equity and accessibility of child care services. If left to an unregulated market, high quality services would be out of reach of low and moderate income households. Governments in Australia have recognised the need to subsidise the costs of child care for most families to ensure that a balance is struck between the setting and enforcing of quality standards and the cost of services.

[63] Ibid at 5.

Meeting indirect costs of children - supporting at-home care

The current system assists with the indirect costs of children through Family Tax Benefit Part B, Paid Parental Leave and Parenting Payment (Single).

Family Tax Benefit Part B is a subsidy for parenting ‘at home’ while the new Paid Parental Leave scheme is designed to partially compensate parents for lost earnings. Parenting Payment (an income support payment for low income parents) also assists parents to care for younger children at home, since this payment is not work-tested until the youngest child reaches 6 years of age.

There is significant policy debate about whether, and to what extent, Governments should support parents to stay at home and care for children full-time, and if so, when they should do so. Although it has been argued that the costs of direct and indirect child care should be treated in the same way, there are some important differences between these costs which justify different treatment in the payment system. Importantly, the indirect costs of caring for children do not increase with the number of children, though the length of time out of the workforce is likely to be longer.

Designing a structure to meet the objectives of family payments

Introduction

The structure of family payments should be designed to meet the objectives outlined in the previous section, with a priority on the alleviation of child poverty. The system must also strike an appropriate balance between competing objectives where tensions arise.

There are a number of positive features of the current system which are well aligned with their objectives. Most importantly, the integration of FTB into a single system for families without paid work and working families has a number of important benefits for low income families. Compared with systems that divide family allowances for families without paid work and working families (like the US model of welfare benefits and tax credits), the Australian system is more equitable, simpler and provides better work incentives. However, an additional supplement which explicitly recognises the costs of sole parenthood is needed.

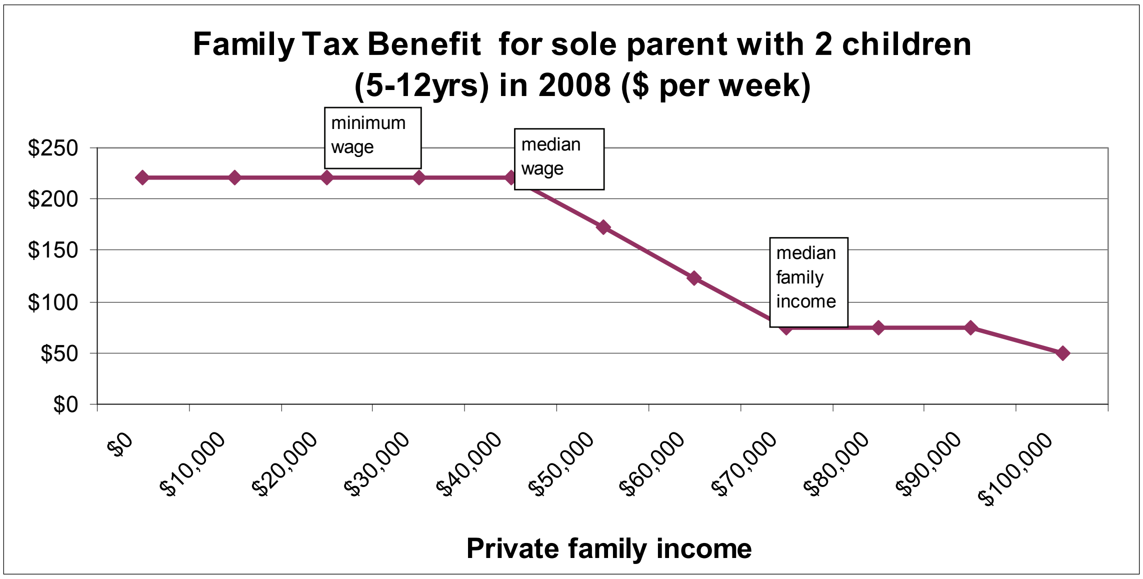
The current system also strikes a good balance between targeted and universal assistance through the combination of a base payment to moderate income families and a higher rate of payment to low income families.

However, there are a number of changes to the structure of the family payments system which would better enable it to achieve its objectives. In this section, changes to the structure of the child care payments system and support for the indirect costs (at-home care) of children are proposed.

A single integrated family payment system for working families and families without paid work

Australia has a system of family payments in which assistance for working families and families without paid work is integrated, as in Figure 4 below.

Figure 4



At the centre of the system is a single cash payment for the direct costs of children, FTB Part A. This payment incorporates a lower level of semi-universal 'family allowances' for middle and higher income families and a higher level of support for the costs of children in low income families and families without paid work. Some other countries split general support with the direct costs of children into supplements for social security payments for families without paid work and tax credits or rebates for 'working' families.

ACOSS supports the retention of a single integrated payment system for both working families and families without paid work. An integrated payment system has a number of advantages compared with separate transfer and tax systems for working families and those without paid work related to simplicity, work incentives, flexibility, fairness and equity. It is better adapted at dealing with changing patterns of labour market participation related to caring responsibilities, where people may transition into and out of the labour market a number of times.

In this section, the US and UK systems are analysed to compare the impacts of separate split and integrated systems for working families and those without paid work.

The US model: a split system

The US model features separate systems of support for working families and families without paid work and has been advocated by some key economists for adoption in Australia.[64]

Earned Income Tax Credits

Assistance to working families in the US is provided via the Earned Income Tax Credit (EITC) while families without paid work receive very limited support through cash assistance programs like Temporary Assistance for Needy Families (TANF) and Unemployment Insurance.

To qualify for the EITC, a family must have at least one wage earner. In this way, the payment subsidises earnings for low-income working families. It is also argued that the payment represents a publicly funded wage subsidy for employers. The credit is equal to a fixed percentage of earnings until a maximum level is reached, dependant on the number of children.

The EITC is refundable, meaning that taxpayers receive the full amount of the credit for which they are eligible (in the form of a tax refund) even if it exceeds their tax liability.

[64] See letter published in *The Australian* to Prime Minister John Howard on 16 October 1998 from Peter Dawkins, John Freebairn, Ross Garnaut, Michael Keating and Chris Richardson and included as an appendix to Ian Watson, 'Proposals for a wage freeze and tax credits: Will subsidizing low wage jobs solve unemployment?', 22 June 1999, Parliamentary Research Paper 29 1998-99, Commonwealth Parliament accessed at: http://www.aph.gov.au/library/pubs/RP/1998-99/99rp29.htm#4.

Figure 5: Earned Income Tax Credit Parameters, 2009.

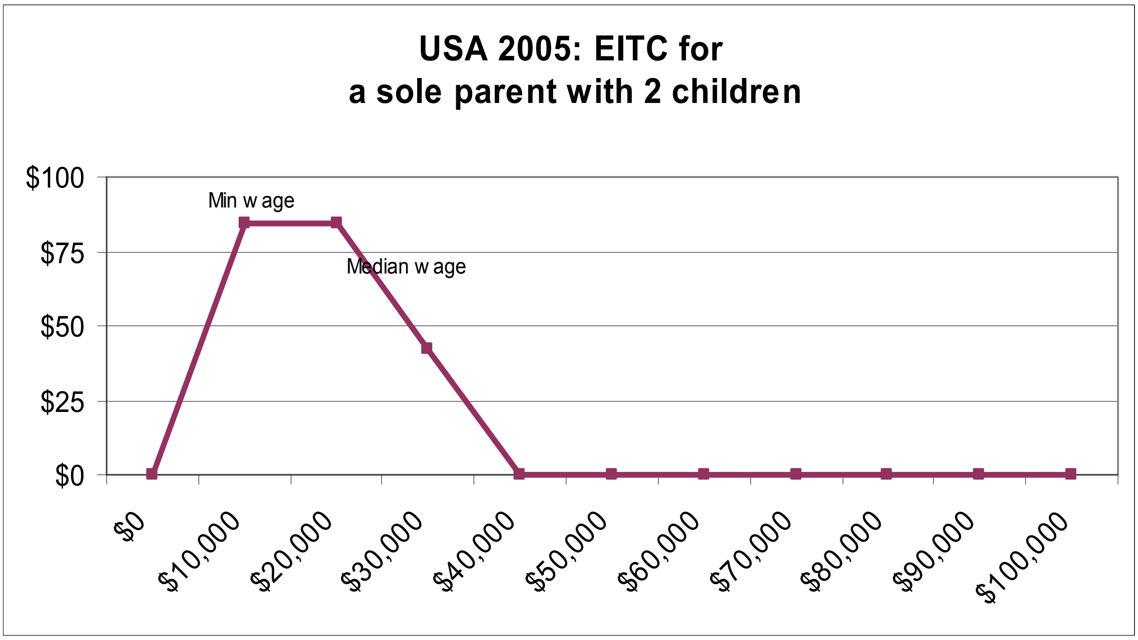
No of children	Credit rate (%)	Income level for max credit	Max credit	Phase-out rate (%)	Phase-out range*	
					Beginning income	Ending income
None	7.65	5,970	457	7.67	7,470	13,440
One	34	8,950	3,043	15.98	16,420	35,643
Two or more	40	12,570	5,028	21.06	16,420	40,295

The phase-out range for married couples begins and ends $3,120 higher than the values listed in this table. All dollar levels are adjusted annually for inflation.

Source: Tax Policy Centre, Urban Institute and Brookings Institution: *Tax facts: Historical EITC parameters* 21 April 2009, USA.[65]

The graph below shows the basic structure of the EITC. It shows that, unlike the integrated Australian system of family payments, families without paid work do not receive any assistance through the EITC but are forced to rely on TANF (discussed below). The level of EITC received by a working family increases until earnings reach just above the US minimum wage (which is quite low), with the credit income tested before income reaches the median wage.

Figure 6:



Recent changes under the Obama administration have increased the maximum rate for working families with three or more children to 45% in 2009 and 2010 (formerly the same as the rate for two children) and increased the phase-out income levels for married couples.

[65] Accessed at: http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=36.

In 2006, $43.7 billion was claimed in EITC, from 22.4 million claims (including both individual and families).[66]

Temporary Assistance for Needy Families (TANF)

Temporary Assistance for Needy Families (TANF) provides cash payments to low income families.

Income eligibility and benefit levels vary widely between states, but more than a third of states have an income limit of less than 50% of the federal poverty line, while in other states earnings above the poverty line may qualify for benefits.[67] In terms of Australian dollar purchasing power, the payment averages around $200 per week for a sole parent with two children (less than the rate of Newstart allowance paid to singles without children in Australia in a week). The TANF child supplements are also much lower than the EITC.

In 2006, 1.8 million families received TANF, with 3.2 million children. Federal government TANF spending was $20.5 billion or $25.6 billion combined with state expenditure.[68]

Analysis

A comparison between the EITC and TANF shows that the US Government now spends more on assistance for low-income working families than on unemployed families.

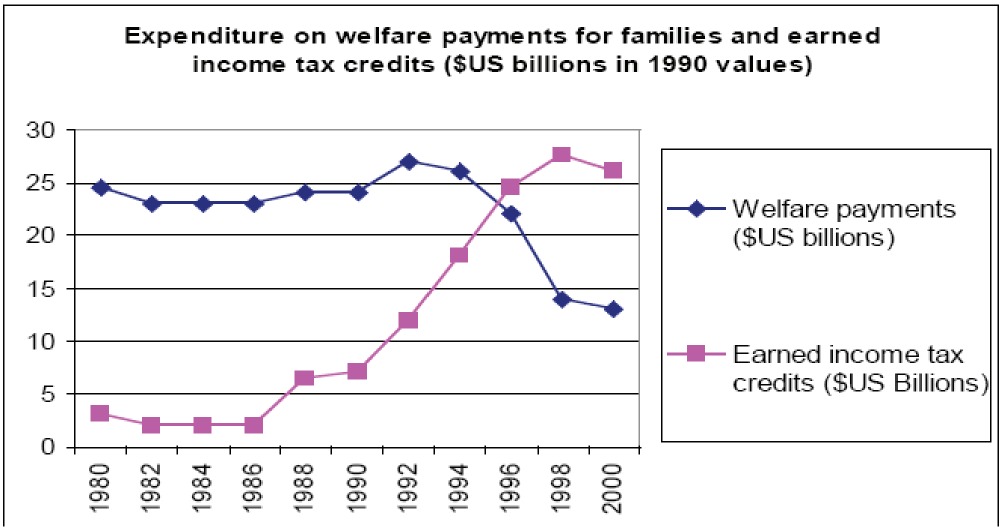
However, this is still lower than the level of assistance provided to low-paid working families in Australia.

[66] Internal Revenue Service: Earned Income Tax Credit statistics. 2008. Available: http://www.irs.gov/individuals/article/0,,id=177571,00.html

[67] National Center for Children in Poverty: Temporary Assistance for Needy Families (TANF) Cash Assistance, 2007. Available: http://www.nccp.org/profiles/index_36.html

[68] US Dept of Health and Human Services, Administration for Children and Families, TANF financials.

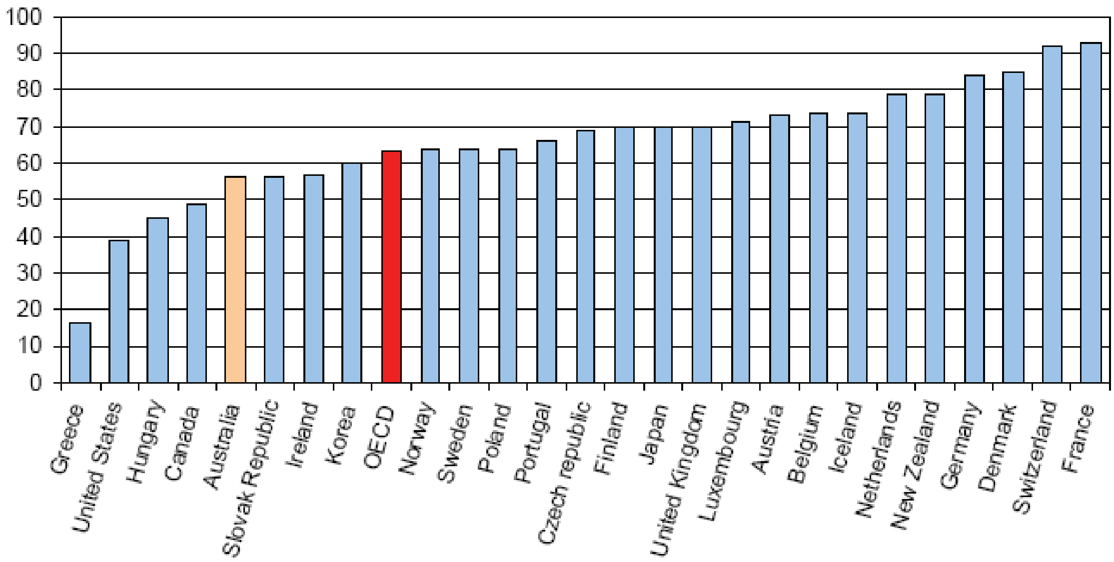
Figure 7:



Source: Burtless G 2003, *Welfare reform*, in Hard heads – soft hearts, Melbourne Institute conference, 2003.

When comparing the effect of moving from being without paid work to employment on or around the minimum wage, the US system provides slightly better work incentives than the Australian system. However, this is principally because of the lower rate of assistance provided to families without paid work in the US, rather than higher levels of support for working families.

Figure 8: Effective average tax rates when a family without paid work receives a low paid fulltime wage



Source: Peter Whiteford, Transfer issues and directions for reform: Australian transfer policy in comparative perspective, Social Policy Research Centre, 2008.[69]

Australia also performs better than the US in alleviating child poverty, pointing to some clear benefits of an integrated system. In 2003, it was estimated that the EITC had lifted 2.4 million US children out of poverty.[70] However, child poverty has always been much higher in the US than the OECD average due to the inadequacy of sole parent and unemployment benefits, and the lack of family payments for families without paid work. While Australia's child poverty rate is 11% (based on a 50% of median income poverty line), child poverty in the US is about double this, at 20%.[71]

The above analysis shows that the Australian system of family payments is more effective than the US system in alleviating child poverty and that both countries perform relatively well at maintaining work incentives for families without paid work. The Australian system manages these competing objectives more effectively, by providing higher levels of assistance to families without paid work within an integrated system in which work pays for most.[72]

A further difficulty with split systems is that payment recipients must shift between the social security system and the tax credit system as they move in and out of paid work. In recognition of this problem, in 2003 the UK Government replaced its separate Working Families Tax Credit and child supplements in the income support system with a single integrated Child Tax Credit which is similar to our FTB.

Conclusion: The benefits of a single integrated system

An integrated system of family payments has a number of important benefits for low income families related to simplicity, work incentives, fairness and equity. Families are not required to transition between transfer and tax systems when they move into the labour market, which is both administratively easier and increases work incentives. An integrated system is fairer as it is based on the needs of families and the costs of children rather than on employment status. It also recognises patterns of movement into and out of the labour market due to child care and other responsibilities.

A separate payment for the direct costs of child care

A separate payment to support families to meet the costs of formal child care should be retained in the future family payments system.

The alternative, incorporating the payment into the family payment system, would be difficult to design in a way which recognises the diversity of child care costs. Further, a general family payment which included child care assistance would make other Government policy objectives more difficult to achieve. This is because the provision of child care (at least for

[69] Accessed at: http://taxreview.treasury.gov.au/content/html/conference/downloads/attachment_02S_Peter_Whiteford_slideshow.pdf .

[70] Robert Greenstein, "The Earned Income Tax Credit: Boosting Employment, Aiding the Working Poor," Washington, DC: Centre on Budget and Policy Priorities, August 2005.

[71] OECD, *Growing Unequal? : Income Distribution and Poverty in OECD Countries*, Country Note: United States (2008), accessed at http://www.oecd.org/dataoecd/47/2/41528678.pdf

[72] See Peter Davidson., 'Family payments – Australia's quiet achiever', Presentation to Australian Institute of Family Studies, August 2008.

children aged 3 years or over) is increasingly linked to early childhood education and development. This can be considered as a ‘public good’ distinct from the other costs of children. Retaining a separate child care payment enables governments to have some leverage over the quality and accessibility of services. A separate payment for child care costs therefore has important benefits in terms of early childhood education and development and service quality and accessibility.

The appropriate balance of public support between formal child care and at-home care has been a controversial issue for many years. Some advocates argue that these public subsidies should be equivalent. However, equivalence arguments overlook a complex set of issues around the needs of young children and the effects on parents and the economy of their departure from the labour market for long periods of time. There is also a practical difficulty with comparing these two kinds of costs, since direct and indirect child care costs are of a very different order (one is based on foregone wages, the other on the direct cost of a service).

Minimum base payments with higher levels of assistance for low income families

Achieving an appropriate balance between targeted assistance to low income families, incentives to work and support to moderate income households with the direct and indirect costs of children is a key policy challenge in designing an effective system of family payments.

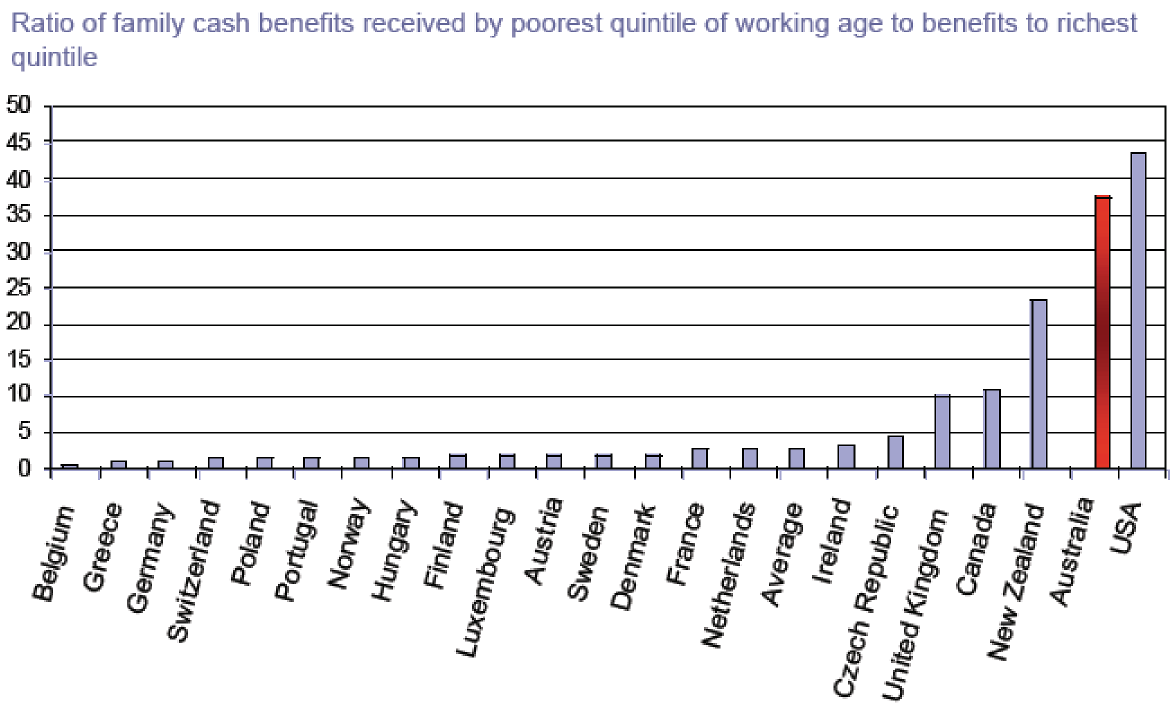
This tension was recently articulated by Secretary to the Treasury, Dr Ken Henry:

> ‘Targeting through means testing is a defining characteristic of the Australian transfer system. Yet targeting government funding according to financial means has its limitations. Significantly, it runs the risk of exacerbating the participation disincentives already in the system. We cannot add further multiple layers of means-tested payments and services on the same groups without, at some point, creating insurmountable barriers to participation.’[73]

Research indicates that the Australian system of family support involves a high degree of targeting of financial support at low-income families with children.[74]

[73] Henry, ARACY speech.
[74] Whiteford (2009) at 43.

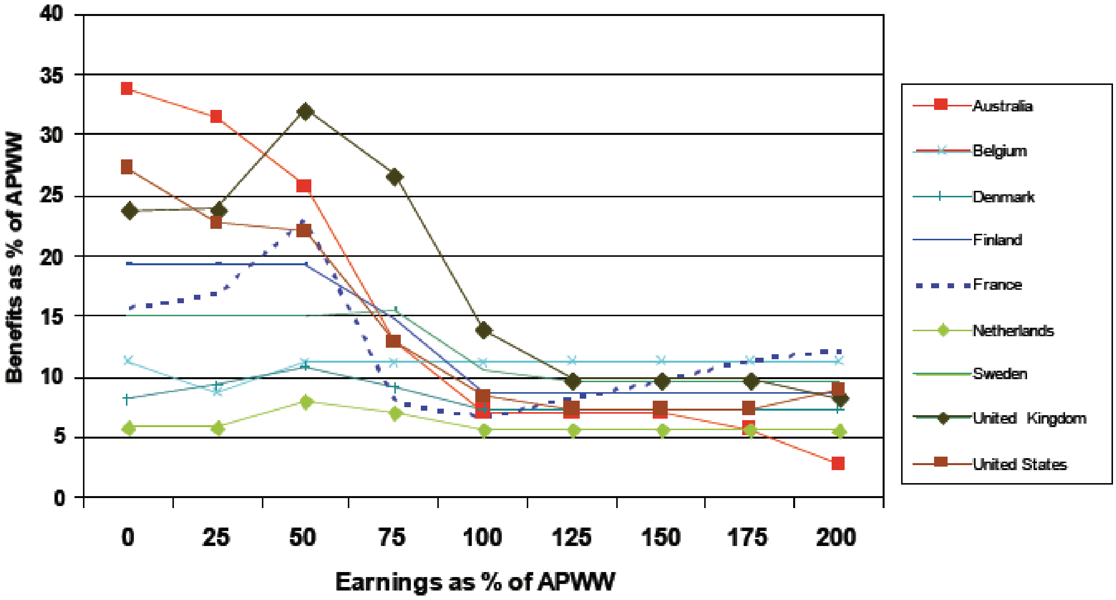
Figure 9:



Source: Peter Whiteford, *Assistance to Families: An assessment of Australian family policies from an international perspective,* Keynote address 10th Australian Institute of Family Studies Conference, 9-11 July 2008, Melbourne.

The graph below compares the level of assistance paid to low and high income families in Australia with other OECD countries.

Figure 10: Comparison of level of benefits to low and high income families



Source: Peter Whiteford, *Assistance to Families: An assessment of Australian family policies from an international perspective,* Keynote address 10th Australian Institute of Family Studies Conference, 9-11 July 2008, Melbourne.

The current system, which combines base levels of assistance to most families and higher payments for low income families, strikes a fairly good balance between these objectives.

Delivery of payments to primary carer

Reforms to family payments were made during the 1980s and 1980s to improve gender equity, including the restructuring of family payments to ensure that the principal carer received direct assistance.[75] However, changes under the Coalition Government retreated from the principle of direct payment to the primary carer by allowing receipt of payment through the tax system where the beneficiary need not be the primary carer.[76]

Family payments should be paid directly to the primary carer in recognition of the additional direct and indirect costs of child rearing. Direct payment also recognises the independence of the primary carer (usually a woman) from her partner and provides some control over income.

Delivery of assistance in regular payments

The vast majority of assistance to families should be delivered via regular fortnightly payments, with a small proportion paid as a lump sum. As many low income families do not have the capacity to save, regular payments enable families to budget more easily for the immediate direct costs of children.

[75] Bettina Cass and Deborah Brennan, 'Taxing Women: The politics of gender in the tax/transfer system', 1(1) *eJournal of Tax Research* 2003 at 40.
[76] Ibid at 41.

If the income estimation system continues, a small lump sum payment should be provided to cover any debts accrued at the end of the financial year, as under the current system of Part A and B payments, with flexibility for families to receive a larger proportion in lump sum form (up to a certain percentage, and ensuring that the vast majority of assistance is received in regular payments). Due to the problems of family payment debts arising from the under-estimation of income, ACOSS recommends that income estimation be abolished. This is discussed in more detail below under 'Reduced work incentives'.

The level of family payments should reflect the costs of children at different ages

The maximum level of family payments should take into account the direct costs of children at different ages (increasing with the age of children) and should be benchmarked to enable low income families to provide a decent standard of living for their children.

The current system of family payments should be simplified to three payment types:

1. A payment for the direct costs of children generally, currently FTB Part A. This payment should be based on minimum costs of children for a low income family, tapering down to a lower 'minimum' payment for middle income families. A supplement to FTB Part A should also be available to sole parent families (to recognise the higher direct costs of children in sole parent families, see below). Payments for the direct costs of children should continue to go to the primary carer, mainly on a fortnightly basis.

2. A separate subsidy for child care costs should be retained but simplified into a single payment (Child Care Benefit).

3. A payment to help sustain parents while caring for children (indirect costs) should be paid separately, integrated with income support payments for adults generally (currently Parenting Payment).

Problems with Australia's family payment system and proposals for reform

Introduction

ACOSS's primary concerns with the existing system of family payments relate to its failure to adequately reduce and prevent child poverty among families with older children and sole parent families.

Payments to older children fail to adequately meet their higher relative cost and therefore increase the risk of child poverty. Current levels of support to sole parents to meet the direct costs of children are also inadequate, at least for those with older children. Child poverty is particularly concentrated in sole parent households, with children in sole parent households three times more likely to be in poverty than children in couple households.

Other problems discussed in this section are the recent changes to indexation of family payments which are likely to result in an increase in child poverty, poor targeting of support for at-home care (which currently extends to children up to18 years of age), reduced work incentives for second earners and high effective marginal tax rates due to overlapping income tests, complexities and inequities in the child care system and issues arising from the interaction of FTB and child support.

Inadequate support for direct costs of older children

Family payments are close to adequate for pre-schoolers (excluding child care costs) but well below the minimum cost of children over 6 years, particularly those who are 16 years and over. This is because, although the rate of FTB Part A increases with the age of children up to age 15, these increases are too small and once a child reaches 16 years of age the income of a typical family without paid work actually falls as they transfer across from FTB to YA, paid at a lower rate ($14 per week less than FTB Part A), or to a lower rate of FTB(A) ($77 per week less than the rate for 13-15 year olds).

As Figure 3, above, shows, the costs of children continue to increase with the age of children, including a significant increase in the costs of 16-17 year olds, while the level of FTB and YA decreases.

As a result of substantial increases in FTB payments to families over the last decade, payments for young children have increased at the same time that payments for youth have largely stagnated. ACOSS recommends that family payments should increase by gradations in rates based on age of child. For example, a payment structure might be based on gradations of 5 years for younger children, with smaller gradations for older children where sharper cost increases occur (e.g. 0-5 years; 5-12 years; 13-16 years; 16-18 years). Support for older children should be increased, with Youth Allowance payments increased substantially. ACOSS recommends that the rate for 16-17 year olds should be initially set at the rate of FTB Part A for 15 year olds. This would mean an increase of $14 for week for 16-17 year olds. This should be a first step until proper benchmarks are set, based on the minimum costs of children at different ages. The rate for children over 17 years of age should be set at the adult allowance rate (i.e. Newstart).

4. An age-based family payment structure should be developed, based on minimum costs of raising children in low income families as they grow older, with benchmarks for the adequacy of child payments taking account of age of child and family status.

5. In the interim, to reflect the costs of children as they grow older, Youth Allowance payments for dependent young people should be increased so that the maximum level of income support for a low income family rises substantially as the child grows older. The rate for 16-17 year olds should initially be set at least at the FTB Part A rate for 15 year olds, until benchmarks to the minimum costs of children are developed.

Inadequate support to sole parents

Children in sole parent families are three times more likely to live in poverty, with around 25-30% of children in these families below the poverty line.[77] This is partly attributable to the fact that families without paid work are concentrated among sole parent households in Australia and partly due to inadequate income support, especially for those with older children. Most sole parent families live on low incomes – over 70% are in the bottom 40% of Australian households ranked by income.

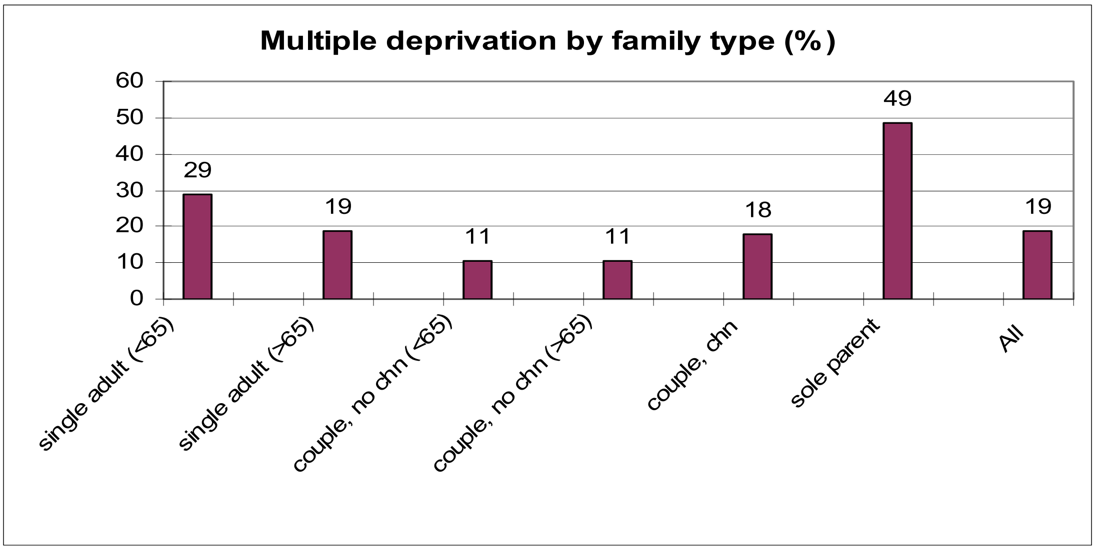
Current levels of support to sole parents, through Parenting Payment (Single) and Family Tax Benefit, do not adequately recognise the additional costs of raising children alone. Research on the costs of children suggests that sole parents face higher costs than parents in couple households, due to diseconomies of scale, and generally have lower household incomes. Housing costs are a major factor in these diseconomies of scale. As noted above, a sole parent with two primary school aged children receiving a weekly income of $550 (including Newstart Allowance, FTB Part A and FTB Part B and CRA), and paying the average national weekly rent of $267 per week will be spending nearly 50% of income on rent each week, which reflects extreme housing stress.

Research by the Social Policy Research Centre published recently by ACOSS, surveyed what Australians regarded as the essentials of life, and who was missing out on them. Only those items considered essential by over half the population were included. The research found that 43% of Parenting Payment (Single) recipients lacked a decent and secure home, 57% could not pay a utility bill in the last 12 months, 56% lacked $500 in emergency savings, 54% could not afford necessary dental treatment, 24% could not afford up to date school books and clothes, and 40% could not afford a hobby or leisure activity for their children.

Figure 11, below, shows that sole parents are much more likely to experience multiple deprivation than other family types.

[77] Melbourne Institute at 36.

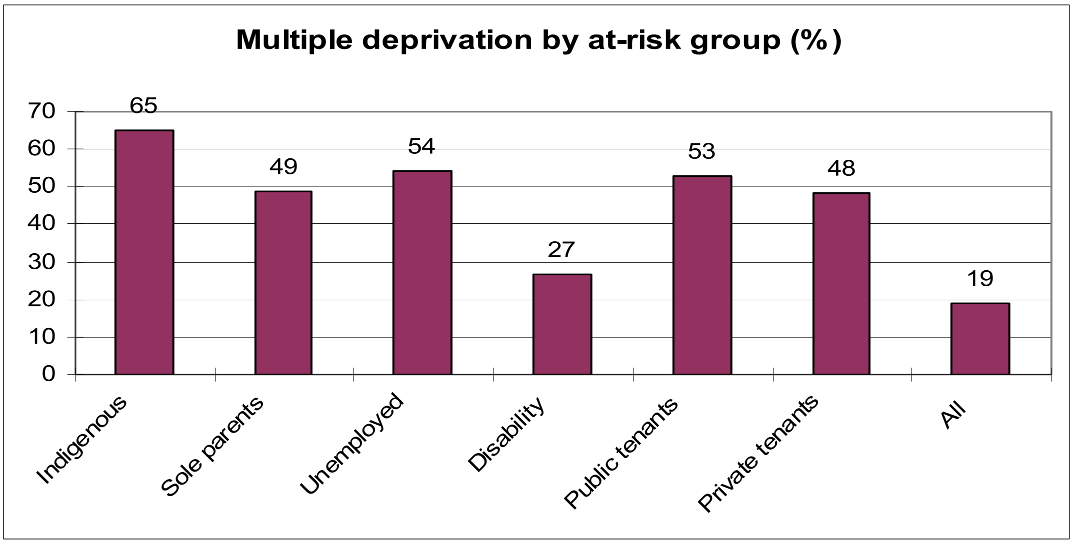
Figure 11



ACOSS, Who is missing out? Hardship among low income Australians, December 2008, pg 14.

As Figure 12, below, shows, sole parents were also among the population groups most likely to be suffering multiple deprivation, with 49% of sole parents missing out on three or more of the 26 items regarded as essential.[78] These items included a decent and secure home, access to dental treatment when needed, $500 in emergency savings and prescribed medications. This evidence tells us that the current levels of payment to sole parents are inadequate to enable sole parents and their children to maintain an adequate standard of living.

Figure 12



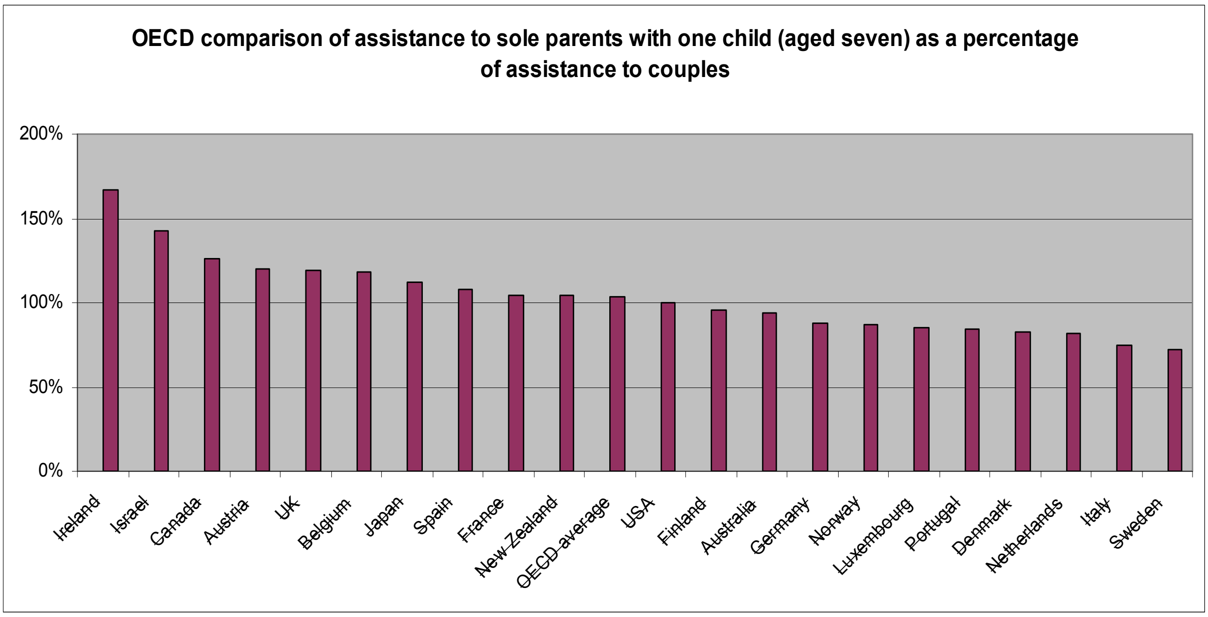
ACOSS, Who is missing out? Hardship among low income Australians, December 2008, pg 14.

[78] ACOSS, 'Who is missing out? Hardship among low income Australians', *ACOSS Info Paper 391*, 8 December 2008 at 2.

Overseas studies have shown that parents are more likely to experience deprivation than their children.[79] This is because parents generally seek to protect their children from poverty by directing maximum available resources to meeting the costs of children and preventing social exclusion, even when this involves depriving themselves of essential items. For sole parents, the burden of this deprivation is likely to fall solely on the primary carer, rather than being shared between two adults, and may explain why deprivation rates are so high among this group.

Financial stress data similarly highlights the financial pressures experienced by sole parents. Breunig and Cobb-Clark make a number of interesting findings in their study of financial stress in Australian households.[80] They point to evidence which suggests that sole parents are much more likely than other families to experience financial stress, with a general incidence of financial stress some 2-3 times higher than other family types.[81] The authors also conclude that couple households are generally more able to use their income to avoid financial stress due to their ability to substitute for and complement one another in labour market work, home production and child care.[82]

Figure 13:



Data obtained from Jonathan Bradshaw, *A Comparison of Child Benefit Packages in 22 Countries – A summary of the child benefit package for each country,* Appendix to Research Report No 174 (2002), Department of Work and Pensions, UK at 129.

By international comparison, assistance to sole parents in Australia is fairly low relative to assistance to couples. Bradshaw's analysis, shown in Figure 13, shows that Australia ranks 13th among the 22 OECD countries.[83]

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[79] McKay and Collard, 'Developing Deprivation Questions for the Family Resources Survey', Personal Finance Research Centre, University of Bristol, Working Paper No 13 (2003).
[80] Breunig and Cobb-Clark.
[81] Ibid at 3.
[82] Ibid at 19.
[83] Although Bradshaw uses a different formula to calculate costs and therefore generates higher ratios than our analysis suggests, the relativities between countries (all measured using the same formula) are useful. See Jonathan Bradshaw, 'A Comparison of Child Benefit Packages in 22 Countries – A summary of the child benefit package for each country',

Figure 14:

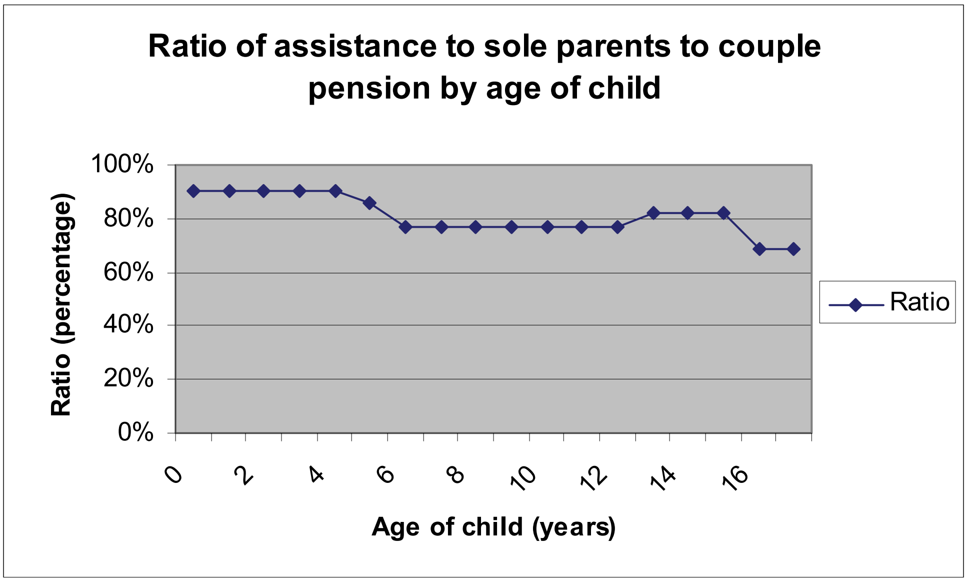


Figure 14, above, shows that the ratio of current assistance in Australia to sole parents compared with the couple pension varies with the age of the child. Despite the increasing costs of older children, the graph shows that assistance to sole parent families is highest when children are young (at 90% for children aged 0-4 years and 86% for 5 year olds), decreasing to 77% when children are between 6-12 years, increasing again to 82% for children 13-15 years, before decreasing to 69% for older children 16-17 years. It is clear from this analysis that, although the level of assistance to children with young families meets the 90% threshold mentioned previously, assistance falls below this level after aged 4 and is not aligned with the increasing costs of older children.

ACOSS proposes that FTB Part B be replaced with two payments to meet two distinct policy objectives: a supplement to Parenting Payment targeted to families with young children, for the indirect costs of children (through providing at-home care, discussed below), and a sole parent supplement for the direct costs of children which recognises the increasing costs of older children. The supplement should be fixed at either a flat rate regardless of the age and number of children or as a percentage of FTB payments for a family, whichever best reflects the additional costs of children in sole parent families. The level of the sole parent supplement should initially be set for children of all ages at the FTB Part B level for under 5 year olds, which requires an increase of $20.30 per week for those sole parents with children aged between 6-17 years.[84]

Appendix to Research Report No 174 (2002), Department of Work and Pensions, UK at 129.

[84] Based on the difference between the FTB Part B rate for 5-15 year olds ($53.35 per week) and for under 5 year olds ($73.63).

6. FTB Part B for sole parents should be abolished and a Sole Parent Supplement be introduced linked to FTB Part A to recognise the additional cost of raising children alone. The supplement should be fixed at either a flat rate regardless of the age and number of children or as a percentage of FTB payments for a family, whichever best reflects the additional costs of children in sole parent families.

Decreasing value of family payments in real terms

The 2009 Budget benchmarked the single pension rate of indexation to 27.7% of average earnings, up from 25%, but excluded sole parents. Further, the link between family payments and the married couple rate of pension was severed, with FTB to be indexed to CPI in the future. While the stated purpose of the measure was to reduce budget waste by reducing spending on middle income families, the impacts of this change will be that low income families will fall behind community living standards. As a result, child poverty, measured against a benchmark of median incomes, is likely to rise.

The link between family payments and pensions was the centrepiece of the Hawke Government's efforts to reduce child poverty in 1987. As mentioned previously, the reforms introduced a 'family allowance supplement', which was targeted towards low income families without paid work and working families. This payment was benchmarked to the couple rate of pension in order to ensure that payment rates were adequate to meet the costs of children, with research suggesting that couples with children require at least 20 to 30 per cent more income than couples without children to achieve a similar living standard.

This meant that family allowances for low income families were indirectly linked to wage increases, which made the payment more effective in reducing child poverty. This is because poverty is generally measured in Australia relative to movements in community living standards. The main poverty lines do not 'stand still' as community incomes rise, but increase to reflect changes in 'minimum adequate living standards' (which are broadly related to wage movements) over time.

Any payment that is frozen in real terms will fall behind community living standards and is therefore likely to fall below commonly-used poverty lines over time.

More than 1.7 million families, with 3.4 million children, received FTB Part A in 2007-8. Of these, 609,000 families receive the maximum rate. This includes 414,000 families and 790,000 children who receive the maximum rate of payment with income support, and 195,000 families and 349,000 children who receive the maximum rate without income support.[85]

Those who will be most affected by the change are families without paid work on income support, low paid working families, sole parent families and large families with low incomes. Sole parent families are doubly disadvantaged by this together with the decision to exclude

[85] Table 2.14, FaHCSIA Annual Report 2007-2008, accessed at http://www.facsia.gov.au/about/publicationsarticles/corp/Documents/2008%20Annual%20Report/financial_notes/1_17.htm.

their pension payments (Parenting Payment Single) from the $32.50 per week increase in pensions for single people.

The 2009-10 Budget predicts a $1.0 billion saving over 4 years due to changes in FTB Part A indexation. While the savings are fairly small in the first year ($43.1 million), they increase to nearly $500 million in 2012-13.[86]

No data has been made available on the expected impact of the changes to indexation on payment rates over time. Our preliminary estimates suggest that by 2012, the reduction in FTB Part A payments due to changes in indexation will be about $6-$9 per week per child, or about $12 per family on the maximum rate (those earning less than $43,000).[87]

No evidence has been presented which suggests that the pre-existing indexation benchmarks were wrong, or that low income families had a lesser need for payment increases than pensioners. Indeed, the evidence suggests that low income families, especially sole parent families, already face high levels of financial hardship. They are also likely to be more severely affected by the downturn, as more low-income parents lose their jobs or end up working shorter hours.

ACOSS therefore recommends that payments for the costs of children should be indexed to the married couple rate of pension, with payments related to Parenting Payment indexed on the same basis as the payment.

7. Indexation of family payments should be benchmarked to the married couple rate of pension, based on the age based structure proposed in recommendation 4, above. This would apply to current YA payments to dependant under-18 year olds, which should be integrated into FTB Part A, as per recommendation 11.

Poorly targeted support for at-home care and inadequate support for indirect costs of raising pre-schoolers

Current support for at-home care of children within the family payments system is provided through FTB Part B. FTB Part B provides assistance to single income families right up until the youngest child is 18 years of age if in full-time study. The payment was intended to encourage stay-at-home carers, but is not limited to younger children where the need for at-home care is much greater. The provision of financial assistance to at-home carers until children are 18 years of age seems unnecessary and out of touch with contemporary social norms. However, it does provide a necessary income supplement for many couples on very low incomes (mostly without paid work) so should not be abolished for those families without simultaneous reforms to improve allowance payments for these parents.

The Treasury Secretary has recently suggested that the payment system should be re-directed towards ‘providing a higher level of support for parents with very young children when their caring and nurturing role is the greatest, and supporting higher levels of

[86] The exact Budget savings for each year are: $43.1 million in 2009-10; $189.5 million in 2010-10; $292.0 million in 2011-12 and $498.7 million in 2012-13. See Commonwealth of Australia, Budget Measures: Budget Paper No. 2 2009-10 at 238.
[87] This is based on Male Total Average Weekly Earnings (MTAWE) being 2% higher than CPI each year.

workforce participation for parents and carers as children move into their school years.'[88] We agree with this assessment, in regard to the indirect costs of children, although, as indicated previously, the direct costs of children rise with age so FTB Part A should also continue to do so.

ACOSS recommends an age-based structure for stay-at-home care which recognises the higher indirect costs (wages forgone) of younger children. In our view, there is a much stronger case for Government support for at-home care of younger children in low-middle income families who are less likely to have choices about whether to stay home.

8. *Support for the indirect costs of children in middle-income families should reflect an age-based structure, giving priority to those with younger children.*
9. *FTB Part B for couples should be replaced with a component of Parenting Payment to assist with the basic living costs of the primary carer, targeted to middle income families caring at-home for pre-school aged children. Assistance should set above the current rate of FTB Part B for young children and provided through either a base rate or by easing the income test for Parenting Payment (Partnered) for couples with young children (which currently cuts out at $40,538). Income support for low income families should be adjusted to prevent income losses.*

Reduced work incentives: second income earners and overlapping income tests

Features of FTB Parts A and B have the effect of reducing work incentives for second earners. In addition, overlapping income tests for FTB Part A, Youth Allowance and CCB create high EMTRs for affected families.

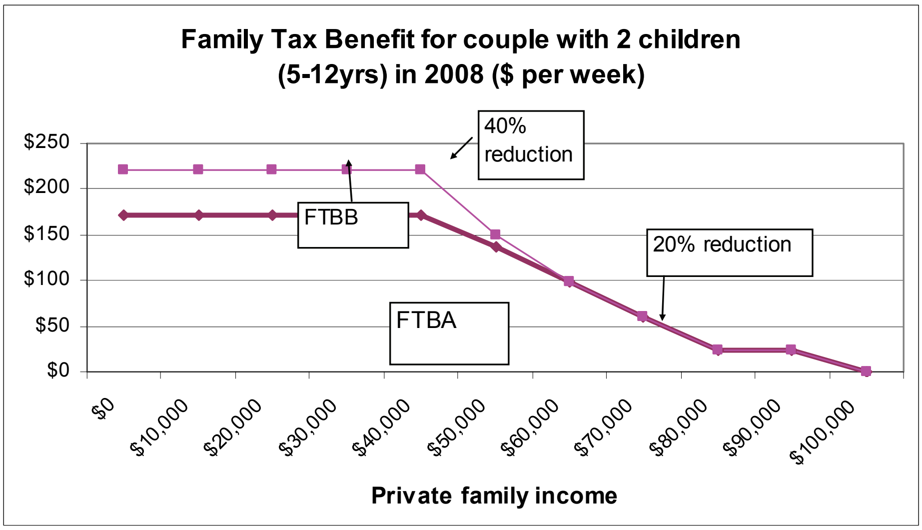
Compared to other OECD countries, Australia ranks badly (4th worst) on incentives for second earners with a low paid spouse. Most countries are relatively neutral or support second wage earners at around the average wage.

Families moving from being without paid work to a single low full-time wage continue to receive the maximum rate of FTB Part A. For this reason, Part A is not an impediment for a family transitioning from being without paid work to being a single wage household. However, Part A is an impediment to moving from one to two wage earners in middle income families.

Changes to income tests on FTB Part A in 2004 improved work incentives for second earners in low income families but reduced incentives for middle income families, as shown in Figure 15. There is now a free area of $44,000 and a taper rate at only 20%, rather than 50% under the previous system. As a result of the changes, a much higher proportion of middle-income families in the income range from about $850 to $1900 per week receive more than the minimum rate. This substantially improved incentives for second earners in low income families. However, these changes reduced incentives for second earners in middle income families and more people are now affected by high EATRs.

[88] Henry speech to ARACY at 13.

Figure 15: Work disincentives for second earners



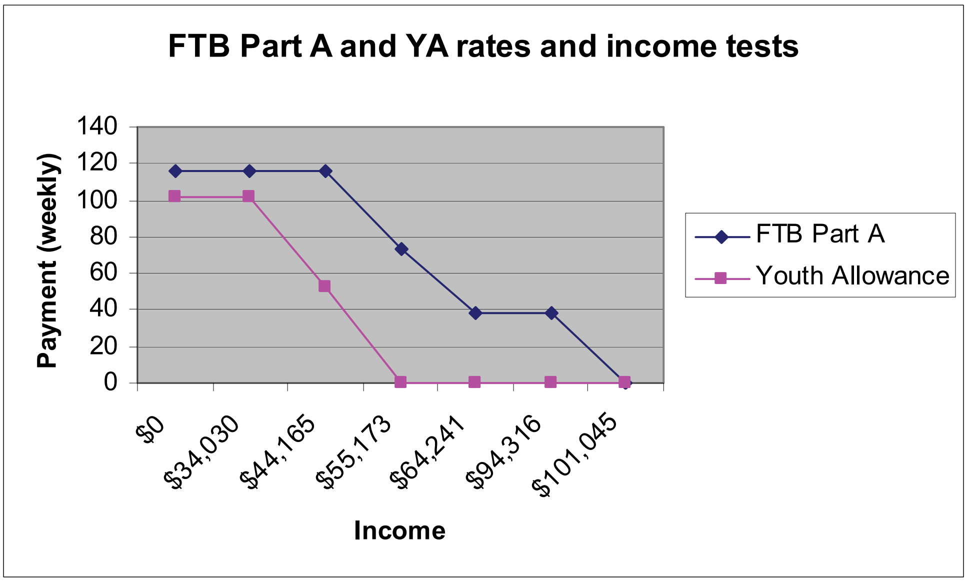
Source: McNamara Lloyd & Harding 2004.

To improve work incentives for second earners, ACOSS recommends that the family income test for the Part A payment be re-designed so that effective tax rates are shifted from second earners to primary earners in the family. One option is to replace the family income test with two income tests – the first applying to the personal income of the main carer and the second applying to that of their partner. This is the structure that applies to the income test for Newstart Allowance and Parenting Payment (Partnered).

FTB Part B is targeted to single income families. It discourages second earners as it is income tested exclusively on their earnings and only paid when the main carer of the child is home most of the time. For this reason, ACOSS recommends abolition of the Part B payment for couples and its integration into Parenting Payment.

Overlapping income tests can create high EMTRs for low income families. Currently, as Figure 16 below shows, the income test for the maximum rate of YA cuts in for a sole parent with an additional dependant child under 16 before the FTB Part A maximum rate (at $34,030), with both taper rates affecting households earning between $44,165 and $55,173. These families are therefore subject to a loss of at least 45 cents in every dollar earned. To prevent this, the free area of YA for families with an FTB child (who also have a YA child) should extend to the point at which the base rate of FTB Part A is paid (currently $64,241), so that the effects of the income tests are not overlapping, but successive. An alternative option is to integrate YA for older dependant children into the FTB system.

Figure 16:



The Dependant Spouse Tax Offset (DSTO, formerly the Dependent Spouse Rebate) was designed to provide a reduction in income tax for a person supporting a dependent spouse and therefore not benefitting from a second tax free threshold within the family.[89] It is available to taxpayers who maintain a dependent spouse for periods in which neither spouse is eligible for FTB Part B (generally, couples without dependent children). The maximum offset available is currently $2159, indexed annually. As contemporary society and social policy settings move away from the sole male breadwinner model, the continuation of the dependent spouse tax offset, which subsidises single income households without children, seems out of step with contemporary norms. It also discourages workforce participation among married women. ACOSS recommends that the rebate be abolished.

The risk of incurring debts to the Australian Tax Office due to the under-estimation of income can also act as a disincentive to work. To receive family payments fortnightly, recipients must estimate their annual income for the current financial year. However, a significant number of families will earn more than expected due to unexpected pay rises, a new higher paying job, re-entry to the labour market after a period of at-home care or older children taking up casual or part-time work. Recent data indicates that, due to the under-estimation of income, 8% of families receiving family payments had a debt in 2008-09 with an average debt of $1,330.[90] Some 74,415 people had their tax return held, fully or partially, to cover a debt.[91]

The repayment of family payment debts can cause serious financial stress for households, and constrains families' abilities to meet the needs of their children, counter to the purpose of family payments. To address this issue, ACOSS recommends that income estimation be abolished and that payments instead be based on earnings in the previous financial year

[89] Parliamentary Library, Taxation Laws Amendment (2007 Budget Measures) Bill 2007, Bills Digest, 21 May 2007, no. 155, 2006-07, ISSN 1328-8091 at 2.
[90] FaHCSIA Annual Report 2008-09, Appendix and page 357 and 359. It is not clear whether this takes lump sum payments into account in reducing the debts owed, and therefore may understate the gross level of debt incurred.
[91] FaHCSIA Annual Report 2008-09, Appendix at page 359.

with an uplift factor and latitude to exceed this threshold by a limited amount without adjusting payment level. A quarterly reporting option should apply for families with fluctuating incomes.

10. *The family income test for the Part A payment should be re-designed so that effective tax rates are shifted from second earners to primary earners in the family.*
11. *Changes should be made to YA to either:*
    a. *integrate YA into FTB Part A for dependant children under 18 years; or*
    b. *integrate the parental income test for Youth Allowance for dependant children under 18, where parent also receives FTB for another dependent child, with the parental income test for FTB Part A to reduce the highest effective marginal tax rates where payments overlap.*
12. *Income tests for FTB A and CCB should be integrated.*
13. *The dependant spouse tax offset should be abolished.*
14. *Income estimation should be abolished, with payment levels based on income from the previous financial year (with an uplift factor and latitude to exceed this threshold by a limited amount before payment level is adjusted.) A quarterly reporting option should apply for families with fluctuating incomes.*

Inequities and complexity in child care payments

Government intervention plays an important role in improving the equity and accessibility of child care services. The provision of assistance by Government for child care enables it to have influence over the accessibility and quality of child care services. While some commentators have proposed that Child Care Benefit (CCB), Child Care Rebate (CCR) and FTB B should be merged into a general contribution to the costs of child care, whether paid, unpaid or by parents, this would undermine the Government's broader early childhood education goals by removing a direct policy and budgetary control. There would also be losers, especially people with more than one child in the most expensive stage of care (the preschool years).

The current system of child care payments is complex and inequitable, with separate payments for low and higher income families and a system of child care for preschool age children that is separate from the system of preschools. Public spending on child care and pre-school in Australia is less than 60% of the OECD average.[92] This includes funding to services as well as cash payments to parents to offset the costs of formal child care.

The current child care payment system is divided between an income tested benefit, Child Care Benefit, and a separate tax rebate, Child Care Rebate, that is targeted towards higher income families. The tax rebate was largely introduced in response to arguments that child care is a work related expense, and should be tax deductible. A major difficulty with this argument is that public support along these lines is regressive, providing a higher level of support to higher income families who pay more tax. The CCR covers part of the gap fee between the income-tested CCB and fees charged. This means that high income families paying the highest fees get the highest level of CCR. As a result, the CCR has an inflationary impact on fees, to the disadvantage of low income families. However, abolishing

[92] Whiteford (2009) at 55.

CCR, without any additional support, would leave many low and middle income families with large gap fees, due to the inadequacy of CCB. This was one of the reasons that the rebate was introduced. ACOSS therefore recommends that the maximum rate of CCB be increased, reducing and ultimately abolishing CCR, and adjusting the CCB income test to minimise losses among middle income families.

Another problem with the present system is that the maximum level of child care subsidy (for a low income family) is generally not sufficient to finance quality care. ABS data for 2008 shows that of all children aged 0-12 years who usually attended child care, the weekly cost of care (after CCB and CCTR) was less than $40 for 75% of children, and for nearly two thirds of those children there were no costs. For 9% of children usually in care the weekly cost was $100 or more.[93] Peter Whiteford calculates that in 2004 net fees for a high income couple were about 14% of net family income (2% points above OECD average) but 7% of net income for a low income lone parent (5% above OECD average).[94] This data indicates that, relative to the OECD average, gap fees are relatively low for mid-income families but high for low income families reliant exclusively on income support, particularly sole parents. Further, inadequate public subsidies mean low wages and limited career development for child care workers. This is contrary to the Government's policy focus on the benefits of quality early child care and development services, especially for children from disadvantaged backgrounds. ACOSS therefore recommends that the maximum rate of CCB be increased to better reflect the actual cost of providing quality care.[95]

Further inequities in the current system of child care payments are created by the provision of Fringe Benefits Tax concessions for child care service. These concessions are of greater value to high-earners and of little or no value to low-income earners. Further, the concessions are only available for child care related to the workplace, which excludes not only families without paid work but also working families who do not have child care services at their workplace (the majority of working families).

We presently have a childcare system for preschoolers that (generally) provides inadequate early childhood education and an early childhood education system that fails to meet the needs of working parents (e.g. by starting late and closing early in the afternoon). To achieve better early childhood educational and development outcomes, support for child care and early childhood education programs should be integrated. Under the current system, child care and education systems (preschools/kindergartens) are separately funded and regulated. Approved child care centres are funded and regulated by the Commonwealth Government through CCB and CCR and national child care accreditation standards. Preschool programs are generally funded by state and territory governments and are usually play-based educational programs designed and delivered by a degree-qualified early childhood teacher.

The arguments for 'ending the care-education divide' were recently summarised by the Expert Advisory Panel on Quality Early Childhood Education and Care.[96] These arguments

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[93] Australian Bureau of Statistics, *Childhood Education and Care, Australia,* (cat. no. 4402.0), 2008, viewed 9 September 2009 at http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4402.0Main+Features1June%202008?OpenDocument.
[94] Whiteford (2009) at 55.
[95] See ACOSS Info Paper 383, Fair Start: 10 Point Plan for Early Childhood Education and Care, February 2006.
[96] See *Towards a national quality framework for early childhood education and care*, Report of the Expert Advisory Panel on Early Childhood Education and Care, January 2009, accessed at:http://www.deewr.gov.au/EarlyChildhood/Policy_Agenda/Quality/Documents/Expert%20Advisory%20Panel%20Report.pdf.

include the inappropriateness of this dichotomy as a conceptual model for early childhood development and learning, the equity and access implications of a divided system (with low income families less likely to access preschools), the need for consistency in care and education standards and the great imbalance between services for over fours compared to under threes. The Panel concluded:

> There is no justifiable, evidence-based reason to separate care and education into separate services, program funding or administrative arrangements. To do this is resource intensive, expensive and wasteful.[97]

COAG has committed to a National Quality Agenda which includes National Quality Standards, enhanced regulatory arrangements, a quality rating system and the Early Years Leaning Framework (EYLF). The RIS encompasses long day care, family day care, outside school hours care and preschools. One of the stated objectives of the COAG reforms is to 'build a high calibre, integrated national quality system, for early learning and care that takes account of setting, diversity of service delivery and the individual development of children.' However, although there are moves to develop an integrated national quality system, this would still leave separate funding streams for child care and education systems.

The integration of these systems into a single early childhood education and care system in which funding for child care and preschools is integrated and both systems are required to meet a number of educational, opening hours and eligibility standards would have some important benefits for children and families. ACOSS suggests that consideration should be given to an integrated model in which the costs of the system are shared between both levels of government, with CCB paid in relation to children in child care and preschool by the Commonwealth as on ongoing subsidy for the costs of care, and the state and territory governments subsidising the educational component (e.g. through teacher salaries). This would achieve a number of objectives. It would improve the educational value of child care centres, with all centres required to offer educational programs (at least for 3 year olds and over) with degree-qualified teachers (as is the case in some States), and pre-schools required to operate long day care hours.[98] The additional costs of longer hours would be subsidised through CCB payments.

Special subsidies for children with high needs should be maintained. Currently, the Inclusion Support Subsidy (ISS) is available for child care services to provide support to children with high needs. The ISS contributes $15.33 per hour towards the cost of employing additional staff. However, the subsidy is only available in relation to children with a medical diagnosis. This means that children with behavioral problems but who may not have received a medical diagnosis do not have access to the Subsidy. There are a number of reasons why a child may not receive a diagnosis, arising, for example, from the unwillingness of parents to take children to be assessed or because the child's behaviour is not part of a recognised medical disorder, for example, where behavioural problems relate to family violence or drug or alcohol abuse context, past or continuing. So that these children are not excluded from early childhood education, it is important that they receive additional assistance though expanding eligibility for the ISS.

[97] Ibid at 12.
[98] These requirements could be phased in gradually in recognition of the teacher shortages in the early childhood sector.

15. The Child Care Rebate should be abolished and replaced with a minimum rate of Child Care Benefit (possibly paid universally for formal child care services). *16. The maximum rates of Child Care Benefit should be increased to better reflect the actual costs of providing quality care.* *17. Special subsidies for children with high needs (e.g. disabilities and Indigenous services) should be retained and eligibility expanded.* *18. Fringe Benefits Tax concessions for employer provided child care should be abolished.*

The interaction of FTB and the Child Support system

Child support payments received affect the level of FTB Part A that a separated parent may receive. The Maintenance Income Test (MIT) operates to reduce FTB Part A payments by 50 cents for each dollar of child support above a prescribed threshold, until the base rate is reached. Rent Assistance paid as a supplement to FTB Part A is also subject to reduction through the MIT.

The Report of the Ministerial Taskforce on Child Support, *In the Best Interests of Children*, identified two key problems with the MIT.[99] The first was that the MIT operates to reduce FTB payments to all children in a family, not just those for whom child support payments are received. The second was that the MIT is not aligned with FTB in a coherent policy framework because it operates to reduce FTB payments to the family following separation such that they receive less after separation than before. The Taskforce argued that the MIT should not claw back FTB Part A beyond the level paid to equivalent intact families, which it described as the ‘neutrality principle’. It recommended that:

> The MIT’s free area, taper rate and scope should be reviewed in order to ensure that the operation of the MIT does not claw back FTB Part A beyond the level paid to equivalent families.[100]

Changes to the child support scheme which took effect on 1 July 2008 introduced a new ‘costs of children’ table based on the net costs of children, thereby taking account of the FTB payments received by receiving parents (as a Government contribution to the cost of parents) and created broader bands within which changes in care do not affect FTB payments.

Recent research measuring the impact of these changes shows that low income sole parents have fared badly, in many cases experiencing a loss of income as a result of the changes. Basing child support costs on the net costs of children (and therefore taking FTB into account), along with other changes to the formula, has resulted in around 45% of receiving parents experiencing a net reduction in combined child support and Family Tax Benefit.[101] The majority of the changes were for $20 a week or less. For receiving parents on income support (around 56% of all receiving parents), around 46% had a net loss, with

[99] *In the Best Interests of Children*, Chapter 11.
[100] Recommendation 9.3.
[101] FaHCSIA, Update to the population impact of the new child support formula, 29 July 2009 at 4.

most of these being $20 or less (65%).[102] Most were sole carers of their children, contrary to a common view that any reductions in child support arising from the changes were due to 'shared care arrangements'.

The significant number of low income lone parents who have experienced a loss in combined child support and family tax benefit income as a result of the recent changes to child support suggests that the interaction of these systems needs to be improved. A basic principle of the previous system was that government income support should not be taken into account in assessing child support entitlements because the purpose of child support is to equitably share the private incomes of separated parents, to meet the needs of their children.

19. The Government should implement recommendation 9.3 of the Ministerial Taskforce on Child Support with a view to increasing the MIT free area (by 20%) and indexing the free area (to CPI) and reducing the taper rate to 40 cents in each dollar of child support received.

[102] Ibid at 7.

Appendix- An overview of Australia's family payment system

Australia has a unique system of family payments.

At the centre of the system is a single cash payment for the direct costs of children, called Family Tax Benefit Part A (FTB A). This payment incorporates a lower level of semi-universal 'family allowances' for middle and higher income families and a higher level of support for the costs of children in low income families and families without paid work.

For older children, low income families receive assistance in the form of Youth Allowance rather than FTB(A).

Payments for the direct costs of children generally are complemented by subsidies to offset the costs of formal child care. These payments are divided into Child Care Benefit (a direct payment), Child Care Rebate and Fringe Benefit Tax Concessions.

In addition, assistance is available for the indirect costs of children to stay-at-home parents in the form of FTB Part B, Paid Parental Leave and the Baby Bonus.

Family Tax Benefit Part B is paid to single income families, including sole parents. This payment was introduced by the previous Government to compensate single income families for the fact that they could only benefit from one income tax free threshold. It provides important assistance to sole parent families.

The Paid Parental Leave scheme is designed to provide financial support for working mothers and will be introduced after 1 January 2011. The 'Baby Bonus' will continue to be available for mothers who are not eligible for the PPL (for example, mothers who have been out of the labour force or not in continuous employment for at least 10 of the 13 months prior to the expected birth or adoption of the child) as well as those who choose to receive the Baby Bonus instead of PPL, for tax or other reasons.

For the purposes of this paper we have excluded funding to education and Parenting Payment (Single and Partnered) which are sometimes included under the category of support of families.[103] A number of proposals for reform of parenting payments will be included in a forthcoming paper on working age payments.

The development of Australia's family payment system

Financial assistance to families with children was first introduced by the Fisher Government in October 1912 in the form of a Maternity Allowance.[104] This was followed by the introduction of a child endowment in 1941 by the Menzies Government, extended to all children in 1950.[105] While tax concessions for children had been abolished when Child Endowment was introduced, they were reintroduced and their monetary value increased

[103] See Peter Whiteford on broad and narrow definitions of family support in 'Social Inclusion: Family Joblessness in Australia', January 2009, A paper commissioned by the Social Inclusion Unit of the Department of the Prime Minister and Cabinet, January 2009 at 11-12.

[104] Dale Daniels, Social Security Payments for People Caring for Children, 1912-2003, Department of the Parliamentary Library, Last updated 20 February 2003, accessed at www.aph.gov.au/library/pubs/online/children.htm on 24/6/2003.

[105] Ibid.

while the value of the Child Endowment was eroded by inflation.[106] In 1976 the Fraser Government abolished tax concessions and introduced the Family Allowance which was paid at a higher rate to the Child Endowment.[107]

In the absence of indexation, the real value of Family Allowance was eroded by the high inflation of the late 1970s and early 1980s.[108] The Family Income Supplement was introduced in 1983 to assist low income families with children who were not in receipt of a social security pension or benefit.[109] FIS was replaced in 1987 by the Family Allowance Supplement with a more generous income test as part of the Hawke Government child poverty package.[110]

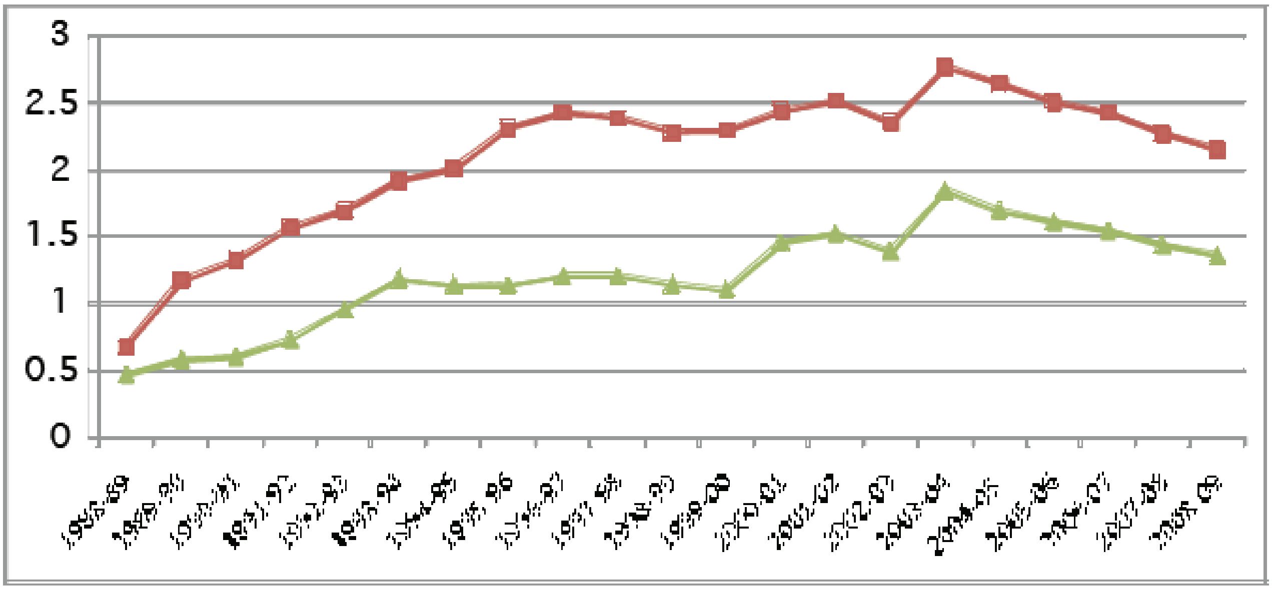
The Hawke/Howe 1988 family package increased the income tested Family Allowance Supplement and extended it from families without paid work to low paid working families. The purpose of the package was to reduce poverty and to boost incentives to move from being without paid work to a full time job. Under this package, the maximum rates of Family Allowance were benchmarked to 15 and 20% of the married pension rate, and were later increased. This linked family allowances with movements in average male earnings. Researchers estimated that over the period 1982 to1995/96 there was a one-third drop in child poverty, attributed largely to the substantial increases in government cash payments to lower income families with children.[111]

The Howard Government replaced Family Allowances with FTB Part A, increased payment rates and progressively eased the taper rate in the income test from 50% to 20%. In July 2000, it amalgamated 12 transfer payments and taxation rebates into three generic tax/transfer programs: Family Tax Benefit Parts A and B and the Child Care Benefit.[112] This change also directed substantially increased assistance to single income families, and enabled the primary breadwinner in couple households to receive payments directly instead of the primary carer.[113] This was intended to extend the payment to middle income families and to support single income families.

[106] Ibid.
[107] Ibid.
[108] Ibid.
[109] Ibid.
[110] Ibid.
[111] Harding and Szukalska, 'Trends in Child Poverty 1982 to 1995/96', presented at the Australian Association for Social Research Annual Conference, 12 February 1999.
[112] Cass and Brennan (2003) at 53.
[113] Ibid at 53.

Figure 17, below, shows that over the longer term, spending has increased significantly over the last 20 years as a proportion of GDP, but started falling in recent years (from 2003-4).

Figure 17: Spending on families as a proportion of GDP.



Source: Peter Whiteford, 'Assistance for families: An assessment of Australian family policies from an international perspective', Keynote Address, 10th Australian Institute of Family Studies Conference, 9-11 July 2008, Melbourne.

Family Tax Benefit

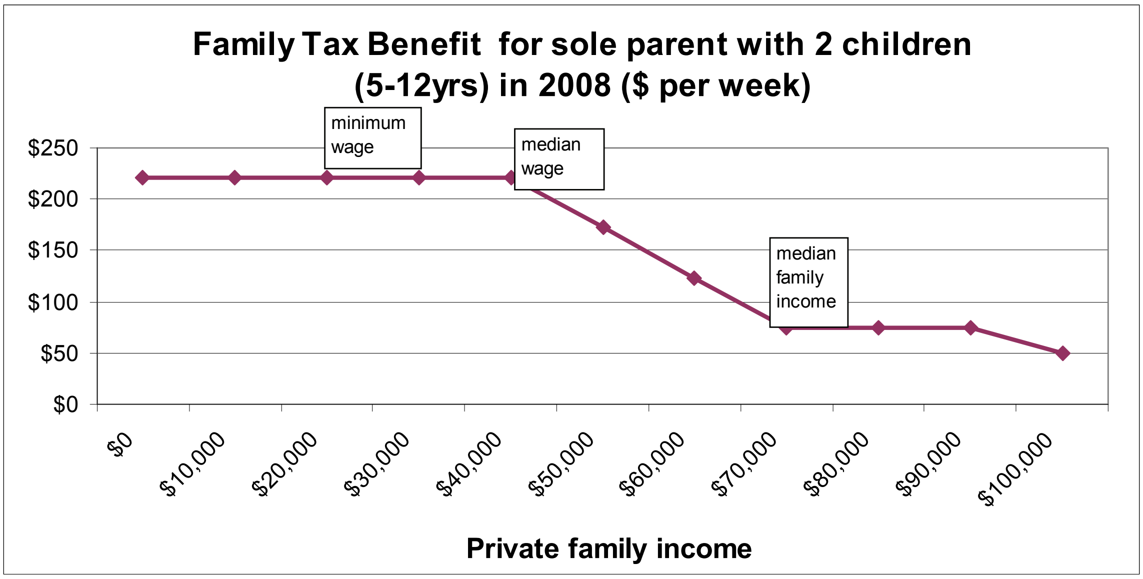
The basic structure of FTB is shown in Figure 18 below. It is divided into a Part A payment which is a general family allowance payment for low and middle income families, and a Part B payment which is restricted to single income families (including sole parents).

Figure 18: Basic structure of Family Tax Benefit (as at September 2009)

Component	Eligibility	Maximum rate ($pw)	Income test ($pa)	Minimum rate ($pw)
FTB Part A	Low and middle income families, child under 25	Per child (including supplement): 0-13yrs: $92 13-15 yrs: $116 16-17 yrs: $39* 18-24 yrs: $47 [* the alternative *Youth Allowance* for 16-17 year olds living at home is $102, for over 18s at home, it is $122]	On family income: Free area is $44,165 Taper rate is 20% Max. rate cuts out (for 2 chn 0-12yrs old) at $72,015 (above which only minimum rate is paid)	Per child: 0-17 yrs: $39 18-24 yrs: $47 Min. rate cuts out (for 2 chn. 0-17yrs old) at $111,569
FTB Part B	Single income family, incl. sole parents	Per family: 0-4 yrs: $74 5-18 yrs: $53	On second earner: Free area is $4672 Taper rate is 20% Cuts out (for chn. aged 5-18yrs) at $18, 542 On higher income earner: Cuts out at $150,000	

A single income or sole parent family earning less than $44,165 with 2 primary school aged children receives a total of $237 per week in FTB, which is about equal to the Newstart Allowance for a single unemployed adult.

Figure 19:



As Figure 19 shows, the Part A payment is income tested on family income, with the highest payments going to those on less than $44,165 per year, and a lower amount extending to many families on up to about $100,000. The Part B payment is mainly income tested on the 'second earner's' income, although families with total income over $150,000 are not entitled to this payment. The income test is based on annual taxable income.

FTB is paid on a fortnightly basis in most cases to the main carer of the child. Until recently, parents could opt to receive FTB through the tax system but less than 5% of families opted to receive it in that form. Changes under the current Government have removed this option.

Unlike income support payments, family payments are tested on income only, not assets, in a manner similar to tax programs. Families can wait until their adjusted taxable income is known and claim the payment as a lump sum. FTB supplements are available at the end of the tax year and can be used to offset any debt arising from an incorrect estimate of income. FTB can also be shared where two adults substantially share the care of a child.

Part A

Family Tax Benefit Part A is a per child payment to assist families with the direct costs of raising children. Maximum and base rates of payment depend on the age of children, with children aged 13-15 having a higher maximum rate than those aged under 13. In this way, the payment structure recognises the higher costs of older children. However, many low income families experience a drop in income once their child turns 16. This is because Youth Allowance becomes available for low income families once a child turns 16, and FTB is paid at a lower rate.

FTB Part A includes Rent Assistance (children under 16), Large Family Supplement and Multiple Birth Allowance. In 2007-8, FTB Part A was paid to 1.7 million families with 3.4 million children, at a cost of $10.7 billion.[114]

FTB Part A is indexed to CPI. Until recent Budget changes, the maximum rates for children under 16 were also benchmarked against pension rates such that the maximum level of FTB for low income families could not be less than 16.6% of the pension rate for a married couple for each child under 13 or 21.6% for each child aged 13-15 years.The link to pensions, and therefore wages, was removed in the 2009-10 Budget as a savings measure.

Part B

Family Tax Benefit Part B is a per family payment to single income families including sole parents, subject to a primary earner income limit of $150,000 since 1 July 2008. FTB B has a dual individual income test.

Families must have a dependant child under 16 or a qualifying full-time student aged 16-18. FTB Part B has a higher rate for families with a child under 5 years. The payment is indexed to CPI.

[114] FaHCSIA Annual Report, 2007-8, accessed at: http://www.fahcsia.gov.au/about/publicationsarticles/corp/Documents/2008%20Annual%20Report/07_1.htm

In 2007-8, FTB Part B was paid to 1.4 million families with 2.6 million children at a cost of $3.4 billion.[115]

Youth Allowance

Most low income families receive Youth Allowance, rather than FTB (A), for children 16-24 years old.

Young people between 16-18 years living at home receive $102 per week, subject to a parental income test which reduces the rate of payment once earnings exceed $32,800 plus an amount for each dependant child.

This compares to $116 per week in FTB (A) for a child 13-15 years, and represents a reduction in family income of approximately $14 per week. This decrease in income is despite the fact that the costs of children increase as they get older.

Paid Parental Leave scheme and Baby Bonus

Paid Parental Leave schemes have a number of objectives related to child and maternal health and development, encouraging women's labour force participation and gender equity.

The Australian Government will introduce a Paid Parental Leave scheme after 1 January 2011. Eligible parents will receive taxable PPL payments at the level of the Federal Minimum Wage ($543.78) per week for a maximum period of 18 weeks.

To be eligible, a person (usually the mother) must be in paid work and have been engaged in work continuously for at least 10 of the 13 months prior to the expected birth or adoption of the child and undertaken at least 330 hours of paid work in the 10 month period (an average of around one day per week).

An individual income test of $150,000 will apply based on the person's adjusted taxable income in the previous year.

Eligible families can choose whether to participate in the Scheme. Some eligible families may choose to receive the Baby Bonus instead, for tax or other reasons.

Many low income households and households without paid work will not be eligible for the PPL as they will be unable to satisfy the continuous employment requirement. These women will still be eligible for the Baby Bonus, which is a payment of $5185 per eligible child paid in 13 fortnightly instalments. The Baby Bonus is income tested on household income, with families with an estimated combined adjusted taxable income up to $75,000 in the six months following the birth of a child eligible to receive the payment.

In 2007-8, Baby Bonus was paid to the parents of 290,000 children at a cost of $1.2 billion.[116]

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[115] Ibid.
[116] Ibid.

Child Care Payments

Payments to assist parents to meet the costs of child care play a major role in improving the affordability of child care and encouraging the workforce participation of parents, particularly mothers.

There are a number of payments designed to assist parents with the direct costs of child care in Australia: the Child Care Benefit (CCB), Child Care Rebate (CCR) and fringe benefit tax concessions.

Child Care Benefit

Child Care Benefit is paid to families who access child care services provided by an approved service or registered carer. Approved services include long day care, family day care, outside school hours care, vacation care and some occasional and in-home care, while registered care includes nannies, relatives or friends registered as carers.

Families can get up to 24 hours of CCB per child per week regardless of their work status. Families where both parents or a sole parent are working, studying, training or looking for work for at least 15 hours a week are eligible for up to 50 hours a week for approved care.

Child care benefit (CCB) is usually paid as an offset to fees for formal child care services. The maximum rate is $180 for a 50 hour week for a preschool age child, or 85% of the hourly equivalent for a school age child.

CCB is income tested on annual family income for approved care. Families with incomes below $37,960 receive the maximum rate. The hourly subsidy is reduced gradually for higher family incomes, cutting out altogether at an income of $136, 375 in the case of a family with 2 children in child care.

Most families receive the benefit as a fee reduction, paid directly to the provider, but it may be claimed as a lump sum annually.

There is no income test for CCB for registered care, but it is only available where both parents or a sole parent are working, studying, training or looking for work at some time in the week, with a weekly limit of 50 hours per week of CCB.

In 2007-08, the Government paid $790 million in Child Care Benefits.[117]

Child Care Rebate

The Child Care Rebate (CCR), formerly the Child Care Tax Rebate (CCTR), meets 50% of the out-of-pocket child care expenses for approved care, up to a limit of $7778 per child per annum in 2009-10.[118]

[117] DEEWR Annual Report 2007-8 at 30.
[118] The Child Care Tax Rebate was renamed the Child Care Rebate on 1 July 2009 in recognition that the rebate is no longer a tax offset under taxation legislation but is paid to families under the Family Assistance Law by the Family Assistance Office.

To be eligible for the rebate, the child must have attended approved child care and be eligible for the CCB i.e. be working, studying, training or looking for work. There is no income test for the CCR. This means that families will be eligible if they are eligible for CCB, even if they do not receive any CCB due to income. Most recipients receive the CCR on a quarterly basis.

Since the CCB is income tested, and high income earners tend to use more expensive child care, gap fees are generally highest for high income families. This means that the main beneficiaries of the rebate are higher income families.

The Child Care Tax Rebate was paid to 600,000 families at a cost of $56.7 million.[119]

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[119] DEEWR Annual Report 2007-8 at page 30.