



20 October 2022

Select Committee on Work and Care  
Senate  
PO Box 6100  
Parliament House  
Canberra ACT 2600  
By email: [workandcare.sen@aph.gov.au](mailto:workandcare.sen@aph.gov.au)

**Attention:** Dr Jane Thomson, Committee Secretary for the Chair, Senator Barbara Pocock

Dear Chair,

### **Response to Question on Notice from Senator Andrew Bragg**

Thank you for the opportunity to present at the public hearing for the Select Committee on Work and Care on Friday, 7 October 2022, as a member of the Work + Family Policy Roundtable co-convened by Professor Sara Charlesworth and Associate Professor Elizabeth Hill. I write to respond to the following Questions on Notice from Senator Andrew Bragg that were raised after that presentation.

1. What is the best way to cut the effective marginal tax rates for the secondary earner in a household to encourage work? (Please include all Commonwealth payments in your answer).
2. What is the best way to improve the attractiveness of work for single income households needing access to care?

In sum, the best policy approaches are:

- Deliver universal, or near-universal free childcare;
- Move from tightly targeted to universal child allowances taxable in the income tax
- Lower taper rates, raise thresholds and taper payments on individual income.

Please contact me for further information or to discuss.

**Miranda Stewart**  
Professor

## SUBMISSION: RESPONSE TO QUESTIONS ON NOTICE

Miranda Stewart,

### Background about family payments

In summary, ABS data indicates the following about the distribution of Family Tax Benefit A and B:<sup>1</sup>

**In June 2022 around 1.4m recipients received FTB A, down from 1.5 million in March 2015.**

- Recipients were split evenly between partnered and unpartnered
- 8% of recipients identify as first nations
- 32% of recipients are under 35, 40% are aged 35-44, and 28% are aged over 45
- 80% of recipients are eligible for both FTB A and FTB B

**In June 2022, just under around 1.1m recipients received FTB B, down from 1.3 million in March 2015.**

- 62% of recipients are not partnered
- 9% of recipients identify as first nations
- 35% of recipients are under 35, 40% are aged 35-44, and 25% are aged over 45

About 42% of FTB recipients also receive other income support payments down from 47% in March 2021.

- Parenting Payment Single (16%) and JobSeeker Payment (11%) are most common for those receiving FTB
- Carer payment (5%), DSP (4%) and Parenting Payment Partnered (3%) are also relied upon.
- 6% of FTB (only) recipients receive rent assistance

An outline of rates and tapers is in this Table. Child support payments reduce both FTB A and FTB B. Family tax benefits are not subject to income tax (they are excluded). However, they are subject to taper rates ad set out in the table.

Family Tax Benefit A	Family Tax Benefit B
<ul style="list-style-type: none"><li>• Maximum rate up to \$58,108<ul style="list-style-type: none"><li>➢ \$197.96/fortnight, \$5,197/year (0-12)</li><li>➢ \$257.46/fortnight, \$6,694/year (12-15; dependent students 16-19)</li></ul></li><li>• Base rate above \$58,108 is \$1,653/year</li><li>• Income test on couple income (if couple exists)<ul style="list-style-type: none"><li>➢ Taper at 20% up to \$103,368</li><li>➢ Taper at 30% above \$103,368</li></ul></li><li>• Supplements for some families</li></ul>	<ul style="list-style-type: none"><li>• Maximum rate (supplement for some families)<ul style="list-style-type: none"><li>➢ \$168/fortnight, \$4,375/year (0-5)</li><li>➢ \$117/fortnight, \$3,054/year (5-13, couple family; up to 18, sole parent)</li></ul></li><li>• Income test on couple income, plus:<ul style="list-style-type: none"><li>➢ Primary earner: Taper at 20% up to max of \$104,432/year</li><li>➢ Secondary earner up to \$6,059/year, then taper at 20% to \$29,985/year (0-5) or \$23,360 (5-13)</li></ul></li><li>• Not payable while receiving Parental leave pay</li></ul>

<sup>1</sup> See <https://data.gov.au/data/dataset/dss-payment-demographic-data> .

Additional effects are produced for families where one or both parents are in receipt of Jobseeker, or of a pension.

### **RESPONSE TO QUESTION 1: What is the best way to cut the effective marginal tax rates for the secondary earner in a household to encourage work?**

In summary, my recommendations are:

1. Expand Child Care Subsidy; deliver universal, or near-free, public childcare
2. Deliver a universal family or per-child child payment that is taxable
3. The universal family or child benefit should be included in income tax for the second earner
4. Taper or income test the family or child payment on secondary earner's income

### **EXPLANATION**

In response to this important question, I first set out a little more information about effective marginal tax rates (**EMTRs**) and why addressing this is important for encouraging secondary earners into work. The key drivers of high EMTRs on secondary earners working hours are net childcare cost, and the loss or tapering of family payments FTB A and FTB B.

#### **Effective marginal tax rates (EMTRs) for the secondary earner in a household**

What we call an 'effective marginal tax rate' is a consequence of combining regular income tax rates (the normal tax rate structure with progressively increasing rates and thresholds) with the withdrawal or 'taper' rates and thresholds that apply to cash payments or transfers to families, including Family Tax Benefit A (**FTB A**) and Family Tax Benefit B (**FTB B**).

An EMTR is a result of the interaction of tax and welfare systems. For cash payments and subsidies, the EMTR measures the **net loss** for an individual resulting from income taxation combined with the withdrawal of a cash transfer or family benefit, applied to an extra (marginal) dollar of income.<sup>2</sup>

The EMTR depends on the **tax rate or taper rate**, the income **threshold** at which these rates apply (as earned income rises), and on the **unit** of assessment of income. In the income tax, the unit of assessment is individual 'taxable income'. However, in the family payments and welfare system, the unit of assessment is a joint, or couple unit. That is, the combined 'adjusted taxable income' of two adults in a 'couple' family is used to determine the income for the eligibility thresholds and taper rates for FTB and FTB B. For sole parent families, the **individual** is the unit for both tax and benefits. However if there is a former spouse or other parent, **child support payments** will reduce eligibility for family payments, producing a de facto couple unit even for separated families.

The EMTR can be presented as a chart where the horizontal axis presents the increasing income of an individual or household, and the vertical axis presents the effective tax rate on the specific dollar of income, as a consequence of combined the rates, thresholds and unit described above.

#### **Work disincentive effects**

Decisions about work and care are often joint family decisions in a couple household, but these decisions tend to focus on the pros and cons of work of the **secondary earner** in the household. For the purpose of understanding the **work disincentive** faced by a **secondary earner** in a family,

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<sup>2</sup> For a general explanation, with examples, see Ingles, David and Plunkett, David, *Effective Marginal Tax Rates* TTPI Policy Brief 1/2016, <https://taxpolicy.crawford.anu.edu.au/publication/12578/effective-marginal-tax-rates>,

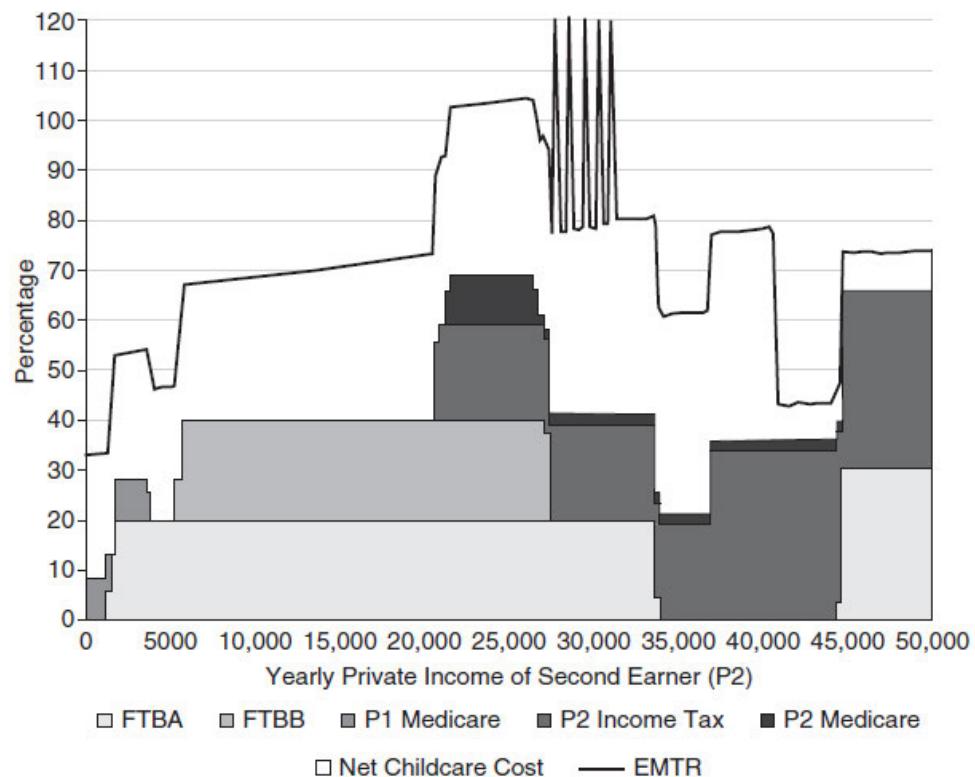
we need to examine the EMTR on the secondary earner's income. This is usually, although not always, the woman in a couple family.

The secondary earner may earn a lower wage and hence the **primary earner's** income is more important in the family, and they choose to 'sacrifice' the second earner's wage in exchange for care in the household. The secondary earner may also have the more flexible or 'elastic' labour supply response in choosing between primary responsibility for care of children in the family, and paid work. In a society and economy where there is a gender pay gap,<sup>3</sup> and social norms of primary caregiving by mothers, and not fathers, the 'secondary earner' is usually the mother, or woman, in a couple.

While an EMTR may be very high at a specific level of earned income, the disposable income of the individual or family may be steady or still rising – it is unlikely to be decreasing. An EMTR chart can also present the **disposable income** of the individual or family being earnings net of taxes and family payments. The disposable income is a consequence of the **average effective tax rate** faced by the individual or family.

Where disposable income of an individual or family (earnings net of taxes and transfers) is flat or grows very little overall, this indicates a high **average effective tax rate**. In this circumstances, there is essentially **little net benefit in working**, compared to remaining at home in a dependent carer role where the family relies on the breadwinner earnings and family payments. This average tax rate is also relevant to understanding **work disincentives** for secondary earners.

**Figure 1: Components of Effective Marginal Tax Rate including net childcare cost (March 2016)**



Source: Ingles and Plunkett (2016), extracted in Stewart and Whiteford (2018).

Notes: Primary earner income fixed \$49,600; two children aged 2 and 3.

Figure 1 is illustrative only and is based on 2016 policy settings. It presents an EMTR chart for the income of a second earner in a couple with two children under the age of 5 in long day care, with

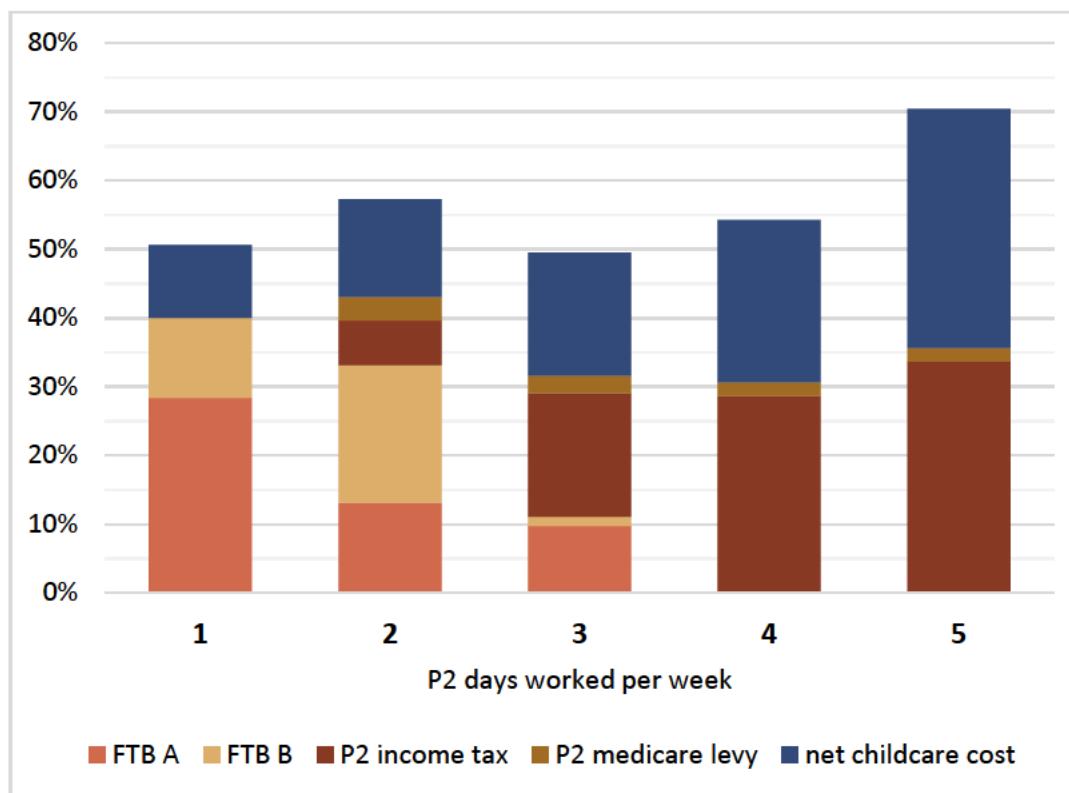
<sup>3</sup> See WGEA, <https://www.wgea.gov.au/the-gender-pay-gap>.

the primary earner at about \$50,000 annual wage and secondary earner starting to earn income (x axis). The y axis presents the EMTR. As illustrated by Figure 1, the EMTR faced by the secondary earner (P2) at \$25,000 of earned income exceeds 100%. This means the family goes backwards at that point, losing more in benefits and tax than is earned in income by P2. The components illustrate the impact of taxes, the Medicare levy, the tapering (loss) of FTB A and FTB B, and childcare cost net of the childcare rebate as it then was. The largest component under 2016 policy settings was net childcare cost, because of the limitations and taper rate for child care benefits. However, at that point in earned income, the secondary earner began paying income tax, and the family loses a proportion of FTB A and FTB B.

### Daily EMTRs and work choices

An easier way to present the data is in a bar chart with daily increments. The **effective marginal tax rate** can be presented as a bar chart on a daily basis, instead of in increments of dollars earned. This is presented in Figure 2 based on **May 2022 policy settings**.

**Figure 2: Components of Daily Effective Marginal Tax Rate on secondary earner (May 2022)**



*Source: Miranda Stewart, with D Plunkett modelling. Notes: Median wage. Primary earner (P1) \$78,000/year (full time male median earnings), P2 earning \$14,000 per year, per day worked (full time female median earnings). Childcare \$10.50/hour/child (long day care at 10 hours/day). Two children 2, 3.*

The cameo presented in Figure 2 demonstrates the impact of policy settings on a median wage family in May 2022 based on the childcare subsidy, income tax rates, and family payment rates at that time. The EMTRs are not as bad as they were in 2016, mainly because the net childcare cost (blue) has come down, although it is still substantial. The red and yellow components indicate the impact of tapering of FTB A and FTB B. Brown indicates that P2 begins to pay income tax and Medicare levy once working two days a week.

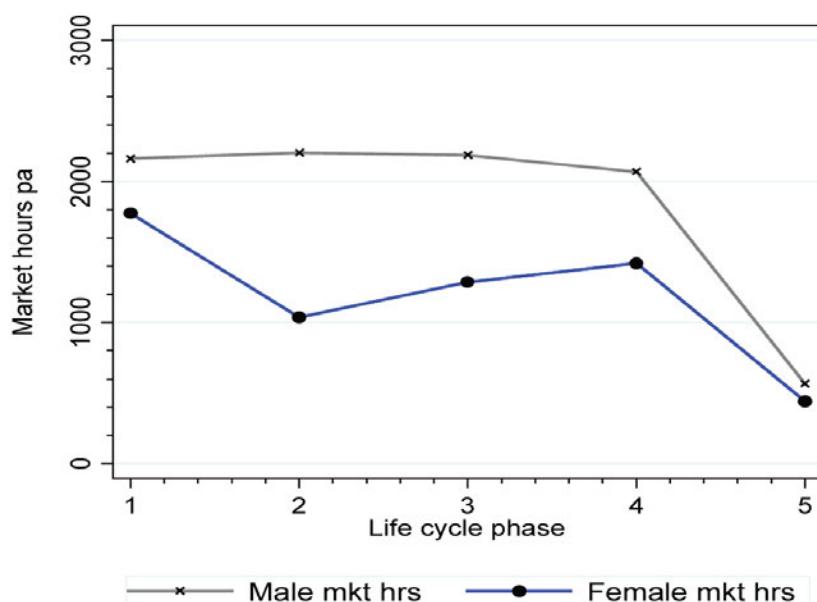
Figure 2 shows that the EMTR is at least 50% on all days for the secondary earner in this cameo family. Some conclusions from this chart are:

- On Day 1 of work (working one day a week), most of the 50% daily EMTR is because the family loses FTB A and FTB B, and pays some net childcare cost, as the secondary earner starts to earn income.
- On Day 2 of work (working two days a week), more than half of the daily EMTR is because the family loses FTB A and FTB B.
- The shift to a much lower ‘basic’ rather than ‘maximum’ rate of FTB A operates as a very high effective tax, and this contributes to the effect demonstrated in Figure 2 where no payment is received at all once the secondary earner income reaches the minimum wage.
- From Days 3 to 5 of work, those family payments are less important, because the family is no longer eligible for much or any payment. Instead, net childcare cost dominates the EMTR.
- The EMTR on moving from 4 days a week to full time work is 70 percent, primarily because of net childcare cost.

Overall, this chart indicates that the **average effective tax rate is close to 60% on the secondary earner’s wage**. The family takes home only about 40% of this wage. This is considerably higher than either the marginal tax rate (47% including the Medicare Levy) or the average effective tax rate on the primary earner’s wage (below 30%).

It should be noted that these effects would also apply to a father in the position of ‘secondary earner’ in a household, either because of family choice or wage differentials. However, the empirical evidence demonstrates that the effect is mostly felt in reduced female workforce participation. The effect on hours worked in the child-rearing phase of the lifecycle, and subsequently, for men and women is illustrated by Professor Patricia Apps (Figure 10, reproduced below).<sup>4</sup> In this policy setting, it is hardly surprising that women’s workforce participation, and in particular the workforce participation of women as secondary earners in families with children, is still relatively low, and is stubbornly part-time, rather than shifting towards full-time work.

**Figure 3: Patricia Apps, Work Hours of men and women by life cycle phase**



Source: Apps (2022); ABS data, 2016.

<sup>4</sup> Apps, Patricia, ‘Optimal Tax Design: Choice of Tax Base and Rate Structure’ (2022) 51 *Australian Tax Review* 103.

Apps presents the lifecycle phases of men and women as: Phase 1: Pre-children; Phase 2: At least one child of preschool age is present; Phase 3: Children are of school age or older but still dependent; Phase 4: Parents are of working age but with no dependent children; and Phase 5: Retirement.

### **Approaches to cut EMTRs for the secondary earner**

I recommend that the Committee consider the following potential approaches to lowering the EMTR and the average tax rate faced by carers of children and therefore remove some of the barriers facing their entry into the labour market, or the increase of paid working hours.

It is important to note that for many low income families, FTB A and FTB B deliver substantial income to the families and help to prevent child poverty. The payments are less successful at achieving this than in the past because thresholds have not been indexed to inflation and have declined in real terms. In any policy reform, distributional and fiscal modelling, taking seriously the work disincentive effects, would need to be done.

#### **1. Expand Child Care Subsidy; deliver universal affordable, or near-free, public childcare**

The Government's proposed expansion of Child Care Subsidy, by increasing the per-hour coverage of the subsidy and lowering taper rates further, will assist in reducing the EMTR on the secondary earner, and on dual earner families in general.

The Government's approach does not go far enough. Early child education and care (ECEC) under primary school should be reconceived similar to universal free public primary school education. While children are of primary school age, childcare is also required before and after school, requiring a reconceptualisation of the delivery of primary education, and expected full time work hours of parents.

This is not the place for a full discussion of ECEC and the many policy and design issues. Australia is in transition to a new approach, and many challenges exist. There will always be families who choose not to avail themselves of child care, or who cannot utilise it for a range of reasons. There should also be quality, diversity in the mode and delivery of ECEC, and fair wages in the sector. However, it is critical that this paradigmatic shift be achieved towards ECEC as universal public provision, and indeed a right of children.

#### **2. Deliver a universal family or per-child child payment**

I recommend delivery of a universal per-child payment that is taxable (see 3 below). A universal per-child payment would recognise the costs of care and alleviate the high EMTRs we see on secondary earners.

Australia historically had a system of universal child allowances. The first income-testing was done in 1987 under a government that was concerned to deliver benefits to the poorest families, and managed the fiscal cost by reducing them across the board. This has become much more extreme due to higher tapers, lower adequacy, and a failure to index thresholds in the last two decades. We now have a highly targeted family payments system, in which fewer than half of families now receive any child or family payments.

The FTB A and FTB B structure still embeds a 'breadwinner-homemaker' model of the family by joint income testing.<sup>5</sup> The income thresholds and taper rates on FTB A and FTB B contribute

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<sup>5</sup> This history is discussed in Stewart, Miranda and Whiteford, Peter 'Balancing equity and efficiency in the tax and transfer system' in R Breunig and M Fabian (eds) *Hybrid Public Policy Innovations: Contemporary Policy Beyond Ideology* (Routledge: London, 2018) 204-231; Hodgeson, Helen, 'More than Just DNA – Tax, Welfare and the Family. An examination of the concept of family in the Tax Transfer system, with particular reference to family benefits' (2008) 43(4) *Australian Journal of Social Issues* 601-614.

significantly to EMTRs at low, median and higher wages of secondary earners, especially in respect of the move from caring in the home to part-time work. This is an important threshold for many parents.

**3. Bring a universal family or child tax benefit into the income tax net for the second earner**

A potential policy response is to deliver a universal family or child payment that is taxable, rather than exempt. This would require an individual unit. For example, the per-child payment could be included in the income of the secondary earner, or that of the lower income earner in the household.

This approach has the great advantage of applying a progressive rate structure (the income tax) to family payments, so that higher income families would benefit less, and lower income families more, while ensuring that those with low incomes still obtain the maximum benefit

**4. Taper or income test the family or child payment on secondary earner's income**

A related approach to (3) above is to test the family payment on the secondary earner's income. This operates as an additional tax rate but based on the individual income, not joint income, so would smooth and reduce EMTRs depending on the design of income thresholds.

**RESPONSE TO QUESTION 2: What is the best way to improve the attractiveness of work for single income households needing access to care?**

In summary, I recommend the following policy approaches:

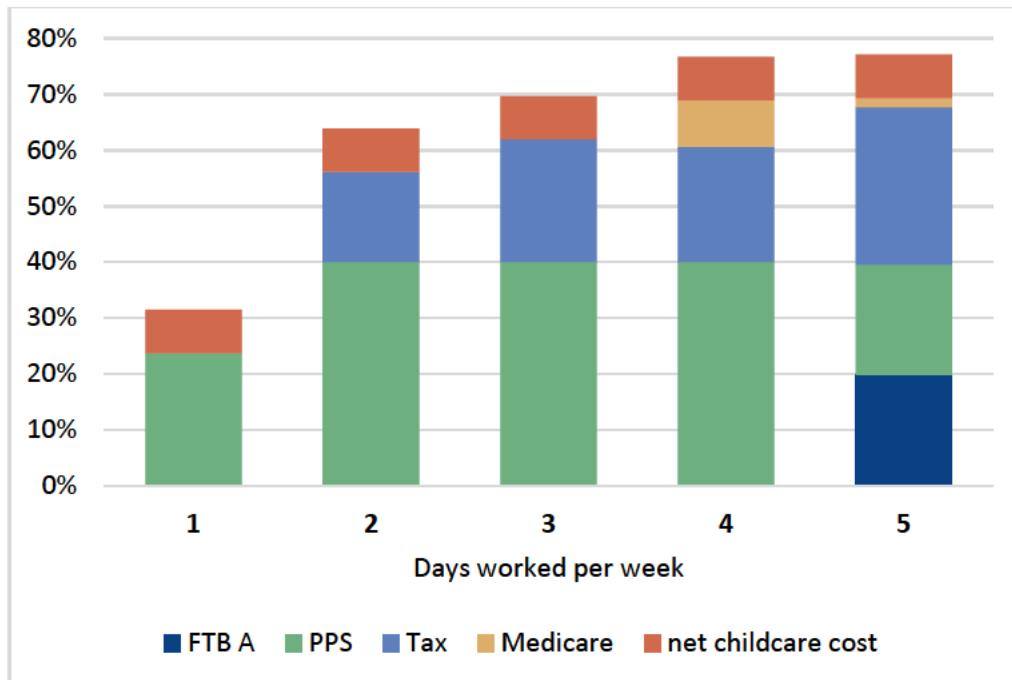
1. Expand Child Care Subsidy; deliver universal, or near-free, public childcare
2. Reduce the taper rate for parenting payment sole over a longer income range
3. Pay a universal per-child payment that is taxable.

**EXPLANATION**

The policy settings set out above for a couple family also apply, in general, to single income households needing access to care. I take this to mean sole parent households, in contrast to couple households which are discussed above. However, a key difference is the role of Parenting Payment, at rates for a single parent.<sup>6</sup> This can be illustrated with another cameo example.

Figure 4 presents an example of EMTRs on sole parents, arising from the withdrawal of parenting payment single, combined with FTB A, and paying income tax, for a parent earning a median female wage.

**Figure 4: Components of Daily Effective Marginal Tax Rate on sole parent (May 2022)**



*Source: Miranda Stewart and David Plunkett modelling. Notes: Sole parent on median female wage (\$14,000/day/year). Childcare \$10.50/hour/child (long day care at 10 hours/day). Two children 2, 3.*

Figure 4 demonstrates the very high reliance of a median wage sole parent on Parent Payment Sole, and the importance of tapering of this payment in contributing to high daily EMTRs for this sole parent. Net childcare cost is a relatively small contributor, indicating that the child care subsidy reforms to May 2022 had reduced the net cost of childcare significantly for a family earning a sole wage up to \$70,000. This family only begins to lose FTB A on Day 5 of work (moving to full time from 4 days), indicating the threshold for FTB A.

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<sup>6</sup> See <https://www.servicesaustralia.gov.au/parenting-payment>.

On Day 2 of work, this sole parent faces a 19% marginal income tax rate (on earnings of \$28,000), plus the Medicare levy, and loses Parenting Payment Sole tapered at 40% (PPS). This generates the combined EMTR above 60% on moving to two days of work a week.

At the median female wage, the combination of losing Parenting Payment sole, income tax and net childcare cost produces high EMTRs at 70% to 80% on Days 3 to 5 of work, and exceeding 60% on Day 2 of work. This family receives substantial benefit from parenting payment. In terms of disposable income, this family's income continues to rise as the sole parent goes into paid work. That is, paid work does 'pay'. However, the rise is rather flat. Relatively little (20 to 30%) is gained financially (in terms of disposable income) from shifting from part-time to full-time work. This may still be attractive, but the EMTR and high average effective tax rate will be a disincentive for many, when the relatively low economic gain is combined with the challenge of managing care of two young children, childcare access, commuting, and working hours.

### **Approaches to reducing work disincentives for sole parents**

Many of the same policy prescriptions apply for sole parents as for secondary earners in couple families. There are good reasons to encourage paid market work by sole parents, including to increase the income and economic wellbeing and ensure longer term economic security of those families. In particular, the longer term economic security of sole parents, who are mostly women, can be protected by retaining and strengthening her connection to the labour market, education, and career development.

However, it is important to observe that sole parenting is extremely demanding of time and that there is less flexibility or support for this family, by definition, than in the couple and potential dual earner family discussed above. I would therefore query, especially when children are young, a suggestion that all, or even the majority of sole parents should be working full time.

The best policy approaches to this issue are:

#### **1. Expand Child Care Subsidy; deliver universal affordable, or near-free, public childcare**

As above, free universal child care will be of assistance in increasing the attractiveness of paid work for sole parents. On the median female wage, it is pleasing that this has been achieved to a significant extent for this family (at least in economic terms). It remains a substantial challenge for sole parents who are on higher wages. In general, it is an unfinished agenda.

#### **2. Reduce the taper rate for parenting payment sole**

The income threshold could be increased or the taper for sole parent payment could be reduced, and this would reduce the EMTR faced by this family. The most effective way to reduce the EMTR on the sole parent in the example discussed here would be to reduce the taper rate on the payment and taper it over a longer income range.

#### **3. Pay a universal per-child payment that is taxable**

A related approach as discussed above, is to universalise a portion of parenting payment sole, or FTB A or B, and to bring that payment into taxable income. This would mean that the 'taper' is essentially the progressive income tax rate, which would be relatively lower than the combined taper and tax rate that we see in Figure 3.

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