

# Family Policies, the Allocation of Talent, Productivity and Growth

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## Executive summary.

Matching workers to jobs that leverage their talents is a key driver of productivity and economic growth. The current patterns of female labour force participation in the UK are such that female talent is severely misallocated: most women with young children are either out of the labour force or employed in part-time jobs that are often below their skill level. A recent IFS report shows that gender wage gaps open up significantly once women have children and widen over the lifecycle, possibly due to missed promotions or simply less accumulation of human capital. While the average wage gap has fallen in recent years, it has actually been increasing for more educated women. These patterns are not driven by innate gender differences in talent or preferences: when they enter the labour market, women in the UK have similar occupational patterns and pay as their male counterparts.

This note reviews the main causes of this phenomenon, highlighting market failures that justify government action. In recent years, government has made effort to address these problems: the coalition government introduced new family policies, a key one being shared parental leave. However, so far take up has been low and evidence from other countries suggests that voluntary sharing is unlikely to have much impact. Increases in free child care apply only to 3 and 4 year olds, and good quality childcare will still be unaffordable for financially constrained families. We propose policies relevant for each stage of parenthood to help women (who want to) work in jobs that match their talent:

1. *Facilitating the return to work after childbirth* through a more balanced division of parental leave (“daddy months”) and measures to help families cover the costs of childcare, such as low interest loans for couples where both parents work full time.
2. *Maintaining career trajectory during childrearing years* through promoting more flexible practices at work (job shares, compressed weeks) and measures to maintain human capital.
3. *Helping women return to work after extended leave* through low interest loans to cover training programs or targeting this segment of the population for currently understaffed public sector positions (e.g. teaching and nursing), and better arrangements for care before and after the school day.

The potential gains of such policies are large. The OECD has estimated that equalising participation in the labour force could raise UK GDP by 10% in 2030 compared to projections where participation rates remain unchanged. Research from the US estimates that eliminating barriers that lead to misallocation of talent would increase GDP per capita by 15% (through better allocation of skills and participation): spread over 15 years this represents an additional 1pp of GDP per capita growth per annum.

Further growth effects could be expected if this implies that previously untapped innovative potential is now used, and social benefits are also likely (in terms of women’s fulfilment, understanding between partners, and wellbeing of children from more involvement of fathers). Whatever the precise magnitude of the effects, it is clear that they would be positive. Overall, the policies outlined in this note do not need to imply high cost to government, as the aim is to improve allocation.

## Background

Despite progress in recent decades, female engagement in the UK labour market remains low. While the female employment rate is around 66.6% (greater than the OECD average of 60.5%), and the gap with male employment is 9.6% (just under the OECD average of 11.9%<sup>1</sup>), the picture is much more imbalanced once we consider full time equivalents (FTE). The female employment rate is 52.4% for FTEs: and the gap nearly triples to 25.5% (now greater than the OECD average of 22.4%). So it is clear that lower working hours amongst women are important for understanding the gender gap – in addition to differences in participation. Similar gaps exist in wages. The gap in hourly wages between men and women is currently 18% (Costa Dias et al, 2016), again, above the OECD average of 15%.<sup>2</sup>

These patterns are not driven by innate gender differences in talent or preferences: when they enter the labour market, women in the UK have similar occupational patterns and pay as their male counterparts (see for example, Manning and Swaffield, 2008). Differences in participation and hours are largely driven by women with children. Mothers are more likely to stay out of work for extended periods during the child rearing years. And once back in work, women are more likely to go part-time: in couples with children, 50.2% of women work 1-29 hours per week, compared with the OECD average of 26.4%.<sup>3</sup> Career breaks and prevalence of part time work help explain wage gaps (Azmat, 2015). Moreover, the wage gap increases over the lifecycle (Costa Dias et al, 2016), suggesting that there is some kind of penalty in terms of human capital accumulation from being out of the labour force, or in part time work. In fact, evidence from Denmark (a country that offers generous family policies where today there is no gap in participation, but still a gender gap in earnings of around 20%) shows that most of the gender gap in earnings is explained by children – in fact that proportion has grown over time (Kleven et al., 2016).

There are significant gains to be made by raising female participation – the OECD has estimated that equalising the roles of men and women in the labour force could raise UK GDP by 10% in 2030 compared to projections where participation rates remain unchanged.

This is likely to underestimate the potential gains as it does not account for the misallocation of talent that occurs when workers are not matched to jobs where the return to their talent is largest. The issue is particularly relevant for women for three reasons: women are now outperforming men in most educational outcomes; part-time jobs that are more prevalent for women tend to be lower skill (high skill part-time jobs are harder to find); and even in full-time jobs women often take on less demanding roles due to difficulties combining these with home life.

Talent misallocation is extremely costly in terms of productivity. Hsieh et al (2013) estimate that 15-20% of growth in aggregate output per worker in the US (over 1960-2008) can be explained through better allocation of talent: mainly through the movement of women into high-skilled occupations. They estimate that eliminating the barriers that lead to the misallocation of talent would increase GDP per capita by a further 15%: spread over 15 years this represents an additional 1pp of GDP per capita growth per annum.

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<sup>1</sup> Source: OECD Employment Database 2014, Chart LMF1.6A.

<sup>2</sup> For more information on gender gaps in employment and pay, see the recent IFS report: Costa Dias et al (2016) and Azmat (2015)

<sup>3</sup> Source: OECD Family Database 2014, Chart LMF2.2.B

## Obstacles faced by mothers who would like to work

A recent survey carried out by the Department for Education found that 54% of non-working mothers would like to work if they could arrange good quality, affordable childcare.<sup>4</sup> Clearly not all mothers would like to work – but for the many who do, a number of institutional obstacles hold them back – either from working at all, or working in the types of jobs that leverage their talent:

- **Parental leave system:** In the UK, mothers can take up to 52 weeks of parental leave (the amount of this, and the extent to which this is paid varies by employer, subject to statutory minimum). Traditionally fathers have taken only 2. In recent years there have been efforts to promote sharing of leave between parents. Since 2011, as well as the standard two-week paid paternity leave, fathers were entitled to up to 26 weeks of paid “additional paternity leave” if the mother returns to work. From this year, employers must offer shared parental leave for children born after 1 April 2015.<sup>5</sup> So far, take-up rates have been low<sup>6</sup>, which is consistent with the evidence from other countries where voluntary schemes have had little effect (more discussion on this below). Certainly, under the status quo, mothers tend to be the default caregiver for the child’s first year. This imbalanced share of childcare duties in the first year gives mothers a comparative advantage in childcare for later years, generating further imbalances through parenthood.
- **Costs of childcare:** Childcare in the UK is expensive relative to other countries.<sup>7</sup> Given that women tend to be the default care giver in the early years – building up comparative advantage in this area (Becker, 1991) – it is they who tend to stay home beyond the maternity period, faced with childcare costs that they cannot afford in the short-term. There are a number of schemes in place that aim to reduce the costs (for example childcare vouchers), but navigating the system can be complex and often the support provided is still insufficient. The July 2015 budget announced free childcare would be doubled to 30 hours, however this only applies to 3 and 4 year olds and even then, additional care is often required.
- **Inflexibilities in the work place:** Many women find it difficult to combine the type of career for which they are qualified with the need (and desire) to care for their children. This is an issue for when women choose whether to work and what type of job to take. Inflexibilities in the way we work is also a source of discrimination, if women miss out on opportunities which their employers deem to be unsuitable for mothers (for example due to expected hours, requirements to travel). But more flexibility for male employees is as crucial. This would allow couples to share responsibilities at home and give women more opportunities at work.

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<sup>4</sup> Childcare and Early Years Survey of Parents, 2012-13, Department for Education, January 2014

<sup>5</sup> The main change is that parents have a flexible choice of how to split the 50 weeks of parental leave, following the initial 2 weeks which must be taken by the mother.

<sup>6</sup> The TUC reported in 2013 that only 1 in 172 fathers were taking advantage of “Additional Paternity Leave”, see: <https://www.tuc.org.uk/workplace-issues/just-one-172-fathers-taking-additional-paternity-leave>. Since the changes in 2015, a small scale survey of 70 employers revealed that take-up of shared leave is still low, see: <http://www.telegraph.co.uk/women/womens-business/11946167/Shared-parental-leave-Most-fathers-in-the-UK-arent-taking-it-up.html>

<sup>7</sup> See discussion by the OECD at:

<http://www.oecd.org/unitedkingdom/Closing%20the%20Gender%20Gap%20-%20UK%20FINAL.pdf>

Furthermore, dealing with these institutional obstacles could also help address societal norms that present further obstacles for women at work.

Traditional expectations that the man will be the primary breadwinner are still common. There is evidence that perceptions are changing over time. Fernandez et al (2002) show that male preferences contributed to the rising proportion of working and educated women in the US. It is argued that these preferences changed because some men experienced a family model where their mother was skilled and/or worked, and therefore chose to marry women with those characteristics.<sup>8</sup> Institutional change that encourages female engagement in the labour market should continue to change these perceptions. In addition, feelings of guilt are prevalent among working mothers: guilt towards children for potentially harming them by being away at work; and guilt at work that they are not doing enough. However, there is evidence that pre-school children can benefit from formal childcare settings (for example, Heckman 2007). Moreover, a recent study from Harvard Business School (McGinn et al, 2015) finds that daughters of working mothers are more likely to work, reach more senior positions and earn marginally more<sup>9</sup> – outcomes that would be considered desirable by many. Maternal employment had no effect on adult daughters' involvement in caring for family members (controlling for employment and hours worked), but sons of working mothers do spend more time on this. Institutional changes to help mothers work flexibly and effectively and afford good quality childcare should address both sources of guilt. These types of findings suggest that more gender equality in the work place can bring benefits not just for this generation, but the next as well.

### **Market failures**

A series of market failures justify the need for government action in this area.

First, policies that involve aggregate benefits to the economy and society are complex for individuals and firms to negotiate due to coordination failure. Family friendly workplace policies are an example of complementarities: that is the return to their implementation is increasing in the number of firms adopting them. All firms would be better off if every firm were to adopt family friendly policies (we reference some evidence below) but the returns from one firm adopting them alone could be low or even negative. Given that parents do not typically work in the same organisation, the first firm that offers flexible hours, say, will have employees overusing them because their partners will not have the option.

Second, credit market failures are relevant for families facing (short term) financial constraints which prevent women from returning to work. Families with young children cannot access affordable loans to cover child care costs because future income streams are uncertain, and banks that only cover a fraction of the market demand require large collateral or high interest payments to cover losses. Families with mortgages are unlikely to have much collateral on which to secure new loans. Since the aggregate effects of improved skill allocation are positive, the government is in a position to subsidise low earners with high earners (as in the case of graduate loans). Similar arguments are now conventional wisdom in the justification of support for investment in human capital.

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<sup>8</sup> Kleven et al (2016) look at the inter-generational transmission of the child wage penalty in Denmark. Women whose mothers worked very little compared to fathers incur a larger child penalty when once they are mothers.

<sup>9</sup> Regressions control for characteristics such as education. Results survive, though slightly weaker, even when prevailing gender attitudes are controlled for. They explain this as an additional effect of maternal employment, teaching daughters a set of skills that enable greater participation in the workforce and in leadership positions.

Third, many of the potential benefits we discuss go beyond increases in aggregate income, but are more intangible: for example, the wellbeing effects from women's fulfilment at work, men's exposure to their children first years, or children's exposure to the teachings of both parents. Markets for such benefits do not exist because property rights over these factors are not defined. Only the government is in a position to make sure these benefits are realised.

### **Policy recommendations**

It is desirable from a productivity and wider social perspective to create a system where both women and men can be good parents with more equality in the home and workplace. Government can achieve this with a holistic approach to parental leave, childcare provision and workplace flexibility to help remove barriers to women achieving their productive potential. It is important that women have real choices about whether and how they would like to work, and that both parents are able to more effectively combine work and home life. We consider policy objectives for the three stages of parenthood.

- *Keeping new mothers in work post childbirth* – how can we encourage women to remain in work after taking maternity leave? This has to involve more sharing of childcare responsibilities between partners and helping families to manage childcare costs.
- *Maintaining existing mothers' career trajectory during childrearing years* – how can we ensure that women continue to work at their skill level and maintain their career path, even during the years where they may wish to slow down temporarily? Promoting family friendly work practices and supportive mechanisms to maintain human capital and professional networks during these years can help.
- *Helping women return to work after extended leave* – how can we encourage women who have taken extended leave to return to work at an appropriate skill level? Being out of work for extended periods can have hysteresis effects like for the long term unemployed. Promotion of training is likely to help in this regard, and there is scope for government to target areas where known shortages exist.

Within this framework, more details are set out below.

### **Keeping women in work post childbirth**

#### **a. Use it or lose it “daddy months”**

We propose one “use it or lose it” daddy month. This could be added to the total leave allocation for a family - so that families are allowed 13 months from the birth of a child. This option is likely to be popular with families as it represents an additional benefit, but would imply some extra cost (depending on how the month is remunerated, see below for discussion). Alternatively, the total allowance could be kept fixed at 12 months with one month being lost if not taken up by fathers – clearly there may be some resistance to this policy from mothers, but it could be revenue neutral since total leave would remain the same.

The rate that the daddy month is paid needs to be given careful consideration and will vary by firm or sector as is currently the case with parental leave – it could be left to firms to

decide subject to a minimum at the statutory rate (SMP is currently 90% of earnings for the first six weeks, and then £139.58 per week for the next 33 weeks). But a fixed percentage of earnings for the daddy month, even when the mother has taken her six weeks would be more likely to incentivise uptake amongst men.<sup>10</sup> Therefore there is a case for remunerating this month at the same rate as the initial parental leave rate (90%), or a lower rate that is still attractive. Government could provide some reimbursement / tax incentive to firms for a transition period until such practices are common and accepted. Government would also have a coordination role, ensuring that firms are treating parents equally in their leave requests and pay. It would be important to emphasise to firms that while they may have additional cost for male employees, they should also retain more female employees – hence saving recruitment and other costs from staff turnover. Should this type of policy prove successful, scope for adding further months could be considered at a later date.

It is necessary to draw on the international experience (in particular from Sweden, the pioneer in this area, and where sound evaluations of policies exist – see for example Eckberg et al, 2013) and learn lessons on what is likely to work in the UK setting. Daddy months have been found to be effective in raising paternal leave in Sweden where men now take around 24% of total leave<sup>11</sup>, but they are paid at a high proportion of earnings (80%).<sup>12</sup>

#### **b. Subsidised loans for childcare costs**

Given failures in credit markets discussed previously, we propose subsidised loans for families where both parents work, to help cover the costs of good quality childcare. Spreading the costs of childcare over a longer time frame would help families who find that in the short term it does not make financial sense for the mother to return to work (this is particularly the case when this is on a part-time basis). This type of scheme can be designed to be revenue neutral with the government recouping support through income-contingent contributions from future income.<sup>13</sup>

Quality is important: excess demand for the best nurseries or childminders raises prices, and experienced nannies charge higher rates. Being able to afford good quality childcare will make families happier to have both parents at work. Indeed, there can be wider benefits for pre-school children being in nursery settings (particularly those from disadvantaged backgrounds – see for example Heckman, 2007)

#### **c. Support for grandparents as carers**

Grandparents are an important source of childcare support for families. 1 in 4 working families and 1 in 3 working mothers use grandparents for childcare.<sup>14</sup> Government has already recognised the importance of this role. The coalition government introduced

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<sup>10</sup> The TUC report into “Additional Paternity Leave” in 2013, considered that a key reason for low take up was that the statutory rate has rarely been topped up by employers- in contrast with the first two weeks of paternity leave that are almost always topped up.

<sup>11</sup> <https://sweden.se/quickfact/parental-leave/>

<sup>12</sup> In Sweden, leave may be taken until a child is 8, but we would recommend restricting it to the first 14 months in order to avoid the “hysteresis” effects discussed earlier (i.e. the concept the process by which people who are out of work for a sustained period of time suffer a disconnection from the labour market).

<sup>13</sup> See for example, see the proposal for National Childcare Contribution Scheme from the Social Market Foundation at <http://www.smf.co.uk/wp-content/uploads/2012/02/Publication-A-Better-Beginning-Easing-the-cost-of-childcare.pdf>

<sup>14</sup> For some government facts and figures on the role of grandparents in childcare, see: <https://www.gov.uk/government/news/looking-after-the-grandchildren-make-sure-it-counts-towards-your-state-pension>.

transferrable National Insurance credits to protect working-age grandparents' pensions where they are caring for a grandchild.<sup>15</sup> In October 2015 it was announced that shared parental leave and pay would be extended to grandparents in this bracket by 2018.<sup>16</sup> These policies are valuable for keeping both mothers and grandparents in the workplace.

### **Maintaining career trajectory during childrearing years**

#### **d. Promoting increased flexibility at work**

The government already allows employees to request flexible working, but employers may reject it if they have a strong business case. We consider that there is scope for government to go further in this area. Mothers who can work flexibly, or count on their partners to work flexibly are more likely to consider that work and family life can be effectively combined in some capacity. Academic research has shown that work life balance policies are correlated with firm productivity (Bloom and Van Reenen, 2006). There is also causal evidence that working from home increases productivity<sup>17</sup> (Bloom et al, 2015). This analysis is carried out on a cross section of firms, and does not capture the dynamic effects that could occur through better use of female skills.

Survey evidence<sup>18</sup> shows that while flexible working is relatively common in the UK: part-time work is the most commonly offered form of flexibility and this is typically only available for low-skilled activities.

Job sharing is an effective way to create part-time jobs at higher skills levels, for instance it is successfully used in some GP practices across the country, but just 1% of survey respondents job-share.

Moreover only 5% of employees have some form of compressed hours (e.g. spreading a five-day week over four days), practices such as meeting scheduling between 10 and 3 would allow parents to juggle work and drop-off/pick-up from school.

Policy levers to encourage these practices could include publishing policies considered best practice and accrediting firms that adhere to this, introducing tighter regulations about what firms should do where feasible from a sector perspective, or tax incentives for family friendly firms - even short term.

#### **e. Retainer schemes**

Some women may remain in work, but in a lower capacity during child rearing years - either going part-time, or taking on a less demanding role so that hours are more predictable. There should be measures for such women to maintain their human capital so that once they are ready to increase effort or hours, they will be less of a permanent scarring to their career trajectory. The GP retainer scheme targeted at women with young children to

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<sup>15</sup> Again, see: <https://www.gov.uk/government/news/looking-after-the-grandchildren-make-sure-it-counts-towards-your-state-pension>

<sup>16</sup> See: <https://www.gov.uk/government/news/chancellor-announces-major-new-extension-of-shared-parental-leave-and-pay-to-working-grandparents>

<sup>17</sup> Bloom et al (2015) study the impact of an experiment in a large, listed Chinese travel agency. Working from home led to a 13% performance increase, of which 9% was from working more minutes per shift (due to fewer breaks and sick days), and 4% from taking more calls per minute (attributed to a quieter and more convenient working environment).

<sup>18</sup> See [http://www.cipd.co.uk/binaries/5790%20Flexible%20Working%20SR%20\(WEB2\).pdf](http://www.cipd.co.uk/binaries/5790%20Flexible%20Working%20SR%20(WEB2).pdf)

provide educational support and the option of part-time work for about five years is a useful example. This type of scheme could be extended and applied to other sectors.

### **Helping women return to work after extended leave**

#### **f. Subsidised loans for training**

Women who have been out of the workplace may need to update their skills in their previous line of work (this is particularly the case given the fast pace of technological progress). While some firms recognise the potential in highly skilled women in this category and pay for the training, it could be beneficial to go on a course before the job search. Some may wish to retrain in a different area before re-entering the workforce. Future-income contingent, low interest loans would help women undergo this type of training.

Government could also offer extra support in areas where there are known shortages of high quality professionals such as nurses or teachers.

#### **g. More “wraparound” care**

Women in this category are likely to have school aged children and so provision of more “wraparound” care (i.e. before and after school hours - which currently is rather ad hoc) would make it easier to work. This type of facility uses existing infrastructure and should not imply significant extra cost.



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