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Effects of Subsidies on the Child Care Market: Large Increases in Capacity, Small Increases in Price

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POLICY BRIEF

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BRIEF HIGHLIGHTS

- *Subsidies can make child care affordable for families with low incomes, but evidence about their effects on child care markets is limited.*
- *We study how child care subsidies for parents with low incomes in Minnesota impact local child care pricing and capacity.*
- *We find that an additional investment of $100 per young child in the local population increased the capacity of licensed private providers by 4 percent and raised the average price of weekly, full-time child care by 0.3 percent.*
- *The results suggest that expanded public funding can provide an effective path toward broader child care access for families with low incomes.*

For additional details, see the full working paper at https://research.upjohn.org/up_workingpapers/394/.

The cost of child care is out of reach for many low- and middle-income families in the United States (Landivar 2023), and parents and other caregivers may be unable to work without reliable and affordable child care. As these people leave the labor force or cut back on their work hours, local employers and wider communities are also affected. Disadvantaged children and their future families, neighbors, coworkers, and employers also miss out on the substantial long-term benefits of high-quality child care experiences (Chaparro, Sojourner, and Wiswall 2020).

Subsidies are a key way to make child care affordable for families with low incomes and can help address racial and ethnic disparities in access to high-quality experiences during early childhood. However, subsidies may also drive up costs and thus increase the prices unsubsidized parents must pay. How much subsidies expand service, compared to how much they increase prices, depends on how flexible child care supply is in meeting increased demand. Policymakers considering public funding for child care would benefit from evidence about the effects of subsidies on local care markets. In particular, policymakers may want to know whether new money supplements or crowds out existing resources, but such evidence has been limited.

We study the effects of a nationwide block-granted program that subsidizes low-income families' use of child care services, focusing on Minnesota's implementation of this program through subsidies for care delivered by private providers. Using school districts to represent local child care markets, we determine how much is spent through these subsidies in each local area each year. Changes in funding within local areas over time allow us to estimate the causal effects of public funding on two critical aspects of the private child care market: capacity and price.

We find that increased subsidies produced relatively large increases in total local child care capacity but only small increases in average prices. In our results, the supply of private child care services was highly elastic, meaning that local resources expanded to meet increased demand with relatively little adverse effect on unsubsidized families. Overall, our estimates imply a supply elasticity of 10.7—for every 1 percent price increase driven by the increased subsidy, total capacity increased by more than 10 percent.

We also find that these public investments catalyze child care markets and induce additional families to use care and to start paying their own private resources into the sector. An increase of about $4,200 in public subsidy created one new full-time child care slot, which has a value of about $10,000, with the difference coming from new private funds. These results suggest that relatively modest public investments can have large impacts.

These results should help to reduce concerns that increases in child care subsidies would be absorbed mostly by unintended price increases that might crowd out families with low and middle incomes who do not receive subsidies. We found that the market in

Subsidies are one way to make child care affordable for families with low incomes, but there is concern they could also raise costs.

Minnesota responded flexibly in providing more care when more resources were made available to pay for that care. Our findings suggest that expanded public funding can provide an effective path toward broader child care access for families with low incomes.

How Do Public Investments Affect Child Care Markets?

Despite the known benefits of high-quality child care, the United States spends much less per child per year on programs for children ages 0 to 4 than on K-12 education. Public spending on the early years is also much lower in the United States than in peer nations (Davis and Sojourner 2021). New investments in child care, such as those proposed in the 2021 Build Back Better Act (White House 2021), are high on state and federal policy agendas. But a lack of recent evidence about how subsidies affect capacity and price in child care markets has hampered the policy debate.

Because new funding increases the number of families seeking child care, the effects of public investment will depend on how the provision of child care changes to meet demand. This response is described by the child care services supply curve. On the one hand, if supply is highly elastic (characterized by a flatter supply curve) and quantities increase to meet demand as new providers enter the market at higher rates and existing providers exit at slower rates or expand, price increases should be minimal while the total number of child care slots increases. On the other hand, if supply is inelastic (characterized by a steeper supply curve) and quantity does not increase much in response to increased demand, prices are likely to rise dramatically, helping fewer new intended beneficiaries and making it harder for those without subsidies to afford care.

Research using data from the 1980s and 1990s suggests that the supply of child care in the United States was highly elastic (Blau 2001), but the situation may have changed over time. Women have more job options than they did three decades ago. Regulations now set more limits on staff-to-child ratios, group size, and staff qualifications, which limit the ability of providers to expand. More recent evidence on the dynamics of child care markets is needed to inform policy choices.

Public Child Care Funding in Minnesota

We study child care subsidies provided through the state-federal Child Care Development Fund (CCDF) partnership, a longstanding program that provides subsidies for private-sector child care to parents with low incomes. Minnesota's CCDF program is called the Child Care Assistance Program. About 3 percent of Minnesota children under age 5 receive child care subsidies through the program.

We use administrative data from 2012 to 2018 on public child care spending in local child care markets (defined along the geographic lines of school districts). Through an agreement with the Minnesota Department of Human Services, we accessed de-identified data on each child whose care was subsidized by CCDF. We use these data to measure how many dollars flowed into each market in each year.

During the years covered by our data, the Minnesota state legislature increased funding per child with the goals of making participation in CCDF more attractive to providers, improving care quality and access, shortening waiting lists, and serving more children. From 2012 to 2018, the funding amount per child in the population increased from $447 to $466 in 2012 dollars (about 4.3 percent).

To compare markets that vary in size, we calculate spending on CCDF subsidies per young child (aged 0–4) in the local population. We combine our estimates of the annual subsidy spending in each of the 317 school districts with data on private-market child care prices and licensed capacity. We then use a panel regression model that controls for school district fixed effects and year fixed effects to estimate the relationship between subsidy spending and child care market outcomes.

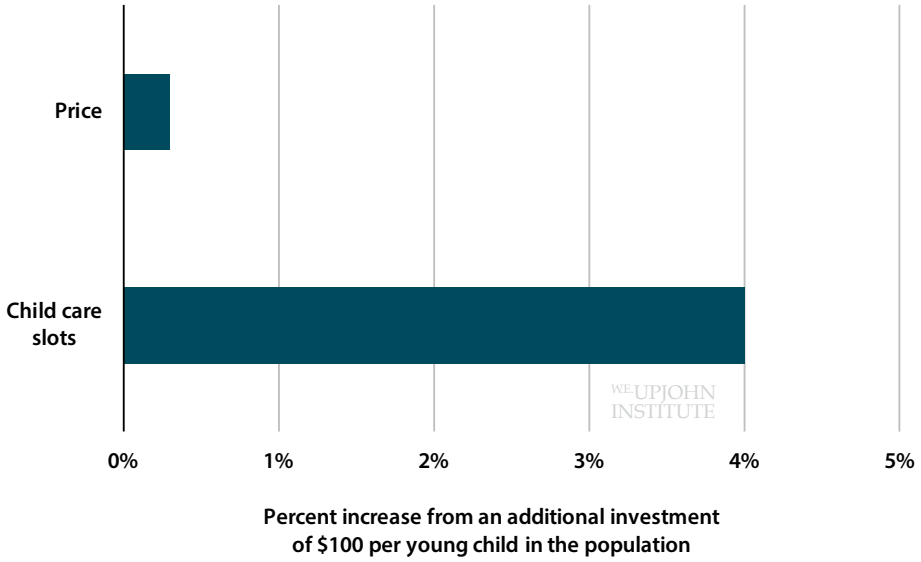
In our study, the effects of increased subsidies on child care capacity are more than 10 times as large as their effects on price.

Effects of Subsidies on Child Care Markets

We find that an additional investment of $100 per young child in the population increased the capacity of licensed private providers by 4 percent and raised the average price of weekly, full-time child care by 0.3 percent, as shown in Figure 1.

In absolute terms, an increase of $100 per local young child produced an increase in capacity of 0.026 slots from an average capacity of 0.6 slots per local young child, and an increase in price of $0.56 per week from an average price of $187 per week per full-time slot. Our estimates imply a high supply elasticity.

Figure 1 Effects of Subsidies on Local, Private Child Care Service Markets



NOTE: Dollars are in nominal terms. For details, see the full paper.
SOURCE: Authors' estimates based on school district-level provider data for 2012–2018; funding data from the Minnesota Department of Education and the Department of Human Services.

We also investigate the changes among new and existing child care providers that drove these results. Increases in capacity resulted mostly from a strong increase in the entry rate of new child care providers. Prices tended to increase among existing providers while new providers entered the market with slightly lower prices. We also find a small increase in the share of providers who are highly rated in the state's quality rating system.

An important consideration for policymakers is how much it costs to expand market capacity, and how the cost of expansion is divided between public and private revenues. If public investments help to catalyze a market and attract private funding, relatively modest public investments can have large impacts. Our estimates suggest that an increase of about $4,200 in public subsidies creates one new full-time child care slot. Because the annual cost of a private child care slot averages about $10,000, our estimates suggest that public funding attracts private revenue rather than crowding it out. The additional private spending may come as copayments from families who are able to access child care because of the subsidies that help them afford the cost as well as from families who start paying for care privately at new providers who are better able to serve their families' needs.

Modest public investments in child care can have big impacts when they catalyze child care markets and attract private funds.

Conclusions

Our research provides new evidence on the effects of public investments on private child care markets. Increases in subsidies for families with low incomes produced relatively large increases in licensed child care capacity along with minimal increases in price. This evidence suggests that child care supply remains highly elastic despite increases in women's employment opportunities and child care regulation over the past three decades.

Because previous research on supply elasticity in child care markets is now decades old, additional research on child care markets in other locations will be valuable for today's policy decisions. The impact of public subsidies on local child care markets will likely depend on the size of the subsidy, the availability of other subsidized programs, and the overall strength of the local labor market.

However, in the case of Minnesota during 2012 to 2018, funding increases appear to have largely achieved policymakers' objectives of opening up care for more families without the unintended consequence of large increases in price. As policymakers seek ways to increase access to affordable child care, public investments (including expanded funding for subsidies to help families pay for child care) may be a useful option to consider.

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