FINANCING EARLY LEARNING AND CHILD CARE IN CANADA

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Good quality early childhood learning and child care can deliver important benefits to children, families and to society as a whole; the future of child care in Canada, following the lead of many other countries, is as a public service, accessible to all children. Following debate and discussion over many years, Canada's federal government has now decided to lead the way in developing a cross-Canada system of Early Learning and Child Care – a national child care plan. The issues dealt with in this short paper all relate to financing this child care plan: who should pay, how much should they pay, and how financing is delivered to service providers.

The current financing arrangements for child care in Canada are not difficult to summarize. Until Quebec's recent reforms, most of the care and education used by preschool children in Canada has been financed by individual families, bought and sold on the private market, with governments providing some funding to specific services and specific families. Kindergarten is an exception to this, provided in all provinces and territories as a free public service available to all children at age five for half-days or full-days during the school year, and in many school boards in Ontario at age four. In Quebec, early childhood education and care services are also provided as a public service for full-days year-round for children 0-4, in centres and family homes, with a parental contribution of $7 per day. In the rest of Canada, some types of child care (centres, family homes and sometimes nursery schools and preschools) are licensed and regulated, but there is only minor government financial support of these services. Very low-income families are eligible to apply for child care subsidy, as long as the parents are working or studying. Further, the Child Care Expense Deduction allows families in which both parents are employed to pay for child care with pre-tax dollars, up to a limit of $7,000 annually for each preschool child; in effect, child care is treated as a legitimate work expense for tax purposes, and so the income used to pay for child care is not taxed.

To be effective, a financing plan for a new system of Early Learning and Child Care must ensure:

- adequacy and dependability of financing,
- public accountability for dollars spent,
- equity in the distribution of the costs and benefits,
- efficiency in the use of public dollars.

The last issue of efficiency is a key concern for sustaining public support, aside from being a value in its own right. It involves getting the most services and the best quality per dollar spent, keeping a lid on costs as the system develops, ensuring that the quality, convenience and accessibility of services are adjusted so as to maximize the benefits to children and parents while keeping overall costs affordable. On top of these four concerns above, there are also important issues about the nature of the transition from the present patchwork of services and financing to the future system. These "phase-in" issues may be particularly important in maintaining political support and momentum for reform.

We have written extensively, in other places (Cleveland and Krashinsky, 1998, 2001, 2003b) about the public benefits associated with good quality early childhood learning and child care services. We do not intend to repeat those arguments here. As far as we are concerned, the debate over whether early learning and child care should be financed mainly by parents or mainly by the public is over. By our calculations (Cleveland and Krashinsky, 1998, 2003b), the incremental social and economic benefits of a publicly financed system of early learning and child care services for children two to five years of age exceed the costs by a margin of at least two to one. Even more to the point, cash-strapped young parents will not automatically choose the type and quality of care that will maximize social benefits without considerable financial assistance as well as public encouragement for expansion of developmentally-oriented early learning and child care facilities. Early learning and child care services should be largely publicly financed, perhaps with a parent contribution.

Once we have decided that early learning and child care will be publicly financed, there are still several major issues to resolve:

1. Should the new child care plan deliver money on the demand side (to individuals) or the supply side (to services)? In other words, will public dollars be delivered to parents to spend or will public dollars be delivered to early learning and care service providers to finance services? Many other financing issues are related to this one.
2. Should services be delivered by the public sector or the private sector, or a combination of both? If there is private sector involvement, should this be exclusively composed of non-profit providers or should public funding also go to commercial service providers?
3. What should the amount of parent contribution be? Should services be free to users, should contributions be based on parent incomes, should there be a flat fee (as in Quebec), should parents pay a certain percentage of costs?
4. How should the public contribution be financed…by income taxes, by business taxes or charges, by a dedicated tax or out of general revenue? And what should the federal, provincial (and municipal) shares be?
5. How should support for new early learning and child care programs be phased-in? The federal government has put $5 Billion over 5 years on the table to begin the financing of a national child care plan. Should this money be used to expand existing subsidy and operating grant programs with the eventual objective of making financial support more universal? Or, should universally accessible programs be phased in more directly, along the lines followed in Quebec (starting with ages five and four), or perhaps starting with infants and working up?

We do not directly address issues of financing aboriginal child care or child care for children with special needs in this paper.

Demand Side or Supply Side

Demand-side financing is funding directed towards parents, either in the form of a tax credit based on eligible child care expenditures, or some kind of voucher which parents can "spend" buying child care services. Supply-side funding is directed to a set of approved suppliers of early learning and care services.

The debate about financing child care on the demand side or the supply side is laden with unstated ideological preconceptions for most participants in the debate. Those who favour demand-side funding typically believe that markets work relatively well, that it is very important to preserve parental choice over a range of child care services, that parental choice will enforce competition between different potential suppliers of child care, that this competition will ensure that services are produced at lowest possible cost for the quality chosen and that suppliers will constantly seek to innovate to attract parental dollars. Most advocates for demand-side funding also believe that private for-profit suppliers will respond best to these market incentives so that for-profit firms should definitely be eligible for parent-directed publicly-provided funds (i.e., tax credits or vouchers).

Those who favour supply-side funding (i.e., financing goes directly to services, and then parents choose amongst these low-cost or free services) typically believe that the market for child care and early learning services does not work particularly well. In other words, providing additional funds to parents does not solve all of the "market failures". In particular, markets only work well if purchasers can effectively monitor the output they are purchasing and reward firms that produce the highest quality at the lowest price. As with medical care, long-term care, and education, it is difficult for consumers to make these judgments about the early education of young children. Parents generally overestimate the quality of care they purchase relative to assessments based on objective measures of quality (based on child development). Supply-side funding, it is argued, gives governments the power to monitor, promote and regulate quality, whereas demand-side funding does not.

Advocates of supply-side funding typically insist that public dollars should go only to public (e.g., through the education system) or non-profit services. Private, for-profit early learning and care services have strong incentives to cut costs. In the context where quality is variable, and difficult for purchasers to accurately perceive, for-profit providers are likely to provide child care that seems to be of high quality (e.g., bright, cheery rooms; attractive facilities) but is not (e.g., fewer teachers, more assistants; lower education and training levels of staff and directors; less attention to curriculum issues). As a result, in a competitive market, these low-cost producers will tend to drive the truly higher quality firms out of the market.

If we follow the logic of these two alternatives to their conclusions, we can see that publicly-financed early learning and care programs would look very different funded on the demand side versus the supply side. On the demand side, there will be a tendency to fund services at a much wider range of quality levels, and to regulate their quality levels less intensively. The price of care would vary considerably as suppliers in affluent neighbourhoods offered extra services to families, establishing a sort of "two-tier" system of services. It is likely that commercial providers would attempt to attract children without learning disabilities or behaviour problems (those that is cheaper to serve), leaving the more challenging developmental problems to be concentrated in non-profit and public services. There would be substantial commercial developments in early learning and care, with major publicly-traded corporations being established to provide chains of centres across the country (as in Australia and the U.S.), with chain-wide cost efficiencies, but also inflexibility. These corporations would lobby effectively against tighter regulation of quality, and against limitations on business decisions.

Funded on the supply side, services would be either public or non-profit, with considerably less competition between suppliers and more government involvement in establishing quality targets, curriculum guidelines, and cost controls. The price of care in different centres would be more nearly uniform. There would be more parental input on advisory and management boards. At the same time, it is likely that, because of decreased competition, there would be less incentive for individual centres to innovate, or to keep costs under control (replaced by government encouragement to innovate and controls over costs).

There are, it should be noted, two models of service provision and financing on the supply side.

1. Building on the existing kindergarten model, providing early learning and child care services in or near schools, with "child care" and "kindergarten" being integrated in some way, either:
    a. kindergarten for the full school day with extra services on the same site before and after school and in holiday times, or,
    b. integrated services provided by a mix of kindergarten and child care staff.
2. The second supply-side model would be similar to that developed in Quebec for under 5's, with a large number of non-profit community-based Early Childhood Learning Centres each co-ordinating a web of services (centres and family homes) under an administrative hub.

Public, private, non-profit

There is good evidence that non-profit child care centres provide higher quality of care than for-profit centres, even controlling for differential access to public funding in some jurisdictions. Non-profit centres hire staff that are more educated and trained, encourage staff to engage in more on-going professional development opportunities, and pay higher wages and benefits to all staff. Non-profits also are more likely to provide services to children from low-income families, children with special needs and infants and toddlers. However, non-profit status is far from a guarantee of good quality.

The appropriate context for considering the differences between public, non-profit and commercial service providers is what is called "principal-agent theory". Since there is a public interest in the provision of early learning and care services, we want the service providers (the agents) to faithfully pursue, as much as possible, the wishes of the government (the principal). Ideally, the agent should sign a contract promising to deliver specific results, and the principal should monitor and measure the service delivery results to enforce the contract. However, this is difficult to ensure for two reasons. First, the public interest is complex and difficult to state clearly (e.g., in a legal contract for services). There is a strong public interest in good quality of services, but there is also a public interest in having services delivered efficiently, at lowest possible cost for the desired quality level. There is also a public interest in having services that are reasonably flexible in adapting to parental needs and child needs (e.g., hours of care and special learning problems or opportunities). Second, there are strong information asymmetries between the principal and the agent, with only the agent knowing the true quality and cost of services provided. Service outcomes are difficult for governments to quantify and monitor. In this situation, non-profit organizations are believed to have objectives which are less divergent from those of the principal (the public interest) than are the objectives of profit-seeking service providers.

Providing public funding only to public or non-profit services will tend to avoid the worst excesses of rampant commercial development of child care, and will tend to improve public accountability for the expenditure of funds. However, it will not, by itself, ensure quality, innovation, attention to specific parent and child needs, or cost efficiency. Supply-side funding to non-profit providers would have to be complemented by important public initiatives to monitor and enhance quality (e.g. data collection, public reporting, ongoing quality assessment, etc.). It would probably be wise to ensure that non-profit and public suppliers are compensated on a per-user basis (e.g., service funding is reduced when enrollment falls below 95% of capacity) to provide a modest amount of "market pressure" on service-providing agencies. It is similarly important that funding rates reflect actual resource requirements (costs of service) so that service providers do not have incentives to lower costs by avoiding providing service for infants, special needs children, children with English as a Second Language, etc.

Parents' Contribution

Many of the benefits of early learning and care accrue to society, but some of them contribute to the income and well-being of individual families. Families using good quality, publicly-financed child care will be able to earn higher incomes. These parents will, as a result, pay higher income, payroll and sales taxes, but it is not unreasonable for parents to pay a modest direct fee as well. In Quebec, $7 per day per child (about $1800 per year, or between 20% - 30% of the costs depending upon the age of child) does not seem to be a substantial barrier to most families in exchange for good quality, convenient, developmentally-oriented care. In a number of European countries, some early learning and care services charge a fee (e.g., about 20% of costs in Denmark, about 10% in Finland, about 30% in Norway, free in France; in every country, at least one-year of preschool is free, usually in the education system). There are some families for whom even a modest fee may make child care inaccessible; it may be possible to compensate low-income child-care-using families through the tax system - altering the Child Care Expense Deduction program, for example - effectively lowering the price of child care.

A parent contribution will reduce the amount of expenditures that need to be financed through the tax system, will increase the sense of fairness for those taxpayers who may not have children, and will give parents a sense that they have every right to complain if the quality of services falls short. As long as the contribution does not significantly affect accessibility, it is a reasonable expectation.

The flat fee charged in Quebec has much to recommend it. It is easy to administer, perceived as fair, and gives parents a stake in the services they receive. A sliding scale of fees, linked to income, is ostensibly fairer, but requires collection of personal information from families and granting of "welfare-like" benefits to individual families who are "needy". Charging a flat fee but also directing compensation to low-income families through the tax system may be an efficient way to address fairness, while avoiding stigma.

How Should the Public Contribution be Financed?

Child care and education are both in provincial jurisdiction for the most part, but most provincial governments have been unwilling or unable to put forward the funds necessary for universal preschool programs. The federal government has more access to tax resources and a mandate to develop the framework of national social programs if the provinces and territories agree. Since good quality early learning and care services are expensive to provide, sharing the burden of coming up with the funds between federal, provincial and territorial governments makes good political sense, even if economists want to emphasize that there is, ultimately, only one taxpayer for all jurisdictions.

It is clear that the federal government will have to play a considerable role in financing, particularly if the less affluent provinces and territories are to provide good quality programs. However, there is no clear way of determining what the federal/provincial/territorial breakdown should be (let alone determining an appropriate municipal contribution).

Most countries finance child care/early education through general government revenues, rather than through dedicated taxes (taxes whose revenues are exclusively directed to the particular purpose of paying for). The exceptions are countries such as France and the Netherlands, where an important component of the financing comes from private sector businesses (in France, businesses pay into a family allowance fund which provides about 25% of all funding; in the Netherlands, employers contribute towards a child care foundation to purchase child care spaces for their employees). If child care was provided through the education system in Canada, substantial funds would come through the municipal property tax, with a specific fraction of the annual mill rate being devoted to education/child care. In this case, provincial subsidies to municipal authorities would be necessary to compensate for variations in the tax base.

Phasing-In Early Learning and Care

The benefits of good quality early learning and care may be high, but it is also true that the costs are fairly high. A few quick approximate calculations can indicate what the costs of care are likely to be and also can show what the major cost-drivers are likely to be. The calculations refer to centre-based care; family home care is typically less expensive, but the quality may also be lower. The calculations in the table below show the annual full-time cost of centre care at different staff-child ratios and for two possible compensation levels of teachers, assistant teachers and directors. It is assumed there is one director for every 50 children (not included in the staff-child ratio), that 75% of classroom staff are teachers and 25% assistant teachers, that rent or depreciation and non-teaching operating costs add 20% to total costs. Centres are open 10 hours per day, 260 days per year. In the lower-wage column, teachers earn (on average across the country) $26,000 annually, assistant teachers earn $18,000 on average and directors earn $30,000. In the higher wage column, teachers are assumed to earn $35,000, assistant teachers earn $24,000 and directors earn $50,000. An allowance for non-wage benefits is also included.

Table 1

Estimated Annual Costs of ELCC in Centres by Staff-Child Ratio and Wage Level

Staff-child ratio	Lower Wages Assumed	Higher Wages Assumed
1:15	$3,700	$5,200
1:12	$4,400	$6,200
1:10	$5,100	$7,200
1:9	$5,600	$7,800
1:8	$6,200	$8,600
1:7	$7,000	$9,700
1:6	$8,000	$11,000
1:5	$9,500	$13,000
1:4	$11,600	$15,900
1:3	$15,200	$20,700

Note: Detailed assumptions available from authors; figures are rounded to nearest $100.

The table makes several things clear about the costs of early learning and child care. First, the annual cost of care for older children (i.e.,with ratios of 1:8 to 1:15) is much lower than the cost of care for young children, where more staff are required to provide good quality care for each child. Second, costs are very sensitive to staff-child ratio (they rise rapidly as the staff-child ratio improves) in the region of 1:6 to 1:3. Third, as staff compensation levels rise, the annual cost of care rises by close to the same percentage.

We draw several conclusions.

- First, it makes sense to start implementing universal child care on an age-related basis, starting with older preschool children. Public money will go farthest with older children, so the ratio of benefits to costs is likely to be highest. This will provide services to a critical mass of parents who can become advocates for further expansion of universal services. The initial success is likely to help "sell" universal early learning and care to current doubters.
- Second, in working on the extremely important goal of improving quality in child care, enhancing staff-child ratio will be a very expensive way to do so. Other methods of improving quality are likely to be first on the agenda.
- Third, it is clear that staff compensation levels will and should rise from current low levels in centre-based child care. Since this will impact strongly on total costs, it is important that wage and benefit increases are used to reward improved staff training and education, so that higher costs bring enhanced child care quality along with them.

Conclusions

- Canada currently has no "system" of early childhood learning and child care. Apart from Quebec's recently-developed system and kindergartens in the schools, early childhood care is a market service, supplemented by the subsidization of low-income families.

- Because of the public benefits from providing appropriate developmental care for our young children and positive supports to employment for young families, early learning and child care should be a publicly-financed service. This financing must be provided in a way that supports services, is carefully monitored and publicly accountable, distributes benefits equitably, and spends scarce public resources efficiently.

- Because the public benefits from early learning and care are dependent upon the developmental quality of the services, financing must be designed to promote quality. Quality is difficult for individual families to assess. Funding provided directly to services can be used to promote quality more readily than funding provided directly to individual families.

- Non-profit status is not a guarantee of quality, but, on average, non-profit facilities provide better care, and providing substantial public funding to commercial providers is unlikely to promote either public accountability or higher quality of services.
- Since individual families benefit from early learning and child care, and because the costs of care are high, it is not unreasonable

to plan for some parental contribution for pre-kindergarten age services. The flat daily fee system in Quebec has much to recommend it.

- The federal government has taken a major financial initiative towards developing a national child care plan. If a system is to be developed, the federal role will have to be considerable, while other jurisdictions will need to contribute substantial amounts as well.

- Because preschool learning and care (3-5 years) is an important priority for many families, because the costs of care for older children are much lower than for younger children, and because the precedent of public provision of education to preschoolers is already well established, it may be wise to place public priority on the development of early learning and child care services for children at age five, age four, and then age three and two. Initially, this will require developing innovative models that integrate existing kindergarten services with the broader concepts of learning which characterize child care.

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