LABOR

The Regressive Effects of Child-Care Regulations

More strenuous requirements raise child-care prices but have little apparent effect on quality.

BY RYAN BOURNE

Child care in the United States is expensive, but its cost varies greatly by region. Data from Child Care Aware of America, a nonprofit that works in child-care policy, indicate the average annual cost for full-time care of an infant at a child-care center in 2016 ranged from $5,178 in Mississippi to $23,089 in the District of Columbia. Even if we account for different income levels by state, these costs are very high. In Mississippi that infant's child care is 24% of median income for a single-parent household, while in D.C. it is a staggering 89.1%. For households with two young children, the combined burden is higher still.

Child-care policy is left to state governments and wide variation exists regarding policies and subsidies to assist poorer families with these costs. Overall, data from the Organization for Economic Cooperation and Development (OECD) suggest U.S. out-of-pocket child-care costs for a lone parent working full-time are higher as a percentage of earnings than in any other OECD country. And there is less taxpayer support for U.S. child care than in other OECD countries.

This high cost can have a large negative effect on the poor and can fuel political demands for increased government intervention and spending on child care. Empirical research indicates that parents (poorer single mothers especially) are particularly sensitive to child-care prices when making decisions about entering the labor market. Evidence from a range of studies suggests mothers from poorer families and those with low levels of educational attainment are least likely to be working.

High prices for formal care also lead poorer parents to rely on informal care arrangements such as assistance from extended family. U.S. Census Bureau data show that among children with employed mothers, those living in poverty are more than twice as likely to be cared for by an unlicensed relative.

The long-term trend is for more mothers of young children to opt for work. According to data from the U.S. Bureau of Labor Statistics, in 1975 28.3% of mothers with a child under the age of 3 and 33.2% of mothers with a child under the age of 6 were employed; in 2016 those numbers were 59.4% and 61.5%, respectively. As a result, the high cost of child care is becoming a particularly salient issue, with pressure building for government to "do more" to support it, not least as a means of helping poor families.

WHY IS CHILD CARE SO EXPENSIVE?

Before adopting new subsidies or beginning direct government provision of child care, it is worth assessing the underlying causes of high child-care prices. There are good reasons to think these prices would be high naturally in a free market. Formal child care is a labor-intensive, personalized service entailing the care of something many parents regard as the most valuable aspect of their lives. There is a strong correlation between areas with the highest absolute money cost of child care and the cost of child care as a proportion of income. This suggests that child care is strongly "income-elastic," meaning that as people get richer they become willing to spend relatively more of their income on it.

Yet economic evidence also suggests that child-care prices are driven up by existing variable state-level regulations and policies introduced to achieve other objectives. Input regulations designed to improve the "quality" of care, including requirements on the qualification levels of staff and/or the ratio of staff per child, appear to have a significant effect on child care prices.

These regulations tend to be justified on "market failure"

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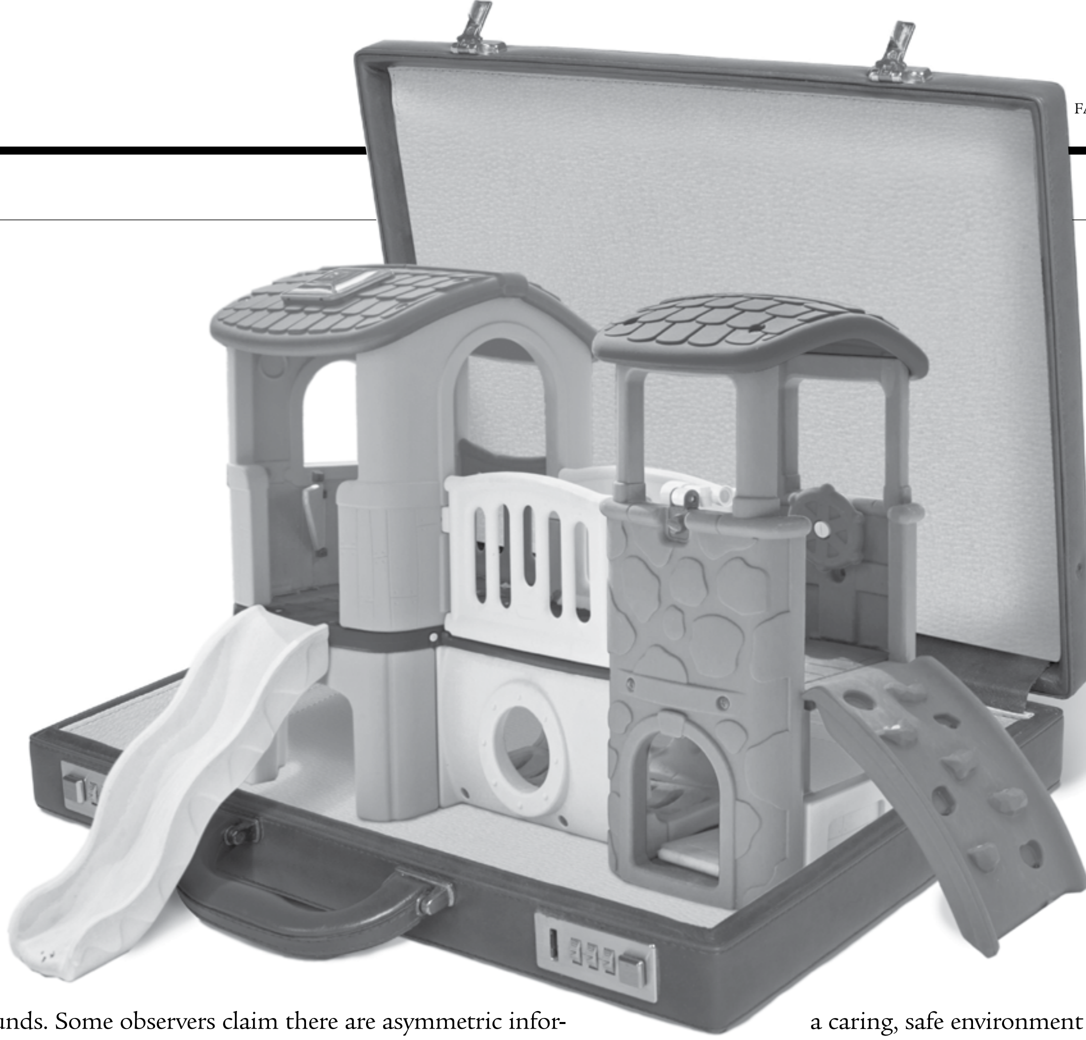

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grounds. Some observers claim there are asymmetric information problems in the sector; parents ostensibly have difficulty ascertaining whether child-care providers are high-quality providers. Others claim there are positive externalities—broader social benefits—arising from "high-quality" child care in children's early years, and those benefits are overlooked when child care is left to private transactions. These failures are said to justify ensuring providers meet minimum standards.

But these theoretical arguments of market failures have always been shaky. After all, direct parental care is an alternative to outside child care, yet there is no political movement for direct regulation of parents. And regulations can raise child-care prices, thereby reducing the spillover benefits from child care.

It is not entirely clear how meaningful the concept of "quality" in child care is, even if it can be divorced from what consumers—in most cases, parents—want for their children. Child-care research tends to use the term "quality" to simply mean that the child care and/or caregiver is in compliance with various process regulations or that it achieves certain outcomes. But deciding what educational provisions are best for a particular child is a multi-faceted judgment dependent upon the child's individual needs. Government may be able to use its centralized information to produce a regulation that generally improves outcomes in some particular average metric, but this is also likely to have unforeseen effects that may themselves have negative externalities.

Theory does not really get us very far in ascertaining the effects of regulations and any tradeoff between quality and affordability. One reason for this is that true "quality" is likely to be subjective: for some parents, it may simply mean that the caregiver provides a caring, safe environment for their children; for others it may mean an environment conducive to robust cognitive development.

Another reason why regulations do not proxy well for overall quality is that the market for child care is competitive across types of care and includes homecare, informal care, and care by the parent directly. Regulatory policies affecting perceived quality and prices can therefore cause substitutions from one type of care to another.

A couple of examples make this clearer. Suppose a regulation increases the staff–child ratio or requires child-care workers to achieve higher qualification levels. The former could theoretically increase quality by increasing staff interactions with individual children, and the latter by increasing caregiver training. Yet at the same time, raising the staff–child ratio may restrict the wages of caregivers by restricting the revenue potential of each caregiver. The lower wages, in turn, may result in lower-quality caregivers. Child-care providers may also respond to higher government certification requirements on caregivers by lowering their standards for support workers or facilities. As a result, the overall effect on quality of both regulations is ambiguous.

Finally, it is not even theoretically obvious what the effect of these regulations will be on overall formal child care use. By increasing the cost of formal care, regulations may reduce supply and reduce the quantity demanded. But if parents believe that a regulation truly does ensure quality, then a "quality assurance" effect might increase the demand for child care overall. The important thing to remember in any analysis of the effects of the regulation on overall quality is to consider the effect on children whose parents substitute them from one setting to another, either because of price or perceived quality changes stemming from the regulaton.

COST EFFECTS OF DEREGULATION

A burgeoning empirical literature attempts to shed light on these issues. One finding that appears robust across studies is that stringent staff-to-child ratios increase child-care prices substantially with little beneficial effect on observed quality.

Diana Thomas and Devon Gorry, for example, use variation in prices and state regulation requirements to estimate that loosening the staff–child ratio by one child across all age groups (regulations tend to vary by child age) reduces center-based care prices by 9–20% generally, or 2–5% for 4-year-olds particularly. This echoes an older result from Randal Heeb and Rebecca Kilburn, who found increasing the stringency by reducing the number of children in the allowed staff–child ratio by two raised the price of child care by 12%.

Applied to real-world child-care costs, the conservative end of these estimates suggests that relaxing the staff–child ratio by one child across the board in Mississippi and D.C. could reduce average child-care prices by $466 and $2,078 a year, respectively. These numbers are extremely uncertain, of course, and the effect is likely to be non-linear in reality, with the price effect larger in states with the most stringent regulation.

But the indicative results are large. And further evidence suggests the poor suffer disproportionately. Thomas and Gorry show that a small but measurable number of mothers stop working altogether as a result of these regulations. One would imagine that these are likely to be relatively low-income people on the margins of the labor market.

A more comprehensive paper by Joseph Hotz and Mo Xiao supports the intuition that the effects are particularly regressive. Using a panel dataset across three census periods and with extensive individual child-care center data, state data on day home care, and a host of control variables, they find tightening the staff–child ratio by one child reduces the number of child-care centers in the average market by 9.2–10.8% without increasing employment levels at other centers. This reduction in supply occurs wholly in relatively low-income areas and leads to lots of substitution to home day care. Increased stringency in the regulation actually increases child-care centers in high-income areas, probably because of the "quality assurance" effect, meaning the overall effect is highly regressive.

REGRESSIVE EFFECTS AND A SLIPPERY SLOPE

As with housing, child care is an example of a sector where government regulations restrict the supply of the service, to the financial detriment of the poor. Whereas zoning restrictions deter labor mobility, formal child-care regulations—by raising prices—reduce the payoff to work for groups with low levels of labor market attachment. In the case of staff-to-child ratios, there is no evidence of a net "quality" tradeoff, as restricting the number of children per staff member holds down potential wages for child-care workers and causes demand substitution to perceived lower-quality child-care settings.

Other regulations have similarly large effects on price, although with more mixed consequences for quality. Thomas and Gorry find that requiring lead teachers to have a high school diploma can increase child-care prices by 25–46% percent. Hotz and Xiao likewise find that increasing the average required years of education of center directors by one year reduces the number of child-care centers in the average market by 3.2–3.8%. Again, this effect manifests itself overwhelmingly in low-income markets, with quality improvements (proxied by accreditation for the center) overwhelmingly occurring in high-income areas.

Policymakers should bear this in mind before continuing the push for further regulation of the sector. Yes, there is some evidence that increased teacher training in early childhood education can have positive effects on child development, but a host of input regulations appear to reduce the supply of available care, reduce access, and raise prices for the poor.

Yet some governments continue to heap regulations on child care. Last year, the D.C. city government passed new rules requiring that teachers at child-care centers and caregivers at home-based centers obtain a two-year degree in early childhood education, while assistant caregivers must obtain a newly created Child Development Associate certificate. Even if these measures raise quality in terms of outcomes for children whose families can afford care, the requirements will further constrict the supply of child care in a market where prices are already very high. That may explain why city leaders have delayed implementation of the new regulations and are engaged in new attempts to subsidize child-care provision.

The UK offers a cautionary tale of how government involvement begets government control over this sector. Intervention advocates appealed to the positive externalities of higher female employment and greater child achievement, but the resulting policies have left consumers facing high out-of-pocket costs and taxpayers facing higher subsidy payments, including government funding of "free" care for children ages 2–4. Commentators now cite the higher cost as justification for ever-greater government subsidy of child care.

The expanded UK government funding and intervention appear to have yielded little advancement on the stated policy goals. Research indicates that universal government-funded care for 3-year-olds raised employment levels by only 12,000 workers, at a cost of £65,000 (about $88,000) per new job (many of which were part-time). Though there did appear to be a small gain in educational attainment at age 5, that effect weakened by age 7 and completely disappeared by age 11, meaning the policies had no long-lasting benefit.

These meager results have not given policymakers pause; rather, many claim that "more needs to be done." These days, the high cost of child care itself is seen as indicative of a market failure, even though that cost is partly the result of regulations and state crowd-out designed to achieve other objectives.

CONCLUSION

The potential for huge unintended consequences from such regulation is clear. Policymakers seem to give little thought to the effect of these policies on child-care prices, parental preferences for care, and the availability of care for the poor. Leading indicators, in the form of debates on child-care policy in other countries such as the United Kingdom, suggest subsequent concern about high prices will lead to demands for universal government provision of care, funded by taxpayers.

The case for abandoning input regulations that raise prices without delivering higher quality is overwhelming in this economic and political context. Major European countries already do not bother with mandated staff-to-child ratios, for example, with apparently few ill-effects.

That does not mean the market need be "unregulated." In fact, this kind of service sector seems ripe for within-market regulation. Parental preferences will likely provide binding constraints against inadequate staffing levels while allowing providers to find optimal scale. And formal providers might voluntarily choose to obtain qualifications as a reputational mark of quality. Intermediate institutions usually develop in a free economy to provide such quality signals.

More broadly, there is a philosophical argument that judging child-care "quality" should be left to the parents, especially given the fact that they, themselves, are not required to obtain formal qualifications in child education in order to care for their children.

Existing empirical evidence suggests even a modest shift from government to within-market regulation on staffing could significantly reduce prices, with modest changes delivering savings of around $500 per year or more for families with children in full-time care. The net benefits to poor people's well-being could be much greater still if lower child-care prices make it financially rewarding for them to return to work.

READINGS

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