Systematic Thinking About Subsidies for Child Care (Part 3 of 3)

Part Three: Application of Principles

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In trying to design child care policy, a variety of principles can be applied, even though they sometimes come into conflict. The family is necessarily the first caretaker, but those receiving welfare and other assistance are expected to work and give something back to society. There should be equal justice under the law, but experimentation and diversity are still prized. The law should be neutral with respect to child care provided inside and outside the home, but applying progressivity to many separate welfare and tax provisions has removed some of that neutrality. Finally, the tax system can be an appropriate vehicle to deal with child care, but only under two conditions: it should be the most efficient delivery mechanism, and, if a subsidy is provided beyond a reasonable measure of the tax base, the cost should be recognized as a direct outlay.

While these principles and standards do not give us unequivocal guidance with respect to child care policy, they do set boundaries around what is reasonable. However amended, some set of guidelines should be used to determine what to do with the many child care proposals that will bounce around Capitol Hill this year. Principles and standards serve as a counterweight to the political tendency to try to do a little bit of everything—to worry more about whether programs sound attractive than whether they work. To demonstrate the potential effectiveness of these standards, I will apply them below to some of the controversial issues surrounding child care policy.

Welfare and Work. Nothing demonstrates the ambivalence of national child care policy more than its application to welfare. Recent welfare reform legislation abandoned the notion that single parents needing help were the best care givers for their children, and, that, therefore, they would not be required to work if they received assistance. An expanding economy and various state and federal reform efforts have succeeded in reducing the number of welfare recipients. Still, many remain, and a surplus of federal and state funds has increased, rather than decreased, the average amount of assistance for each remaining recipient. Because few policymakers want to provide additional welfare assistance in the form of money, much has gone into work support efforts, such as child care, education, transportation, or assistance from social workers. President Clinton's recent proposal to expand child care grants to states is only the latest of several efforts to expand noncash assistance in the last couple of years.

While child care assistance may work for one recipient, however, it is provided very unequally. A person has to be in the right place at the right time to have access to limited child care funds. Moreover, equally poor people who never get into the welfare system generally are not eligible.

The goal of recent welfare reform is to create work opportunity for people who may have few skills. The problem with many child credits and allowances is that they subsidize child care outside the home even when it might be provided much more efficiently by grandparents, other relatives, cooperative arrangements, or neighbors. A better alternative would be to try to determine what overall level of help is going to be provided on condition of work, but then retain flexibility as to what forms that help might take. For example, it may be much more efficient and fair to provide additional transportation expenses to someone who might find other adult sources of care with nearby friends or relatives. Another recipient may need additional educational support rather than extra child care support. I have applied the term, "structured choice" to this type of arrangement—structuring the goods and services that can be purchased with assistance, but allowing social workers or recipients some flexibility and choice to negotiate the most efficient among the limited options.

Progressivity. It is often asserted that a credit is more progressive than a deduction or exclusion. The argument is not always true. If the tax rate structure is adjustable, the tax/transfer system can be made as progressive as wanted without introducing progressivity into every type of credit or deduction. Another way of saying this is that the rate structure is the primary means of achieving progressivity and should be separated from the issue of the appropriate tax base. For example, in the design of tax reform in the mid-1980s, Treasury suggested that a child care deduction replace the child care credit. This would have had no effect on the progressivity of the tax system because the rate structure would have been adjusted accordingly to hit the same level of overall progressivity. Thus, the choice between a deduction and a credit would only affect tax burdens within income classes (horizontal equity), not between income classes (progressivity or vertical equity).

To make matters worse, introducing progressivity into many separable provisions of the law almost inevitably means adopting a variety of hidden tax systems that operate through phase outs of benefits. As income increases, each subsidy is made less available. Few policymakers pay much attention to the effective tax rate structures they are creating when they try to make every subsidy, credit, and deduction more progressive.

Progressivity by itself is not an adequate justification for providing child care allowances or assistance above whatever adjustment is needed to measure net income. After all, progressivity can be provided in a variety of ways outside of child care. Thus, the rationale for child care allowances must involve more than the simple notion of redistribution. It must be justified by some other improvement not made possible through alternative mechanisms.

Adjustments for Children. It is a common and necessary feature of tax and expenditure programs to adjust both for family size and for certain costs of work. Take the case of child care where there are no extra benefits provided by a paid worker (such as education or house cleaning). Assume that two families have identical incomes except that the first one takes care of dependents without any outside expense, while the second has more market-based work and formal child care expenses. The first family then has more income left over after child care with which to buy other consumption goods.

Now consider the choice between a child care deduction and a child care credit. Take the example of two neighbors who care for each others kids and pay each other $5,000 for the effort. If the credit rate is higher than the rate of tax on their income, then they make money out of the tax system. If the credit rate is lower than the rate of tax on their income, they lose money by working and paying for child care outside the home. The neutral rate is provided by a deduction, not a credit.

Note that the credit rate under current law is often much higher than the tax rate of the taxpayer. The child care credit in the tax system has rates as high as 30 percent already, and credits or subsidies provided through the expenditure system often provide rates of 100 percent. At 100 percent, child care outside the home is very heavily subsidized relative to care within the home.

Providing Choice. One of the issues surrounding child care proposals is how much choice should be allowed to taxpayers. Child credits—as opposed to credits for child care—provide cash directly for raising children, regardless of how the child care is provided. Thus, they provide considerable choice as to what to do with the money. Child credits raise some separable issues; for instance, if set too high, they can become welfare-like payments.

There is no reason that a tax/transfer system cannot have both child credits and child care allowances. They do not necessarily conflict with each other. The first may be a way of adjusting family burdens for family size, the second an adjustment for different costs of work. An analogy can be made with personal exemptions and office rental expenses associated with work. Self-employed workers may be eligible for personal exemptions in the income tax, but that is no reason they should not also be provided a deduction for office rental expenses in determining their net income.

Using the Tax System. The tax system is often thought to be a logical place to make adjustments for work costs in determining net income subject to tax. Here child care tax allowances make most sense. Child care policy, however, has evolved beyond a deduction into a somewhat elaborate credit mechanism that is similar to an outlay. At a minimum, those extra subsidies should count in the outlay budget, and compete with other outlays on an equal footing.

The Issue of Education. Some allowance for child care can be appropriate for measuring the tax base and determining when families in equal situations are to pay equal taxes. When the subsidy rate is high, however, a child care allowance clearly favors care outside the home. Because it is not neutral with respect to where the child care takes place, policymakers must be especially careful that they are getting something extra for their money. Providing welfare recipients with work training or experience may be one example. Another, however, is education. To the extent that children are to receive additional subsidies, funds should be concentrated where evidence of investment returns are most likely and where market failure most justifies the intervention. Thus, increases in funds for programs like Head Start often may be superior to direct subsidization of formal child care.

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Other Publications by the Authors

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