The Financing of Child Care: Current and Emerging Trends

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Editors’ Note

Early care and education services in the United States are financed by a complex mix of public and private funds totaling about $40 billion annually. In this article, the authors describe the principal sources of funding for child care and conclude that parents pay the primary share, followed by funds from the federal government and those state expenditures that are required to match federal funding. The authors detail a fragmented and underfunded system of finance that is the product of unresolved conflicts between child care policy and early education policy, and between tax policy and expenditure policy. The policy conflicts and insufficient resources create fragmentation in service delivery and inequities in allocation of subsidies.

Federal welfare reform will affect many federal child care funding streams. Therefore, welfare and accompanying reforms can potentially resolve some of the fragmentation, but the authors conclude that the eventual effect of these reforms will depend on the policy choices made concerning key issues, including whether funds for child care will be open-ended and/or an entitlement, whether state matches for funding will be required, and which services will be provided for which families with flexible block grant dollars.

While block grants coupled with increased funding might help solve some of the fragmentation issues in the delivery of child care services, true resolution of the problems will depend upon additional change that addresses underlying policy conflicts. Are public dollars to be used to support work force participation by parents, to promote child development, or both? How do the ways in which subsidies are provided (through the tax system to individuals or as expenditures for programs and services) influence our ability to reach policy goals? The authors urge that tax policy and expenditure policy be integrated, and that child care and early education policy goals be considered together.

—DSG and NJK

The United States does not have a single coordinated child care system. Instead, child care and early education involve a complex mix of private and public funding for an array of formal and informal, regulated and unregulated, primarily educational and primarily custodial

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This article was written before President Bill Clinton signed The Personal Responsibility and Work Opportunity Reconciliation Act of 1996. For a brief review of that welfare reform bill and its implications for child care, see page 4 in this journal issue.
care arrangements. Public funding may be federal, state, or local and may be in the form of tax relief, vouchers or reimbursements to families, contractual arrangements with providers, or direct provision of services. This article describes the principal sources of public and private funding for child care, highlights some of the key issues resulting from the current fragmented funding approach, and suggests some possible consequences if pending federal legislation restructuring several public funding programs is enacted.

It is impossible to quantify the amount of public and private funding expended on child care and early education each year. In part, this is because of difficulties in determining what should be counted in the calculation. Also in part, it is because data are not regularly or consistently reported in some of the categories that ought to be part of the calculation. In part, it is because some of the reporting likely results in double-counting (for example, parent fees for which a tax deduction is also provided). With these caveats, however, it appears that total public and private funding expended on child care and early education may reach or exceed $40 billion annually. This includes funds for a diverse range of services supported by contributions from families; federal, state, and local governments; and the private sector. It appears that most child care and early education expenditures are borne by families, most governmental expenditures are borne by the federal government, and the majority of federal expenditures are for two programs (Head Start and the Child and Dependent Care Tax Credit [CDCTC]) that are only occasionally considered in discussions of funding for child care.

Government policy in relation to child care and early education is inconsistent and fragmented, with troubling consequences. (See also the article by Cohen in this journal issue.) Among families in similar economic circumstances, some receive government subsidies and others do not. When a family enters the subsidy system, assistance may terminate long before the need for child care ends. Different funding streams operate with varying standards and rules, so child care providers that meet the health and safety standards applicable to one subsidy may not meet the standards of another. At the same time, the variation in standards among programs impairs the ability of government to use standards for publicly funded care as a means to affect the overall quality of child care.

Pending federal legislation would make significant changes in the federal and state roles in funding child care. At the time this article was completed, it was unclear whether Congress and the White House would agree on welfare legislation in 1996. The welfare legislation passed by Congress, and vetoed by President Bill Clinton in January 1996, contained substantial changes affecting four of the principal federal child care programs: the Child Care and Development Block Grant, the At-Risk Child Care Program, AFDC Child Care, and Transitional Child Care. In the welfare debates, there has been considerable controversy about the proposed level of child care spending, but far less dispute about the basic structural changes in child care under consideration. The last section of this article discusses the key
The Amounts Spent on Child Care and Early Education

Estimating the amount of money spent on child care and early education can be difficult because it requires both a careful definition of which services and activities are subsumed in the discussion and the availability of good data. In her article in this journal issue, Sandra Hofferth identifies child care centers, nursery schools, Head Start, public prekindergarten programs, family child care, in-home providers, and relatives. In considering the array of public and private expenditures, it is also helpful to broaden the discussion to include funds made available to support school-age child care programs (including recreation programs and summer camps) and to consider funds for services that are often defined as early intervention, such as special care and education programs for preschool-age children with disabilities.1

Even with a clear definition, however, the availability and quality of the data concerning expenditures for these services are very uneven. The public and private entities involved in financing early childhood programs often operate in isolation from one another, view early childhood services in very different ways, and report data differently. Some do not collect data at all or group expenditures only into broad categories. Data are sometimes reported for the calendar year, federal fiscal year, or state fiscal year. Further, the language used to describe the contributions made by the various sectors varies. For example, local school districts do not typically view the support they provide to preschool education or school-age child care as a subsidy, even though this support helps reduce child care costs paid by families. Despite these challenges, by making some generalizations in language and approach, it is possible to paint a broad picture of how child care and early education services are financed in the United States.

Families as Payers

Families bear the brunt of the burden of paying for child care. According to the Census Bureau, total consumer expenditures for child care before taxes were estimated as $23.6 billion in 1991.2 Researchers have estimated that, in 1990, consumer expenditures represented about 70% to 75% of all expenditures for child care, with the balance derived largely from public subsidies.3,4 There has been a notable increase in government spending since 1990. It is not known whether the expansion of government spending resulted in some substitution of governmental for parental expenditures. However, even if one assumes substantial substitution, one would still conclude that the parental stake represents the majority of total expenditures.

Child care expenditures vary across families. Some families incur no child care costs, either because they are able to obtain care without charge or because a government subsidy covers its full cost. As reported in the article by Hofferth in this journal issue, in 1993, employed mothers with children younger than five years of age reported spending, on average, $79 per week for child care; but this amount varies widely.
depending upon the child's age, the location of the program, and the type of care. In New York State, for example, a family with a four-year-old child living in a rural area and using a family child care home could pay as little as $60 per week, but a family with a nine-month-old enrolled in a New York City child care center could pay more than $240 per week (both for full-time care).

The percentage of family income consumed by child care costs also varies widely. In 1991, among women making child care payments, women in families that were in poverty expended 27% of their monthly income on child care, but those in families that were not in poverty expended 7% of their monthly income on child care. (See also the article by Hofferth in this journal issue.) Even families that have relatives to care for their children incur child care costs. In 1990, one out of three employed mothers who reported that they rely on relatives as their primary child care arrangement paid their relatives for the care of their children.

**Government as Payer**

Federal, state, and local governments each contribute to the cost of child care and early education. The federal contribution can be quantified most easily because data from existing reporting are available to identify annual expenditures for most of the relevant programs. State expenditures that qualify for federal match are also not difficult to determine, though estimates are necessary for a range of other state programs. The role of local government is most difficult to quantify; it is clear that some local governments make significant ongoing contributions to the cost of child care for their residents, but it has been difficult to locate any comprehensive survey or other instrument from which to estimate the aggregate local role.

In considering the role of each level of government, it is helpful to draw a distinction between tax-based subsidies and expenditure-based subsidies. About one-fourth of government support for child care comes in the form of tax-based subsidies, which primarily benefit middle- and upper-income families. The remaining three-quarters of government support comes in the form of expenditure-based subsidies, which are largely targeted to low- and moderate-income families. The federal government provides a modest additional amount of support for child care in its role as an employer.

**Tax-Based Subsidies**

Tax-based subsidies for child care take the form of tax credits, tax deductions for employers, and arrangements that allow employees to use pretax dollars to pay for child care. In general, these subsidies are designed either to help individuals cover the costs of child care or to encourage employers to address the child care needs of their employees. Tax credits can be either refundable or nonrefundable, but the largest tax-based subsidy for child care, the Child and Dependent Care Tax Credit (CDCTC), is a nonrefundable credit. This means that families can never recover more in credit than what they actually owe in taxes. Families that have not earned enough to pay taxes but nevertheless have child care expenses cannot benefit from the credit.

Federal Tax-Based Subsidies. The estimated revenue loss associated with the CDCTC was $2.8 billion in federal Fiscal Year 1995, an amount exceeding the combined federal spending for the four programs (Child Care and Development Block Grant, AFDC Child Care, Transitional Child Care, and At-Risk Child Care) that are often identified in discussions of the federal role in child care assistance.

Taxpayers using the CDCTC may receive a credit of up to 30% of the first $4,800 of the cost of caring for a child under the age of 13 or an incapacitated dependent or spouse. A family with two or more qualifying children or dependents may receive a credit of up to 30% of the first $4,800 of its costs. The maximum credit is $720 for one child and $1,440 for two or more children. The percentage of the credit declines as family income increases.

Current tax expenditures for the CDCTC are significantly lower than compa-
rable levels for 1988, when the cost of the CDCTC was $3.8 billion. The Family Support Act of 1988, among other changes, modified the law to provide that a taxpayer would not be eligible for the CDCTC unless the tax return included the name, address, and taxpayer identification number of the dependent care provider. In apparent response, the number of returns claiming the CDCTC dropped from 9 million in 1988 to 6 million in 1989 and was projected to be 6.1 million for 1994.

By design, low-income families can receive a higher percentage credit than can higher-income families. In practice, however, the benefits of the CDCTC are primarily received by middle- and upper-income taxpayers. Because the provision allows only for a reduction in tax liability, it provides no assistance to lower-income taxpayers who owe no federal income tax and only limited assistance to those whose otherwise allowable child care credit exceeds their tax liability. In other words, if a family has spent $2,000 on child care over the year but has a tax liability of only $500, it can receive a credit of at most $500, even if it would otherwise be eligible for a larger child care tax credit. According to preliminary data from 1994, only about 14% of the benefits of the CDCTC went to families with adjusted gross incomes of less than $20,000, nearly half (47%) of the benefits were provided to families with adjusted gross incomes between $20,000 and $50,000, and about 39% of the benefits were received by families with adjusted gross incomes in excess of $50,000.

A second federal tax provision also provides significant support for private child care arrangements. Under an employer-established Dependent Care Assistance Plan (DCAP), the Internal Revenue Code permits an employee to use up to $5,000 per year ($2,500 for a married individual filing separately) in pretax earnings for child care, shielded from income and Social Security taxes. If an employer participates in such a plan, the employee’s pay is reduced by the amount designated by the employee (up to the cap), and the employee receives reimbursement for allowable dependent care costs (up to the amount designated). The employer also saves its share of Social Security taxes on funds placed in a DCAP. In 1994, the estimated revenue loss from DCAP participation was $675 million.

The DCAP is not a tax credit; rather, it reduces taxable income. As a result, it provides its greatest benefits to families in the highest tax brackets. Moreover, unlike the CDCTC, it does not phase out as taxable income increases. Accordingly, one would anticipate that the benefits of DCAP programs would be even more sharply tilted toward middle- and upper-income families than are the benefits of the CDCTC, but no data are available on distribution of DCAP benefits.

State Tax-Based Subsidies. In addition to the tax subsidies provided by the federal government, many states provide tax-based subsidies. A 1994 report indicated that 22 states and the District of Columbia currently offer a tax subsidy for families incurring child care costs. The total value of these state tax benefits is not available but has been estimated in the range of 5% to 10% of the total federal tax-based subsidy (CDCTC and DCAP), which would translate to $175 million to $350 million for 1994.

In addition, 14 states have established an Employer Tax Credit, which typically allows an employer to claim a corporate tax credit of up to 50% of the cost of an employee child care benefit. Unfortunately, these tax credits appear not to have stimulated much employer involvement in early childhood services. As a result, they have produced minimal revenue loss for the states that have established them. A study by the Child Care Action Campaign found that, in 1989, fewer than 1% of eligible employers actually took advantage of the availability of employer credits. Employers who do not use tax credits or who reside in states that have not established them may still deduct expenditures for child care programs as reasonable and necessary business expenses, but there are no available data to estimate
the revenue loss associated with these deductions.

**Expenditure-Based Subsidies**

Expenditure-based subsidies are those involving direct government spending on child care programs and services rather than forgone tax revenue. In contrast with tax-based subsidies, most federal expenditure-based subsidies are designed to serve children from low-income families, including those that receive Aid to Families with Dependent Children (AFDC or "welfare"). The funding

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**Most of the federal funds expended for child care and early education in 1995 were attributable to six programs.**

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programs differ from one another in some significant ways: (1) whether states are required to provide assistance to all eligible families or individuals (an "individual entitlement"), (2) whether the funding programs require state contribution of funds to draw down some or all federal dollars available to a state, and (3) whether federal funding is available to states on an open-ended or capped basis. (See Table 1 for a listing of key federal funding streams for child care and early education services.)

Some funding streams provide what is called an individual entitlement to services. For those funding streams, states have a legal responsibility to provide child care assistance for qualifying individuals or families. Where there is no individual entitlement, a state may, but has no responsibility to, provide assistance to any eligible family.

Some federal child care and early education programs require states to contribute their own dollars to draw down federal funds. The required level of state match is based on a formula (known as the "Medicaid match rate") under which a state's match rate varies with state per capita income. The wealthiest states have a match rate of 50% (one dollar from the state is matched by one dollar from the federal government); a poor state's match rate may be as low as 20% (one dollar from the state is matched by four dollars from the federal government).

Finally, some funding streams are capped at a particular level each year, while others provide open-ended funding. When a funding stream is open ended, the federal government has an ongoing duty to match qualifying expenditures, even if expenditures increase beyond anticipated amounts. In a capped funding stream, federal funding is limited to a specific allocation regardless of the demand for services.

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**Federal Expenditure-Based Subsidies.**

Although many federal funding streams may be used to support child care and early education, most of the federal funds expended for child care and early education in 1995 were attributable to the following six programs, which are described in Table 1:

- **Head Start** is a federally funded program subject to a 20% local match (which may be in-kind or waived) primarily targeted at low-income families with three- and four-year-old children. Head Start programs include child development, early education, social, health, and nutrition services and are typically part-day and part-year. Federal funding for Head Start in FY 1995 was $3.5 billion, the largest amount for any single tax- or expenditure-based child care/ early education program.

- **The Child and Adult Care Food Program (CACFP)** provides open-ended federal funding for reimbursing costs of meals, snacks, and nutrition education in licensed child care centers, family and group day care homes, and Head Start centers. Eligible providers are public and private nonprofits and, in some circumstances, for-profit providers. In FY 1995, federal funding for the CACFP reached $1.6 billion; 98% of the expenditures were for children, the remainder being for adult day care centers.

- **The Child Care and Development Block Grant (CCDBG)** provides a block grant of federal funds to states with no requirement for state match. CCDBG funds may be used for child care services for low-income families (defined as having incomes at or below 75% of the state median income) and for activities to improve the quality and supply of child care. Federal funding for CCDBG was $935 million in FY 1995.

- **AFDC Child Care** provides states with an open-ended federal funding stream, subject
Table 1

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<td>Child and Adult Care Food Program (CACFP)</td>
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<td>Improving America's Schools Act: Even Start</td>
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to a state match requirement, to pay the cost of child care for families receiving AFDC assistance and working or participating in a work or training program. AFDC Child Care is an entitlement for individuals: states have a legal responsibility to provide child care assistance for qualifying families. Federal funding was $666 million in FY 1995.

- The At-Risk Child Care Program provides a limited amount of federal funding to states, subject to state match, to provide child care assistance for working poor families whom the state considers at risk of receiving AFDC unless such assistance is provided. The annual capped amount for the program is $300 million; federal funding was $357 million in FY 1995 (because funds were carried over from a prior year).

- The Transitional Child Care (TCC) Program is an open-ended federal funding stream available to states, subject to state match, to pay the cost of child care for up to one year for qualifying families that have left AFDC due to employment. TCC is an entitlement for qualified families. Federal funding for TCC was $199 million in FY 1995.

In addition to these six programs, Title XX or the Social Services Block Grant (SSBG) is a significant federal source of child care funding in some, but not all, states. SSBG provides a block grant to states without a state match requirement; in FY 1995, federal funding for SSBG was $2.8 billion. A state’s SSBG allocation may be used for a broad array of social services. Unfortunately, there are at best very limited data regarding how states use their SSBG funds or what percentage they spend on child care. Data from 23 states concerning their 1990 SSBG expenditures indicate that they spent 16% of their SSBG funds on child care. Child care advocates have raised concerns, however, that some states significantly reduced their use of SSBG funds for child care when new federal child care funds became available to the states under the Family Support Act of 1988 and the 1990 Child Care and Development Block Grant. Because more recent data are not available, it is not possible to know how current SSBG utilization patterns compare with the limited 1990 data.

Two additional federal programs are not typically included in discussions of funding for child care and early education but are potentially significant sources of funding: the Individuals with Disabilities Education Act (IDEA) and Title I of the Improving America’s Schools Act (formerly called Chapter 1).

The IDEA established an entitlement to special education services for children ages 3 through 21 with disabilities, and authorized three primary grant programs to assist states in serving them: State Grants (Part B) may be used for children with disabilities ages 3 through 21; Preschool Grants (Section 619) are specifically targeted to children ages 3 through 5; and Grants for Infants and Toddlers (Part H) may be used to develop and implement a comprehensive statewide system of early intervention services for children under age 3 and their families. Slowly, these services are becoming part of the mainstream child care and early education system. In FY 1995, total federal funding for infants and toddlers (Part H) was $316 million, while total federal funding for preschoolers (Section 619) was $360 million, although the percentages of these totals used for child care are unknown.

School districts may also use federal Title I funds to support preschool education and school-age child care programs. Title I, Part A grants are made available to local school districts serving a high percentage of low-income families to support services for “educationally disadvantaged” children. Providing support to preschool and school-age child care programs is an allowable use of these funds. Although the total Title I funding level is substantial (almost $6.7 billion in 1995), fewer than 2% of children served with these funds are of preschool age, and the amount expended for preschool or school-age child care activities is unknown. In addition, Title I, Part B grants (the Even Start Program) are made available to schools to provide a variety of services, including

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child care, to educationally disadvantaged one-to-seven-year-old children and their parents. Again, the percentage of Even Start funds used for early childhood education is unavailable, but is estimated to be small.

Federal expenditure-based support for child care and early education is not limited to the funding programs mentioned; several smaller funding streams exist that may be used to support these services. In fact, a 1994 General Accounting Office (GAO) report identified more than 90 federal early childhood programs in 11 federal agencies and 20 offices. However, although child care and early education may be an allowable expenditure under many funding programs, the vast bulk of federal expenditures (other than tax expenditures) is clearly in six programs (Head Start, the Child and Adult Care Food Program, the Child Care and Development Block Grant, AFDC Child Care, At-Risk Child Care, and Transitional Child Care) plus the Social Services Block Grant. In the GAO’s analysis, 34 “key” early childhood programs were identified, but 80% of the federal funding attributable to early childhood in this set of programs was concentrated in the six programs already noted, plus the SSBG.

State Expenditure-Based Subsidies. State expenditure-based support for child care and early education programs falls into two general categories: state matching funds that must be contributed as a condition of drawing down federal funds and state funds that support state-sponsored child care and early education initiatives. Although the amounts required to match federal funds are readily ascertainable, it is more difficult to quantify the second category of state expenditures.

In 1994, states spent $724 million for the required match for AFDC Child Care, At-Risk Child Care, and Transitional Child Care. States also make significant investments in part-day, part-year preschool programs, primarily for four-year-old children. In 1991–92, some 32 states with aggregate state investments in preschool programs reaching approximately $665 million served almost 290,000 children.

Some state governments have also developed subsidy programs to help low-income families pay for child care. These initiatives may also address specific needs, such as child care services for teen parents, families participating in substance-abuse programs or that are homeless, campus-based child care programs, or school-age child care programs. States typically garner resources for these initiatives from a range of federal and state sources, making it difficult to quantify the precise amount of funds expended by states alone. Data contained in a Children’s Defense Fund survey suggest that states spent a total of $1.2 billion on such initiatives in FY 1990; however, based on the manner in which data were reported, it is impossible to be certain how much of this figure may have represented state expenditures of federal funds.
State funds also support initiatives to increase the quality and supply of child care programs, including start-up and training funds, licensing and monitoring efforts, or accreditation initiatives. Data are not available on the total amount of state funds invested in these initiatives, although much may have been derived from federal funds.

In considering the state role, it is important to appreciate the enormous variation in funding levels across states. In 1990, state expenditures for child care and early education ranged from $0.24 to $152 per child under age 14. Two-thirds of all state expenditures for state prekindergarten initiatives in 1991–92 were concentrated in just five states.

Local Expenditure-Based Subsidies. Local support for the child care and early education system is significant in some communities, especially when the contributions made by local school districts and recreation departments are considered. But comprehensive information on the amount of local funds expended to support early childhood services is not available. Local city and county government contributions often constitute the matching funds necessary to draw down federal and state appropriations; in 1992, 11 states required local governments to provide a part of the required state match to draw down federal child care funding.

In 1990, state expenditures for child care and early education ranged from $0.24 to $152 per child under age 14.

In addition, local government expenditures may include special programs or services that are supported by local tax levy funds. For example, in FY 1993, the District of Columbia spent more than $18 million in district funds to support its system of subsidized child care centers and homes and in FY 1994, the New York City Department of Human Resources contributed more than $137 million in city tax levy funds to help support its subsidized child care system and more than $146 million to support preschool programs in the city schools during the 1993–94 school year.

Other locales may use generic federal and state funds, such as Community Development Block Grant (CDBG), Community Services Block Grant (CSBG), and Job Training Partnership Act (JTPA) funds to support child care. Dallas and Minneapolis, for example, spend approximately half a million dollars each in CDBG funds for local child care subsidy programs.

Special education and early intervention services for young children with disabilities are supported by local funds in at least 26 states and local governments have also paid for building or renovating child care facilities. The Housing and Redevelopment Authority in Sacramento, California, for example, used $2.48 million in tax increment and CDBG funds to support the construction of various child care facilities in low-income areas.

Before- and after-school child care programs are often located on school grounds and operated by the school district or a community-based agency. Although most families that use these programs pay fees (80%), more than one-third of the programs receive free or reduced rent and other donations or in-kind services. In some communities, local recreation departments administer or fund before- and after-school child care or recreation programs and summer camps, and a few are involved in sponsoring full-day child care programs as well. Estimates of national totals for these types of programs are not available.

Government as an Employer

In 1988, the Bureau of Labor Statistics reported that 26.4% of government establishments provided some form of child care benefit or service to employees. These services range from sponsoring an on- or near-site child care center or providing assistance with child care expenses to providing child care resource and referral or other counseling services. A 1989 survey on the implementation of work/family policies in state government indicated, however, that government activity in this area has focused largely on reevaluating policies regarding flexible work schedules, such as flextime and permanent part time, to ensure that they
meet the needs of employees with families or on establishing pretax dependent care assistance plans for their employees.32

The U.S. General Services Administration (GSA), along with 29 state governments and a number of local governments, has helped to develop work site child care centers. GSA has sponsored a network of more than 100 child care centers located on or near federal work sites. Roughly 15% of the families that use these programs receive some form of subsidy from the center. Although some of the state workplace initiatives are extensive (New York State, for example, has 55 work site centers and a host of other child care initiatives for state employees), most are very small. A 1991 study found that most states had established only one or two centers.32,33

### The Private Sector as Payer

Contributions from the private sector probably represent less than 1% of the total expenditures for child care and early education services in a given year. However, this support can be very significant for some early childhood programs and some communities.

### Employer-Supported Child Care Initiatives

In the past five years, major corporations have invested more than $350 million in child care initiatives.34 These funds have primarily been used to help start new child care centers, recruit new family child care homes, and improve the quality of child care services.

However, the role of the business community remains limited. The most extensive survey on employer-supported child care initiatives indicated that in 1988 only about 2% of U.S. work sites with 10 or more employees (25,000 establishments) had established on- or near-site child care centers, and about 3% (35,000 establishments) offered some form of child care subsidy. When services such as counseling and resource and referral are added to the picture, about 11% of employers provided some form of child care benefit or service.35

### Philanthropy

Charitable organizations help to support child care and early education services in communities across the country. Chief among these is United Way, a network of local organizations that employ community-wide campaigns to raise funds to support local human service agencies. A 1994 survey conducted by United Way of America found that nearly $193 million—or 8.8% of the total dollars distributed by United Way—was awarded to child care programs.36 Unlike other private-sector contributions, United Way funds are often used for general operating support to specific child care programs that serve large numbers of low-income families. In addition, United Way funds sometimes support the local child care system, for instance, by creating a community-wide scholarship program for low-income families that do not receive government subsidies or as local match to help draw down funds from the state or federal government.

Private foundations provide support to the child care and early education system as well. In the Foundation Grants Index covering the 1993 or late 1992 fiscal years, 174 foundations reported that they awarded 383 grants for the primary purpose of child care; these awards totaled almost $18 million.37 Most foundations do not provide general operating support, but they may offer one-time assistance in starting a new center or network of family child care homes support for staff training and professional develop-

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### Religious Organizations

Religious organizations also support child care and early education programs. A 1983 study of 15 Protestant denominations
reported that 26% of the churches that housed child care centers offered scholarships or other direct subsidies to low-income families. When all forms of financial assistance were considered, including free or reduced rent, utilities, janitorial services, and so forth, it was estimated that, of the 14,589 church-housed centers included in the study, 94% were subsidized in some way by the churches in which they were housed.39

In addition to receiving support from individual congregations, some child care programs receive support from religious organizations that raise funds for human services. The United Jewish Appeal/Federation of Jewish Philanthropies and Catholic Charities, for example, distribute millions of dollars each year to human service agencies, many of which sponsor early childhood programs.

**Hidden Subsidies: In-Kind Donations and Forgone Wages**

Data from a national survey of child care programs suggest that approximately one-third of all child care centers receive in-kind donations, including free space, supplies, food, equipment, and toys.40 Many centers also receive donated services, such as janitorial and maintenance help; nursing or other medical support; and legal, accounting, clerical, or teaching assistance. A few early childhood initiatives have been able to raise as much as $1 million a year in various forms of in-kind contributions and volunteer services.41 (See the article by Helburn and Howes in this journal issue for a discussion of the role of in-kind contributions and donations in the funding of child care centers.)

It has also been suggested that an important hidden subsidy to the cost of child care programs is provided by their staff, who earn significantly less in child care than they could in other occupations.42 One estimate concluded that when the full cost rather than the expended cost of operating a child care center is considered, the contributions made by staff in forgone earnings and benefits account for approximately 19% of the cost. The estimate concluded that, taken together, in-kind contributions and forgone wages account for more than 25% of the full cost of operating a child care center.43 (See also the article by Helburn and Howes in this journal issue.)

**Tentative Conclusions from Limited Data**

The data concerning current funding for child care are limited in some areas (especially state, local, and private contributions). But those available lead to three major conclusions. (1) Parents bear the largest burden in the current system of financing child care. (2) The federal government's contribution is next largest and is due primarily to six expenditure-based subsidy programs and two tax-based subsidy programs. (3) The great majority of subsidy funding comes from either the federal government or from state expenditures required to match federal funding.

**Fragmentation in Current Policy: Causes and Consequences**

The nature of the governmental role in child care has changed profoundly in the past decade as the federal government established a set of new federal funding streams for child care, each with its own target populations, fiscal structure, and requirements. In a two-year period (1988 to 1990), Congress enacted four new child care funding streams: AFDC Child Care, Transitional Child Care, At-Risk Child Care, and the Child Care and Development Block Grant. By FY 1995, federal funding for these programs provided more than $2 billion for states. Implementation of these funding programs has significantly expanded the ability of states to provide child care subsidies to low-income families but has been accompanied by a set of frustrations flowing from the complexities of integrating four funding programs with (sometimes) four sets of rules.

Over the past five years, it has become common for child care administrators and
other concerned persons to speak about “fragmentation” in the child care system and to articulate a vision for a single system of “seamless service.” Variations in rules and requirements among the four programs have complicated attempts to develop a unified approach to the governmental role in child care and early education and to blend the four streams into a single system. Yet it is also important to appreciate that the barriers to seamless service are only partly attributable to differences in rules between funding streams. The barriers also reflect the difficult choices that must be made when resources are insufficient to assist all who are in need, the lack of integration between child care subsidy policy and tax policy, and the lack of integration between child care policy and early education policy. In the broadest sense, what is sometimes seen as fragmentation is a reflection of the lack of an overall vision for a social policy that harmonizes the goals of encouraging and supporting work force participation by parents with ensuring safe, healthy, and stimulating environments for children.

Seen from the perspective of families needing assistance, the fragmentation of current policy is apparent in a number of respects:

- Among low-income families with similar needs and circumstances, some benefit greatly from child care subsidies while others receive no assistance at all. For example, a working poor family receiving AFDC may be eligible for a subsidy while an equally poor family not on AFDC is not.

- A family that enters the subsidy system may lose all assistance while still in need simply because the family no longer qualifies for a particular categorical subsidy. For example, a parent who is employed may qualify for a subsidy but become ineligible if she loses her job, even if child care is essential for her job search; a family receiving a child care subsidy through the Child Care and Development Block Grant may lose its entire subsidy when a dollar of income places it above income eligibility guidelines (75% of state median income); and a mother who has left welfare for work may lose all aid for child care at the end of her 12 months of transitional child care assistance, even though her economic circumstances and need for child care are the same in the 13th month as they were in the 12th.

- The source of care that may offer the most appropriate child development services may operate only part-day, part-year (as is often the case with Head Start, public prekindergarten programs, and segregated programs for children with special needs). It may be difficult or impossible to combine participation in such a program with another source of “wraparound” child care.

On first impression, one may be tempted to blame some of the fragmentation described on “restrictive federal rules” that specify when particular federal funding streams can and cannot be used for particular populations. In some respects, this charge is accurate. For example, federal law mandates that a state provide transitional child care for 12 months but bars use of the funding stream for the 13th month. Federal law permits use of AFDC Child Care funding to provide for child care for extended periods of job search, but a state cannot use Transitional Child Care or At-Risk Child Care in similar ways. Moreover, there are often frustrating variations between funding streams in rules relating to sliding fee scales, payment rate requirements, and health and safety standards.

In a broader sense, however, the principal source of perceived fragmentation in child care services is not rules but resources. States currently have the legal authority to link federal funding streams with one another to, for example, extend transitional child care indefinitely to a low-income family through use of At-Risk, CCDBG, or SSBG (Title X X)
funds, to provide child care subsidies to non-AFDC families, or to make child care broadly available for parents in education, training, or job searches. And, in any of these cases, states could opt to use state-funded subsidies to cover gaps in federal coverage. To a great extent, what is treated as a problem caused by inconsistent rules is in fact a problem caused by inadequate resources to serve all in need. Scarcity of dollars forces states to use their limited funds in restrictive ways.

A 1995 GAO survey of 7 states found that 5 states had waiting lists for subsidized child care ranging from 3,000 to 36,000 families; the other 2 states did not keep waiting lists. Another 1995 study reported that 36 states indicated they had waiting lists for working poor child care, with 8 states reporting at least 10,000 children on their waiting lists.

Sixteen states reported using CCDBG funds to provide child care for families that would qualify for AFDC Child Care and Transitional Child Care, effectively displacing non-AFDC families from those CCDBG slots. However, a state’s choice to do so largely reflected its inability or choice not to expend the state dollars needed to draw down matching federal funds for AFDC-related child care.

To some observers, a principal flaw in the current system of financing is that states are mandated to guarantee child care to AFDC recipients who are working or in approved education and training programs and to provide 12 months of child care to families leaving AFDC due to employment. Open-ended federal funding is available, subject to state match, for these purposes. To minimize expenditure of state funds, states often prefer to use first the funds that do not require a match (for example, CCDBG). This can create a scenario where the only available child care slots are for AFDC and former AFDC recipients because child care subsidy funds that could have been used for the low-income working poor will have been expended. However, even with recent expansions, only a small fraction of AFDC families actually receives child care assistance—in FY 1993, fewer than 4% of AFDC recipients received child care assistance to participate in work, education, or training programs each month.

Although most of the discussion of fragmentation in child care policy focuses on the previously mentioned programs, there are two other important senses in which system fragmentation is substantial: the relation between direct expenditure and tax expenditure policy and the relation between child care subsidy and early education efforts. As noted, the annual federal tax expenditure associated with the CDCTC exceeds the combined federal spending for the four low-income subsidy programs. Moreover, the lack of any phaseout for DCAPs as level of family income increases means, in effect, that federal law offers a $1,980 annual subsidy for families in the highest tax bracket (based on an exclusion of $5,000 in taxable income for a family at a 39.6% marginal tax rate). At the same time, there may literally be no assistance to a working poor family that is too poor to incur tax liability and unable to access an existing subsidy program.

Perhaps the single largest area of fragmentation, however, involves the uncertain relationship between child care policy and early education policy. This is evidenced not just by the different rationales for the funding of early childhood programs (see the article by Cohen in this journal issue), but also by the way in which the programs operate. The largest single federal expenditure for a program involving the care of young children is for Head Start, commonly seen as an early education program. Most state prekindergarten and Head Start programs operate only part-day and part-year, despite the needs of working parents for full-time child care. The 1993 Advisory Committee reported that fewer than 1% of Head Start children were served in programs operating eight or more hours a day and more than 48 weeks a year, even though 33% of Head Start children had at least one parent working full time.
The separation between child care and early education policy also reflects the tension between two very different visions of the primary goal, in which programs labeled as child care subsidy programs are viewed primarily in terms of strategies to support or require parental labor force participation, while programs labeled as early education programs are designed to focus on educational, developmental, health, and other needs of children. The work force subsidy goal is often driven by the need to maximize coverage with limited resources and sometimes results in attempting to minimize payment rates, encourage less formal care arrangements, and at times encourage families to manage without subsidized care at all. Each of these pressures leads to policy results in direct contravention of the early education goals. As long as these are viewed as opposing goals—rather than goals to be integrated into a single system—the fragmentation in government policy will not be alleviated by simply increasing the funding available for subsidies or simplifying rules governing particular funding streams.

**Potential Impact of Welfare Reform**

In 1995, consideration of the federal role in child care became subsumed in the debate about welfare reform. The welfare legislation enacted by Congress, and vetoed by the president, would have made significant changes in the federal child care role, though those changes were rarely given much public attention except in the context of discussions about whether there was "enough" child care to meet the anticipated needs of mothers who, because of newly proposed requirements, would be required to enter employment or participate in work programs in order to continue to receive welfare benefits. As of early 1996, it is unclear whether any welfare legislation will be enacted, and the details of new legislation may differ from the details of the vetoed bill. Nevertheless, it is helpful to highlight the principal child care-related changes that were contained in that bill because some of its basic tenets appear likely to remain in subsequent legislation, and those tenets have the potential to affect profoundly the overall framework of federal-state child care and early education policy.

**The Personal Responsibility and Work Opportunity Act of 1995**

In December 1995, Congress passed (and on January 9, 1996, the president vetoed) the Personal Responsibility and Work Opportunity Act of 1995, H.R. 4. The legislation would have substantially altered the federal child care role, both indirectly through the repeal of the AFDC program and directly through a set of changes to child care funding streams. There were three principal legislative provisions affecting child care in H.R. 4:

1. The AFDC program would have been repealed and replaced by a block grant to states. States would have been able to use the block grant to provide cash, noncash assistance, or services to needy families. The individual entitlement to aid would have been eliminated, and states would have had no responsibility to provide aid to families in need. To receive a full block grant, a state would have been required to satisfy “work participation rates” to ensure that a steadily increasing percentage of those receiving aid were participating in work activities. States would have been prohibited from using federal funds to aid a family for more than five years (with a limited number of exceptions allowable).

2. Individual entitlements to child care assistance and open-ended federal funding for such assistance would have been eliminated. The bill would have repealed both state responsibilities to provide child care assistance for AFDC families participating in work or training and the duty to provide transitional child care to families leaving AFDC due to employment. The bill would have also ended the availability of open-ended federal funding for such purposes.

3. Child care funding streams would have been consolidated. Four child care funding streams (AFDC Child Care, Transitional Child Care, At-Risk Child Care, and the Child Care and Development Block Grant) would have...
been consolidated into two funding streams. States would have qualified for an amount somewhat above their 1994 funding levels (for the four programs) with no requirement of state match. An additional capped amount of funding above that level would have been available subject to a state match. In addition, the legislation would have reduced the annual authorization of Title XX (the Social Services Block Grant) by 10% and restructured reimbursements in the Child and Adult Care Food Program to generate federal savings.

If welfare/child care legislation is enacted in 1996, the specific details and funding levels contained in affected programs could change from those in H.R. 4. However, based on the provisions contained in H.R. 4 and the kinds of changes under consideration, it is possible to identify a set of key issues whose resolution will shape the ultimate effects of the legislation. These key issues will include the following:

Will states reduce the availability of care, amounts paid for care, or standards for allowable care?

Will states shift substantial resources away from cash assistance for poor families and toward child care subsidies? Under H.R. 4, states could have transferred up to 30% of funds from their AFDC-replacement block grant to child care, could have spent AFDC-replacement block grant funds on child care, and could have counted state child care spending toward satisfying “maintenance of effort” requirements of the AFDC-replacement block grant. In many respects, the structure seemed to encourage states to respond to increased child care needs by reducing the availability of cash aid for poor families. If a similar structure is ultimately enacted, will states expand child care by reducing income support for poor families?

Will there be any group of families entitled to receive child care assistance as a matter of federal law? Under H.R. 4, all low-income child care entitlements would have been eliminated. States would no longer have had a duty to guarantee child care for AFDC families or families leaving AFDC (or its successor) due to employment. If states no longer have a duty to guarantee care for participants in work and training programs, would states reduce the availability of care, amounts paid for care, or standards for allowable care?

Will states reduce the availability of paid child care for older children? H.R. 4 provided that a state could not reduce or eliminate a family’s cash assistance based on failure to comply with work requirements in the case of a single-parent family with a child under six with a demonstrated inability to attain needed child care. In any other case, a state would have been free to impose grant reductions or terminations for failure to comply with work requirements, even if needed child care was unavailable. If states face such a structure, will they respond by reducing the availability of subsidized child care slots for parents of school-age children?

Will child care funding be set at a level sufficient to meet welfare work participation requirements without severely curtailing
access to care for families not in the welfare system? H.R. 4 made use of accelerating welfare work requirements under which states would have faced a requirement that 50% of the “welfare” caseload must be participating in work activities for 35 hours a week by FY 2002. As noted, under current law, only about 4% of AFDC recipient families are currently receiving child care subsidies from AFDC-related child care funding streams. If there is a vast expansion of need, and limited resources with which to respond, how will it affect the availability of care for the working poor not in the welfare system? Will states divert resources from working poor families in order to meet welfare work participation rates?

How will the role of child care change in the context of time-limited welfare? Under H.R. 4, a state would have been prohibited from using federal funds to provide cash assistance to a family for longer than 60 months (with exceptions allowable for 15% of the caseload). From recent and pending state proposals, it is clear that some states envision implementing welfare time limits significantly shorter than the five-year limit. How does time-limited welfare change the role of child care? If child care is unavailable to a family reaching a time limit, a parent’s prospects of attaining employment may be significantly reduced. At the same time, if families that have reached a time limit become a new child care priority, will tensions with other groups in need be exacerbated? In a context of limited resources, how are priorities to be set?

How will the new structure address the problem of fragmentation in child care policy? The enactment of legislation along the lines of H.R. 4 may reduce fragmentation in child care policy in the narrow sense of reducing differences in rules between programs. However, it seems likely to exacerbate the fragmentation problems presented by the inadequacy of overall systems resources. It leaves wholly unaddressed the fragmentation that currently exists between direct expenditure policy and tax policy and between child care policy and early education policy. If states face pressure to maximize labor force participation, then, coupled with already severe demands on available funding, there is reason to fear that the tension between child care and early education policy will become more extreme.

Conclusion
This survey of current funding streams for child care and early education leads to three principal conclusions. First, it is not now possible to present a comprehensive picture of the role of all sectors of government (federal, state, and local) and of the private sector (business, religious community, foundations) in the financing of child care and early education in the United States because the data are not available to describe fully the private sector role or even the roles of state and local governments. There is a clear need for more extensive documentation of the nonfederal role, a need that is likely to become more pressing in an era of devolution.

Second, from available data, one reaches the conclusion that, for the nation as a whole, the great majority of subsidy funding comes from either the federal government or state expenditures required to match federal funding. Although the federal role is often criticized for involving multiple and fragmented funding streams, it is also important to appreciate the crucial role of federal funding and requirements in expanding the resources available for child care and early education programs and assistance.

Third, discussions of child care financing are often confined to a consideration of child care subsidy expenditures. However, when the discussion is broadened to include tax expenditures and early education programs, the universe of resources becomes larger, and the nature of system fragmentation can be seen quite differently.

If pending legislation is enacted, it will present a clear challenge to states. Can states construct unified child care and early education policies in the absence of a unified federal policy? Can the state begin with an
articulated philosophy of ensuring the safety, well-being, and healthy development of children and develop policies to encourage and support parental work force participation without undercutting the goals for children’s development? What are the best ways to advance that dual vision while drawing on the inventory of available federal and state resources?

Although resource constraints are likely to be a theme in every state, the constraints may be less severe when the universe of available resources is broadened. If tax policy and expenditure policy are envisioned together, and child care and early education policy are integrated, the possibilities for reorganizing and expanding resources may be significantly increased.

Early childhood care and education services must be viewed as a system, rather than a disparate array of services, and must focus on the needs of both children and families. The agencies involved in funding and administering federal, state, and local early childhood subsidy programs must work together to establish common goals, policies, and procedures. The private sector must be brought to the table, included in the vision, and encouraged to view its contributions as part of an overall system.

Ultimately, however, although coordinating early childhood funds and services is essential, it is not enough. There must also be a willingness to invest additional public and private funds in the care and education of young children. Even if all current funding streams were used most effectively, we would still fall dramatically short of the investment needed to ensure that all children receive the early care and education they need to succeed. We should not act as if resource shortfalls were the only problem, but neither should we act as if better coordination or fewer regulations can compensate for the resources essential to an effective unified system of child care and early education.

1. In a sense, both kindergarten and postkindergarten programs can also be seen as part of a broader system of care and education for children, but the cost and financing of elementary and secondary education are not included in this article. These will be reviewed in a forthcoming issue of The Future of Children.


7. Although tax-based subsidies are in theory a form of child care assistance, most families do not consider these funds when reporting the amount of family income expended for child care and apparently do not view this assistance as a child care subsidy. See note no. 5, Hofferth, Brayfield, Deich, and Holcomb, and the Hofferth article in this journal issue.

8. Accordingly, the $2.8 billion figure somewhat overstates the share of CDCTC tax expenditures attributable to child care because it also includes dependent care costs for physically or mentally incapacitated dependents or spouses. The same issue applies to the tax expenditures associated with Dependent Care Assistance Plans.


14. The 14 states with Employer Tax Credits for child care are Arizona, California, Connecticut, Kansas, Maine, Maryland, Mississippi, Montana, New Mexico, Ohio, Oregon, Pennsylvania, Rhode Island, and South Carolina.


16. For-profit providers are eligible for CACFP funding if at least 25% of the children in their care receive assistance under the Social Services Block Grant (Title XX).

17. Federal IDEA funds represent a fraction of all dollars spent to serve young children with disabilities. A 1994 profile of Section 619 services indicates, for example, that 41 states report spending state special education funds for these services, and many others use state early childhood, general education, developmental disabilities, social services, health, and private insurance funds. Federal funds under Head Start, Title I, Medicaid, and Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) are also used in a majority of states. See Heekin, S., and Tollerton, D. Section 619 profile. Chapel Hill, NC: National Early Childhood Technical Assistance System, 1994.


23. This estimate excludes state appropriations for preschool initiatives, state contributions to Head Start, and the state match required to draw down federal welfare reform funds. Additionally, the survey was conducted before the Child Care and Development Block Grant was implemented and the effects of welfare reform child care initiatives were fully felt.


27. Additional examples include Seattle, which pools approximately $2.4 million each year in CDBG, JTPA, city general funds, and a special tax levy to support child care, and Austin, which pools CDBG and local funds and spends almost $1.2 million a year. See Urban child care administrators’ exchange. New York: National Center for Children in Poverty, July 1994.

28. See note no. 17, Heekin and Tollerton.


31. As cited in U.S. House of Representatives, Committee on Ways and Means. Overview of enti-
33. Although the number of employees and children served by government work site initia-
tives is limited, these initiatives may have a profound impact in some communities and can
serve as an important catalyst for the child care and early education system as a whole.
The U.S. Army's system of Child Development Services (CDS) is a case in point. The army
has sponsored child care centers and homes, before- and after-school programs, on-site
short-term care, and referrals to off-post child care programs. Although these child care
programs, located at 171 installations worldwide, are independently operated and charge
family fees, the army provides a one dollar match for every one dollar paid by army fami-
lies that use child care. CDS has also focused on improving the quality of care by imple-
menting a caregiver wage program that provides for competitive pay for staff and by estab-
lishing a goal that all CDS child care centers obtain national accreditation by 1996. See
U.S. Army, Child Development Services. Information about Child Development Services,
undated.
34. Friedman, D. Planning with business partners to assist low-wage workers: Let's talk about
it. Speech presented at the Administration for Children and Families Planning
37. The Foundation Grants Index includes only grants of $10,000 or more.
38. The Marin Education Fund's effort to create a child care scholarship fund for low-income
families that live in Marin County, California, is a notable exception.
39. Lindner, E., Mattis, M., and Rogers, J. When churches mind the children. Ypsilanti, MI:
41. Schultz, T., Lopez, E., and Hochberg, M. Early childhood reform in seven communities: Front-line
practice, agency management and public policy. Washington, DC: U.S. Department of
42. Helburn, S., Culkin, M., Morris, J., et al. Cost, quality, and child outcomes in child care centers:
43. In this study, the term expended costs referred to cash costs or expenses incurred by a cen-
ter to operate its programs. The study found that the average forgone wage was $5,238 per
year for a child care teacher and $2,582 per year for an assistant teacher. Ninety-three per-
cent of the teachers and assistant teachers in this sample were underpaid. See note no. 42,
Helburn, Culkin, Morris, et al.
46. HHS Information Memorandum CC-ACF-IM-94-2 (December 2, 1994).
47. It may be contended that the Earned Income Tax Credit (EITC) provides such workers
with a refundable tax credit that could be used to defray child care costs. However, the
EITC is available whether or not a family incurs child care expenses and does not vary
depending on child care costs.
48. Advisory Committee on Head Start Quality and Expansion. Creating a 21st century Head
49. Since November 1994, 11 states have submitted federal waiver proposals seeking to imple-
ment a time limit in which all cash aid to a family would be cut off after a period shorter
than five years. Seven states have sought to implement statewide cash aid time limits of two
years or less. See Racing to the bottom? Recent state welfare initiatives present cause for concern.