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Welfare means test reform ‘to free $21bn’

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The Policy Institute Australia, whose board includes Anthony Albanese’s former department secretary Glyn Davis, says the government could cut $21bn in welfare through better means testing four key programs, including rejecting the Prime Minister’s universal childcare subsidy in favour of an option that reduces wealthier household’s benefits.

The biggest savings from the institute’s redesign would come through stricter application of the assets test in the Age Pension and Aged Care programs – with savings of around $16bn – while savings from Parental Leave Pay and the Child Care Subsidy are more modest, at around $5bn, reflecting their smaller scale.

The institute doesn’t recommend how the savings are used but provided several options, including tax cuts.

“To the extent that program savings are redistributed through tax cuts, the most well off households could experience little change. In our modelled example, a family with household income of $247,000 (the median of the top 20 per cent) could lose $5600 in childcare subsidy benefits but gain up to $4300 in tax savings,” it said.

The institute compared the benefits provided to the least-well-off 20 per cent of households as against the most-well-off 20 per cent of households, by income or wealth.

Policy Institute Australia chief executive Amy Auster said it was pretty evident that social safety nets were growing faster than the economy because the way many means tests worked disproportionately favoured wealthier households.

“The failure to evolve how we assess people for payments has meant more is going to households that have greater capacity to pay their own way. This inequity has intensified in recent years with rising cost-of-living pressures,” Ms Auster said.

“Sensible changes to means testing can bolster our social safety net while freeing up budget capacity. This would give policymakers a greater range of choices in how we invest in Australia’s future prosperity,” she said.

On childcare subsidies, the institute rejects the “universal option” often cited in public statements by the Prime Minister as his “desire for a universal childcare system.”

“In its 2024 report, the Productivity Commission concluded that a universal 90 per cent subsidy comes at a higher cost and does not prioritise families experiencing disadvantage,” the institute said in its report, titled Home Truths: The case for rebalancing toward better means testing.

The authors, including Ms Auster, Henry Williams, Indra Parta and Nicholas Tarrant, warned that subsidies around childcare have to be carefully considered given that most evidence shows a 1 per cent reduction in childcare costs is associated with an increase in maternal participation of only 0.02–0.29 per cent and hours worked of 0.02 to 0.65 per cent.

“Most estimates sit below 0.2 per cent, broadly consistent with international evidence,” the institute said.

"When the commonwealth government introduced the Child Care Subsidy in 2018, they indicated it would draw 230,000 families into more paid work. However, the impact was much more limited, with about one tenth that number reporting more work – and an overall 1.4 per cent increase in hours worked for single parents, and 0.3 per cent for (couples)."

The institute's redesign of childcare subsidies includes lifting the standard subsidy rate from 90 per cent to 95 per cent for the first child of families with income up to $133,000, which increases support (and reduces a barrier to work) for families more in need. It also tightens the income test at the top, so that the standard subsidy for the first child falls to 0 per cent when family income reaches $250,000, down from the current $535,000.

It also lifts the threshold for second and younger children, so that the higher subsidy remains at 95 per cent up to $250,000 before also falling to zero.

"This novel structure separates the phase-out for the first and second child rates to minimise the disincentive to work associated with paid childcare where it is strongest – for families with two children in paid care." The means test is expected to save $3.2bn.

On parental leave, the institute says the means test should lower the household income threshold for the full Parental Leave Pay entitlement from $373,000 to $200,000. It also recommends removing the separate individual income threshold, currently set at $180,000, so that households with incomes above the household income threshold cannot claim a substantial benefit.

On aged pensions, the institute recommends more equitable treatment of households with substantial equity in owner-occupied housing, by including the net value of owner-occupied housing above $500,000 in the assets test. It also wants to lift the asset test threshold for homeowners by $258,000 to match non-homeowners, removing the mechanism by which every retirees' home is accounted for in the current asset test.

On aged care, the institute wants better treatment between homeowners and non-homeowners by removing exemptions that exclude owner-occupied housing wealth from assets tests when the house is occupied by the recipient or a "protected person" such as their partner. It also wants to include value above $500,000 in assets tests, in line with our preferred option for the Age Pension.

A "Retirement Contribution Scheme", ReCS, has also been suggested which allows cash-poor, asset-rich retirees to borrow against their home equity to fund daily living expenses without being forced to sell their property.

The government provides these regular payments as an inflation-indexed loan, which is only repaid later when the home is eventually sold.

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