

Participating in growth

Free childcare and increased participation

Free childcare would act as effective short-term stimulus as well as a long run driver of economic growth

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Summary

The provision of free childcare provides the rarest of economic policy opportunities – it's both an effective form of fiscal stimulus in the short term and has the capacity to boost the long-term participation rate and, in turn, the long run rate of economic growth.

When the Prime Minister, Scott Morrison urged the states to re-open schools during the COVID19 pandemic, he argued that doing so would lead to higher labour force participation rates. Scott Morrison repeatedly highlighted the significant economic gains for the country that flowed from freeing parents from full-time caring responsibilities and went as far as to suggest that re-opening schools could increase the number of people in work by 300,000.

By the same logic it follows that making it easier and more affordable for parents to access high quality childcare would also have a significant and positive impact on labour force participation rate. Such logic is borne out by international evidence that shows countries with superior early childcare policies to Australia have superior employment outcomes, particularly for women.

While Nordic countries have similar proportions of full-time to part-time work as Australia, they have much more generous childcare policies and much higher rates of female participation in full-time work.

Compared to Nordic countries, Australia's female participation rates fall significantly at the ages when the largest number of people are raising young families. Policies that make it easier for women to choose to go back to work, like the provision of free childcare, could mean that Australia reaps billions in benefits over the long run.

Higher labour force participation rates have the potential to increase the size of the Australian economy. If Australia had the same labour force participation rates as Nordic countries do, then the economy would be \$60 billion, or 3.2 per cent of Gross Domestic Product (GDP), larger. If Australia had the same participation rates as Iceland, the Nordic country with the highest female participation rates, then Australia's GDP would be \$140 billion, or 7.5 per cent, higher.

But the benefits of free childcare do not only accrue in the long term. The provision of free childcare provides a significant form of fiscal stimulus spending targeted towards families with young children. As such families tend to have a very high 'marginal propensity to consume' stimulus provided in the form of free childcare is likely to have a larger impact on consumer spending than many other forms of stimulus spending.

The Morrison Government's decision to end free childcare will reduce the disposable income of young families, meaning they will reduce their consumer spending at a time when

GDP is already shrinking, and unemployment is rising rapidly. This decision, combined with the decision to direct significant spending on construction projects is at odds with the Prime Minister's statement that his number one priority is getting people back into jobs.¹ The empirical evidence makes clear that expenditure on services like childcare, and indeed general consumer spending, creates more jobs per \$1 million spent than expenditure on construction.²

¹ AAP (2020) *Scott Morrison announces additional \$1.5 billion towards 'shovel-ready' projects*, SBS News, 15 June, available at <<https://www.sbs.com.au/news/scott-morrison-announces-additional-1-5-billion-towards-shovel-ready-projects>>

² Denniss R, Grudnoff M, & Richardson D (2020) *The macroeconomic impact of the NSW public sector pay cut*, The Australia Institute, 1 June, available at <<https://www.tai.org.au/content/nsw-public-sector-pay-cut-cost-1100-jobs-and-harm-regional-economies>>

Introduction

According to Treasury, increasing workforce participation is one of three ways to permanently increase the rate of growth of Gross Domestic Product (GDP). The other two are increasing productivity and increasing population. This paper will look at the long run economic benefits of increasing Australia's labour force participation rate. It will also look at the short-term benefits of using free childcare as a form of fiscal stimulus to boost aggregate demand by increasing the disposable income of families with young children.

A simple way to increase participation rates can be achieved by helping secondary income earners, often women, re-enter the workforce after the birth of a child. This paper looks at Australia's workforce participation rates and compares them to Nordic countries, which have some of the highest participation rates in the world. This paper estimates how much additional GDP would be generated if Australia's participation rates were as high as those of Nordic countries.

Subsidised, high quality childcare is one way Nordic countries have increased female participation rates. Women, who are usually the primary carers for children in Australia, are more likely to choose to go back to work if high quality and affordable childcare is available. The Australian Government's recent provision of free childcare in response to COVID-19 had the potential to significantly improve Australia's female participation rate.

While the long run benefits to GDP of increasing female participation rates are described in detail below, it is also important to understand that there are also short-term benefits from retaining the existing free childcare arrangements. Free childcare is stimulatory. It significantly boosts the disposable income of families with young children, income that is likely to boost consumer spending and, in turn, aggregate demand.

Childcare and labour force participation

The COVID19 pandemic has highlighted the difficulties parents face when having to mix work and parenting responsibilities. The shutdown of schools during the pandemic meant many parents had to juggle looking after children and working from home. Some were able to work but were less productive. Others could not work at all.

The Prime Minister highlighted the impact shutting schools had on participation when he tried to convince the state Premiers to re-open schools and quickly as possible. The Prime Minister said of opening schools:

...it's also important because it frees up the workforce to go back to work. And women are some of the most affected by that with school closures and even if they're trying to work from home while at the same time looking after kids, it's not an easy job... It does impact on the productivity. So kids going back to school lifts productivity, helps people get back to work and helps the economy get back on its feet.³

The Prime Minister went on to say:

Well, the estimate from Treasury, based on the second round impacts of schools being reduced in the way they have over a six month period, is around 300,000 jobs.⁴

The Treasurer announced further estimates of the impact closing schools and childcare centres was having on the economy.

It was Treasury's estimate at the time that the macro-economic impact from closing schools and childcare centres for 3 months could reduce GDP by around \$34 billion, or 7 per cent for a quarter. This was based on the assessment that school and childcare closures could result in around 1 million adults needing to withdraw from the workforce to care for children at home.⁵

³ Morrison S (2020) *Press Conference – Australian Parliament House, ACT*, 5 May, available at <<https://www.pm.gov.au/media/press-conference-australian-parliament-house-act-05may20>>

⁴ Morrison S (2020) *Press Conference – Australian Parliament House, ACT*, 5 May

⁵ Frydenberg J (2020) *Address to the National Press Club*, 5 May, available at <<https://joshfrydenberg.com.au/latest-news/address-to-the-national-press-club-of-australia-5-may-2020-2/>>

The Prime Minister and Treasurer are correct in their assessment that schools and childcare centres have an important impact on workforce participation and that higher participation rates flow through to higher levels of GDP.

CHILDCARE POLICY IN AUSTRALIA

While childcare plays a similar role in shaping participation rates as schools do, there has been less discussion about the importance of providing free childcare in the same way that we provide free schooling.

In the short term, the ongoing provision of free childcare boosts the disposable income of households with young children and will likely provide an effective form of stimulus to consumer spending and, in turn, aggregate demand. This is particularly the case because the young families who will be the beneficiaries of free childcare are also likely to have high marginal propensities to consume, making the stimulus more effective.

And in the long term, as discussed below, making high quality childcare more affordable has the potential to significantly boost labour force participation and GDP.

But despite these short term and long run benefits, the Morrison Government announced that it will end free childcare on the 12th July and will also be ending access to JobKeeper for childcare centres on the 20th July. Childcare centres are the only businesses that the Government has announced it will withdraw JobKeeper from before the originally announced end date in September.

This decision should be reversed. At this time of economic crisis caused by the COVID19 pandemic, now is an opportune time to both stimulate the economy in the short term and increase the size of the economy in the long term, by making the provision of free childcare permanent.

In the short-term, free childcare is stimulatory, at a time when the economy is shrinking, and unemployment is rising rapidly. Free childcare reduces the financial burden on households that use it. This allows those households to spend money on other things, which increases aggregate demand.

Removing free childcare will mean a big cut in disposable income for households that put their young children in care. This will be contractionary. It will have an equivalent impact to imposing a new tax on families, meaning they have less money to spend on other things and hence reduce aggregate demand.

In the longer-term free childcare will be good for the economy as it will encourage labour force participation from families with young children. Families with young children who have decided that one parent will stay home and look after the children could re-evaluate that decision if childcare was treated like schooling and provided for free.

CHILDCARE IN NORDIC COUNTRIES

There has long been free, or very low-fee, and overwhelmingly publicly subsidised, early childhood education and care (ECEC) in the Nordic countries. For a brief period, as part of its response to the COVID19 pandemic, Australia has provided free childcare. The Government has announced that this will end in July. Part of Australia's problem is that it has long relied very heavily on the private marketplace to deliver childcare for profit. This has caused serious problems of affordability, deterring women from returning to the paid workforce.

Nordic countries provide well-resourced, high-quality ECEC through publicly provided services. These investments reduce pressures on working parents at important and stressful times in their lives.

In Sweden for example, the national and municipal governments together pay 90 percent of the cost of all ECEC services, which makes the fees paid by parents to cover the other 10 per cent of ECEC services affordable. Net childcare costs in Australia for a couple on an average wage absorb 17 per cent of household income, compared to just 4 per cent in Sweden and Iceland.⁶

We will now look at the economic benefits that higher labour force participation rates could provide if Australia had similar participation rates as Nordic countries.

⁶ OECD (2020) *Net childcare costs*, OECD Data, available at <<https://data.oecd.org/benwage/net-childcare-costs.htm>>

Participation rates

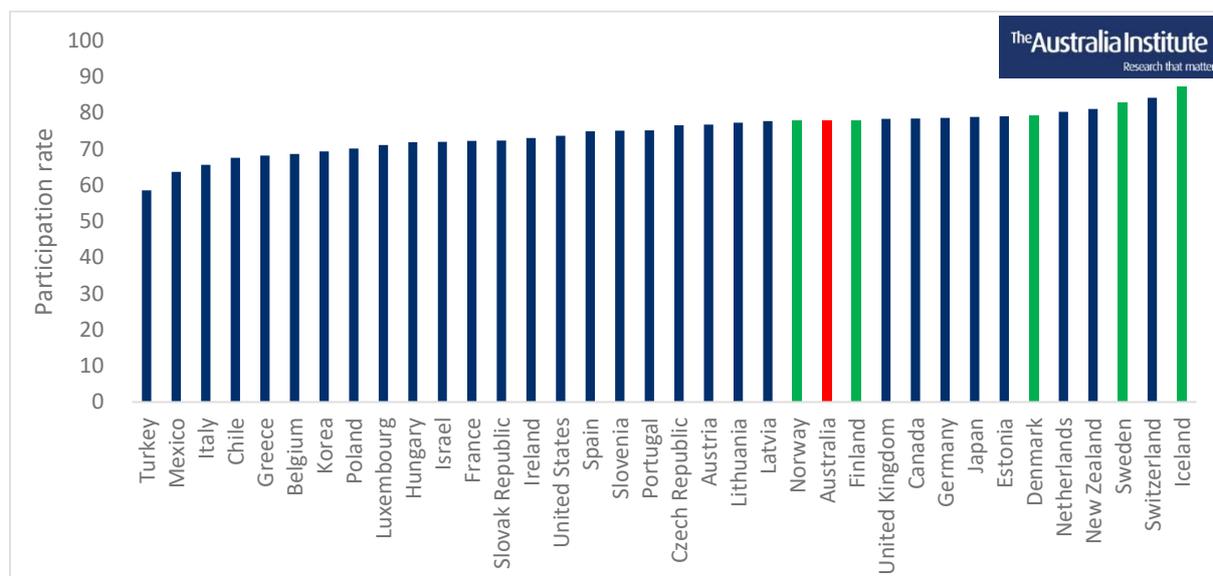
HOW DO AUSTRALIA'S RATES COMPARE?

Australia's workforce participation rate is the proportion of people aged over 15 who are either working or are actively looking for work. Australia's participation rate is 66 per cent.⁷ This means that 66 per cent of those over the age of 15 are working or actively looking for work and 34 per cent are not in the labour force. There are many reasons why someone might not be in the labour force. They could be in full time study, at home with caring responsibilities, retired or face barriers to seeking paid work such as discouragement, needing more support for skills development or deterred by the wages for work not being enough to cover the costs of childcare.

If Australia were to increase its participation rate, a larger pool of labour would be available to produce things and increase Australia's Gross Domestic Product (GDP). So how does Australia compare with other developed countries?

If we look at other developed countries, we can see that Australia does reasonably well. Of the 36 Organisation for Economic Co-operation and Development (OECD) countries, which are considered the group of developed nations, Australia's participation rate ranks 13th. This puts Australia in the top third.

Figure 1 – Participation rates by OECD country

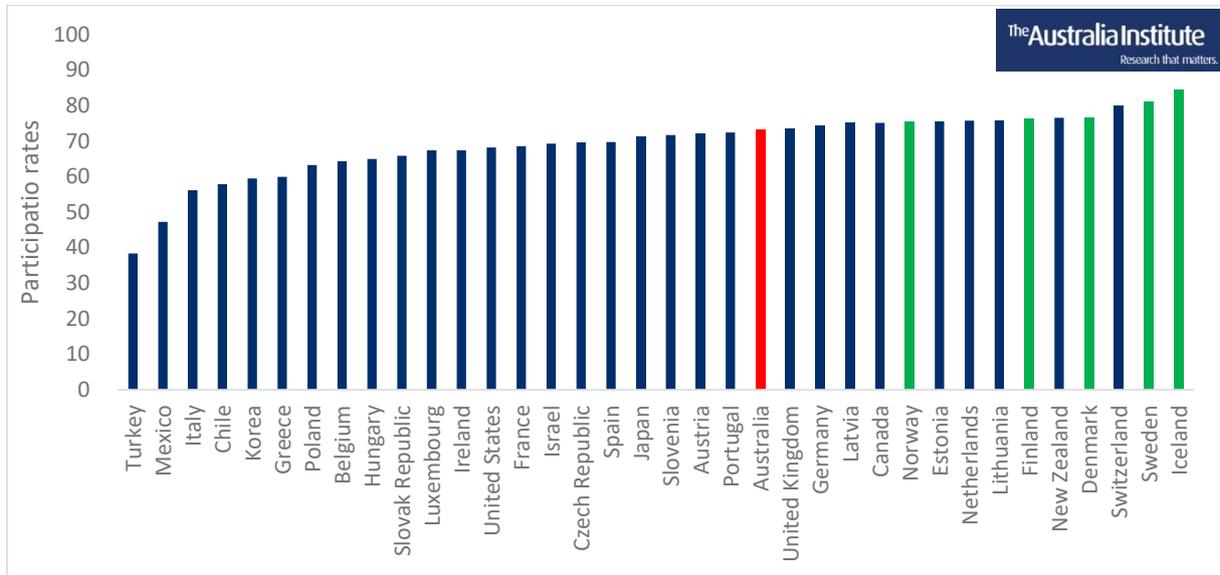


⁷ ABS (2019) 6202.0 - Labour Force, Australia, Oct 2019, Australian Bureau of Statistics, available at <<https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6202.0Oct%202019?OpenDocument>>

Source: OECD data

Comparing Australia's female participation rate, we can see that Australia ranks two places further down at 15th out of 36. It also shows that Nordic countries have some of the highest female participation rates in the world. Switzerland and New Zealand also rank highly.

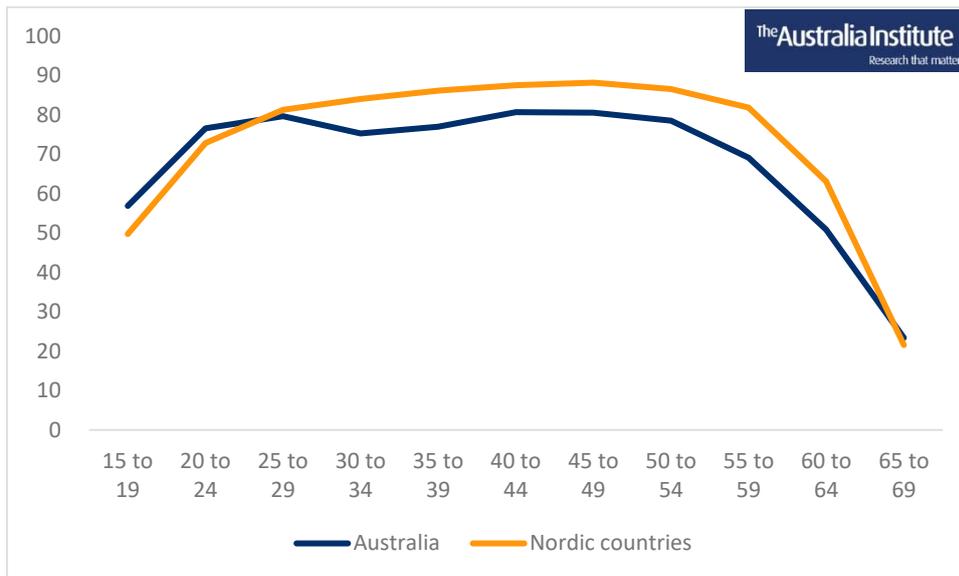
Figure 2 – Female participation rates by OECD country



Source: OECD data

If we look at female participation rates by age, we can see a difference between Australia and the Nordic countries. While Australian women in their twenties have similar participation rates as women in Nordic countries, a distinct change occurs with women aged in their early thirties. This is the age when the largest number of families are raising young children. Australia's female participation rate falls before recovering and peaking with women in their forties. Women in Nordic countries see no drop in participation rates in their thirties and don't see their participation rates peak until they're in their late forties. The peak is also higher for Nordic countries than for Australia.

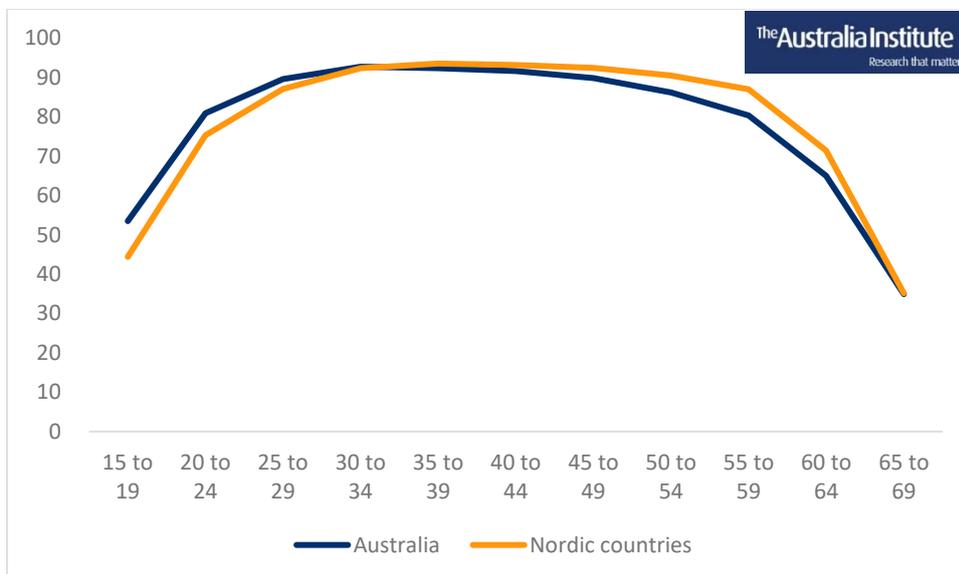
Figure 3 – Australian and Nordic female participation rates by age



Source: OECD data

If we compare male participation rates by age in Australia and the Nordic countries, they are more similar than female participation rates. Australian male participation rates are higher for those aged 15 to 30 and Nordic countries' participation rates are higher for those aged over 40.

Figure 4 - Australian and Nordic male participation rates by age



Source: OECD data

This means that the overall difference between Australian and Nordic participation rates is mainly explained by differences in female participation rates. It also means that most of the potential economic gains for Australia having the same participation rates as the Nordic

countries are likely to come from women rather than men and, in particular, from women raising children.

POTENTIAL ECONOMIC GAINS

GDP is not just the sale of all final goods and services in an economy, it is also equal to the sum of all incomes.⁸ Higher participation rates mean more wages being earned, more things being produced and businesses making more profit. Higher participation rates mean higher GDP.

The size of the increase in GDP associated with an increase in labour force participation will depend on the extra goods and services created in the economy. A large proportion of that increase will come in the form of the increased wages bill paid to the additional workers, as well as the increase in business profits as more goods and services are sold.

In measuring the expected change in GDP, we will differentiate between the increase in wages, and the total increases in GDP, which includes, for example the increase in profits and other incomes.⁹

Table 1 shows the impact on wages and the impact on GDP that would occur if average Nordic country participation rates by age and gender were applied to Australia. Most of the increase comes from the increase in female participation rates, with a smaller increase coming from the male participation rates. Overall the increase in the wages would be \$31.7 billion while the increase in GDP would be \$60.4 billion or a lift in GDP of 3.2 percent.

Table 1 – Increase in Australian GDP from using average Nordic participation rates

Gender	Wages	GDP	% GDP
Female	\$25.4 billion	\$48.5 billion	
Male	\$6.3 billion	\$11.9 billion	
Total	\$31.7 billion	\$60.4 billion	3.2%



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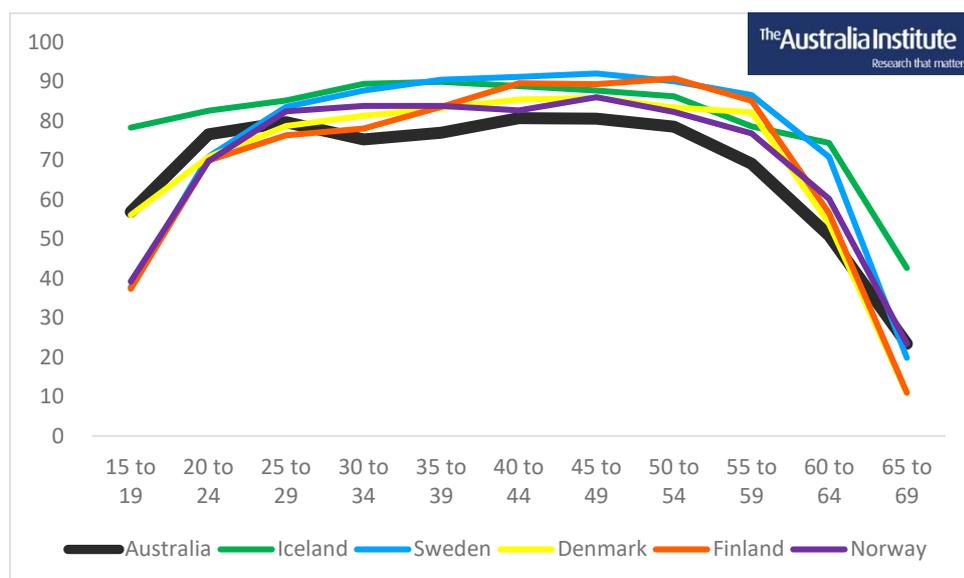
Source: See Appendix A

There are variations in participation rates among Nordic countries. Figure 5 shows the female participation rates of all the Nordic countries and Australia by age. Australia has been highlighted by the thick black line. We can see that Australia is the only country that sees a distinct dip in female participation rates at the age when many families are raising children.

⁸ GDP using the income method is the sum of all factor incomes plus taxes less subsidies on production and imports

⁹ For more information on how the increase in GDP was calculated, please refer to Appendix A

Figure 5 – Australian and 5 Nordic countries’ female participation rates by age



Source: OECD data

We can also see the increase in Australian GDP if each of the five Nordic countries’ participation rates were applied by gender and age. This is shown in Table 2. Iceland has the world’s highest male and female participation rates. If Australia had the same participation rates as Iceland, then in the long run GDP could be almost \$100 billion per year higher. Some Nordic countries have lower male participation rates than Australia; if Australia had their male participation rates, it would see less men in work and therefore GDP from men would be lower. However, in these cases the loss in GDP would be more than offset by increases in female participation rates.

Table 2 – Change in Australian GDP by using Nordic participation rates

Country	Gender	Wages	GDP	% of GDP
Iceland	Female	\$42.5 billion	\$81.0 billion	
	Male	\$31.8 billion	\$60.6 billion	
	Total	\$74.3 billion	\$141.6 billion	7.5%
Sweden	Female	\$37.0 billion	\$70.4 billion	
	Male	\$16.9 billion	\$32.3 billion	
	Total	\$53.9 billion	\$102.7 billion	5.4%
Finland	Female	\$19.6 billion	\$37.2 billion	
	Male	-\$9.4 billion	-\$17.9 billion	
	Total	\$10.2 billion	\$19.3 billion	1.0%
Denmark	Female	\$15.3 billion	\$29.1 billion	
	Male	-\$1.3 billion	-\$2.5 billion	
	Total	\$14.0 billion	\$26.6 billion	1.4%

Norway	Female	\$12.9 billion	\$24.6 billion	
	Male	-\$6.8 billion	-\$12.9 billion	
	Total	\$6.1 billion	\$11.7 billion	0.6%

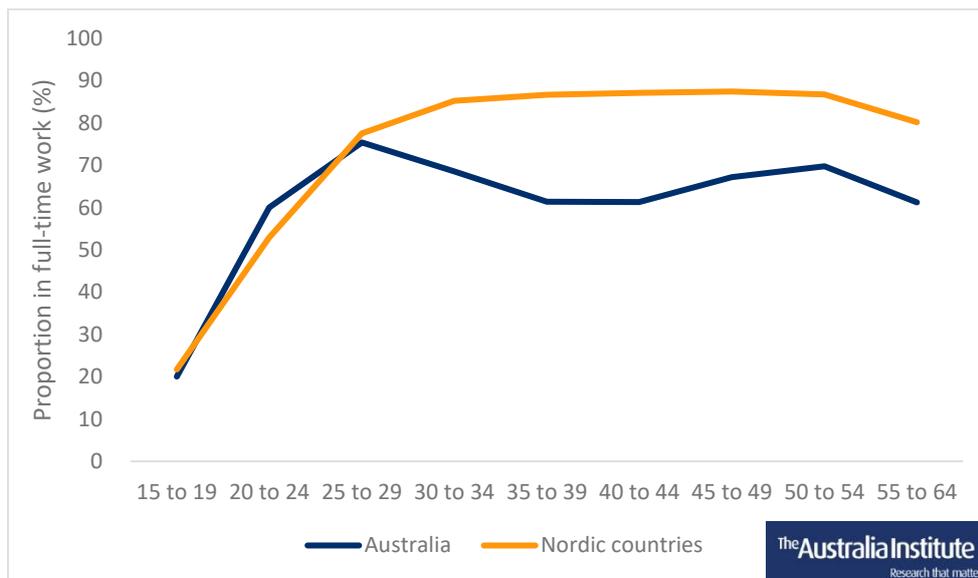
Source: See Appendix A



FULL-TIME VERSUS PART-TIME WORK

Nordic countries do not just have higher female participation rates than Australia, they also have a larger proportion of the female workforce in full time employment. Figure 6 shows the proportion of those in work who have a full-time job. It shows that at the age when many households are raising children, the proportion of Australian women in full-time work falls. It also shows that the proportion of the female workforce in full-time work never reaches the height that it was before typical child raising age.

Figure 6 – Proportion of women in full-time work for Australia and Nordic countries

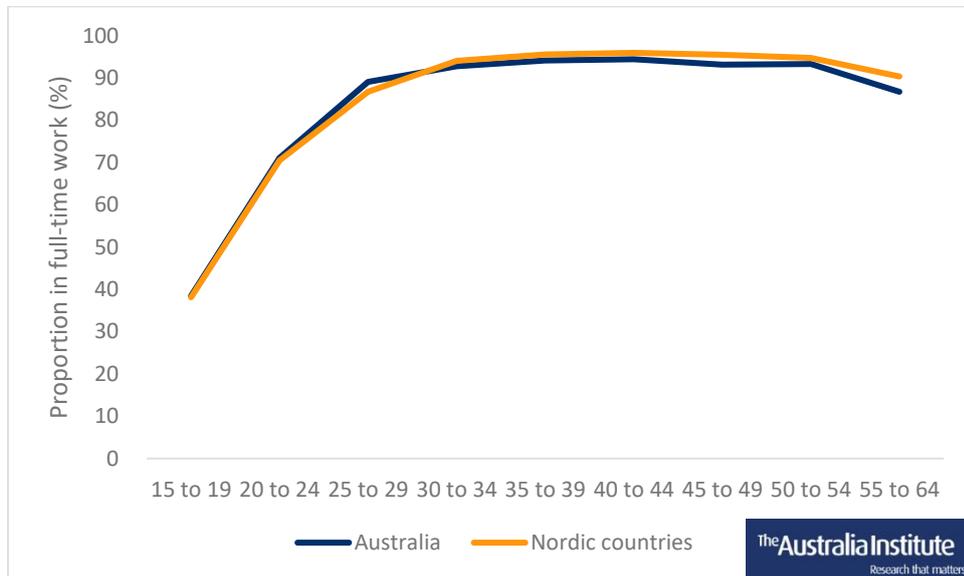


Women in Nordic countries don't see any drop in the proportion of workers in full-time work. The higher proportion in full-time work also stays at that higher level throughout their working lives, eventually falling slightly in their late fifties and early sixties. A higher proportion of workers in full-time work means higher female life-time earnings.

Figure 7 shows the proportion of men in full-time work by age for Australia and Nordic countries. It shows a small difference between Australia and the Nordic countries with higher participation rates among middle-aged and older workers in the Nordic nations. This indicates that the differences between full-time and part-time work are mainly based on

gender and changes appear to occur when women reach the age where families with young children are at their peak.

Figure 7 – Proportion of men in full-time work for Australia and Nordic countries



Conclusion

Comparing Australia's female participation rates and its full-time/part-time shares to those of the Nordic countries shows that there is significant potential to boost Australia's long run growth rates by emulating key design elements of Nordic childcare policy. There are key policy reasons why Nordic countries have higher female participation rates and more women in full-time employment. These include the provision of extensive paid parental leave and high quality freely available public early childhood education and care.

The empirical data makes clear that Nordic countries avoid the fall in participation rates that is so apparent in the data for Australian women, particularly women in their thirties. Significantly, the higher participation rates for Nordic women in their thirties continue after typical child raising ages.

Australia has a unique opportunity, brought on by the pandemic, to realise some of these economic gains by making permanent the temporary policy of providing free childcare.

Nordic countries experience the benefits of higher female participation rates and more women in full-time employment. Australia should look more closely at how Nordic countries support women to remain in the workforce while raising a family. If Australia can close the gap to the Nordic countries, then it has the potential to generate tens of billions of dollars in additional economic growth.

While the budgetary cost of introducing free child care would typically be used as a barrier to its introduction by conservative governments, the need for the Morrison government to both stimulate demand in the short term and increase the long run rate of economic growth removes this explanation for their historic reluctance to pursue such policy reform.

The Morrison Government's decision to end free childcare will reduce the disposable income of young families, meaning they will reduce their consumer spending at a time when GDP is already shrinking, and unemployment is rising rapidly. This decision, combined with the decision to direct significant spending on construction projects is at odds with the Prime Minister's statement that his number one priority is getting people back into jobs.¹⁰ The empirical evidence makes clear that expenditure on services like childcare, and indeed general consumer spending, creates more jobs per \$1 million spent than expenditure on construction.¹¹

¹⁰ AAP (2020) *Scott Morrison announces additional \$1.5 billion towards 'shovel-ready' projects*, SBS News, 15 June

¹¹ Denniss R, Grudnoff M, & Richardson D (2020) *The macroeconomic impact of the NSW public sector pay cut*, The Australia Institute, 1 June

Appendix A

Participation rates are calculated by gender and by age. Participation rates by gender and age were downloaded from the OECD website.¹² The number of workers and their average wage is used for each age group by gender from ABS data.¹³ Percentage changes in participation rates can then be applied by gender and age group for different OECD countries.

New entrants to the Labour force created by higher participation rates are assumed to have the same employment/unemployment rates as existing participants in the labour force. Therefore, the unemployment rate for men and women is subtracted from the new employees.¹⁴ The total wage bill can then be compared. This gives the difference in total wages bill from applying different participation rates. This is how the wages figure is calculated.

The GDP figure is calculated using the labour share of GDP from the National Accounts.¹⁵ The difference between the wages figure and GDP figure is the non-labour share. The GDP figure is the labour share plus the non-labour share.

Nordic countries' participation rates are calculated as the average participation rate by gender and age group for Denmark, Iceland, Finland, Norway and Sweden. The full-time proportion for Nordic countries is calculated as the average proportion of full-time employment to total employment by gender and age group for Denmark, Finland, Norway and Sweden. Iceland is not included because OECD data by age and gender is not available.¹⁶

¹² OECD.Stat (2019) *Labour, Labour force statistics, LFS by sex and age, Labour force participation rate*, Organisation for Economic Co-operation and Development, available at <<https://stats.oecd.org/#>>

¹³ ABS (2019) *Employee Earnings and Hours, Australia, May 2018*, Australian Bureau of Statistics, Table 2 available at

<<https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6306.0May%202018?OpenDocument>>

¹⁴ ABS (2019) *Labour Force, Australia, Sep 2019*, Australian Bureau of Statistics, Table 1, available at <<https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6202.0Sep%202019?OpenDocument>>

¹⁵ ABS (2019) *Australian System of National Accounts, 2018-19*, Australian Bureau of Statistics, Table 16 available at <<https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5204.02018-19?OpenDocument>>

¹⁶ OECD.Stat (2019) *Labour, Full-time Part-time employment, Incidence of FTPT employment – common definition*, Organisation for Economic Co-operation and Development, available at <<https://stats.oecd.org/#>>