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FEDERAL FINANCING OF CHILD CARE: ALTERNATIVE APPROACHES AND ECONOMIC IMPLICATIONS

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**Federal Financing of Child Care:
Alternative Approaches and
Economic Implications**

by

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Abstract

This paper surveys alternative approaches to financing child care at the federal level and discusses their economic implications with respect to female labor force participation, fertility, child care demand and supply, and poverty. The current system of federal support for child care is seen to consist of a series of overlapping programs that tend to create inefficiencies and inequities in the distribution of child care benefits. Four basic principles of an ideal child care system are outlined, and a general two-tiered system of support is proposed that would satisfy these four principles. The two-tiered system is centered on a refundable tax credit considerably more progressive than the current child care tax credit. A simulation analysis indicates that the proposed refundable tax credit would not cost much more than many of the more popular child care bills currently being debated in Congress.

Federal Financing of Child Care: Alternative Approaches and Economic Implications

1. INTRODUCTION

Child care is rapidly becoming one of the most important social issues of the 1980s. There are now over 25 million women in the United States with children under the age of 13 and more than three-fifths of them (close to 15 million) are in the labor force (Hayghe, 1986). In 1987, more than 70 bills (representing close to 50 distinct pieces of legislation) were introduced into Congress with provisions for child care. Versions of many of these bills (plus some new ones) were introduced in 1988 and 1989. The child care bills before Congress cover an enormous range of alternative options for providing federal support for child care. Because the child care needs of the population are so diverse, the problem of ensuring access to affordable, adequate child care for the more than 25 million children of working mothers represents a significant national challenge.

This paper surveys recent trends in labor force participation and child care, examines alternative mechanisms for financing child care at the federal level, and discusses the economic implications of government interventions now in use. Currently, a wide variety of government programs supply or subsidize child care, but there is no coordinated policy. This fragmented system has led to inefficiencies in the distribution of child care benefits. Furthermore, although government subsidies for child care have recently increased, most of the benefits have gone to middle- and upper-income families and the constant-dollar value of benefits for lower-income families has fallen. This represents a growing inequity in the distribution of child care benefits and may be contributing to a growing incidence of poverty among families with young children. It is argued in this paper that in order to achieve efficiency and equity in the distribution of child care benefits, a two-tiered system of federal support is needed. The first tier would use the tax system to provide child care benefits to all working families with children. The second tier would act as a "safety net" to provide child care benefits directly to chronically disadvantaged families who are either unable to take advantage of benefits through the tax system or who cannot find what they consider adequate-quality child care at low cost. Such a two-tiered system, coupled with the establishment of a federal agency responsible for coordinating national child care policies, would go a long way toward meeting U.S. child care needs.

The remainder of this paper is organized as follows. Section 2 gives a brief description of recent trends in female labor force participation, fertility, child care, and poverty, and discusses some of the economic forces influencing these trends. Section 3 discusses the economic rationale for government subsidization of child care and the likely economic effects of such subsidization. Section 4 discusses current federal involvement in the child care industry. Section 5 discusses interactions among the various components of the existing system of federal support and how such interactions lead to inequities and inefficiencies in the distribution of child care benefits. Section 6 summarizes the wide range of child care related legislation currently being debated in Congress. Section 7 discusses four elements of an ideal child care system. Section 8 proposes a suggested two-tiered system of federal support for child care and how it can be achieved within the current era of large federal deficits. Section 9 presents the major conclusions of the paper.

2. RECENT TRENDS IN FEMALE LABOR FORCE PARTICIPATION, FERTILITY, CHILD CARE, AND POVERTY

Recent Trends in Female Labor Force Participation

Ever since the turn of the century, labor force participation rates of women have been rising. Since 1970, the rise has been most dramatic for married women with children. In 1970, for example, the labor force participation rate of married women with children under 18 was less than the rate for married women with no children under 18 (39.8 percent versus 42.2 percent). By 1985, the rate for married women with children was substantially higher (61.0 percent versus 48.2 percent). Between 1970 and 1985, the labor force participation rate of married women with no children under age 18 rose by 14 percent; for married women with children between the ages of 6 and 17 it rose by 38 percent; and for married women with children under age 6 it rose by 77 percent. Even more dramatic is the rise for married women with newborn children. Between 1970 and 1985, the labor force participation rate of married women with children under 1 year of age rose by 106 percent.

A variety of factors are responsible for these recent increases in female labor force participation. According to Bergmann (1986), the most important has been rising wage rates. A vast economic literature has developed in the last decade documenting the sensitivity of married women's labor force participation to changes in wage rates (see, for example, Smith, 1980; and Killingsworth, 1983).[1] Women's wage rates have been rising primarily because of considerable investments in human capital (experience, education, and training). Coupled with these increased investments in human capital has been a rising technology in the production of goods and services in the home that has facilitated entry into the labor force. The advent of such modern labor-saving devices as microwave ovens and frozen dinners has enabled women to reduce the amount of time spent in performing necessary household chores and consequently increase the amount of time available for performing market work.

Other factors responsible for the recent increases in female labor force participation are the introduction and widespread use of the contraceptive pill (O'Connell and Bloom, 1987), the rising divorce rate (Johnson and Skinner, 1986), the tremendous growth in the service sector of the economy relative to the goods sector (service jobs tend to be more attractive to women because of the lesser physical demands), the reduction in stigma associated with leaving young children in the care of others (child care is now an accepted institution in America), the desire to cushion economic shocks caused by an unexpected loss of a job, and government subsidization of child care costs.[2]

While the labor force participation rate of women with young children has been increasing in recent years, it is interesting to note that the percentage of all labor force participants with children has actually been decreasing. Tabulations from the Current Population Survey (available from the author on request) indicate that parents represented a smaller portion of the total labor force in 1985 than they did in 1968, despite significant increases in labor force participation rates of women with children over this period. Such apparently contradicting trends are the result of a large influx of single persons into the labor force that has been swamping the increased labor force participation of mothers. Hence, although women are becoming a more dominant force in the labor market, parents are not. This may partly explain why the business sector has been slow in responding to the child care needs of parents (see section 5, below). However, as the pool of prime-aged workers is expected to shrink in the future because of the aging of the population, firms will likely be seeking ways, child care benefits being one of them, to induce greater numbers of young parents to join the labor force.

Recent Trends in Fertility

As the above discussion indicates, reduced fertility is one cause of the increased labor force participation of women. However, economists have also established that fertility itself is responsive to economic variables (Moffitt, 1984a; Cain and Dooley, 1976). Vital statistics published in U.S. Department of Commerce (1987a) indicate that in about 1976 the birthrate reversed an earlier downward trend and began to increase. It continued increasing until about 1980. Although no one knows for sure why birthrates rose during the late 1970s, it is possible that economic factors may have played a role. In particular, the growth in child care subsidies during this period may have induced some additional births. According to Blau and Robins (1989), child care subsidies reduce the "cost" of children, which in turn could induce greater fertility. Although the effect is likely to be small, it may not be entirely coincidental that birthrates began to rise the year after the Child Care Tax Credit was instituted and continued to drift upward slightly during years in which use of the tax credit increased substantially.[3]

Recent Trends in Child Care

Along with the rising female labor force participation rate and an increasing birthrate, there has been a corresponding growth in the child care industry. Between 1970 and 1980, the number of persons employed in child care grew by 84 percent (O'Connell and Bloom, 1987), while total employment grew by only 26 percent (Economic Report of the President, 1987). By 1980, according to Census Bureau figures cited by O'Connell and Bloom (U.S. Department of Commerce, 1984), 727,000 persons were employed as child care workers, 80 percent of whom worked in a setting outside the child's home. In 1970, over half of all child care workers were employed inside the child's home. According to the National Association for the Education of Young Children (NAEYC), licensed child care programs in the United States grew by 72 percent from 1977 to 1985 (NAEYC, 1985). NAEYC reports the existence of 229,000 licensed child care programs in 1985, consisting of 61,000 child care centers, 168,000 family day care homes, and 6,000 group homes.[4] Center growth was by far the largest, increasing by 234 percent between 1977 and 1985. According to Kahn and Kamerman (1987), the number of child care centers operated by Kinder-Care, the largest commercial provider of child care services in the United States, grew from 510 in 1980 to 1,040 in 1985. Kinder-Care now serves well over 100,000 children. Also contributing to center growth in recent years has been the proliferation of employer-sponsored care. According to Lydenberg (1986), just under 600 companies had on- or near-site child care centers in 1985.[5]

Household survey data on child care utilization patterns of families are consistent with the employment trends. Based on published data from four Census Bureau surveys, Table 1 records trends in child-care arrangements for children under the age of 5 from 1965 to 1985.[6] As this table indicates, the use of in-home care has been declining steadily since 1965. Moreover, there has been a significant increase in the use of licensed care. In 1965, only 6 percent of all young children were cared for in organized group facilities (centers, nursery schools, and preschools), virtually all of which are licensed. By 1985, 25 percent of all young children were cared for in these institutional settings. Similarly, in 1965, 32 percent of all young children were cared for in another home, whereas in 1985 this had grown to 38 percent. It is not known what proportion of outside home care is licensed, but it is likely to be quite small, given the fact that almost two-fifths of all child care is in this category. Fossburg (1981) estimates that about 6 percent of all family day care homes are licensed. Hence a rough guess would be that somewhere between 30 percent and 35 percent of children are currently cared for in licensed facilities as compared to between 10 percent and 15 percent twenty years ago.

The growth in licensed, institutionalized child care and the corresponding reduction in in-home care is the result of a variety of interacting social forces. Many of these forces are economic in nature. Hofferth (1987) reports that over the past decade, survey-reported costs of institutionalized child care have remained roughly constant in constant dollar terms while the costs of home care have risen significantly. This change in relative prices of child care could very well explain much of the shift toward center care. Of course, this

Table 1

Changes in Primary Child Care Arrangements for Children under 5, 1965-1985
(Percentage of children cared for)

	June 1965[a]	June 1977	June 1982	Winter 1984-1985	Percentage-Point Change 1965-1985[b]
<u>Informal</u>	94	87	84	75	-19
In Child's Home[c]	47	33	32	29	-18
Mother employed full time	47	29	27	23	-24
Mother employed part time	47	42	41	39	-8
In Another Home	32	42	42	38	+6
Mother employed full time	37	48	46	43	+6
Mother employed part time	17	30	36	30	+13
By Mother	15	11	10	8	-7
Mother employed full time	7	8	7	5	-2
Mother employed part time	32	18	15	14	-18
<u>Formal</u>	6	13	16	25	+19
In Day Care Center	n.a.	n.a.	10	15 n	+5
Mother employed full time	n.a.	n.a.	12	18	+6
Mother employed part time	n.a.	n.a.	5	10	+5
In Nursery School/Preschool	n.a.	n.a.	6	10	+4
Mother employed full time	n.a.	n.a.	8	12	+2
Mother employed part time	n.a.	n.a.	3	6	+3

Sources: 1982 and 1984-1985 figures are from the U.S. Department of Commerce (1987b; Table 3); 1965 and 1977 figures are from the U.S. Department of Commerce (1982; Tables A-4, A-7).

n.a. Not available by separate category.

[a]1965 figures are for children under 6.

[b]Changes for day care center and nursery school/preschool are from 1982 to 1985.

[c]Includes care by father, when present in household.

raises the question of why constant dollar costs of center care have not risen in recent years while constant dollar costs of in-home care have. One possible reason is that the supply of in-home providers has been decreasing, forcing up the price of such care. As greater numbers of women enter the labor force, fewer relatives, neighbors, and friends are available to provide in-home care (Burud, Aschbacher, and McCroskey, 1984).[7] Another possible reason may be the availability of direct subsidies for center care. From 1965 to 1975, there was a growth in "supply"-based subsidies. Supply subsidies are funds distributed directly to the providers of child care services, such as through Title XX and other programs. These subsidies undoubtedly helped keep down the "net" cost of child care centers to the family, which in turn generated an increase in the demand for center care. In the past decade, however, supply-based subsidies have been declining in constant dollar terms, but the demand for center care has continued to increase. This may be partly explainable by the recent growth in "demand"-based subsidies. Demand subsidies are funds distributed to consumers, either directly through the use of vouchers or cash grants or indirectly through the tax system. As indicated earlier, in 1976 the Child Care Tax Credit was instituted and has been subsequently liberalized on several occasions. In addition, other tax legislation that made child care a nontaxable benefit to employees has led to a proliferation of employer-based subsidies. A study by Robins and Spiegelman (1979) finds that demand-based subsidies generate an increase in the use of institutionalized child care. Finally, the rising wages of women have also probably contributed to the growth in institutionalized child care. Morgan

(1981) and Lehrer and Kawasaki (1985), for example, find that as family income increases the use of institutionalized child care also increases.

Recent Trends in Poverty

As indicated above, although there has been considerable growth in child care subsidies through the income tax system (demand-based subsidies), there has been an actual decline in supply-based subsidies. A study by the Congressional Budget Office (U.S. Congress, 1978, Table 10) shows that most supply-based subsidies are received by low-income families and that few low-income families are eligible for tax-based subsidies. Hence, a disproportionately larger share of federal child care dollars has been going to middle- and upper-income families in recent years, and consequently there has been a growing inequity in the distribution of federal child care benefits. Perhaps not coincidentally, there has also been a significant rise in poverty during the past decade (U.S. Department of Commerce, 1987c). While the causes of poverty are quite complex (see Danziger and Plotnick, 1986), the decline in constant dollar child care benefits to low-income families, inasmuch as it has prevented the family head from working because of a lack of affordable child care, may have played a small role.

The increase in poverty during the past decade is especially troublesome because a growing segment of the poverty population is composed of young children in single, female-headed families. This "feminization" of poverty has resulted from both an increasing incidence of poverty among single-parent families (due primarily to reduced transfer program benefits, including child care) and an increasing incidence of single-parent families (due primarily to an increasing divorce rate and an increasing rate of illegitimacy).[8] In 1959, there were 2.5 million female-headed families with children, representing 9 percent of all families with children. By 1983, female-headed families totaled 6.6 million, or 20 percent of all families. The poverty rate among female-headed families was an astonishing 56 percent in 1983, compared to a rate of 13 percent for other types of families (U.S. House of Representatives, 1985).

The principal reason for such a high poverty rate among female-headed families is a low level of earnings, attributable to both a low level of work effort and a low net wage rate.[9] Hence, it would appear that increased child care benefits could play a role in alleviating poverty for this group by encouraging work and increasing net wage rates. In a recent study, Robins (1988) finds that provision of low-cost child care services to public housing residents has a substantial effect on the likelihood these families will achieve economic self-sufficiency. Congress seems to recognize the importance of child care as part of an overall antipoverty policy. The recently enacted Family Support Act of 1988 contains a significant child care component, essentially guaranteeing child care services to welfare recipients who obtain employment.

3. WHY SUBSIDIZE CHILD CARE?

Before examining alternative approaches to financing child care, it is useful to ask the rather basic question, "Why subsidize child care?" After all, it could be argued that child care is simply another commodity available for purchase by consumers and the decisions to have children, work, and purchase child care are all voluntary ones; therefore there is no economic justification for treating child care differently from other commodities.

This argument is deficient for two reasons. First, subsidization of child care may be cost-effective for the government, particularly if utilized in conjunction with other antipoverty policies. As indicated above, lack of adequate low-cost child care is a barrier to employment for many welfare recipients. By providing child care for welfare recipients who are either working or are in training, the dollar savings in future welfare costs (due to increased earnings and eventual economic independence) may exceed the dollar costs of the child care being subsidized. While no one has yet performed a formal study testing this conjecture, it seems likely that an argument can be made for the cost effectiveness of subsidizing child care for welfare recipients.

But what about child care subsidies for families that are not receiving welfare benefits? Again, it is possible to provide an economic justification, based on the argument that some working parents lack information about the quality of care their children are receiving and that this care may be of inadequate quality. Subsidization induces these parents to increase expenditures on child care and presumably increase the quality of care being purchased. Because raising children has benefits that accrue to individuals beyond the family, government subsidization is warranted. While we do not know the extent to which parents lack information about the quality of care their children are receiving, or whether such care is actually of low quality relative to what is socially desirable, if society is risk averse, then subsidizing child care services purchased by families with working parents will make society better off.

Given that subsidization is warranted, two important questions still remain. First, who benefits from child care subsidies? Second, in what form should the subsidies be distributed--demand or supply subsidies? These questions are briefly discussed, in turn.

Implicit in most discussions of child care subsidies is the assumption that families (consumers of child care) are the main beneficiaries. In fact, if they are not, then the case for subsidization is probably weakened considerably. Whether or not the family benefits from child care subsidies depends on the elasticities of supply and demand. If the supply of child care is relatively elastic, then families will be the main beneficiaries of either demand or supply subsidies. If the demand for child care is relatively elastic, then the suppliers of child care services will be the main beneficiaries.

A recent study by Blau (1989) investigates the incidence of child care subsidies. Blau finds that, regardless of the type of subsidy (supply or demand), families are the main beneficiaries. In other words, Blau's results are consistent with the notion that the supply of child care services is very elastic. Blau's results strengthen considerably the case for government intervention.

It is not clear whether demand or supply subsidies benefit the family the most. In general, most economists tend to advocate mechanisms that allow the greatest amount of individual choice, consistent with the way the private market system operates. Usually, but not always, individual choice tends to be greatest with demand subsidies. Hence, subsidies such as tax credits or unrestricted vouchers may be the preferred approach over alternatives such as direct subsidies to day care centers, because with tax credits and vouchers families are able to benefit regardless of the type of child care arrangement chosen.

4. RECENT TRENDS IN FEDERAL SPENDING FOR CHILD CARE

The current system of federal support for child care is quite diverse and fragmented. A large number of federal programs provide some form of child care assistance, but it is difficult to obtain precise figures on direct expenditures for child care because many of the programs do not identify separately the child care component. One of the consequences of such a fragmented system is that benefits often overlap, creating perverse incentives for families.

Stephan and Schillmoeller (1987) identify 22 separate federal programs that currently provide some form of child care assistance. These programs are listed in Table 2, along with the original authorizing legislation (arranged chronologically) for each program and a brief description of the form of child care assistance. As Stephan and Schillmoeller point out, the programs vary considerably in terms of the types of services provided, the form and intent of the federal financial assistance, the eligible population, and the child care standards required for assistance. For only a few programs are Stephan and Schillmoeller able to identify expenditures specifically for child care.

Although child care assistance comes in a variety of forms, it is convenient to categorize it as either supply subsidies or demand

Table 2

Selected Federal Programs Providing Child Care Assistance, 1987

	Program	Original Authorizing Legislation	Type of Assistance
1.	Child Welfare Services	Title V, Social Security Act, 1935 (under Title IV-B since 1967)	Child care services
2.	Child Care Food Program	Section 17, National School Lunch Act of 1946	Food for licensed child care facilities
3.	Child Welfare Research and Demonstration Projects	Title V, Social Security Act Amendments, 1960 (under Title IV-B since 1967)	Funds for research and demonstration projects in field of child care
4.	Child Welfare Training	Title IV-B, Social Security Act Amendments, 1962 (under Title IV-B since 1967)	Funds for training child care workers
5.	Aid to Families with Dependent Children	Title IV-A, Social Security Act, 1962	Work-expense benefit for child care
6.	Food Stamp Program	Food Stamp Act of 1964	Work expense benefit for child care
7.	Area Economic and Human Resource Development Program (formerly Jobs and Private Investment Program)	Appalachian Regional Development Act of 1965	Child care services
8.	Head Start	Economic Opportunity Act of 1966	Child care services
9.	Special Milk Program	Section 3, Child Nutrition Act of 1966	Milk for licensed child care facilities
10.	Work Incentive Program	Title IV-C, Social Security Act Amendments, 1967	Child care services

(Table, Continues)

Table 2 (continued)

Program	Original Authorizing Legislation	Type of Assistance
11. Child Care as a Business Expense	Section 162, Internal Revenue Code, 1973	Tax deductions for child care services provided by businesses
12. Social Services Block Grant (SSBG)	Title XX, Social Security Act, 1974 (made a block grant in 1981)	Child care services
13. Community Development Block Grant	Title I, Housing and Community Development Act of 1974	Child care services
14. Child and Dependent Care Tax Credit	Section 21, Internal Revenue Code, 1976	Tax benefits for child care (a deduction prior to 1976)
15. Indian Child Welfare Act	Title II, Indian Child Welfare Act of 1978	Child care services
16. Community Services Block Grant	Omnibus Budget Reconciliation Act of 1981	Child care services
17. Accelerated Cost Recovery System	Section 168, Internal Revenue Code, 1981	Business-provided child care center eligible for accelerated depreciation
18. Dependent Care Assistance Programs	Section 129, Internal Revenue Code, 1981	Tax benefits for child care
19. Dislocated Workers Program	Title III, Job Training Partnership Act of 1982	Child care services
20. Job Training Partnership Act	Title II-A, Job Training Partnership Act of 1982	Child care services, child care training
21. Child Development Associate Scholarship Program	Human Services Reauthorization Act of 1986	Scholarships to candidates for child development associate credential
22. Dependent Care Planning and Development	Human Services Reauthorization Act of 1986	Child care services

Source: Adapted from Stephan and Schillmoeller (1987).

subsidies. Examples of supply subsidies are the Head Start program, direct subsidization of child care facilities under the Title XX Social Services Block Grant program, and the Child Care Food program. Examples of demand subsidies are voucher programs under Title XX, the Child Care Tax Credit, Dependent Care Assistance programs, and the work expense disregard under the AFDC and Food Stamp programs.

Some programs offer a mixture of supply and demand subsidies. For example, Kahn and Kamerman (1987, p. 98) describe a Title XX program in Florida in which families choose the child care provider and the state then reimburses the facility directly. This approach exemplifies the increasing trend under Title XX to expand consumer choice by placing greater reliance on demand-type subsidies. In fact, most child care funds are now being distributed in the form of demand subsidies, consistent with the emphasis on "privatization" by the Reagan and Bush administrations. However, demand subsidies vary considerably in terms of restrictiveness of consumer choice. In some cases, families must use specific types of licensed child care facilities in order to qualify for benefits; in other cases, considerable consumer choice is allowed. For example, in-home care is not generally eligible for subsidization under Title XX, whereas it is under the Child Care Tax Credit. Hence, blanket categorization of demand subsidies as representing an expansion of consumer choice relative to supply subsidies can be misleading.

Table 3 presents estimates (based on a variety of sources) of changes in federal spending under the ten largest programs for the 1977-1988 period. In 1977, the largest source of federal funding for child care was the Title XX program, which represented close to 40 percent of the total. By 1988, however, Title XX comprised only about 10 percent

Table 3

Federal Spending for Child Care, 1977-1988

Program	Administering Agency	Federal Spending (millions of dollars) 1977	1980	1984	1988
Title XX (Social Services Block Grants)	Department of Health and Human Services	809[a]	600[c,d]	535[c]	660[g,h]
Head Start	Department of Health and Human Services	448[a]	735[c]	996[c]	1,206[g,h]
Area Economic and Human Resource Development Program	Appalachian Regional Commission	9[a]	11[d]	1[e]	0[g,h]
Child Care Food Program	Department of Agriculture	120[a]	217[c]	357[e]	586[h]
Job Training Partnership Act	Department of Labor	--	--	9[c]	9[g,h]
Aid to Families with Dependent Children (work-expense disregard)	Department of Health and Human Services	84[a]	60[c]	35[c]	44[g]
Work Incentive Program	Department of Health and Human Services	57[a]	115[c]	13[c]	9[g]
Food Stamps (dependent care deduction)	Department of Agriculture	35[f]	35[f]	35[f]	50[f,g,h]
Tax Exclusion for Employer-Provided Child Care	Internal Revenue Service	--	--	40[c]	65[g,h]
Subtotal		1,527	1,738	2,021	2,629
(1988 dollars)		(,977)	(2,492)	(2,299)	(2,629)
Child Care Tax Credit	Internal Revenue Service	521[b]	956[b]	2,649[b]	3,920[g,h]
Total		2,048	2,694	4,670	6,549
(1988 dollars)		(3,993)	(3,862)	(5,312)	(6,549)

(Table, Continues)

Table 3 (continued)

Note: Data are for the fiscal year except for the Child Care Tax Credit, which is measured over the calendar year. Minor programs listed in Table 2, for which data are not available, have been excluded.

Sources:

[a]U.S. Congress (1978; Table 9).

[b]U.S. Department of Treasury (1977, 1980, 1984).

[c]Private communication from William Prosser, Department of Health and Human Services.

[d]Kahn and Kamerman (1987; Table 1.8).

[e]Stephan and Schillmoeller (1987).

[f]Based on quality control data from the Food and Nutrition Service, courtesy of Julie Isaacs, Congressional Budget Office.

[g]Besharov and Tramontozzi (1988).

[h]U.S. Department of Labor (1988).

of total spending. There are two reasons for this dramatic change. First, the Omnibus Budget Reconciliation Act of 1981 (OBRA) amended Title XX to create the Social Services Block Grant, eliminating the separately funded Title XX social services program. Total Title XX funds were cut by about 20 percent and states were given considerable flexibility in allocating program expenditures. As a consequence, Title XX spending for child care declined by almost 60 percent in constant dollars from 1977 to 1988. Second, over the same period, the Child Care Tax Credit expanded greatly, increasing by a factor of more than 7.5 from 1977 to 1988 (a factor of almost 4 in constant dollars). This expansion was the result of liberalized provisions and increased use by eligible families. By 1988, the Child Care Tax Credit had become the dominant form of government subsidization of child care, representing about 60 percent of all federal spending for child care, up from 25 percent in 1977.

As Table 3 indicates, spending has increased significantly in only four programs. These are Head Start (which was generally insulated from the 1981 budget cuts but only provides half-day care in most instances), the Child Care Food Program (which was initially cut but later expanded), employer subsidies, and the Child Care Tax Credit. These four programs currently account for almost 90 percent of all current federal spending for child care. Excluding the Child Care Tax Credit, federal spending for child care declined by almost 12 percent in constant dollars from 1977 to 1988. Because most of the child care benefits accruing to low-income families are from programs other than the tax credit, there has been a decided shift in the distribution of federal child care benefits. The Congressional Budget Office (U.S.

Congress, 1978; Table 10) estimated that in 1977, 60 percent of all non-tax-related child care benefits accrued to low-income families, while less than 1 percent of the tax-related benefits accrued to these families. Hence, although federal spending for child care has risen by almost 65 percent in constant dollar terms since 1977, virtually all of the increased benefits have gone to middle- and upper-income families.

The increased spending for child care under the Child Care Tax Credit has been the result of more extensive use of the credit by the working population rather than greater subsidies per family. Table 4 shows how use of the tax credit has changed since its inception in 1976. First, in 1982 the tax credit was increased to 30 percent for low-income families and was reduced gradually on a sliding-scale basis to 20 percent for families with incomes above $28,000. Prior to this the credit was a flat 20 percent for all families. Second, also in 1982, the maximum amount of child care expenses to which the credit could be applied was increased from $2,000 to $2,400 for one child and from $4,000 to $4,800 for two or more children. Third, and perhaps most important, in 1983 the credit was added to the short income tax form (1040A), which extended coverage to more low-income families.

As Table 4 indicates, the 1982 changes had only a minor effect on utilization of the credit, although it did significantly increase the average credit per family (from $325 to $367 in 1988 dollars). The changes were not enough, however, to make up for the inflation that had occurred since the late 1970s. As the first two columns of figures indicate, even though the credit was increased from 20 percent to 30 percent for low-income families, the maximum constant dollar benefit for this group was only 6 percent higher in 1982 than it was in 1976 ($1,763

Table 4

Use of the Child Care Tax Credit,
1976-1988

Year	Maximum Credit Available for Two or More Children[a]		Number Claiming Credit (Thousands)	Percentage of Total Returns Claiming Credit[d]	Number Claiming Credit as a Percentage of Families with Working Mothers[e]	Total Amount of Credit ($ millions)[a]	Average Credit per Family[a]	Average Credit as a Percentage of Average Tax Liability[f]
	Poor[b]	Nonpoor[c]						
1976	$1,660	$1,660	2,660	3.9%	18.2%	$ 951	$358	7.7%
1977	1,559	1,559	2,875	4.2	18.9	1,016	353	7.2
1978	1,449	1,449	3,431	4.7	21.5	1,185	346	6.8
1979	1,301	1,301	3,833	5.2	23.3	1,291	337	7.0
1980	1,147	1,147	4,231	5.6	24.5	1,371	324	6.7
1981	1,039	1,039	4,578	5.8	25.6	1,491	325	6.7
1982	1,763	1,175	5,004	6.3	27.9	1,838	367	8.4
1983	1,708	1,139	6,367	7.9	35.2	2,433	382	9.3
1984	1,638	1,091	7,546	8.9	40.4	3,012	399	9.7
1985	1,581	1,054	8,445	9.8	44.3	3,374	400	9.5
1986	1,551	1,034	9,228	10.7	n.a.	3,674	398	9.4
1987	1,491	994	n.a.	n.a.	n.a.	3,600	n.a.	n.a.
1988	1,440	960	n.a.	n.a.	n.a.	3,920	n.a.	n.a.

Sources: U.S. Department of the Treasury (1976-1985); U.S. Department of Labor (1985).

Note: n.a. = not available

[a] Expressed in 1988 dollars, using the Consumer Price Index.
[b] Those eligible for maximum credit (20% until 1982, 30% thereafter).
[c] Those eligible for minimum credit (20%).
[d] Denominator is number of returns with positive tax liability before credit.
[e] Working mothers in one- and two-parent families with children under the age of 18.
[f] Average tax liability measured before credits.

in 1982 versus $1,660 in 1976). For middle- and upper-income families, the maximum constant dollar benefit fell by 29 percent (from $1,660 to $1,175), despite the increase in qualifying expenses. Hence, although the average credit per family in 1982 was 13 percent higher than in 1981, it was only 3 percent higher than in 1976. The addition of the short form in 1983 had a significant effect on the number of taxpayers using the credit, but had little effect on the size of the average credit.

Overall, then, from 1976 to 1988 child care subsidies through the Child Care Tax Credit increased by 412 percent in constant dollars. This increase came about primarily because of more extensive use by eligible families. It is estimated that the percentage of families with working mothers using the credit increased from 18.2 percent in 1976 to 44.3 percent in 1985.[10] In contrast, the average constant dollar credit per family increased by only about 11 percent from 1976 to 1986.

5. INTERACTIONS AMONG PROGRAMS

The diverse and fragmented child care system in the United States has created significant overlaps and interactions among programs that can lead to perverse decision-making on the part of families. Lewis (1983) examined the effects of some of these interactions in Pennsylvania before and after OBRA. In his analysis, the choices faced by families involved private day care (the expenses for which were eligible for subsidization under AFDC, food stamps, and the Child Care Tax Credit) and public day care (funded under Title XX). The interactions arose because federal tax withholdings were deducted from earned income in determining the AFDC grant, Title XX payments were based on family income, and the AFDC grant had to be included in income used to calculate the food stamp benefit. Generally, Lewis found that the interactions among the programs made it financially desirable to utilize publicly funded child care facilities at some income levels and privately funded child care facilities at other income levels. Hence, if income were to change over time, families might be induced to change child care arrangements in order to maximize their subsidy from the government. If stability of child care arrangements is important to a child's overall emotional well-being, then such a system of overlapping benefits is socially undesirable.

More recent tax legislation has created additional complications and inequities in the distribution of federal child care benefits. These pertain to use of the tax system to provide employee benefits in the form of flexible spending accounts (FSAs) and the Tax Reform Act of 1986. As described by Friedman (1985) and Burud, Aschbacher, and McCroskey (1984), an FSA is a reservoir of funds upon which employees can draw to pay for certain expenses, including child care. The FSAs are almost always funded through salary-reduction plans, rather than through employer contributions, because salary-reduction plans are costless to employers (but not to taxpayers). Because the funds accumulated in FSAs escape taxation, the family receives a subsidy from the federal government equal to the taxes saved as a result of the voluntary salary reduction. In fact, employers are also subsidized, because they do not pay social security or federal unemployment insurance taxes on the reduced salary amount. Although it is estimated that only about 800 firms provided child care benefits in the form of

FSAs in 1985 (Lydenberg, 1986), the number has been increasing rapidly and should continue to increase in the future as parents become a growing fraction of the labor force. Because there are more than five million business concerns in the United States, and more than 44,000 have 100 employees or more, this form of child care benefit could expand enormously.

Currently, the maximum child care expenses that can be applied to FSAs is $5,000 per year. If the family is in the 15 percent tax bracket and applies for and spends the total allotted amount, the family will receive a child care subsidy of $750 (excluding savings in social security taxes). If the family is in the 28 percent tax bracket, it will receive a subsidy of $1,400. Hence, unlike the Child Care Tax Credit, which is progressive (higher percentage subsidies to lower-income families), FSAs are regressive (higher percentage subsidies to higher-income families). The regressivity of FSAs is even more pronounced because most low-income families do not currently work for firms providing such benefits.

An additional complication is created by the fact that employees qualifying for an FSA can also make use of the Child Care Tax Credit. Prior to 1989, the two programs were additive, meaning that portions of an employee's total child care expenses could be applied to either program (although the same portion could not be applied to both programs). This meant that the limits imposed by each program on allowable expenses (and hence the maximum subsidy) were not really binding, because if an employee had expenses in excess of the limits of either program, the employee could use both programs to obtain a greater subsidy. Hence, the programs interacted in a way that defeated somewhat the objectives of each program individually. Moreover, the optimal allocation of expenses between the two programs was not always obvious and depended, among other things, on the employee's tax bracket and the number of children.

The complex interaction between the Child Care Tax Credit and FSAs was eliminated to a large extent by a provision in the 1988 Family Support Act. Under the new law, the amount of expenses eligible under the Child Care Tax Credit are reduced dollar-for-dollar by amounts claimed under an FSA. Hence, if an employee now sets funds aside for an FSA that exceed the limits allowed under the tax credit, the employee is not eligible for a subsidy under the tax credit. However, for lesser amounts both programs can be used.[11] Whether or not this new law can be rigorously enforced remains to be seen.

The Tax Reform Act of 1986 has added still further regressivity to the system of tax-related child care benefits. Currently, the Child Care Tax Credit is nonrefundable, which means that it is limited to the amount of the individual's tax liability.[12] The 1986 Tax Reform Act reduced taxes for most low-income families. As a consequence, many of them will lose part of their child care subsidy. To illustrate, Table 5 shows the estimated change in tax liability and loss in tax credit for families in each income decile.[13] As this table indicates, the tax credit loss is greatest for families with incomes between $10,000 and $16,000. For these families the subsidy is now about 30 percent lower on average than it was before the Tax Reform Act. The entire loss in the tax credit is concentrated among families with incomes below $16,000, the bottom three deciles of the income distribution. It is

Table 5

Changes in Average Tax Liability and Estimated Loss in Child Care Tax Credit as a Result of the Tax Reform Act of 1986

Income Decile[a]	Estimated 1988 Average Tax Liability[b] Before Change in Law	After Change in Law	Average Change in Tax Liability	Percentage of All Taxpayers in Decile Taking the Child Care Tax Credit	Average Child Care Tax Credit before Change in Law[c]	Average Loss in Child Care Tax Credit[c]	Aggregate Loss in Child Care Tax Credit[d] (millions)
$0 - $6,274	$ -9	$ -18	$ -9	.1%	$ 53	$ 9	$ .1
$6,275 - $10,492	46	-1	-47	3.9	277	47	29.7
$10,493 - $15,763	353	219	-134	7.2	453	134	134.4
$15,764 - $21,612	929	740	-189	8.8	448	0	0
$21,613 - $28,041	1,685	1,456	-229	10.5	384	0	0
$28,042 - $35,752	2,660	2,384	-276	12.3	347	0	0
$35,753 - $44,765	3,911	3,493	-418	13.6	354	0	0
$44,766 - $56,658	5,558	4,900	-658	13.7	382	0	0
$56,659 - $75,569	8,180	7,428	-752	12.4	416	0	0
$75,570 +	19,566	18,911	-655	6.2	480	0	0

Sources: Adapted from Weinberg (1987) and U.S. Department of the Treasury (1984).

[a] Income includes employer contributions to health insurance, pension plans, and legally required benefits.

[b] Average is over all taxpayers and is before child care tax credit.

[c] For those taking the credit.

[d] Average loss times estimated number of persons taking the credit.

estimated that the Tax Reform Act will eliminate roughly $164 million in child care subsidies for the poorest 30 percent of families.[14]

The above examples illustrate how a fragmented system of overlapping child care subsidies can create inefficiencies, inequities, and perverse incentives. From a public policy standpoint, it appears to make more sense to develop a system in which the benefits complement one another, rather than interact in a way that leads to a situation (such as regressivity) that may be inconsistent with overall national objectives. In the remainder of this paper, some of the alternatives currently being debated in Congress are discussed and some recommendations are offered on how the current system can be improved.

6. ALTERNATIVES BEING DEBATED IN CONGRESS

Child care legislation was introduced at a frenetic pace in 1987, when more than 70 bills (representing close to 50 distinct pieces of legislation) were introduced into Congress. Many bills called for increased spending under existing programs, while others created new programs. The bills covered virtually every aspect of financing, from tax credits to service delivery. In the tax area, for example, bills were introduced to make the Child Care Tax Credit refundable, to make it more progressive, and to phase it out at high incomes to finance a system of child care vouchers. There were bills to expand employer subsidies by establishing a tax credit for employer-sponsored child care and requiring cafeteria plans[15] to provide a child care option. In the service-delivery area, numerous bills dealt with child care problems of special groups. Several bills called for subsidized child care for welfare recipients participating in new or existing work and training programs; others requested child care funds for residents in public housing, disadvantaged youth, participants in an English literacy program, dislocated workers, college students from disadvantaged backgrounds, unemployed individuals, students in health care education programs, and persons receiving foster-parent training. Other bills called for restoring cuts in Title XX funding and increased funds under Head Start and child-care-related food programs. Other bills provided funds for improving state licensing and regulatory systems, and several call for the establishment of a federal agency responsible for coordinating national child care policy. There was even a bill to establish a national lottery to assist in financing child care under the Title XX program. The most comprehensive bill introduced in 1987 was the Act for Better Child Care Services (ABC). It called for $2.5 billion per year to fund a broad range of child care services. This bill was supported by more than one hundred national activist groups (members of a coalition known as the Alliance for Better Child Care) and had more than two hundred cosponsors in both houses of Congress. Although the original bill did not become law, a compromise version was reintroduced in 1989 and is pending as of this writing, along with several other new initiatives, including a tax credit bill supported by the Bush administration.

Virtually all of the child-care legislation being proposed would require additional federal spending. This poses a problem during an era of large federal deficits. Nevertheless, it should be pointed out that in comparison to other social programs, current expenditures on child care are extremely modest. In 1988, federal child care expenditures of

$6.5 billion represented under 4 percent of total federal spending on education, training, employment, social services, and income security (excluding spending on Medicare, other health programs, and Old Age, Survivors, and Disability Insurance). Thus, it would appear there is some justification for reorienting national priorities to increase the federal commitment to child care.

7. ELEMENTS OF AN IDEAL CHILD CARE SYSTEM

Most of the recent child care initiatives introduced into Congress represent patchwork reform that would tend to perpetuate the inefficiencies and inequities of the existing system. Although numerous polls reveal that the American public favors a major federal commitment to child care, reform has yet to be enacted. Both Congress and the public appear confused about what constitutes meaningful reform.

With child care currently being given center stage in the policy arena, it would appear useful to delineate what would constitute an ideal system. From an economic standpoint, it is possible to identify four basic principles of an ideal child care system. These include:

1. <u>Flexibility</u>: Benefits should not be tied to any particular child care arrangement (as they often are today) to ensure freedom of choice and to recognize the diverse needs of the population.
2. <u>Equity</u>: Poorer families should receive a greater share of benefits than richer families.

3. Simplicity: The system should not consist of overlapping programs that interact in a manner that is difficult both to understand and to administer.

4. Target Efficiency: Monies spent on child care should go directly to families rather than being filtered through a bureaucratic maze.

With these four principles in mind, some minor changes could be made to the existing child care system to make it more efficient and equitable, and perhaps eliminate the need to introduce new programs. Although the two-tiered system described below would require additional federal spending, suggestions are made for how this additional cost could be offset by reductions elsewhere in child care spending.

8. A SUGGESTED TWO-TIERED SYSTEM OF FEDERAL SUPPORT

The first tier of the proposed system would provide child care benefits for all working families with children. In my view, the most efficient way to provide these benefits is through the Child Care Tax Credit. Because the tax credit currently provides benefits in an inequitable way, it must be adjusted. One adjustment that would contribute greater equity is to make the credit refundable and more progressive. To help pay for the expansion of the tax credit, I would recommend repealing the provision of the Internal Revenue Service Code Section 129 that makes child care a tax-free benefit to employees (the so-called flexible spending accounts), and I would recommend phasing the tax credit out at very high incomes. The reason for eliminating the tax advantages for flexible spending accounts is not because they are undesirable, but because they overlap in an inefficient manner with the tax credit and add to the regressive treatment of low-income families under the current system. Employers would still have the option of offering flexible spending accounts, but they would have to be financed by employer contributions and would be taxable benefits to employees. In this sense such child care benefits would be equivalent to higher wages.

A comparison of the current tax credit and the proposed alternative is given in Table 6. Ideally, an initial refundable tax credit of somewhere around 80 percent, gradually reduced to zero at around $60,000, would seem to be a politically feasible goal. To maintain the current tax advantages created by the combined credit and flexible spending accounts, it is recommended that eligible expenses under the tax credit be increased to $3,600 for one child and $7,200 for two or more children. Empirical evidence (for example, Blau and Robins, 1988) suggests that this general form of "demand" subsidy would have beneficial impacts on society. In particular, it would generate substantial increases in labor force participation among low-income families and would increase the quality of care purchased by labor force participants. Increased labor force participation by low-income families would provide the work experience necessary to escape poverty through future earnings growth.

One criticism of the tax credit as a means of subsidizing child care for low-income families is that families would not benefit from the credit until they filed their tax returns, and thus they might be unable to meet monthly (or even weekly) child care expenses (U.S. Congress, 1985). This problem could possibly be avoided by using the existing

Table 6

Current Law and Proposed Change in the Child Care Tax Credit

Provision	Current Law	Proposed Law
Refundable	No	Yes
Credit percentage	30%, AGI $\leq$ \$10,000	80%, AGI $\leq$ \$10,000
	1% reduction per \$2,000 additional AGI	2% reduction per \$1,000 additional AGI up to \$40,000
	20%, AGI $\geq$ \$28,000	1% reduction per \$1,000 additional AGI up to \$60,000
		0%, AGI $\geq$ \$60,000
Expenditure ceiling	\$2,400, 1 child	\$3,600, 1 child
	\$4,800, 2 or more children	\$7,200, 2 or more children
Credit ceiling	\$720, 1 child	\$2,880, 1 child
	\$1,440, 2 or more children	\$5,760, 2 or more children

withholding system to meet monthly child care needs. Families paying positive federal income taxes could have their withholding reduced in order to have enough disposable income to pay monthly child care expenses. For families not paying any regular federal income taxes, monthly child care expenses could be partly met by reducing social security taxes withheld (including the employer's portion). Social security taxes are paid on every dollar earned up to the taxable maximum. Currently, the combined employer-employee contribution rate is 15.02 percent. Reducing the social security withholding tax for low-income families by an amount not to exceed the combined employer-employee contribution rate would lessen (but perhaps not eliminate) the need to develop a system of refunding child care credits on a less than annual basis. When tax returns are filed at the end of the year, reconciliations can be made. If the family elects to receive the credit at the end of the year, the same mechanism can be used to distribute benefits that is currently being used for the Earned Income Tax Credit, which is also refundable. A family able to balance its child care account with the government would receive full credit for its appropriate social security contributions.

If it is not feasible to use the withholding system to meet monthly child care needs, then consideration might be given to a system of direct vendor payments on a monthly basis. Under such a system, licensed child care facilities would periodically bill the government for a portion of child care expenses incurred by the family. Such a "copayment" system could be patterned after the reimbursement system used by the Medicare and Medicaid programs. If this proves infeasible as well, consideration might be given to a system of child care vouchers, distributed monthly and patterned after the Food Stamp program. In any event, when families file their tax returns at the end of the year, the appropriate amount of the refundable credit would be calculated and reconciliations would be made.

Another criticism of the tax credit is that most low income families cannot afford to purchase child care in the open market (i.e., from child care centers or licensed family day care homes). Instead, they tend to rely upon in-home babysitters or out-of-home arrangements that are usually unlicensed (and hence illegal) and pay less than minimum wages to caretakers who do not declare their income for social security purposes (U.S. Commission on Civil Rights, 1981). A refundable credit at the rate of 80 percent for very low-income families would induce some of them to seek higher-quality (licensed) arrangements, and many caretakers might also then seek licenses and declare their income for tax purposes. This would indirectly lead to an increase in federal tax revenues.

Still another criticism of the tax credit is that it raises the price of child care to families ineligible for a public subsidy (Grubb, 1989). Whether or not this occurs depends on the elasticity of the supply of child care services. As indicated earlier, a study by Blau (1989) suggests that this elasticity is very high, which means that the demand for child care can expand considerably without a corresponding increase in the price of child care services.

Finally, it is argued that the tax credit encourages widespread cheating because it is difficult to verify claimed expenses (Besharov, 1988). While this argument has some merit, cheating can be effectively controlled by requiring certification of providers and limiting the credit to families that utilize certified providers. As noted earlier, the 1988 Family Support Act has instituted just such a provision in the current credit law.

A microsimulation analysis of the distributional effects and costs of this proposed change in the tax credit has been performed by Barnes (1988). Table 7 presents the results. For comparison purposes, results are also presented for the current credit and for a simple refundable credit that does not alter the current subsidy rate or the maximum amount of allowable expenses.[16] The results are given for all families and for one- and two-parent families separately.

As Table 7 indicates, the current credit costs $3.9 billion and is highly regressive, with only one-quarter of the benefits going to the bottom half of the income distribution. For one-parent families, the bottom three-fifths of the income distribution only receives 10 percent of the benefits! Making the credit refundable would make it far more equitable, although a majority of the benefits would still go to the upper half of the income distribution. Making the credit more progressive as well as refundable would tilt benefits even more to lower-income families. It is interesting to note that altering the tax credit in the manner proposed is estimated to cost about $3.4 billion more than the current credit. This is less than $1 billion more than the original cost of the ABC bill. However, it should be pointed out that the simulations reported in Table 7 do not allow for any behavioral responses to the proposed change in the credit. In particular, it is quite likely that the proposed change will increase the number of children born (see Blau and Robins, 1989), the number of women with children who are working (see Blau and Robins, 1988), and the amount of

Table 7

Distributional Effects of Altering The Child Care Tax Credit

Families, by Level of Income (percentage of families in category)	Current Credit (1988)	Make Current Credit Refundable	Make Current Credit Refundable and More Progressive
All families			
$0 - $13,240 (30%)	3.3%	17.2%	27.0%
$13,241 - $22,830 (20%)	20.3%	21.5%	32.5%
$22,831 - $35,350 (20%)	27.1%	22.2%	28.1%
$35,351 or more (30%)	49.3%	39.1%	12.3%
Cost	$3.9 billion	$4.7 billion	$7.3 billion
One-parent families			
$0 - $13,240 (58.5%)	9.5%	34.7%	38.3%
$13,241 - $22,830 (20.7%)	42.1%	34.3%	36.7%
$22,831 - $35,350 (13.6%)	31.6%	20.5%	19.6%
$35,351 or more (7.2%)	16.8%	10.4%	5.4%
Cost	$1.3 billion	$1.9 billion	$4.2 billion
Two-parent families			
$0 - $13,240 (10.1%)	.4%	3.9%	9.2%
$13,241 - $22,830 (15.6%)	9.7%	11.7%	25.7%
$22,831 - $35,350 (24.6%)	25.0%	23.5%	41.8%
$35,351 or more (49.7%)	65.0%	60.8%	23.3%
Cost	$2.6 billion	$2.7 billion	$3.1 billion

Source: Adapted from Barnes (1988).

money spent on child care. All of these behavioral responses will tend to make the cost of the proposed change in the tax credit greater than reported in Table 7.

The second tier of the proposed child care system would act as a "safety net" to provide benefits to chronically disadvantaged families who are either unable to take advantage of tax-based benefits or who cannot find decent quality care at low cost. In particular, "supply"-oriented subsidies, such as financing the establishment of licensed centers within public housing projects or in other areas with a high incidence of poverty, should be instituted on a large scale. Poor families should receive the services of these facilities at little or no cost. Again, empirical evidence (for example, Robins, 1988) suggests that supply subsidies of this type can induce a considerable degree of economic self-sufficiency among low-income families.

A system of publicly funded child care centers could be financed entirely by the federal government or possibly through matching grants, with the federal government providing the bulk of the matching funds. A system of matching grants would be desirable if it induced additional state funding of the centers. Evidence on the effects of matching formulas on state funding of social programs is controversial. One carefully done study (Orr, 1976) concludes that federal matching at the margin can have a modestly positive effect on the overall amount of benefits provided by states.[17]

In addition to such a two-tiered system of child care support, it would also seem appropriate to centralize the coordination of national child care policies within a federal agency, probably the Department of Health and Human Services (perhaps within the recently created Family

Support Administration). The functions of such an agency would be to monitor child care spending and to enforce regulations governing the quality of the child care services being provided. All child care that is eligible to be subsidized under the two-tiered system would have to meet minimum federal standards, which individual states could upgrade at their discretion.

9. CONCLUDING COMMENTS

This paper has surveyed alternative approaches to financing child care at the federal level and has discussed their economic implications with regard to female labor force participation, fertility, child care demand and supply, and poverty. The current system of federal support for child care in the United States is shown to consist of a series of overlapping programs that tend to create inefficiencies and inequities in the distribution of child care benefits. Despite the large number of programs in existence, overall federal assistance for child care, which totaled approximately $6.5 billion in 1988, is seen to be quite modest relative to federal spending in other social policy areas. Most child care assistance comes from the Child Care Tax Credit and other tax-based methods (primarily flexible spending accounts), which have been increasing in recent years. Tax-based methods of financing child care are seen to be generally regressive in nature, benefiting almost exclusively middle- and upper-income families. Direct subsidies for child care, which have been traditionally used to benefit lower-income families, are currently in a state of decline.

In order to achieve efficiency and equity in our nation's child care policies and to facilitate meeting the needs of a labor force that is going to consist increasingly of greater numbers of young parents, modifications to the current system are sorely needed. A general two-tiered system of support would go a long way toward meeting our national child care goals. This two-tiered system would be centered on a refundable tax credit, considerably more progressive than the current tax credit. A simulation analysis indicates that the proposed refundable tax credit would not cost much more than many of the more popular child care bills currently being debated in Congress. In addition to the refundable tax credit, A "safety net" of federally funded child care centers would be established to cater to the child care needs of special groups, principally chronically disadvantaged families. These child care centers would adhere to minimum federal standards regarding quality and would be located in areas accessible to low-income families, such as public housing projects. To ensure an efficient and equitable distribution of federal child care benefits, a federal coordinating agency should be established within the Department of Health and Human Services.

Notes

[1]Labor force participation behavior of men, on the other hand, has been shown to be fairly insensitive to changes in wage rates.

[2]Economic theory indicates that the cost of child care is an important component of a woman's net wage rate and that higher child care costs reduce the net wage rate and consequently reduce the probability of participating in the labor force. Because subsidization of child care costs has been increasing in recent years, this has undoubtedly played a role in sustaining the growing labor force participation rates of mothers of young children.

[3]Two things should be noted here. First, before 1976 child care subsidies were available through the federal income tax in the form of an itemized deduction. Depending on an individual's tax bracket, the subsidy rate for an itemized deduction could be larger than the 20 percent rate available through the tax credit. However, the itemized deduction was not used as much, because it was only available to itemizers and was not available to high-income families (it was phased out at income levels of between $18,000 and $27,600). Statistics presented in U.S. Department of the Treasury (1976) show that there was a doubling of child care subsidies after the tax credit was introduced in 1976, apparently because of the elimination of the income requirement and because it became available to nonitemizers. Second, as pointed out by Blau and Robins (1989), economic theory does not unambiguously imply that child care subsidies would lead to increased fertility, because such subsidies also act to induce labor force participation, which

decreases fertility. Nevertheless, their empirical findings indicate that the net effect of child care subsidies is to increase fertility.

[4]Hofferth and Phillips (1987), citing a methodology discussed in Prosser (1986), estimate that out of a total listing (from the states) of 62,989 child care centers in the United States in 1986, 39,929 (or 63 percent) were in operation with a total capacity of approximately 2.1 million children. Out of a total listing of 165,276 licensed family day care homes, approximately 105,417 (or 64 percent) were in operation with a total capacity of 434,603 children.

[5]Lydenberg notes that about 2,500 companies provided some form of child care assistance in 1985, but this is only 5.6 percent of the more than 44,000 companies in the United States with more than 100 employees.

[6]Over time, virtually all child care for children over age 5 is reported as either in school (75 percent) or in the child's home (12 percent). In 1985, only 3 percent of children over age 5 report organized child care facilities as the primary form of care and only 4 percent report care in another home as the primary form of care.

[7]The long-run implications of the growth of female labor force participation for the supply of in-home providers needs to be carefully studied. One such study along these lines is Connelly (1987).

[8]The divorce rate (per 1,000 married women aged 15 and over) increased from 9.3 in 1960 to 21.3 in 1983. The rate of illegitimacy increased from 5.3 percent in 1960 to 21.0 percent in 1984 (U.S. Department of Commerce, 1987a).

[9]Ellwood (1986) argues that earnings alone is not sufficient to

permit the majority of poor single-parent families to become self-supporting. Earnings would have to be supplemented by other means, such as child support or a children's allowance.

[10]These percentages are calculated using data from two sources. The number of working mothers are from U.S. Department of Labor (1985) and the number of families using the credit are from U.S. Department of the Treasury (1976-1985).

[11]Two other provisions of the 1988 Family Support Act pertaining to the Child Care Tax Credit are likely to curtail its use in the future: a reduction in the maximum age of the child covered from 15 to 13 and a requirement that taxpayers must now provide specific information about the child care provider, including name, address, and taxpayer identification number.

[12]As pointed out by U.S. Congress (1985), the Child Care Tax Credit is applied before the refundable Earned Income Tax Credit (EITC). Therefore, the Child Care Tax Credit is not limited by the EITC.

[13]These estimates are very rough approximations based on information in Weinberg (1987) and U.S. Department of the Treasury (1984).

[14]This figure is obtained by multiplying the average losses in the last column of Table 9 by estimates of the number of persons using the credit in each income decile from U.S. Department of the Treasury (1984).

[15]A cafeteria plan is a "menu" of taxable and nontaxable benefits provided by employers to give employees greater flexibility in choosing

alternative forms of compensation. FSAs may be one of these benefits. Because of the increasing diversity of the work force, cafeteria plans are growing in popularity. For an excellent discussion of cafeteria plans, see Friedman (1985).

[16]The data in Table 7 are from an unpublished appendix to Barnes (1988) and were kindly made available to me by the author. The methodology underlying the simulations are described in the paper.

[17]For an analysis yielding different conclusions, see Moffitt (1984b).

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