KPMG

ACCC Childcare inquiry

KPMG submission

KPMG Australia, October 2023

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Executive summary

This report is in response to the ACCC's invitation for submissions on the preliminary findings and recommendations of the interim report on its Childcare Inquiry released in September 2023.

KPMG has been analysing the childcare system in Australia for several years and making recommendations for reform.

The Child Care Subsidy introduced in 2018 to replace the Child Care Benefit and the Child Care Rebate provided much-needed support for those accessing childcare. However, due to the rate at which the CCS phased out as family income increased, there are strong disincentives up and down the income scale for mothers to return to work after having a child or having returned to work, to increase their days of work.

To quantify these disincentives, KPMG developed the concept of a Workforce Disincentive Rate (WDR); the percentage of any extra earnings that is lost to a family after taking account of additional income tax paid, loss of family payments, loss of Child Care Subsidy, and increased out-of-pocket childcare costs.

KPMG found WDRs of 75-120 per cent were common under the original Child Care Subsidy. These punitive rates for mothers are much higher than the top personal tax rate for men of 47 per cent.

KPMG argued that, in circumstances of an ageing population and weak productivity growth, Australia needed greater workforce participation by working-age Australians. Further, since around 60 per cent of university graduates are women, reducing the disincentives mothers face in returning to work would boost productivity growth.

KPMG proposed various reforms to the Child Care Subsidy that would greatly reduce these high WDRs. KPMG's modelling of proposals for reform of the Child Care Subsidy has suggested that the benefits to GDP would far outweigh the budgetary cost.[1] Similar modelling of the economic benefits of a universal Child Care Subsidy could be expected to produce similar results.

The Morrison government announced reforms to the Child Care Subsidy in its 2021-22 Budget which benefited around 270,000 families.

The Albanese government introduced further reforms from 1 July 2023 that increased the Child Care Subsidy for 1,260,000 families, which is almost every family using it. Under the Cheaper Childcare policy, WDRs were reduced for almost all families.

Updated KPMG analysis, which factors in the most recent tax rules, has found that since these reforms were introduced WDRs have decreased for many families to between 45 and 65 per cent, however, in most cases they remain above the highest marginal tax rate of 47 per cent.[2] KPMG supports the Women's Economic Equality Taskforce's (WEET) recommendation to review the taxation and transfer systems with a gender lens to identify negative gender biases and examine options to address the high Effective Marginal Tax Rates (EMTRs) experienced by women.[3]

Formal childcare should be thought of as the initial stage of early childhood education. Formal schooling is not means tested and, in several states, preschool is being made universally available. A universal Child Care Subsidy would:

- Enable access to an early education for all children;
- Remove the workforce disincentives from the Child Care Subsidy faced by mothers;
- Boost workforce participation and opportunity for mothers; and

[1] The child care subsidy: options for increasing support for caregivers who want to work
[2] Including Stage 2 personal income tax and the removal of the low and middle income tax offset.
[3] Women's Economic Equality Final Report

– Increase national productivity.

In responding to the ACCC's interim report on its Childcare Inquiry, KPMG has focused on several of the draft recommendations in the report. KPMG's principal recommendations are:

RECOMMENDATION 1:

KPMG agrees with the ACCC that consideration should be given to a daily fee cap to replace the hourly cap for centre-based care

RECOMMENDATION 2:

KPMG recommends the removal of the Child Care Subsidy activity test for people accessing Commonwealth support payments since it falls most heavily on families in low-socioeconomic communities and is contributing to those households using a disproportionately large number of unsubsidised hours, leading to both access and affordability problems

RECOMMENDATION 3:

KPMG supports the ACCC's draft recommendation that the Australian government should consider maintaining and expanding supply-side support options for Aboriginal Community Controlled Organisations that provide childcare and additional support services for First Nations children, parents and guardians

RECOMMENDATION 4:

KPMG supports the ACCC's view that in remote areas government should become involved in meeting unmet demand.

If you would like to discuss the contents of this submission further, please do not hesitate to reach out.

Yours sincerely,

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Background

About KPMG

KPMG is a global organisation of independent professional firms, providing a full range of services to organisations across a wide range of industries, governments and not-for-profit sectors. We operate in 146 countries and territories and have more than 227,000 people working in member firms around the world. In Australia, KPMG has a long tradition of professionalism and integrity combined with our dynamic approach to advising clients in a digital-driven world.

KPMG insights

KPMG Insights

KPMG analysis and reform proposals for the Child Care subsidy

KPMG has advocated reforms to the Child Care Subsidy in a series of reports dating back to 2018. This includes:

- Ending workforce discrimination against women
- The cost of coming back: Achieving a better deal for working mothers
- Unleashing our potential: The case for further investment in the child care subsidy
- The child care subsidy: options for increasing support for caregivers who want to work
- Towards a more equal sharing of work

In an early report, KPMG developed the concept of a Workforce Disincentive Rate (WDR) for recipients of the Child Care Subsidy. The WDR is the percentage of any extra earnings that is lost to a family after taking into account additional income tax paid, loss of family payments, loss of childcare payments and increased out-of-pocket childcare costs.

Analysing the Child Care Subsidy introduced in 2018 to replace the Child Care Benefit and the Child Care Rebate, KPMG identified WDRs in the range of 75-120 per cent.[4] A WDR of 75 per cent indicates the household would lose 75 per cent of the earnings from an extra day's work by a mother returning to work after having a child. A WDR greater than 100 per cent indicates that the household would go backwards financially from the mother doing an extra day's work.

These very high WDRs for working mothers identified by KPMG far exceed the top personal tax rate for men of 47 per cent.

If retained, such punitive WDRs for mothers returning to work would have had a very high economic cost. In circumstances of an ageing population and weak productivity growth, Australia needs greater workforce participation by working-age Australians. Further, since around 60 per cent of university graduates are women, reducing the disincentives mothers face in returning to work provides a welcome boost to productivity growth.

KPMG conducted economic modelling of various options to reform the Child Care Subsidy introduced in 2018. In its 2020 report, *The childcare subsidy: options for increasing support for caregivers who want to work*, KPMG proposed an increase in the Child Care Subsidy to 95 per cent of the hourly rate cap for all families and the elimination of the annual per-child cap. As an interim step, KPMG proposed an increase in the maximum Child Care Subsidy rate to 95 per cent of the hourly rate cap and commencement of the family income-based reduction in the subsidy at $80,000 per annum.

KPMG modelling estimated the budgetary cost of the first option at $5.4 billion, a gain to GDP of $6.0-7.5 billion and an additional productivity benefit over 20 years of $10 billion. The estimates for the interim option were a budgetary cost of $2.5 billion, a GDP gain of $4.3-5.4 billion and an additional productivity gain of $7 billion.

This modelling suggested that the economic benefits of the reformed Child Care Subsidy would far outweigh the budgetary cost.

Australian government reforms to the Child Care Subsidy

In the 2021-22 Budget, the Morrison government announced reforms to the Child Care Subsidy:

- Removal of the annual cap that limited the annual Child Care Subsidy to $10,560 per child for families with a combined income above $189,390; and
- An increase in the Child Care Subsidy for second and subsequent children by up to 30 percentage points, capped at 95 per cent.

The Albanese government announced further reforms under its *Cheaper Childcare* policy, which came into effect on 1 July 2023:

[4] Unleashing our potential: The case for further investment in the child care subsidy

- – An increase in the base rate from 85 per cent to 90 per cent;
- – A reduction in the rate at which the subsidy is withdrawn as household income rises, such that some subsidy is payable on household income of up to $530,000 per annum; and
- – An extension of the Child Care Subsidy to outside school hours care.

The Albanese government has also announced that the Productivity Commission will undertake a comprehensive review of the sector, including consideration of the implementation of a universal 90 per cent childcare subsidy for all families.[5]

The reformed Child Care Subsidy reduces WDRs for all families receiving it.

KPMG's response to the ACCC's draft recommendations

KPMG's response focuses on the draft recommendations set out below.

ACCC Draft Recommendation 2

The ACCC recommends further consideration and consultation on changes to the Child Care Subsidy and existing hourly rate cap mechanism, to simplify their operation and address unintended consequences, including on incentives and outcomes. In doing so, we recommend consideration be given to:

(b) changing the hourly rate cap to align with the relevant pricing practice for the service type. This could include consideration of a daily fee cap for centre-based day care. Consideration will need to be given to setting and monitoring minimum requirements to avoid creating incentives for childcare providers to reduce flexibility or quality;

(c) removing, relaxing or substantially reconfiguring the current activity test, as it may be acting as a barrier to more vulnerable children (for example, households with low incomes or disadvantaged areas) accessing care and creating a barrier to workforce entry or return for some groups. An alternative would be to consider a specific entitlement, such as a certain number of days of care.

KPMG response:

The ACCC's interim report finds that: "… there appears to be a disconnect between the Child Care Subsidy being calculated on an hourly basis and actual pricing for centre based day care, which is typically set on a daily basis. Because of this, the hourly rate cap is unlikely to be a strong price signal for households" (p. 23).

The hourly rate cap makes it difficult for households to calculate their out-of-pocket expenses and the net benefit they might receive from obtaining paid employment.

KPMG agrees with the ACCC that consideration should be given to a daily fee cap for centre-based care. This would enable parents more easily to compare the advertised fee to the maximum fee that is subsidised.

However, as the ACCC points out, a daily rate cap may not be appropriate for other service types where fees are not generally advertised at a daily rate.

The activity test is an assessment of the combined hours of paid work, self-employment, unpaid work in a family business, looking for work, training, study, recognised voluntary work or other recognised activity undertaken by a family. It is used to determine the number of hours of subsidised childcare to which a family is entitled.

The activity test is based on the activity of the parent who is performing the lesser amount of eligible activity.

Low-income families who otherwise would not meet the activity test are nevertheless entitled to 24 hours of care per fortnight, which is 12 hours per week, but owing to the standard length of a session equates to only one day per week.

Families are obliged to update their activity fortnightly to ensure they are not overpaid, creating the risk of overpayment if they do not do so accurately.

The ACCC's interim report finds that households with the lowest incomes are most affected by the activity test – and that these households with a lower entitlement tend to use a greater share of unsubsidised hours, leading to higher out-of-pocket expenses and potentially making childcare unaffordable for them (Figure 4.11, p. 180-181).

Highlighting the potential unaffordability of childcare for low-income families created by the

[5] Productivity Commission - Early childhood education and care

activity test, the ACCC's interim report further finds that those in the lowest income decile ($0 to $36,999) are using more unsubsidised hours on average than households in all other income deciles other than the highest ($247,144 and above) (Figure 4.13, p. 181).

The ACCC concludes:

"Households on lower entitlements are likely to be impacted the most from the activity test. The relatively higher use of unsubsidised hours indicates the desire for care beyond what is available to them at subsidised rates. Further, because these households are often on the lowest incomes, the out-of-pocket expenses paid will represent a greater share of their household income than they would for higher income households" (p. 182).

KPMG considers that childcare is an essential building block in the socialisation of children in preparing them for preschool and formal schooling. Children from low-socioeconomic communities are especially disadvantaged if they do not have access to formal childcare.

KPMG recommends the removal of the activity test since the activity test falls most heavily on families in low-socioeconomic communities and is contributing to those households using a disproportionately large number of unsubsidised hours, leading to both access and affordability problems. The removal of the activity test could be limited to those accessing Commonwealth support payments.

ACCC Draft Recommendation 5

The Australian Government should consider maintaining and expanding supply-side support options for Aboriginal Community Controlled Organisations that provide childcare and additional support services for First Nations children, parents and guardians.

KPMG Response

In view of the particular disadvantage that First Nations children face in remote communities, and that Aboriginal Community Controlled Organisations can deliver tailored services, including wrap-around services, for their communities, **KPMG supports the ACCC's draft recommendation that the Australian government should consider maintaining and expanding supply-side support options for Aboriginal Community Controlled Organisations that provide childcare and additional support services for First Nations children, parents and guardians.**

ACCC Draft Recommendation 6

A market stewardship role should be considered for both Australian and state and territory governments, in identifying under-served areas and vulnerable cohorts, along with intervention whether through public or private provision. A competitive tender process is one tool that could be used by governments to facilitate delivery in these areas.

KPMG Response:

The ACCC has confirmed that the market model for the provision of childcare at affordable cost is not working in remote areas of Australia. Unsurprisingly, supply costs are higher in remote areas – and the Child Care Subsidy, and the number of prospective users are not large enough to make childcare provision privately profitable.

KPMG supports the ACCC's view that government should become involved in meeting unmet demand in remote areas and that:

"A competitive tender process could be used to select a private provider, determine the operating grant needed to support the service, set a regulated fee, and minimise the cost burden for taxpayers. Where a competitive tender process is unable to generate private supply, it may be necessary for direct provision by government" (p. 35).

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