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# **The ACOSS better family incomes package**

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# Summary

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Many low and middle income parents struggle with the costs of raising their children.

Improving payments to families - such as Family Tax Benefit Parenting Payment and Child Care Benefit - is a fairer and more cost effective way to help these families than across- the- board cuts in income tax.

Australia has a long and proud tradition of family allowances to help with the costs of children. However, these and other family assistance payments<sup>1</sup> and tax rebates for families are out of touch with the actual minimum costs of raising children. There are three main problems with the present system:

- family and youth payments do not meet even the bare minimum costs of children. This is a major cause of child poverty, in low income jobless and working families. The biggest problem here is the high cost of teenagers
- they also fail to meet the basic needs of working families with very young children who are juggling child care and jobs. This is a major cause of financial stress among low and middle income working families. The biggest problem here is the high cost of caring for very young children, both at home and in formal child care services
- the income tests applied to some family assistance payments penalise employment. In extreme cases, parents may lose 100% of their next dollar earned.

The ACOSS Better Family Incomes plan deals with these three problems.

## **1. Inadequate help with the general costs of raising children in low and middle income families, especially teenagers**

Family and youth allowances have a vital role in preventing child poverty.<sup>2</sup> To achieve this, they must cover *all of the minimum basic costs* of raising children in families that rely substantially on social security. Otherwise children in jobless and low paid working families must go without.

Our family and youth payments fail to achieve this. This is one of the reasons that in 2000, an estimated 740,000 children lived in families who were income poor.<sup>3</sup>

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<sup>1</sup> This refers to all payments and tax offsets targeted towards families with children and dependent young people.

<sup>2</sup> By *family allowances*, we mean principally Family Tax Benefit (Part A).

<sup>3</sup> Smith Family -NATSEM (2001), *Financial disadvantage in Australia*. The poverty line used, for a family of four, was about \$450 per week.

The largest gaps between family and youth payments and the minimum costs of raising children are for the most expensive children - teenagers. According to research into family budgets, in 2003:

- a preschool age child cost at least \$98 per week (excluding day care) compared with a family allowance payment of just \$76 per week
- a 5- 12 year old child cost at least \$137 per week compared with a family allowance payment of just \$76 per week
- a teenager aged 16- 17 cost between \$160 and \$220 per week, compared with a Youth Allowance of just \$85 per week.<sup>4</sup>

Further, the extra costs of raising a child alone, or sharing the care in two households, is not fully recognised in the family assistance system. As a result of this and other anomalies in the social security system, the overall level of social security payments for many low income sole parent families actually *falls* by \$60 to \$70 a week when their youngest child reaches 16 years.

### **Proposed reforms:**

The maximum rates of Family Tax Benefit and Youth Allowance should be based on research into the actual minimum costs of raising children of different ages in different family settings. The first steps towards removing the worst poverty gaps in the present system should be to:

- increase *Youth Allowance* by \$13 per week for 16- 17 year olds living at home and \$7.50 per week for 18 year old, and extend *Rent Assistance* to dependent young people [Approximate cost \$200 million per year]
- introduce *Sole Parent and Shared Care Supplements* to acknowledge the extra cost of raising a child alone and in shared care arrangements. The Sole Parent Supplement should replace the existing Family Tax Benefit (Part B) for sole parent families. It should be paid at the higher 'child under five' rate. [Approximate cost \$300 million per year]

## **2. Inadequate help with the costs of caring for young children, at home and in child care services**

Although the general costs of children rise as they grow older, child care costs are highest in the first few years. This is also the time of life when many middle income families come under the greatest financial stress. Their incomes are relatively low (due to withdrawal from paid work to care for the child) yet their expenses are relatively high (due to home mortgage and child care costs).

Income support for young families is too complex. There are three payments designed to assist parents with the costs of caring for children at home: *Parenting Payment*, *Family Tax Benefit (Part B)* and the *Baby Bonus*. In addition, *Child Care Benefit* helps with the costs of formal child care.

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<sup>4</sup> ACOSS calculations, updating the Social Policy Research Centre's *Indicative Budget Standards, 1998*; and the AMP NATSEM *Income and wealth report, 2002*.

These payments are *inadequate* to sustain a parent caring for a young child at home. The highest rate of Family Tax Benefit (Part B) is just \$56 per week. The maximum Baby Bonus is \$50 per week, though most receive much less. Parenting Payment at least recognises the basic income support needs of the parent (it is paid at the same rate as other social security payments for jobless people - \$174 per week), but it does not extend to families with incomes above about \$30,000.

Moreover, access to paid parental leave in the first four months after birth when mother and child are recuperating, is limited to a fortunate few.

The Family Tax Benefit (Part B) and Baby Bonus are also *inflexible*. They are based on an outdated distinction between parents who stay at home and those who undertake paid work and place their children in day care. They offer little or no help to middle income parents who combine part- time employment with part- time care for young children at home.

Families that use *formal child care services* are left substantially out of pocket. The average gap fee for full- time day care is over \$50 per week. Even many low income families are forced to pay this much for full time care.

The purpose of early childhood services is not only to enable parents to undertake full or part time employment. They should provide preschool age children a supportive, caring environment in which to grow and develop, and a head start for their formal schooling. Yet many three and four year olds miss out on early childhood education.

### Proposed reforms

More help should be provided for low and middle income families with the costs of caring for the youngest children, in ways that reflect families` changing needs as children grow. Introduce a new universal *Maternity Benefit* .to support mothers while they prepare for and recover from childbirth. We raise the following options for consideration:

- a Maternity Benefit would be paid at a minimum of Parenting Payment rates for mothers previously outside the workforce, up to the minimum wage for those who have foregone income - to support mothers over the first 4 months. The Baby Bonus would be abolished but the existing lump sum Maternity Allowance should remain to help with the up- front costs of a new child [Approximate cost \$100 million per year]
- extend the existing *Parenting Payment* (currently paid to low income families only at up to \$174 per week) to support middle income parents caring at home for a child under 3 years old, full or part time. This would replace the smaller Family Tax Benefit (Part B) paid to these families [Approximate cost of indicative option: \$1,000 million per year]
- Ease child care gap fees by increasing *Child Care Benefit* for low and middle income earners facing the highest costs, linking the maximum rates explicitly to a `standard fee` which services are discouraged from exceeding, easing the worst shortages in the supply, and extending subsidies to meet special

needs. [Approximate cost of indicative proposal to increase Child Care Benefit: \$200 million per year]

- in collaboration with State Governments, develop and progressively implement a *basic entitlement to early childhood education* for 3 and 4 year old children, and work towards the integration of preschools and day care centres into a single system of early childhood care, education and development with appropriately qualified staff.

### 3. Poverty traps

Poverty traps are caused by badly designed income tests for some family assistance payments. They especially discourage part-time employment by mothers in low and middle income families.

Due to the effect of family assistance income tests, income tax, and other income tests such as those affecting public and community housing tenants, 20% of workers in married couple families and 50% of those in sole parent families keep less than 40 cents of their next dollar earned.<sup>5</sup>

The worst poverty traps are sprung when two or more income tests (for example Family Tax Benefit and Youth Allowance) are applied to the same income. In these cases, some parents lose *all* of their next dollar of earnings.

#### Proposed reforms

- *ease poverty traps* by replacing the existing income tests for three family payments (Family Tax Benefit, Youth Allowance, and Child Care Benefit) with a *single family income test* in which each payment is withdrawn in turn at a uniform rate of 25 cents for every dollar of parental income; 'overlapping' of income tests would be thus avoided [Approximate cost \$500 million per year]
- reduce the incidence of *family payment debts*, by making the income test for Family Tax Benefit more sensitive to variations in earnings within each year, in cases where parental incomes are likely to vary substantially.

### 4. The way ahead

The ACOSS package would boost the incomes of over a million families, at the times in their lives when they need it most. It would significantly *reduce child poverty* and financial stress within families, especially low income families struggling with the high cost of teenagers. It would help low and middle income families exercise more choice in their care arrangements for preschool age children - a time when most *middle income families* come under the greatest pressure. It would improve work incentives.

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<sup>5</sup> Beer G (2002), *Work incentives under a New Tax System*. Conference of Economists, Adelaide October 2002.



Our proposals would greatly simplify the present system, by reducing the number of separate payments and income tests. However, we do not support proposals recently advanced to replace all payments for children with a *single flat rate payment*. Such a payment could not possibly meet the diverse needs of Australian families. Indeed, the families with the greatest need for income support would be the most likely to lose out (see below).

We also reject proposals to introduce an Earned Income Tax Credit along US lines into Australia - that is, a family allowance paid through the tax system that is only available to parents with jobs. We do not oppose giving parents a choice to receive family allowances as a tax credit. Indeed, this choice is already open to families receiving Family Tax Benefit. However, to deny jobless families a proposed new tax credit would clash with a fundamental principle of our family allowance system: that family allowances are for children. The needs of children must remain paramount, regardless of whether their parents have jobs.

## **5. The costs and benefits of the ACOSS Better Family Incomes package**

The *ACOSS better family incomes package* would boost the incomes of well over a million families, many by more than \$100 a week. It would significantly reduce child poverty and financial stress within families. It would help low and middle income families exercise a real choice in their child caring arrangements and significantly improve work incentives for mothers.

Our priority is to improve the incomes of low and middle income families. Their incomes would improve substantially. Some high income families would lose due to the income testing of payments that extend to them. The cost of maintaining their present incomes is also detailed.

The main effects of the package on family incomes would be:<sup>6</sup>

- around 200,000 families with teenage children on incomes up to \$50,000 would gain an average of approximately \$12 per week from higher Youth Allowance and Rent Assistance
- around 350,000 sole parent families with incomes below \$50,000 would gain an average of approximately \$16 per week from the new Sole Parent Supplement. Approximately 36,000 sole parent families on \$45,000 or more would lose an average of \$30 per week, due to the income testing of a universal payment.<sup>7</sup>

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<sup>6</sup> Calculations based on NATSEMs *Stinmod* model, Centrelink data, and ACOSS calculations. The overall number of winners is less than the total of the winners from all proposals, since these groups overlap.

<sup>7</sup> Most sole parent winners would have older children. The cost of maintaining incomes for those affected by the income test would be approximately \$60 million. We were unable to model the effects of the Shared Care Supplement.

## The ACOSS better family incomes package

- around 150,000 mothers of newborn children with little or no paid maternity leave would gain up to \$275 per week for 4 months from the new Maternity Benefit.<sup>8</sup>
- around 300,000 families on \$20,000 to \$75,000 per year who are caring for a 0-2 year old child at home full or part time would gain an average of approximately \$70 per week from the extension of Parenting Payment to middle income families with young children. Approximately 70,000 single income couples with 0-2 year olds, on incomes above \$70,000 would lose an average of \$45 per week due to the income testing of the income of the main earner<sup>9</sup>
- around 400,000 families on up to \$80,000 per year who use formal child care services would gain an average of about \$10 per week from the increases in Child Care Benefit
- around 550,000 families on \$30,000 to \$80,000 per year who have dependent children would gain an average of approximately \$17 per week from the single income test for families (much more if they receive more than one family assistance payment). Approximately 60,000 families with incomes above \$80,000 would lose an average of around \$15 per week due to the tightening of the income test for those on the highest incomes.<sup>10</sup>

Overall, we estimate that the package would cost approximately \$2.5 billion per year. To put this in perspective, this would only pay for a general tax cut worth \$5 per week for each average full time wage earner in Australia, which would not help families on the lowest incomes. In contrast, our family package would deliver much more support to families that need it most, when they need it.

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<sup>8</sup> Subject to any loss of Baby Bonus, which we were unable to take into account due to lack of data. This would mainly affect mothers from higher income backgrounds. Note that this payment has been undersubscribed.

<sup>9</sup> These estimates take account of any loss of Family Tax Benefit (Part B). Low and middle income families generally gain more from the (higher) Parenting Payment than they would lose from FTB(B). However, this is not so for some families whose primary earners are on high incomes, since the FTB(B) is not income tested on their income. The cost of maintaining incomes for those high income families with a child under 3 years who would otherwise lose is approximately \$160 million. An additional 130,000 single income couples (approximately) with children aged 3 to 18 years on incomes above \$70,000 would lose an average of \$35 per week if a similar income test were applied to the Family Tax Benefit (Part B) they currently receive. This has not been taken into account in costing this proposal, but it would save approximately \$240 million. Note that many of these families would gain from other proposals in the package.

<sup>10</sup> The cost of maintaining their incomes would be approximately \$50 million.

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# The costs of children

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Children are both a joy and a challenge. One of the big challenges is the cost. The cost of raising a child to age 20 in an average income family was recently estimated at \$200,000<sup>11</sup>.

Since the introduction of child endowment 70 years ago, Governments have offered financial help both with the general direct costs of children and with the specific costs of caring for children at home or in child care services (see box below).

Governments can't be expected to meet all of those costs. However, there are three good reasons for Government to provide financial help for parents:

1. to help with the *general costs* of raising children in low and middle income families, such as food clothing and housing, in order to prevent child poverty and to offset the tax families pay so that they are treated equitably vis- a- vis taxpayers without children.
2. to help with the *costs of caring* for young children, whether at home or in formal child care services, so that parents can balance their work and family responsibilities and to give preschool- age children a head start in their formal education.
3. to ensure that parents are always better off financially when they work more hours, in order to *improve work incentives*.

## The costs of children

Parents face two kinds of costs: general costs like food and the cost of providing child care

**1. General direct costs** such as food, clothing and housing.

Family Tax Benefit Part A (formerly Family Allowance) and Youth Allowance (for dependent children over 16) are designed to help with these costs.

These costs rise as children grow older. The families coming under greatest pressure from these costs are low income families with older dependent teenagers.

**2. The costs of caring for children**, including sustaining a parent while they care for a child at home (together with any foregone wages) and formal child care costs.

There is a confusing array of payments designed to help with these costs, including Parenting Payment (for families on very low incomes), Family Tax Benefit (Part B), the Baby Bonus, and Child Care Benefit.

These costs are usually highest in the early years, when children need constant care. The families coming under greatest pressure from these costs are low and middle income families with preschool age children, especially when these families are also burdened with other costs such as large home mortgage repayments.

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<sup>11</sup> AMP-NATSEM (2002).



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# The three main problems with family assistance payments

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This package deals with reform of Australian Government family assistance payments. For our purposes, family assistance payments include:

- Family Tax Benefit (Part A) - the former Family Allowance
- Family Tax Benefit (Part B) - an extra payment for single income families
- Youth Allowance - a payment for low income families supporting young people aged 16 - 24 years
- Parenting Payment - an income support payment for parents of children under 16 years in low income families
- Child Care Benefit - a cash payment or subsidy to help with formal child care costs
- Baby Bonus - a tax rebate available to mothers caring at home for a first child under 5 years, based on their income prior to the birth of the child
- Maternity Allowance - a lump sum payment to help parents with the one-off costs of a new baby.

The present system of family assistance payments is a good one by international standards, but it still fails on three counts. The fundamental problem is that it is out of touch with the actual costs faced by low and middle income families. Its three key weaknesses are as follows:

## 1. Inadequate help for families suffering hardship, especially those with teenagers

For many years, Australian Governments have paid family and youth allowances to low and middle income families to help them meet the general `direct` costs of raising children, such as food, clothing and housing, and to offset some or all of the tax a family pays to the Government. For example, due to the Family Tax Benefit (the present name for family allowances), a single income family with two primary school age children effectively pays no tax until its income exceeds \$40,000 per year.

Family and youth allowances have a vital role in preventing child poverty. To achieve this goal, they must cover *all of the minimum basic costs* of raising children in families with no source of income apart from social security. Otherwise children in jobless and low paid families will go without.

## The ACOSS better family incomes package

Despite big improvements since the mid 1980s, our family and youth payments fail to achieve this fundamental goal. This is a major cause of the high level of income poverty among Australian children. Poverty researchers estimate that in 2000 over 740,000 children lived in families who were income poor.<sup>12</sup>

Another major cause of child poverty is joblessness among parents. However, child poverty will not be eliminated, even if unemployment falls to zero. Many low income parents are not in a position to work, for example because they have young children or a disability.<sup>13</sup>

The table below shows that the largest gaps between family and youth payments and the actual costs of raising children are for families with the most expensive children: teenagers.

### The minimum costs of children, compared with family and youth allowances (dollars per week, September 2003)

Age of child:	Under 5 years	5- 12 years	13- 15 years	16- 17 years	18- 24 years
Cost of a child in a Low Income Budget (SPRC study)	\$98	\$137	\$152	\$163*	\$178*
Cost of a child in a Low Income Budget (AMP- NATSEM study)	\$56	\$100	\$132	\$217	\$219
Family and youth payments	\$76	\$76	\$94	\$85	\$102

**Sources:** DSS 1998, Indicative Budget Standards. AMP- NATSEM 2002, Income and wealth report. Centrelink data.

**Notes:** *Family and youth payments* include Family Tax Benefit Part A, Youth Allowance (for children over 16 years living at home), and the child's share of the family's Rent Assistance. The following payments are not included:

- Family Tax Benefit Part B and the Baby Bonus, because they offer additional help for parents who forego wages to care for a child at home, so are not generally available to low and middle income families with children.
- Parenting Payments, because these are only designed to meet the minimum living costs of the parent (hence they are paid at the same rate as unemployment allowances or pensions).
- Child Care Benefit, because there is no allowance in the low cost budgets for child care costs.

\*The Social Policy Research Centre Budget Standards only extend to age 14. A trend line has been added to extend them hypothetically to older children. Note that the resulting estimate for older teenagers is likely to be conservative. It is much lower than the equivalent figure from the NATSEM study. Assumptions, data and sources available from ACOSS.

Low income families with teenagers (whether jobless or on low wages) face the risk of deep poverty. This is due to years of neglect of their income support needs, compared with younger families, by successive Governments. For example:

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<sup>12</sup> Smith Family -NATSEM (2001). The poverty line used (for a family of four) was around \$450 per week.

<sup>13</sup> ACOSS (2003), *The bare necessities*; UNICEF (2000); Bradbury (2002).

- the Youth Allowance for 17 year olds living at home is just \$85 per week, about half the minimum cost of raising them. Low income families receive no help with the extra rental costs for older children, as they do for children under 16 years.

Sole parent families also face a high risk of poverty. For example, an estimated one in four sole parent families with two or more children lives in income poverty<sup>14</sup>. Sole parents face extra costs because they don't enjoy the same economies of scale enjoyed by married couples. One expert estimate suggests that a sole parent with one child needs 90% of the income of a childless couple to achieve the same standard of living.<sup>15</sup>

Family assistance payments do not directly compensate for those extra costs. Although the 2000 tax package significantly increased the incomes of many low income sole parents with children under five years (through the introduction of Family Tax Benefit Part B), those with older children received much lower increases in the GST compensation package. As a result of this, and other anomalies in the social security system, the overall social security payments of most sole parents actually *fall* as children grow older. Many sole parents on social security payments lose around \$30 per week when their youngest child reaches 5 years, and at least another \$60 a week when they reach 16 years. Given the fact that the general cost of raising children increases as they grow older, these anomalies directly contribute to child poverty.

Parents who share the care of a child in two households also face higher costs than intact families. For example, in most cases each parent maintains a bedroom for the child. That means that the cost of housing a child cared for in two households is approximately twice that for intact families. For example, one expert estimate suggests that a parent who cares for a child for 20% of the time faces 31% to 56% of the costs (not just 20% of the costs) of an intact family caring for the same child.<sup>16</sup> These extra costs are not recognised in the family assistance system. Instead, the standard Family Tax Benefit payment for an intact couple is split between the two households, causing hardship for both in many cases.

## 2. Inadequate help with the costs of caring for young children

As well as helping with the general costs of children, family assistance payments should assist with the cost of providing *care for children*, whether at home or in formal child care services. Although the general `direct` costs of children rise as they grow older, child care costs are greatest in the first few years. This is the time of life when many middle income families come under the most financial stress, because their incomes are low (due to withdrawal from paid work to care for the child) and their expenses are high (due to high home mortgage payments and child care costs).

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<sup>14</sup> Smith Family -NATSEM (2001).

<sup>15</sup> Whiteford, 1991 and 1998.

<sup>16</sup> Henman & Mitchell (2001).

Income support for young families is inadequate, inflexible, and complicated. The system is based on outdated distinctions between parents who stay at home and those who undertake paid work and place their children in day care.

There are three payments designed to assist parents with the costs of caring for children at home: *Parenting Payment*, *Family Tax Benefit (Part B)* and the *Baby Bonus*. *Child Care Benefit* helps with the costs of formal child care. The main problems with these payments to assist with child care costs are as follows:

- unlike most wealthy countries, Australia has no widely available system of paid maternity leave or equivalent Government funded maternity benefits
- as noted above, there are three payments to help with the cost of caring for a child at home, instead of one. This leads to confusion. The Baby Bonus is very complicated
- these payments offer too little help to middle income families when they need it most: over the first few years after the birth of a child. Family Tax Benefit (Part B) and the Baby Bonus are tokenistic. They do not come near to meeting the basic income support needs of the parent providing care. The highest rate of FTB (Part B) is just \$56 per week, and the maximum Baby Bonus is \$50 per week, though most receive much less. Parenting Payment at least recognises the basic income support needs of the parent (since it is paid at the same rate as other social security payments for jobless people – \$174 per week for a married parent), but it does not extend to families with incomes above about \$30,000
- the Baby Bonus and Family Tax Benefit (Part B) are inflexible. They are targeted towards parents who care for a child fulltime at home. They offer little or no support to parents who combine part time employment and care for a young child at home, as many mothers choose to do
- the Baby Bonus and Family Tax Benefit Part B extend to high income families (including parents whose partners are millionaires) who don't need such help
- Child Care Benefit is paid at too low a rate to make child care affordable. The average 'gap fee' for full time care in a day care centre is more than \$50 per week. This and more must even be paid by many families on low incomes, discouraging many women from returning to employment. This problem is exacerbated by other weaknesses in our system of child care funding, including severe shortages of child care places in many areas, low pay and high turnover of staff, and inadequate support for families with high needs (such as jobless families, infants, and children with disabilities)
- it is now widely acknowledged that a formal preschool education program gives children a head start into school, yet for most children below 4 years (and for children of this age in New South Wales) this is still a privilege confined to a minority of children. Moreover, the early childhood system is fragmented between day care centres (which may or may not offer full educational programs) and preschools (which may or may not operate for extended hours to allow parents to return to full time employment).



### 3. Poverty traps

Australia's system of family allowances helps improve work incentives for jobless people and low paid workers by extending the maximum level of payments (Family Tax Benefit Part A and Youth Allowance) to all families earning up to at least \$30,000 per year. This means that there is no financial penalty if a parent in a jobless family moves from joblessness to a low paid full- time job.

However, in other ways the system undermines work incentives. The inadequacy of the Child Care Benefit is a prime example. In 1999, almost 100,000 women indicated to the Australian Bureau of Statistics they were not able to seek employment because they couldn't find suitable, affordable child care.<sup>17</sup>

Severe work disincentives, referred to as 'poverty traps', are also caused by the harshness of the income tests attached to some family assistance payments. These particularly discourage part- time employment among 'second earners' in middle income families. In the case of the Family Tax Benefit, they also lead to excessive levels of debt from families to the Government.

Income tests are needed to ensure that family assistance payments are affordable for Governments. However, some of them are badly designed. Due to the cumulative effect of family assistance income tests, income tax, and other income tests such as those imposed on public and community housing tenants, 20% of workers in married couple families and 50% of those in sole parent families retain less than 40 cents of the next dollar they earn.<sup>18</sup>

The worst poverty traps are sprung when two or more income tests are applied at once (see box below).

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<sup>17</sup> Unpublished data from the ABS *Not in the Labour Force* series.

<sup>18</sup> Beer G (2002).

### **How multiple family assistance income tests discourage employment**

A family with a main breadwinner earning \$30,000 has a 10 year old child in after school care and a 16 year old. If the main carer of the child takes on a part- time job and earns \$10,000, their family payments are reduced by four separate income tests. The family stands to lose:

- 30 cents of the first dollar earned in Family Tax Benefit (Part A) payments (loss of income: \$2,200)
- another 30 cents off their Family Tax Benefit (Part B) payments (loss of income: \$2,000)
- another 25 cents off the older child`s Youth Allowance (loss of income: \$2,500)
- another 10 cents off their Child Care Benefit (loss of income: \$800)
- another 17 cents in income tax (loss of income: \$500).

Adding up all of these income tests, the main carer of the child could lose 100% of the next dollar earned! Of the \$10,000 she earns from the part- time job, the family would only keep \$2,000. When child care gap fees are taken into account, they are left with even less. The other \$8,000 would be taken off their family assistance payments, plus income tax.

The problems with the present income tests are threefold:

- first, some income tests (in particular Family Tax Benefit) are too severe. Family Tax Benefit is withdrawn at the rate of 30 cents for every dollar earned. This is less than the 50 cents that applied prior to the 2000 tax package, but is still too high
- second, as the example in the box above shows, the various family income tests for different payments are poorly integrated. The effective tax rates they impose stack up on top of one other
- third, the income test for Family Tax Benefit is not sensitive enough to changes in people`s earnings as they occur through the year (for example, as a parent gains or loses casual work). This is because the income test is based on the recipient`s estimate of their annual income at the start of each year, and there are only limited requirements to report changes in income more regularly. Further, there is no latitude for error in these income estimates, because payments are adjusted at the end of the year to reflect the income that was actually earned. As a result, hundreds of thousands of families are burdened with family payment debts to Centrelink at the end of the year.

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# Blind alleys on the path to reform

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Debate over reform of family assistance has been diverted into blind alleys. The reason for this is a lack of focus on the basic purpose of family assistance: to help with the costs of raising children.

Debate has been diverted away from this issue of *substance* towards issues of *form*, especially:

1. whether family assistance should be paid through the tax or welfare systems. This has led to debate over proposals to introduce a United States style Earned Income Tax Credit
2. whether parents who care for their children at home should get the same level of financial help as those who use child care services. This has led to proposals to replace all family assistance payments with a single flat rate payment.

## 1. Earned Income Tax Credits

The argument over whether family payments should be paid through the tax or social security systems should have ended when the Family Tax Benefit was introduced in 2000. Since then, families have had a choice to receive exactly the same payment as a tax offset or direct fortnightly payment. In fact, over 90% choose the direct payment. This demonstrates that most mothers value family allowances highly and do not regard them as `welfare` payments.

It is ironic that there is an ongoing policy debate over the pros and cons of tax credits, when Australia has had a tax credit for families - Family Tax Benefit - for the last three years. The real issue in this debate is not whether we should have family tax credits: it is about *who should receive them*.

Family Tax Benefit (Part A) is paid to practically all low and middle income families with children. The rate of payment is determined by the needs of the family (the number of children and their ages) and its means (the family`s income).

However, an *Earned Income Tax Credit* along United States lines, which some advocate for Australia, would discriminate against jobless families. It would *only* be paid to low and middle income families that have jobs. There are two main reasons jobless families are excluded from this payment in the United States: unlike Australia, the US has no history of national family allowances, and there is a strong political aversion there to cash payments for jobless families.

One outcome is that despite relatively low unemployment, the US has the highest level of child poverty among wealthy countries.<sup>19</sup>

The main argument raised by advocates for an Earned Income Tax Credit for Australian families is that it would improve `rewards for work`. However, as noted above, the Family Tax Benefit does this already, by extending the full rate of family allowance payment to families on incomes well above minimum wages (up to \$30,000). The main problem with the present family assistance system from an incentives standpoint is that badly designed income tests discourage employment in families on slightly higher incomes (especially second earners). This is best addressed by easing the income tests. An Earned Income Tax Credit would be a much more costly way to ease poverty traps because it would also benefit many families not affected by poverty traps in the first place.<sup>20</sup>

There is no point adding to the complexity of the family assistance system by superimposing a new tax credit on top of it, when an improved Family Tax Benefit can achieve all of the objectives sought by advocates of an Earned Income Tax Credit. For this reason, both the British and Canadian Governments recently decided to integrate their Earned Income Tax Credits for families into their family allowance systems (which resemble our Family Tax Benefit).

The strongest argument against an *Earned Income Tax Credit* for families in Australia is that it would undermine the core principle on which our system of family allowances was founded - that their purpose is to help with the costs of raising children. Therefore, family assistance payments should be targeted according to the needs and the means of each family. Whether the parents have jobs should not be taken into account, except to the extent that this affects family income.

## 2. A single payment for families

The old argument over whether family assistance should give preference towards `stay at home` mothers or `career` mothers is also unhelpful. This argument implies that mothers fall into one or other of two `camps` that have competing interests, and that the level of help offered to each `camp` is an issue for ideological debate. Those who want mothers to stay at home advocate more help for women to do so, while those who want mothers to pursue careers argue for higher child care subsidies instead.

This old argument ignores the work and caring patterns of parents today. As the table below suggests, most progress from one to the other, or combine parenting and part- time employment. For example, the table below shows that approximately 50% of mothers of pre- school age children are employed, usually on a part- time basis.

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<sup>19</sup> UNICEF (2000).

<sup>20</sup> The estimated cost of the earned Income Tax Credit proposal associated with the `Five Economists` is approximately \$3,000 million per year. By contrast, our proposals to improve work incentives by easing income tests would cost around \$500 million.

## Employment status of mothers in 2000

Age of youngest child	Married mothers				Single mothers			
	Employed full time	Employed part time	Unemployed <sup>21</sup>	Not in the labour force	Employed full time	Employed part time	Unemployed <sup>22</sup>	Not in the labour force
0- 4 years	16.1%	31.9%	3.5%	48.6%	9.1%	19.5%	8.4%	63.0%
5- 9 years	25.9%	40.8%	4.5%	28.7%	22.1%	30.1%	8.1%	39.7%
10- 14 years	36.7%	36.7%	2.5%	24.1%	31.6%	30.7%	6.1%	32.5%
all dependent children	26.1%	35.1%	3.3%	35.5%	23.2%	25.9%	7.4%	43.5%

Source: ABS, *Labour force status and other characteristics of families* (1985 and 2000)

Note: Data in each row should add up to 100%

These developments have led some to advocate collapsing payments to assist parents to care for children and child care subsidies into a *single payment for families*, leaving parents to `choose` how they spend the money. This is superficially attractive because it would simplify the system. However, it is really just a new version of the old argument. The single payment idea is based on the false assumption that the only way to fairly resolve the competing claims of the two `camps` is to offer both exactly the same level of support.

This assumption is wrong because parents have diverse income support needs that cannot be properly met by a single payment. For example, parents with two or more children face higher child care costs, but the income support needs of a parent who cares for them at home are the same regardless of the number of children in the family. Parents who combine care at home with part-time employment (an increasingly popular choice among mothers of preschool age children) would lose out under a single payment. They would no longer be able to claim *both* a payment to assist them to care at home (Parenting Payment or Family Tax Benefit Part B) *and* Child Care Benefit to help them with formal child care costs.

Another serious problem with the single family payment idea is that if a separate Child Care Benefit is abandoned, the Federal Government would lose the financial leverage it now has to help ensure that child care is affordable and of high quality.

Some take the single payment idea to its logical extreme. They argue for a flat rate of family assistance for all families regardless of their income. The system of family assistance payments should be simplified. However, moving from a system of family payments that reflects the different income levels and needs of different families towards a flat rate payment for all would either cost a great deal of money, or produce many losers as well as winners. The main losers would be low income families and the main winners would be those on high incomes who presently receive only limited support. A proposal from the Centre for Independent Studies<sup>23</sup>

<sup>21</sup> These percentages are less than unemployment rates as commonly understood, since they represent the percentage of *all* mothers (not the percentage of mothers *in the labour force*) who were unemployed.

<sup>22</sup> See footnote above.

<sup>23</sup> Maley B (2002), *Families fertility and maternity leave*. CIS Issue Analysis No 24, at [www.cis.org.au](http://www.cis.org.au).

to replace existing family assistance payments with a flat \$4,000 payment for each child in all families, would have both outcomes. It would cost more than \$4 billion per annum, unless Parenting Payment (the basic income support payment for low income parents) were abolished outright. Even if this were not done, many low income families would lose out.

Parents need income support that adapts to their particular needs as they progress through different stages of their parenting `careers`. This cannot be achieved using an inflexible, flat rate payment.

### **3. Family assistance payments based on the costs of children**

Most of the problems with our system of family assistance payments can be summarised very simply: they are out of touch with the actual minimum costs of raising children. Too many of these payments are based on arbitrary judgements made in isolation from the actual needs of low and middle income families.

Governments cannot be expected to meet all of the costs of raising children, but they should meet the bare minimum costs for families with no other source of income. This should form the basis for fixing the *maximum rates* of the various payments. That is, the maximum amounts paid should be enough for children in jobless families to avoid poverty. Income tests should then be used (as they are now) to reduce public support as a family's income rises.

A system of family assistance based on the actual costs of children would be much simpler than the present one, but it could not be reduced to a single flat payment. Four payments are needed, as described in the table below. These payments exist already. Over time, remaining payments (such as Family Tax Benefit Part B) could be integrated into this simpler structure.

## Proposed system of family assistance payments

Payment	Purpose	Target group	Rate
Family Tax Benefit <sup>24</sup> (equivalent to Family Tax Benefit Part A)	To help with the general costs of raising younger children	Low and middle income families with children under 16 (as now)	Based on minimum cost of raising a child (which increases with age)
Youth Allowance <sup>25</sup>	To help with the general costs of raising older children	Low and middle income families with children over 15 (as now)	Based on minimum cost of raising a child (which increases with age)
Parenting Payment (replacing Family Tax Benefit Part B and Baby Bonus for families with young children)	To sustain a parent caring for a child at home	Low income families with children under 16 (as now), extending to middle income families with children under 3 <sup>26</sup>	Based on minimum cost of sustaining an adult (equal to other social security payments for adults) <sup>27</sup>
Child Care Benefit	To make child care services affordable	Low and middle income families with young children in child care (as now)	Based on a proportion of reasonable child care costs, leaving an affordable `gap fee` for parents to pay

The proposed system would be sensitive to the changing needs of families as children grow older:

- The largest cost associated with young children is the cost of caring for them at home or in child care services. This is the stage of family life when middle income families come under the greatest pressure, due to the loss of all or part of one income and high child care costs, and (in many cases) home mortgages.

This is one reason for extending the Parenting Payment to middle income families caring for children under 3 years. Another reason is the strong preference among mothers to care at home for children in the first three years, often in combination with a part time job. Many other wealthy countries offer low and middle income families substantial financial assistance to do so. Australia provides little more than \$56 per week for most middle income families to care for a child at home. This is a token amount.<sup>28</sup>

<sup>24</sup> This could be paid as a direct payment or a tax credit, as is the case now. It would include an entitlement to Rent Assistance and a Maternity Allowance, as is the case now, together with a new Sole Parent/Shared Care Supplement to replace the Family Tax Benefit Part B for sole parents.

<sup>25</sup> Unlike the present Youth Allowance, this would include an entitlement to Rent Assistance.

<sup>26</sup> Parenting Payment is presently restricted to families with incomes below about \$30,000. This income test would be eased in the case of parents with children under 3 years old.

<sup>27</sup> For mothers with newborn children, we propose a higher level of payment than this - a universal Maternity Benefit - to at least partly replace wages foregone in the first four months or so while the mother recuperates. We propose a maximum rate of payment equal to the Federal Minimum Wage over this period. However, extending this `income replacement` principle further up the income scale than this (or over a longer period) would be very costly.

<sup>28</sup> McDonald (2002). The \$56 per week is the Family Tax Benefit (Part B). The only other payment specifically for this purpose - apart from Parenting Payment for low income families with incomes below about \$30,000 - is the Baby Bonus. But few families receive the full \$50 per week in Baby Bonus payments. One reason for the

- On the other hand, the general costs of raising children grow as they grow older. Most middle income families enjoy increases in their earnings as their children grow older, and this insulates them to some extent from the high costs. However, parents in low skilled jobs and those who have lost their jobs do not benefit from this financial `buffer`. The costs of their children rises, but their incomes remain the same, or even fall. This is the reason the largest increases in payments for low income families are for those with teenagers. The package is designed to reverse the bias in the present system in favour of higher family assistance payments for families with younger children, while at the same time acknowledging the high cost of care for very young children.
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token level of these payments is that they extend to many carers of children with high income partners. The FTB(B) also extends to parents caring at home for children up to 18 years old. This means that anything more than a token payment would be very costly indeed.



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# The ACOSS better family incomes package

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Our proposals for reform of family assistance payments are carefully targeted to meet the needs of low and middle- income families at those stages in their lives when they need it most.

## 1. More help for families facing hardship, especially those with teenagers

The maximum rates of Family Tax Benefit and Youth Allowance should be based on research into the actual minimum costs of raising children of different ages in different family settings. The first steps towards removing the worst poverty gaps in the present system should be to:

- increase *Youth Allowance* by \$13 per week for 16- 17 year olds living at home and \$7.50 per week for 18 year olds, and extend *Rent Assistance* to dependent young people [Approximate cost \$200 million per year]
- introduce *Sole Parent and Shared Care Supplements* to acknowledge the extra cost of *raising a child alone and in shared care arrangements*. The Sole Parent Supplement should replace the existing Family Tax Benefit (Part B) for sole parent families. It should be paid at the higher `child under five` rate [Approximate cost \$300 million per year].

## 2. More help with the costs of care for very young children

More help should be provided for low and middle income families with the costs of caring for the youngest children, in ways that reflect families` changing needs as children grow.

- introduce a new universal *Maternity Benefit*. The basic principle is that this should be a universal payment for all new mothers to support them and replace any lost earnings (up to a reasonable level) while they prepare for and recover from childbirth. Our illustrative proposal is for a Maternity Benefit paid at a minimum of Parenting Payment rates for mothers previously outside the workforce, up to the minimum wage for those who have foregone income - the Baby Bonus should be abolished but the existing lump sum Maternity Allowance should remain to help with the up- front costs of a new child [Approximate cost of illustrative proposal: \$100 million per year]<sup>29</sup>
- extend the existing *Parenting Payment* (currently paid to low income families only at up to \$174 per week) to support middle income parents caring at home for a child under 3 years old, full or part time. This would replace the

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<sup>29</sup> This takes account of \$400 million of savings from abolition of the Baby Bonus.

smaller Family Tax Benefit (Part B) paid to these families. Our illustrative proposal would provide the full rate of Parenting Payment (\$174) to parents caring at home full time whose partners earn up to \$41,000 per year, and a part rate for those combining part-time employment and care. The rate would reduce with additional earnings by the main carers and their partners [Approximate cost of illustrative proposal: \$1,000 million per year]

- ease child care gap fees by increasing *Child Care Benefit* for low and middle income earners facing the highest costs, link the maximum rates explicitly to a `standard fee` which services are discouraged from exceeding, ease the worst shortages in the supply, and extend subsidies to meet special needs. [Approximate cost of indicative proposal to increase Child Care Benefit: \$200 million per year]
- in collaboration with State Governments, develop and progressively implement a *basic entitlement to early childhood education* for 3 and 4 year old children, and work towards the integration of preschools and day care centres into a single system of early childhood care, education and development with appropriately qualified staff.

### 3. More incentive to work

Poverty traps should be eased by replacing the existing income tests for various family payments with a simpler and less severe integrated family income test that is more sensitive to changes in family income within each year.

- the parental income tests for Family Tax Benefit (Part A), Youth Allowance, and Child Care Benefit should be integrated into a *single parental income test* in which these payments are withdrawn at a uniform rate of 25 cents for each dollar of parental income and thus overlapping of income tests (on the same income) would be avoided<sup>30</sup> [Approximate cost \$500 million per year]
- the income test for Family Tax Benefit should be made more sensitive to variations in earnings within each year, in cases where parental incomes are likely to vary substantially. In other cases (where the income test is still based on annual income), consideration should be given to using last year's taxable income as the benchmark, and ignoring increases or decreases in actual annual income of less than a certain amount.<sup>31</sup>

### 4. Benefits and costs of the package

The *ACOSS better family incomes package* would boost the incomes of well over a million families, many by more than \$100 a week. It would significantly reduce child poverty and financial stress within families. It would help low and middle income families exercise a real choice in their child caring arrangements and significantly improve work incentives for mothers.

Our priority is to improve the incomes of low and middle income families. Their incomes would improve substantially. Some high income families would lose due to

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<sup>30</sup> For recipients with one child only in child care, the suggested withdrawal rate for Child Care Benefit would be 15%.

<sup>31</sup> The budgetary effect of this proposal is not known.

the income testing of payments that currently extend to them. The cost of maintaining their present incomes is also detailed.

The main effects of the package on family incomes would be:<sup>32</sup>

- around 200,000 families with teenage children with incomes up to \$50,000 would gain an average of approximately \$12 per week from higher Youth Allowance and Rent Assistance payments
- around 350,000 sole parent families with incomes below \$50,000 would gain an average of approximately \$16 per week from the new Sole Parent Supplement. Approximately 36,000 sole parent families on \$45,000 or more would lose an average of \$30 per week, due to the income testing of a universal payment<sup>33</sup>
- around 150,000 mothers of newborn children who have little or no access to paid maternity leave would gain an average of up to \$250 per week for 4 months from the new Maternity Benefit<sup>34</sup>
- around 300,000 families on \$20,000 to \$75,000 per year who are caring a 0- 2 year old child at home full or part time would gain an average of approximately \$70 per week from the extension of Parenting Payment to middle income families with young children. Approximately 70,000 families with 0- 2 year olds, on incomes above \$70,000, would lose an average of \$45 per week due to the income testing of the income of the main earner. An additional 130,000 single income couples (approximately) with children aged 3 to 18 years on incomes above \$70,000 would lose an average of \$35 per week if a similar income test were applied to them. However, many of these families would gain from other proposals in the package<sup>35</sup>
- around 400,000 families on up to \$80,000 per year who use formal child care services would gain an average of about \$10 per week from the increases in Child Care Benefit
- around 550,000 families on \$30,000 to \$80,000 per year who have dependent children would gain an average of approximately \$17 per week from the single income test for families (much more if they receive more than one family assistance payment). Approximately 60,000 families with incomes above \$80,000 would lose an average of around \$15 per week due to the tightening of the income test for those on the highest incomes.<sup>36</sup>

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<sup>32</sup> These estimates are based on NATSEM's *Stimod* model, Centrelink data, and ACOSS calculations. The overall number of winners is less than the total of the winners from all proposals, since these groups overlap.

<sup>33</sup> Most sole parent winners would have older children. The cost of maintaining incomes for those who lose due to the income test would be approximately \$60 million. We were unable to model the effects of the Shared Care Supplement.

<sup>34</sup> Subject to any loss of Baby Bonus, which the average figure cited here does not take into account due to lack of data. This would mainly affect mothers from higher income backgrounds. Note that this payment has been undersubscribed.

<sup>35</sup> These estimates take account of any loss of Family Tax Benefit (Part B). Low and middle income families generally gain more from the (higher) Parenting Payment than they would lose from FTB(B). However, this is not so for some families whose primary earners are on high incomes, since the FTB(B) is not income tested on their income. The cost of maintaining incomes for those high income families with a child under 3 years who would otherwise lose is approximately \$160 million. If a similar income test were applied to single income families with older children receiving Family Tax Benefit (Part B), this would save approximately \$240 million (one quarter of the overall cost of this proposal).

<sup>36</sup> The cost of maintaining their existing incomes would be approximately \$50 million.

## **The ACOSS better family incomes package**

Overall, we estimate that the package would cost approximately \$2.5 billion per year. To put this in perspective, this would only pay for a general tax cut worth \$5 per week for each average full- time wage earner in Australia, which would not help families on the lowest incomes. In contrast, our family package would deliver much more support to families that need it most, when they need it.

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# Attachment one

## Detailed proposals and options for reform

The ACOSS Better Family Incomes Package includes a number of detailed final proposals (such as the increases in Youth Allowance), and other proposals that are expressed as objectives (for example to extend Parenting Payment to middle income families with a child under 3 years). These latter proposals need careful consideration before we finalise the detail. The box below sets out illustrative options to put these objectives into practice, as well as our detailed proposals for reform, to give an indication of the overall shape of the package. The illustrative options are marked separately. Major changes to the present system appear in bold type.

### Proposals and options for reform of family assistance February 2004

<b>1. More help for families facing hardship</b>			
<b>Payment Parameters</b>	<b>Existing payment</b>	<b>Proposed payment</b>	<b>Comment</b>
<b>(a) Sole parent supplement</b>			
	Family Tax Benefit (Part B)	Sole parent supplement	To compensate for extra costs of raising a child alone, with priority to reducing child poverty in sole parent families with older children.  Replaces Family Tax Benefit (Part B) for sole parents.
Eligibility	Sole parents with a dependent child up to 17 years	Sole parents with a dependent child up to 17 years	
Maximum rates	<b>\$56pw (child under 5)</b> <b>\$39pw (no child under 5)</b>	<b>\$56pw</b> paid as a supplement to FTB(A)	
Income test	<b>None for sole parents</b>	<b>New FTB(A) income test</b> applies (see below), reducing after 'core' FTB(A) payment	
<b>(b) Youth Allowance increases</b>			
	Youth Allowance (at- home rates)	Youth Allowance (at- home rates)	To reduce poverty and housing costs in low income families with dependent young people
Eligibility	Young people 16- 24 years living at home	Young people 16- 24 years living at home	
Maximum rates	<b>\$87pw (16- 17 years)</b> <b>\$105pw (18- 24 years)</b>	<b>\$100pw (16- 17 years)</b> <b>\$113pw (18- 24 years)</b>	
Rent Assistance	<b>none</b>	<b>Yes. An extra \$8pw for sole parents and \$11pw for couples</b> (as for Family Tax Benefit)	
Income test	see below	See below	

The ACOSS better family incomes package

<b>2. Care for young children</b>			
<b>Payment Parameters</b>	<b>Existing payment</b>	<b>Proposed payment</b>	<b>Comment</b>
<b>(a) Maternity Benefit</b> <b>(illustrative option only)</b>			
	Baby Bonus <sup>37</sup>	Maternity Benefit (MB)	<p>Income replacement for mothers while they prepare for and recover from childbirth, including those with and without previous employment.</p> <p>Existing Parenting Payment absorbed into the Maternity Benefit over the four month period.</p> <p>Current lump sum Maternity Allowances of (\$1,042 in all) are retained to help with up- front costs of new baby. This is very important. Otherwise many low- income families would lose money they badly need at this time.</p>
Eligibility	<b>Mothers with a first child up to 5 years old</b>	<b>New mothers, one month before birth to 3 months after.</b> <sup>38</sup>	
Minimum rate	<b>\$10 per week</b> , regardless of previous income, reducing with increased workforce participation.	<b>\$226 for sole parents</b> <b>\$174 for couples</b>  (Parenting Payment rates, regardless of previous and current income)	
Maximum rate	<b>\$50 per week</b> , reducing with increased workforce participation.	<b>\$450pw (minimum wage)</b>	
Income test	<b>None</b>	<b>Paid maternity leave benefits reduce it at the rate of 50 cents in the dollar, otherwise income test free.</b>	
Entitlement to more than minimum rate	<b>Based on tax payments in financial year before birth.</b>	<b>Increases above Parenting Payment rates, by a dollar per week for every dollar per week of earnings (on average) in previous year.</b>	

<sup>37</sup> Parenting Payment is also payable to low income families with a newborn child, but cuts out at approx \$31,000 for couples and approx. \$32,000 for sole parents.

<sup>38</sup> The proposed extension of Parenting Payment (see below) is designed to help low and middle income families care for a child under 3 years.

<b>(b) Extension of Parenting Payment to middle income parents caring for a 0- 2 year old</b>			
<b>(illustrative option only)</b>			
<b>Payment Parameters</b>	<b>Existing payment</b>	<b>Proposed payment</b>	<b>Comment</b>
	Parenting Payment (Partnered) <sup>39</sup> and Family Tax Benefit (Part B)	Parenting Payment (Partnered)	Extends Parenting Payment for married couples to middle income families with a child under 3 years, to facilitate choices to care for the child at home on a full or part- time basis, and ease financial pressures on these families.  Paid in lieu of the smaller Family Tax Benefit (Part B) for these families. FTB(B) remains for families with older children.
Eligibility	<b>Parenting Payment:</b> <b>Main carer of a dependent child up to 15 years old in a low income family.</b>  <b>Family Tax Benefit (Part B)</b> <b>Main carer of a child up to 17 years in a single income family.</b>	<b>Parenting Payment:</b> <b>Extend to main carer of a dependent child aged 3 months to 2 years inclusive in middle income families.</b>  <b>Replaces FTB(B) for families with a child under 3 years. FTB(B) remains for others.<sup>40</sup></b>	
Maximum rate	Parenting Payment: \$174pw  Family Tax Benefit (Part B): \$56pw per family (with a child under 5) \$39pw (if no child under 5)	\$174pw	Note: It is not proposed to extend this payment to high income families as they can exercise these choices already without Government help.
Personal income test	Parenting Payment: <b>Reduced by 50% for income between \$31- \$123pw; and by 70% above \$123pw.</b> Cuts out at approx \$15,900pa. (3 days work at the minimum wage)  Family Tax Benefit (Part B): Reduced by 30% for carer income above \$35pw Cuts out at approx \$11,600 (child under 5 - 2.5 days work at the minimum wage).	Parenting Payment: <b>Reduced by 60% by income above \$40pw<sup>41</sup>.</b>  Cuts out at approx \$17,100 (3.5 days work at the minimum wage) <sup>42</sup> .	Continued over page/

<sup>39</sup> Sole parents are not affected by this change to Parenting Payment, as they already receive Parenting Payment where they are predominantly caring for a child at home.

<sup>40</sup> This means that partner income is income tested (see below) and some high income single income families would receive less in Parenting Payment than they now receive in Family Tax Benefit (Part B). To ensure equity in the treatment of single income families with younger and older children, a similar income test could apply to the primary earners in single income families with no child under 3. Since there is no offsetting extension of Parenting Payment to these families, this could be achieved by a new partner income test for FTB(B) for families with no child under 3 years, reducing that payment by 25 cents in the dollar once the primary earner's income exceeds approx. \$65,000.

<sup>41</sup> This is ACOSSs proposed income test for allowances such as Newstart Allowance. Alternately, the taper rate could be reduced to 50% to provide more help for parents combining part time employment and caring. In this case, the payment would cut out at approximately the full time minimum wage, and the cost of the package would be higher. The income test will have some effect on workforce participation among main carers (as will any large increase in income tested payments for parents caring for children at home), which we attempt to minimise by easing the FTB(A) income test (see below). However, the main reason that mothers of very young children care for the child at home is their preference to do so, rather than financial disincentives.

<sup>42</sup> This excludes full-time workers but includes most part-time workers.

<b>(b) Extension of Parenting Payment to middle income parents caring for a 0- 2 year old</b>			
<b>(illustrative option only - continued)</b>			
<b>Payment Parameters</b>	<b>Existing payment</b>	<b>Proposed payment</b>	
	Parenting Payment (Partnered) <sup>43</sup> and Family Tax Benefit (Part B)	Parenting Payment (Partnered)	
Partner income test	Parenting Payment: <b>Reduced by 70% for income above \$291pw.</b> Cuts out at approx \$28,000pa.  Family Tax Benefit (Part B): No partner income test.	Parenting Payment: <b>Reduced by 25% for income above approx \$770pw<sup>44</sup>.</b>  Cuts out at approx \$76,000pa.	
<b>Consequential changes to FTB (Part A) for family with a child less than 3 years old</b>			
<b>(illustrative option only)</b>			
<b>Payment Parameters</b>	<b>Existing payment</b>	<b>Proposed payment</b>	<b>Comment</b>
	Family Tax Benefit (A)	Family Tax Benefit (A)	
Eligibility	Families with dependent children up to 24, subject to income tests.	Families with dependent children up to 24, subject to income tests.	This is designed to ease work disincentives for the main carer of a 0- 2 year old child in a middle income family, arising from the extension of Parenting Payment to them.
Maximum rates	For each child under 13 years: \$65 per week	For each child under 13 years: \$65 per week	
Family income test	Family income test only: Reduced by 30% for income above \$31,800 until base rate of \$21pw per child is reached. This is reduced by income above \$82,000pw (if there is only one child)	Family income test: See proposed <i>streamlined family income test</i> below.  AND  <b>The first \$17,100 of personal earnings of main carer are exempt from the family income test where the youngest child is under 3<sup>45</sup></b>	Otherwise, the income test for FTB(A) would overlap or 'stack' with that for the new Parenting Payment, where family income exceeds \$31,800.  This particularly benefits parents who are employed part time. It increases the disposable income of their families as well as easing any work disincentives.

<sup>43</sup> Sole parents are not affected by this change to Parenting Payment, as they already receive Parenting Payment where they are predominantly caring for a child at home.

<sup>44</sup> Approximately. \$41,000 per year. Where there is only one child, this is just clear of the cut out point for FTBA, avoiding the 'stacking' of income tests on the partner's income. Increasing this 'free area' would extend the maximum rate of Parenting Payment to more middle income families, but at a higher cost. This income test is unlikely to significantly affect workforce participation among primary income earners. Research shows that workforce participation among primary breadwinners on middle to high incomes is relatively insensitive to tax rates and income tests. See Heckman (1993).

<sup>45</sup> This is the cut out point for the income test applying to the main carer in the proposed Parenting Payment.



<b>3. More incentives for work</b>			
<b>Streamlined family income test</b>			
<p>This proposal would replace the existing income tests for three payments: Family Tax Benefit (Part A), Youth Allowance, and Child Care Benefit, with an integrated family income test.</p> <p>Generally speaking:</p> <ul style="list-style-type: none"> <li>• When the same family received more than one family or youth payment, the income test free thresholds of each payment would be aligned with the income levels at which the others cut out, to prevent overlap and stacking of income tests.</li> <li>• The taper rate would be a uniform 25% (except for Child Care Benefit, in cases where there is only one child in care).</li> <li>• This is designed to reduce the highest effective tax rates applying to families in the present system, and to work towards a social security and tax system in which few individuals face an average effective marginal tax rate exceeding two dollars for every three dollars earned (67%).<sup>46</sup></li> </ul>			
<b>(a) Streamlined family income test - Family Tax Benefit (Part A)</b>			
<b>Payment Parameters</b>	<b>Existing payment</b>	<b>Proposed payment</b>	<b>Comment</b>
	Family Tax Benefit (A)	Family Tax Benefit (A)	
Eligibility	Main carer of a child up to 24 years	Main carer of a child up to 24 years	The main changes are a reduction in the taper rate from 30% to 25%; and the immediate loss of the \$21pw base rate once a high family income level is reached.
Family income test	<p><b>Reduced by 30% for income above \$31,800</b> until base rate of \$21pw per child is reached, at approx \$40,000 (for a family with one child under 13) or \$47,000 (2 children under 13).</p> <p><b>The \$21pw base rate is reduced by 30% by income above \$82,000pw</b> (if there is only one child under 18) or \$85,300 (for 2 children under 18).</p>	<p><b>Reduced by 25% from for income above \$31,800</b> until base rate of \$21pw per child is reached, at approx \$41,000 (for a family with one child under 13) or \$50,000 (2 children under 13).</p> <p><b>The \$21pw base rate cuts out immediately once income reaches \$82,000pw</b> (if there is only one child under 18) or \$85,300 (for 2 children under 18).<sup>47</sup></p>	

<sup>46</sup> This goal may seem very modest. Yet, hundreds of thousands of individuals are likely to face higher tax rates than this at present.

<sup>47</sup> See proposed easing of the FTB(A) income test for families with a child under 3 years, above.

The ACOSS better family incomes package

<b>(b) Streamlined family income test - Youth Allowance</b>			
<b>Payment Parameters</b>	<b>Existing payment</b>	<b>Proposed payment</b>	<b>Comment</b>
	Youth Allowance (dependent)	Youth Allowance (dependent)	
Eligibility	Young people 16- 24 years dependent on their parents.	Young people 16- 24 years dependent on their parents.	The main change is to the income test free thresholds.
Maximum rates	<b>\$87pw (16- 17 years)</b> <b>\$105pw (18- 24 years)</b>	<b>\$100pw (16- 17 years)</b> <b>\$113pw (18- 24 years)</b>	Where the family only receives one Youth Allowance payment, and no (FTBA), the threshold equals that for FTBA.
Income test	<b>Reduced by 25% by income above \$28,200 plus:</b> \$1,200 for each child under 16 (FTBA child), \$2,600 for each extra child under 16, \$3,800 for each extra Youth Allowance child, and \$7,600 for each extra tertiary student living away from home.	<b>Reduced by 25% by income above \$31,800</b>  <b>OR</b>  <b>The relevant FTBA cut out point if there is an FTBA child in the family</b> (eg above approx \$41,000 if one FTBA child only),  <b>OR</b>  <b>The relevant YA cut out point if there is another YA child in the family</b> (eg above approx \$50,000 if there is another YA child under 18 at home <sup>48</sup> ).	Where it receives another Youth Allowance or FTBA payment for another child, the threshold equals the point at which that payment cuts out.

<sup>48</sup> This takes account of the \$13pw increase in YA at home rates for young people under 18. It would be sensible to average the two YA payments out, so that one child does not receive a higher payment than the other, due to the parental income test being applied to them alone.

<b>c. Streamlined family income test and reduction in gap fees - Child Care Benefit</b> <b>(illustrative option only)</b>			
<b>Payment Parameters</b>	<b>Existing payment</b>	<b>Proposed payment</b>	<b>Comment</b>
	Child Care Benefit	Child Care Benefit	This is designed to:  Reduce the highest gap fees (especially for families with children in day care centres) by increasing maximum rates for these types of care.  Stop income tests for Child Care Benefit overlapping with FTBA.  Simplify the income test for Child Care Benefit and integrate it with those for other family payments, using a 25% taper rate (except where there is only one child in care).
Eligibility	A family with a dependent child up to 12 years in child care.	A family with a dependent child up to 12 years in child care.	
Maximum rates	<b>\$2.74 per hour for child &lt;5</b> <b>\$2.33 for child 5- 12</b>	<b>\$3.09 per hour for child &lt;5<sup>49</sup></b> <b>\$2.63 for child 5- 12</b>	
Minimum rate	\$0.46 per child <5 \$0.39 for child >5	\$0.46 per child <5 \$0.39 for child >5	
Family day care loading	<b>33%</b>	<b>20%</b>	
Part time loading (Centre based care)	<b>10%</b>	<b>10%</b>	
Loading for 2+ children	Two children in care: 4.51% Three or more: 8.75%	Two children in care: 4.51% Three or more: 8.75%	
Income test for more than minimum rate	<b>If 1 child in care:</b> <b>Reduce by 10% for family income above \$31,800pa.</b>  <b>If 2 or more children in care:</b> <b>Reduce by 15/20% for family income above \$31,800.</b>	<b>If 1 child in care:</b> <b>Reduce by 15% for family income above relevant FTBA cut out point</b> (eg approx \$41,000 for 1 child under 13 or \$50,600 for 2 children under 13). <b>If 2 or more children in care:</b> <b>Reduce by 25% for family income above relevant FTB(A) cut out point</b> (eg approx \$50,000 for 2 children under 13).	

<sup>49</sup> This is sufficient to cover around 80% of the average fee for 50 hours per week of long day care across Australia.



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# Attachment two

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## Effects of the package on family incomes: overall numbers of winners and losers

In overall terms, the main winners from the package would be:<sup>50</sup>

1. around 200,000 low and middle income families with teenagers over 15 years (average gain approx. \$12 per week)
2. around 350,000 low income sole parent families children over 5 years (average gain approx. \$16 per week)
3. around 300,000 low and middle income working families caring for children under 3 (average gain approx. \$70 per week)
4. around 150,000 mothers of newborn children (gain of up to \$275 per week)
5. around 550,000 middle income families affected by `poverty traps` (average gain approx. \$17 per week).

The main losers would be:

1. Approximately 70,000 families with 0- 2 year olds, on incomes above \$70,000 (average loss approx. \$45 per week)<sup>51</sup>
2. approximately 36,000 sole parent families on \$45,000 or more (average loss approx. \$30 per week)<sup>52</sup>
3. approximately 60,000 families with incomes above \$80,000 (average loss approx. \$15 per week).<sup>53</sup>

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<sup>50</sup> Note that many families gain from more than one element of the package (for example, a sole parent with teenage children). So, the overall number of winners is less than the sum of the winners from each of the changes, but many families gain much more than the amounts indicated.

<sup>51</sup> This is due to the loss of Family Tax Benefit (Part B), which in these cases is not fully compensated by the Parenting Payment because the latter is income tested on the partner's income. The cost of maintaining incomes for these families is approximately \$160 million. If a similar income test were applied to single income families with older children, approximately 130,000 additional single income families on incomes above \$70,000 would lose an average of \$35 per week. This would save approximately \$240 million.

<sup>52</sup> This is due to the replacement of Family Tax Benefit (Part B) which is not income tested for sole parents, with an income tested Sole Parent Supplement. The cost of maintaining incomes for these families test would be approx \$60m.

<sup>53</sup> The cost of maintaining their incomes would be approximately \$50 million.

## Some hypothetical examples

The following are examples of the effect of the package on hypothetical families drawn from the first three of these groups. These results are also outlined in the tables and graphs below.

They show that families whose family assistance payments fall well short of their needs would benefit substantially from the ACOSS package.

### Low income families with teenage children at home

- a low income sole parent family (under \$30,000) with *two 16- 17 year olds at home* would gain \$90 per week
- a low income couple (under \$30,000) with *two 16- 17 year olds* would gain \$36 per week.

### Middle income families caring for a child under three

With one child:

- a middle income family on a single income of \$30,000 with one parent caring at home full time for *a child under 3* would gain \$96 per week
- a middle income family on two incomes totalling \$45,000 with one parent caring part time for *a child under 3* and placing her in day care for 25 hours would gain \$83 per week
- a middle income family on two incomes totalling \$60,000 placing a *child under 3* in full time day care would gain \$35 per week.

With two children:

- a middle income family on a single income of \$30,000 with one parent caring at home full time for *two children under 3* would gain \$96 per week
- a middle income family on two incomes totalling \$45,000 with one parent caring part time for *two children under 3*, and placing them in day care for 25 hours would gain \$120 per week
- a middle income family on two incomes totalling \$60,000 placing *two children under 3* in full time day care would gain \$121 per week.

This reflects two major objectives of the package:

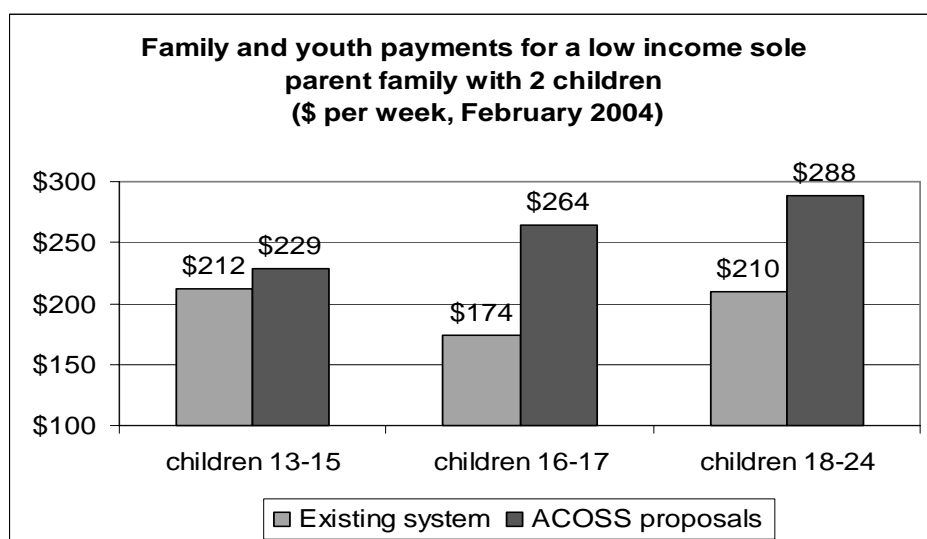
- to reduce financial hardship among low income families with older children
- to improve support for low and middle families with the costs of caring for very young children (both at home and in child care services), in a way that responds to differences in the actual costs faced by different families.

### Example No 1: Sole parent families with 2 children at home, private income less than \$30,000 renting privately

These families gain the most (\$90 per week) when their children reach 16 years. At present, such a family would receive \$174 in family payments, comprising Youth Allowance for two young people living at home. Under the ACOSS proposals, Youth Allowance would increase, Rent Assistance would rise to recognise the extra costs of a young person living at home, and a Sole Parent Supplement would be paid. Overall family payments would rise to \$264 per week for this family, reducing the risk of poverty.

Another benefit of the ACOSS package is that family payments would increase as children grow older, instead of falling by \$38 per week when the youngest child reaches 16, as at present.<sup>54</sup> This is illustrated in the graph below.

#### 1. Sole parent family with 2 children, private income under \$30,000 renting privately



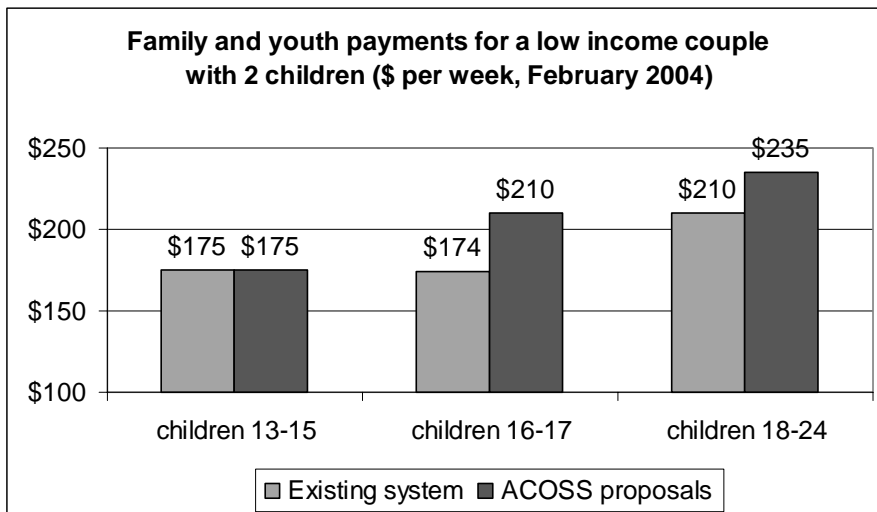
<sup>54</sup> Overall social security payments for such a family fall by around \$60 per week.

**Example No 2: Married couple families with 2 children at home, private income less than \$30,000 renting privately**

These families also gain the most (\$36 per week) when their children reach 16 years. At present, such a family would receive \$174 in family payments, comprising Youth Allowance for two young people living at home. Under the ACOSS proposals, Youth Allowance would increase, and Rent Assistance would rise to recognise the extra costs of a young person living at home. Overall family payments would rise to \$210 per week for this family, reducing the risk of poverty.

Another benefit of the ACOSS package is that their family payments would increase as children grow older, instead of falling slightly (by \$1 per week) when the youngest child reaches 16, as at present. This is illustrated in the graph below

**2. Married couple family with 2 children, private income under \$30,000 renting privately**



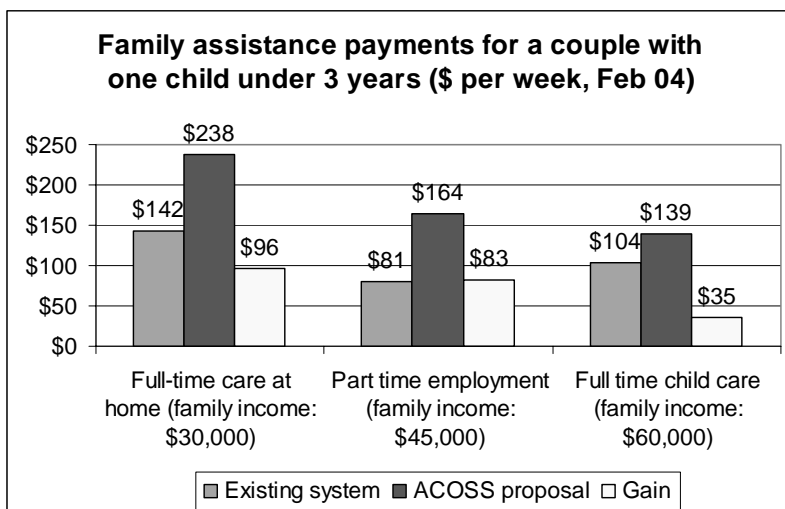


**Example No 3: Low and middle income married couple family with one 0- 2 year old child, with different combinations of employment and child care**

In these examples, the main carer of a young child (usually the mother) either cares for the child full time, or combines part- time employment (placing the child in a day care centre for 25 hours) and part- time care at home, or is employed full time (placing the child in a day care centre for 50 hours). In all cases, the partner’s income is \$30,000 and the main carer earns the same hourly rate. Her earnings rise from zero to \$15,000 (for part- time work) to \$30,000 (for full- time work).

These families gain the most from the ACOSS package when a parent cares full time (\$96 per week) or part time (\$83 per week) for the child at home. This is to redress the inadequate support in the existing system for working parents who withdraw from paid work full or part time to care for a young child.<sup>55</sup> When the main carer obtains full or part- time employment, the family also obtains higher child care subsidies. This is the reason for the substantial gains when the main carer works full time (\$35 per week).

**3. Married couple families caring for one 0- 2 year old child, partner on \$30,000**



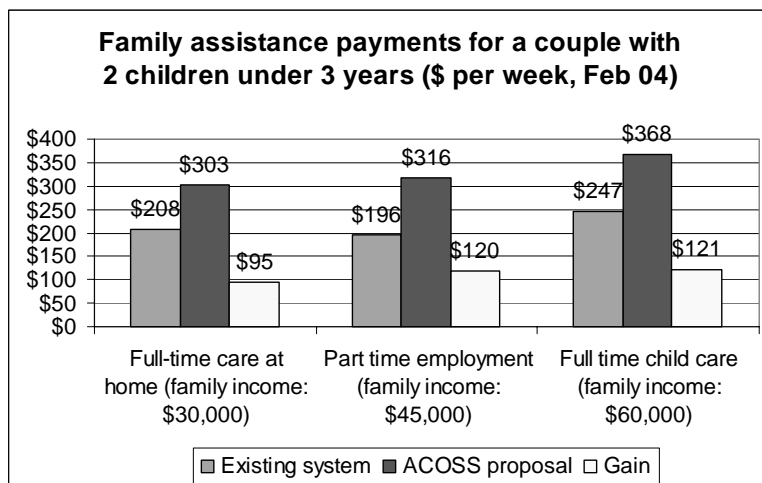
<sup>55</sup> This presently comprises a Family Tax Benefit Part B payment of up to \$56 per week and Baby Bonus of \$21, which would be replaced by a Parenting Payment -at standard social security rates of payments for adults -of \$174 per week. Family Tax Benefit (Part A) -the former Family Allowance - is also included in the table. This remains at \$65 per week.

**Example No 4: Low and middle income married couple family with two 0- 2 year old children, with different combinations of employment and child care.**

As in example 3 above, the main carer of a young child either cares for the child full time, or combines part- time employment (placing the child in a day care centre for 25 hours) and part- time care at home, or is employed full time (placing the child in a day care centre for 50 hours). In all cases, the partner`s income is \$30,000 and the main carer earns the same hourly rate. Her earnings rise from zero to \$15,000 (for part- time work) to \$30,000 (for full- time work).

*However, in this case the family has two children under 3 years.* This substantially increases the family`s day care costs (gap fees). This is reflected in larger gains from the ACOSS package when the main carer is employed full or part time. The largest gains (\$121 per week) occur when she two children are placed in full- time day care (compared with gains of \$35 when one child is placed in care). When the family combines part time employment with care at home, the gains are very similar (120). When the children are cared for full time at home, the gains are the same as for a family with one child (\$96), since the cost of a parent staying at home is the same. Unlike proposals to replace family payments with a flat dollar amount for all families, the ACOSS package is sensitive to variations in the costs of care.

**4. Married couple family caring for two 0- 2 year old children, partner on \$30,000**



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