Financing Early Care and Education in New York State

A Briefing Paper
Prepared for the
Early Care and Education for All Conference

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October, 2001

Introduction

There is not one, best way to finance early care and education. There are many diverse options. A range of funding sources will be needed. Financing an effective early care and education system will require funds for families, for early childhood programs, and for system infrastructure. The goal is to establish policies that allow these funds to work together as a system to support a comprehensive whole.

Higher education is a good example of a comprehensive financing system that provides funds for families, programs and the infrastructure. Government funds are made available to so that college is available and affordable for all families, regardless of income. These are funds to *programs*. In the case of higher education, the programs are colleges and universities. In early care and education, the programs would be child development centers and networks of family child care homes. The higher education system also makes funds available to students and/or their families--to help them pay tuition.[1] These funds to *families* come in many forms, including: scholarships, grants, subsidized loans, tax credits, and so forth. Most early care and education system funds are provided to families, in the form of child care certificates, vouchers from employers, tax credits, and so forth. Finally, the higher education system makes funds available to support the *infrastructure*, which might include facilities, research, the management of a financial aid office, data collection, accreditation, and so forth. The early care and education system has similar infrastructure needs.

In short, effectively financing an early care and education system will require a multi-faceted strategy and a broad view. The goal is not just garnering additional funds, but establishing policies that allow funds to be layered so that multiple streams can support a single program and/or family and multiple needs of the system are met.

Purpose

The focus of this paper is on *financing* not *funding.* In other words, it will discuss where the money for early care and education will come from (financing) not how that money will be spent (funding). This is an important distinction. It is often assumed, for example, that if education dollars (the *financing* source) are allocated for early childhood programs then the funds must be awarded to or administered by schools (the *funding* mechanism). However, this is not always the case. Funds that are included in the education budget need not be limited to schools. Many states have used education dollars to fund a wide range of services provided by community-based organizations as well as school districts.

Similarly, tax credits are often viewed as a financing strategy that can only benefit individuals or businesses that pay income taxes, and are not an effective way to support an industry such as early care and education. Again, this is an erroneous assumption.

[1] It is important to remember that all college tuition is heavily subsidized. On average, colleges derive only 35% of their revenues from tuition. The program support (colleges call it institutional aid) described in this paragraph lowers the price of college for all families, regardless of income. Then, additional support is provided to help families pay those already subsidized tuition. No one accuses colleges of "double-dipping" when they combine assistance to programs with assistance to families. It is assumed that the two will work together to finance the full cost of education.

Tax credits can be made refundable (which means that even those who do not pay taxes will receive benefits); they can be linked to withholding taxes (which means that any business--even a non-profit, will benefit); and they can be linked to a specific type or quality of service.

In short, it is possible to develop financing strategies that use many different funding mechanisms -- portable aid (such as vouchers and scholarships) direct aid (such as grants, contracts, or fund transfers to schools or local governments), cash reimbursement and so forth. Funding methods are not necessarily governed by the financing strategy but can be separate, administrative decisions.

Financing Options

This paper describes a range of financing options, including those that are currently used by states and cities as well as new approaches that have yet to be tried. The options are grouped into four overall strategies, or approaches to finance, which include:

- Increased state general revenues,
- New taxes,
- Targeted tax credits or deductions, and
- Increased involvement from the private sector.

Each of these options will be explored in more detail, followed by a brief discussion of possible next steps for New York. Additional information on the broad range of financing options currently used by states and cities is included in a matrix appended to this report (Appendix A). The matrix briefly describes how each financing option is structured, how the funds are used, and the amount generated each year.

☛*STRATEGY:* Increase State General Revenues for Early Care and Education

Many states allocate public revenues to support early care and education, using a variety of agency budgets and rationales to make the case in far of greater investment. Some examples are discussed below.

Federal Temporary Assistance for Needy Families (TANF) is the largest child care funding stream in many states. The federal government permits states to transfer 30% of their TANF block grant allocation to the Child Care and Development Fund and to spend an unlimited amount of TANF funds directly for child care. Federal TANF funds are not limited to families on public assistance but may be used to help low-income working families pay for child care. TANF funds may also be used to raise reimbursement rates, lower copayments, repay debt service on child care facilities, fund quality initiatives such as wage enhancement and professional development, or increase collaboration with Head Start and prekindergarten.[2]

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[2] See Schumacher, R., Greenberg M., & Duffy, J."*The Impact of TANF Funding on State Child Care Subsidy Programs"* Washington, D.C: Center for Law and Social Policy. August, 2001. Pp 40-44. for detailed information on the types of how states have used TANF funds for child care.

Many states have maximized the use of TANF for early care and education by fully utilizing their ability to transfer and directly spend these funds. For example, approximately 50% of *Wisconsin*'s <u>total</u> TANF allocation is spent on child care. (Approximately 25% of the child care caseload in Wisconsin is currently receiving cash assistance.) According to The Center for Law and Social Policy (CLASP) forty-four states transferred a total of $2.4 billion in TANF funds to CCDF and thirty-four states directly spent almost $1.45 billion in TANF funds on child care in federal fiscal year 2000.

State Education Funds are an important revenue source for early care and education. Forty-two states spend education funds to support a preschool program or to supplement the federal Head Start program. The vast majority of states allocate general funds for a targeted preschool initiative and allow agencies other than public schools to provide their pre-K programs. Three states (ME, WI and WV) permit school districts to enroll four-year olds in public schools and draw down state aid for this purpose. States have also used education funds to support the professional development for all early care and education practitioners (such as the training initiative administered by the Colorado Early Childhood Leadership Team) and for quality improvement efforts in all types of early care and education programs (such as Florida's Collaborative Partnership Project, which made grants available for quality improvements based on local needs assessments).

State and Federal Health Funds can be used to pay for health insurance for families as well as individuals who work in early care and education programs. *Rhode Island* currently does this. Provider training is another common use of state health funding. The *Pennsylvania* Health Department funds the Early Childhood Education Linkage System (ECELS), which offers early care and education providers health and safety training and technical assistance, as well as linkages to health care professionals who volunteer to work with the programs.

State Higher Education Funds are a significant source of funding for campus-based child care in *New York* as well as in at least six other states (CA, FL, IL, KS, MI and OH).

Crime Prevention and Justice Funding is another potential source of funds. *Colorado* has earmarked 20% of it's Youth Crime Prevention and Intervention fund to for services provided to children less than 9 years old. Funded services include: school-age child care, a nurse which is shared by several early childhood programs to conduct home visits, training for staff who work with children who are at risk for later crime or are exposed to violence, parent mentoring and a summer reading program. *New York* currently uses funds from the New York State Office of Court Administration to establish child care centers in court buildings.

State Economic Development Funds are a relatively untapped source. States allocate funds to economic development agencies to oversee initiatives that foster economic growth, attract businesses to the state and create new jobs. These funds are often used to attract industries that appear to contribute to economic growth, such as manufacturing or high technology firms. States like *Texas* have recognized the importance of linking child care and economic development, and include child care set-asides in some of their tax abatement agreements.

The early care and education industry contributes to economic development in many ways. The industry not only cares for children so parents can work, but also generates jobs, tax dollars, and contributes to the local economy through the purchase of goods and services. It has been estimated that early care and education is the third largest employer in the State of *Maine.* A statewide economic impact study that was recently been completed in *California*[3] found that the child care industry contributes $65 billion to gross state product--more than high-profile industries like electronics, motion pictures and food products.

Community Development Financial Institutions (CDFIs) have been key partners in early childhood finance reform in some states and communities. The Alternatives Credit Union (a CDFI in Ithaca, New York) has been working with the child care community, the Chamber of Commerce, Cornell University and others on a community-wide child care fund. University planners have estimated the contributions of the child care industry and the CDFI has used its links to national economic development partners to leverage new financing.

While state economic development agencies have not yet engaged in large-scale early care and education initiatives (although a few have been involved in facilities finance) this appears to be a promising approach.

Next Steps for New York - The amount of general revenue for early care and education services in New York State has grown significantly in the past ten years. Without question, ensuring that this commitment continues is an essential step for advocates. Specific attention should be paid to the following funding streams:

- *Increase TANF expenditures for early care and education.* New York has the flexibility to devote more of its TANF funds to child care and early education than it currently exercises. After accounting for the 10% of TANF fund or $244 million that New York transfers to Title XX annually, the state still has the ability to transfer as much as 20% of its TANF funds or $488 million annually to CCDF for child care. However, New York elects to transfer only $304 million.

  Beyond the ability to transfer more of its TANF funding to CCDF, New York could also decide to spend some of its annual TANF surplus funding directly for child care, something it currently does not do. New York is one of only 16 states that elects to spend no TANF funds directly for child care.

[3] Moss, S. *Child Care and Its Impact on California's Economy*. Oakland, CA: The Economic Development and Law Center. Fall, 2001.

Finally, New York has accumulated an unobligated TANF reserve fund through SFY 2001-02 of about $780 million and has not fully spent obligated TANF funding in other areas. While the vast majority of reserve funds may be needed to finance the increased demand for cash assistance during a sharp economic downturn, some of the reserve could be used to finance child care and early education. The State could also examine areas of obligated previous year funding under TANF, where there is significant underspending, to see if some of these funds might also be redirected to child care and early education. If either previous year reserve funds or unspent funds were to be redirected to child care and early education, they could be targeted to meeting the needs of current TANF recipients, thus freeing additional current year TANF funds for broader child care applications (such an approach would allow the state to navigate current TANF prohibitions on utilizing previous year funds for non-assistance purposes).

- *Continue to push for increased Education Funding for early care and education, including Universal Prekindergarten.* New York policy makers have made a commitment to making preschool universal. This commitment should be backed by sufficient funds. Education funds could also be made available for the workforce development and facilities issues that arise from a universal prekindergarten initiative.

- *Working with the Empire State Development Corporation, as well as local economic and community development agencies, to identify business incentives that might be helpful to the early care and education industry.* A group commissioned by the Maine legislature worked closely with the economic development office in that state and was able to identify a number of existing business development initiatives that could be marketed to, or adapted for, the early care and education industry.

- *Reach out to staff in the Departments of Health and the Division of Criminal Justice to explore the feasibility of using funds from these agencies for early care and education services and/or provider training and support.* In the past DOH has enacted regulations that allow hospitals to bill for higher Medicaid, Medicare and health insurance reimbursement if they provide child care services for targeted employees. Health funding could also support subsidized health insurance for early care and education staff, or additional training and linkages for staff development. Crime prevention funds could be used for early care and education services.

☛STRATEGY: Increase Taxation Earmarked for Early Care and Education

Federal, state and local governments generate revenue through taxation and fees. Taxes are assessed based on what you own (e.g. property taxes), what you spend (e.g. sales taxes) or what you earn (e.g. income taxes). Fees are payments for services you use or transactions you make. Fees can be charged to use a park, drive on a highway, acquire a marriage license, record a deed or buy a lottery ticket. Some states fund early care and education with dedicated revenue sources; that is, they "earmark" a specific tax or fee for early care and education. Examples of this approach include the following:

Dedicated Property Tax - *Florida* enacted a law that allows local governments to create a children's services board and to levy a property tax earmarked for children's services. To date, six Florida counties have taken advantage of this taxing authority. The cities of *San Francisco* (Proposition J) and *Seattle* (Families and Education Levy) have passed referenda establishing dedicated property taxes for children's services.

Dedicated Sales and Excise Taxes - *California* imposed a new tax on tobacco products and dedicated these funds to improving childhood development (Proposition 10). The voters in *Aspen*, Colorado approved a provision to increase the local sales tax and earmark the increase for affordable housing and child care. *Arkansas* recently imposed a new tax on beer, earmarked for preschool and child care subsidies. *Maine, Kansas and Kentucky* have earmarked a portion of the tobacco settlement funds for early care and education.

Dedicated Income Taxes - Although a new payroll tax has often been suggested by early childhood advocates, no state or city has established a dedicated income tax for early care and education *per se.* States have, however, used the disability insurance system (which is funded by payroll taxes) to support partial wage replacement for maternity leave. *New Jersey, New York, California, Hawaii, Rhode Island* and *Puerto Rico* currently require all employers to provide Temporary Disability Insurance (which, by federal law, must include a "pregnancy related disability). Legislation to expand these plans to include paid leave for adoption as well as to care for ill or elderly family members is under consideration in most of these states.

Additionally, many states are exploring the feasibility of using the unemployment insurance (UI) program to help replace wages during family leave. This approach is popular in states that have a well-funded unemployment trust fund. Last year *Vermont* nearly passed a bill that would extend UI to cover family leave. It was estimated that the proposal would cost $2 million a year--less than 1 percent of the state's unemployment insurance trust fund balance.

Washington State has taken a different approach, and is discussing a family leave insurance payroll tax that would require employers and employees to contribute to a state fund for paid leave. *Illinois* is looking at creating a partnership between employers, employees and the state to fund parental leave. Each would contribute up to one-third of the wage replacement--the employee would forego one-third of her or his wages, with the employer and state splitting the cost of the remaining two-thirds.

Dedicated Fees - Three *California cities* (San Francisco, Concord, and Santa Cruz) have established laws that requires any new real estate development project to either make space available for a child care center or pay an "exaction" tax to help fund early care and education facilities. *Kentucky* established a voluntary surcharge on motor vehicle registration or renewal to generate funds for child care assistance. *Massachusetts* established an "Invest in Children" specialty license plate to generate funds for child care quality. The Military uses a portion of revenues from the stores operated on bases to support their early care and education system. Colleges and universities can incorporate a campus-based child care center under "auxiliary services" which allows them to use revenue from housing or the bookstore to offset losses in child care. Some states and cities have proposed set-asides as part of stadium negotiations, or surcharges on the sale of tickets for sporting events however, none of these proposals have yet been enacted.

Lotteries and Gaming - *Georgia* earmarked part of the state lottery for a universal prekindergarten program. *Missouri* earmarked a portion of the Gaming Commission Fund (from riverboat gambling) for early care and education services.

Next Steps for New York - In the current climate, advancing an initiative to increase taxes or fees and earmark them for early care and education programs is likely to meet with opposition. A dedicated fee initiative would probably be more palatable, but still seems unlikely to gain support. One possible window might be to latch on to an existing tax or fee that is up for renewal or revision. Overall, this is probably not the best time to advance a new state tax or fee.

However, there is already a campaign underway in New York State to fund paid family leave through the expansion of Temporary Disability Insurance and Unemployment Insurance. Child care advocates should work with the existing Family Leave Coalition to secure the funds and political support necessary to enact a paid family leave policy in New York State.

☛STRATEGY: Generate Funds via Targeted Tax Credits or Deductions

Individual income taxes are the largest source of revenue for the federal government as well as for the forty-three states that use this form of taxation. On average, revenues generated from individual income taxes are about four times as large as those generated from corporate income taxes. Governments have established a variety of credits (taken against taxes owed) and deductions (subtracted from income before computing taxes owed) for child care related expenses.

Individual Income Tax Credits or Deductions - Over the past few years *New York* has greatly expanded its Child and Dependent Care Tax Credit (DCTC). The credit is now available to all families, regardless of income, and is refundable (which means that even families who pay no tax can receive a refund.) The maximum NYS credit is now $1,584 for two or more children. However, it is important to understand that the maximum credit is only available to families who have incomes below $25,000 and spend $4,800 per year for child care--an unlikely scenario. Most credits are significantly lower than the maximum.

The federal government has raised both the qualifying expense limit and the income ceiling for the federal DCTC. This means that the New York State credit will also increase in tax year 2002, when these changes take effect.

In addition to improving the DCTC for all families, two other strategies are possible:

1) Make higher credits available to families who use higher-quality care. *Maine* and *Arkansas* allow families who use accredited child care to claim a higher DCTC. *Colorado* advocates are proposing that families who select a "quality rated" early care and education program (e.g. one that participates in their Educare Stars initiative) receive an additional tax credit of between $400 (if they select a one star provider) and $1,600 (if they select a for star provider). The proposed Colorado credit will also be extended to parents who stay at home and care for their own children.

2) Create a second credit. *Oregon* has taken this approach, and allows low-income working families to claim a second "working families" tax credit in addition to the state and federal DCTC. Unlike the DCTC, the working family credit has no expense cap; taxpayers may claim up to 40% of eligible expenses.

Employer Tax Credits or Deductions - Twenty-five states provide some sort of income or franchise tax assistance to employers who pay for child care for their employees. Unfortunately, these credits are not widely used in most states. Several states have attempted to address this problem by making the credits much more generous and/or developing new kinds of employer tax incentives. For example, interest in the *Georgia* employer child care tax credit jumped significantly when it was increased to allow companies to claim a credit of 75% of their investment in employer-sponsored care and 100% of the investment if they construct an on-site facility.

The federal government has recently established an employer tax credit, beginning in tax year 2002 employers will be eligible for a credit equal to 25% of expenses to acquire, renovate or operate a child care facility and 10% of expenses for child care resource and referral services.

Investment Tax Credits - Several states have established tax policies designed to encourage businesses or individuals to invest in the child care industry as a whole. *Colorado* established a Child Care Contribution Tax Credit -- that is available to anyone, not just employers -- equal to 25% of any contribution to promote child care in Colorado, up to $100,000. *Oregon* just enacted the Pilot Corporate Child Care Tax Credit, an new initiative modeled after the success of the Low Income Housing Tax Credit (LIHTC). Like the LIHTC, the child care pilot allows businesses to receive a significant financial return on their investment. Businesses may use the dollars they invest in the child care industry to purchase tax credits with a value greater than their initial investment. (In other words, for every .50 to .80 invested in child care the business would receive a tax credit worth $1.) Approved community agencies will be responsible for selling child care tax credits to investors and allocating the funds collected to eligible child care programs.

Community Development Financial Institutions (CDFIs) could also be given incentives to use the public and private funds available to them to invest in the child care industry. For example, the Alternatives Credit Union in *Ithaca, New York* is exploring the feasibility of using funds from the New Markets Tax Credit, along with support from the National Community Capital Association to seed a community-based early care and education fund.

Provider Tax Credits - It is possible to craft a tax credit that directly benefits early care and education providers. For example, a new "School Readiness Tax Credit" has been proposed by Colorado advocates. Licensed child care providers will be permitted to claim a refundable tax credit of between $400 (for one-star providers) and $1,600 (for four-star providers) per enrolled slot. Licensed, non-profit providers could file a tax return for the purpose of claiming the credit; family child care providers would claim the credit on their personal state income tax return. A more detailed description of this proposal is included in Appendix B.

Maine has an initiative that refunds withholding taxes to businesses that create at least 15 new jobs, pay more than the average wage, and offer health and retirement benefits. While this credit is currently not available to child care businesses, it could be modified for this purpose. The credit could, for example, be made available to child care businesses that pay higher wages, offer benefits, and ensure that their staff participate in the state's career development system.

Next Steps for New York - In the current climate, New York policy makers are inclined to support tax credits. To this end, it seems prudent to carefully explore ways to strategically expand take credits and build on previous successes in this area. Possible next steps include:

- *Explore the feasibility of developing new early care and education investment and provider tax credits.* Colorado advocates have crafted a very interesting strategy, which is appended to this memo. This approach could be combined with direct appropriations for early care and education (from general revenues) and shaped into an omnibus early care and education finance reform bill that might appeal to New York policy makers on both sides of the isle.

- *Consider making further modifications to the DCTC*, such as allowing families who use higher-quality care to claim a higher credit or expanding the credit to include families who stay at home and care for their own children. (Because New York State already has the most generous Earned Income Tax Credit in the nation, creating a second, working families tax credit is probably not a realistic option at this point.)

- *Develop and implement an outreach campaign to make sure that parents and early care and education providers are aware of the increased Dependent Care Tax Credit (DCTC) and how to apply for it.* The DCTC can only affect consumer behavior, and contribute to early care and education finance, if it is marketed effectively. Think about how real estate agents market the home mortgage tax deduction, making sure that potential homebuyers know that they can afford a more expensive home. A similar campaign could be launched for the DCTC. The

National Women's Law Center might help to develop outreach materials and providers could be given technical assistance on how to use these materials when informing parents about fee increases.

- *Reach out to Community Development Financial Institutions (CDFIs) in the state* to explore new financing partnerships that could attract funds that are only available to these non-profit, federally-approved entities. Many CDFIs are able to tap into funds generated by federal tax incentives, such as the Low Income Housing Tax Credit or the New Markets Tax Credit.

☛*STRATEGY:* Expand Private Sector Funds for Early Care and Education

Overall, the private sector plays a relatively small role in early care and education finance. On average, funds from this sector represent only 1% of all funds expended for early care and education. Historically, private sector contributions have been focused on short-term grants and initiatives that target their own employees. This trend is changing. Businesses and foundations have learned that their contributions can be more effective if they work in collaboration--with each other and with government. To this end, a host of new public-private partnerships have been developed in recent years; partnerships that are not only leveraging increased funding but also focused on systemic change. Some examples follow:

Florida used a portion of its CCDF allocation to seed a matching grants program for employers who agree to provide on-going child care subsidies to their low-wage employees. The initiative, which is run by a private sector board, has not only leveraged significant funds but also spawned a private sector early care and education advocacy campaign--led by business leaders, using business lobbyists.

Foundation and business leaders in some states (e.g. *Colorado*) and cities (e.g. *Pittsburgh, Philadelphia, Kansas City, Rochester, and Seattle*) have spearheaded large-scale efforts to finance and reform the early care and education system. Others have created similar partnerships but elected to focus on targeted initiatives--such as the accreditation facilitation projects financed by public-private partnerships in *New Jersey* and *Chicago.*

Unions have used collective bargaining to pool funds from multiple employers into a coordinated early care and education fund, such as the 1199/Employer Early care and education Fund in *New York City* and the Joint Labor Management Early care and education Advisory Committee in *New York State.*

Community foundations in *Indiana* and *Pennsylvania* are helping to build early care and education endowment funds.

Next Steps for New York - Developing strong private sector partners could help to increase both public and private revenues for early care and education in New York. There are many ways to do this, including the following:

- *Propose that New York State develop a matching grants program, similar to the Florida Child Care Partnership Act*. A New York initiative could target employees who earn too much to qualify for government child care subsidies but who cannot afford high-quality early care and education. Establishing a private sector board to administer the initiative could be a key step in building private sector buy-in and support.

- *Explore the feasibility of developing a public private partnership focused on improving the quality of early care and education services.* Although New Jersey and Chicago have chosen to focus on accreditation, a New York initiative could focus on one or many different quality improvement strategies. Polling potential private sector partners regarding their current interests and portfolios might be a first step.

Conclusion

New York State has taken important steps toward financing a comprehensive early care and education system. Over the past ten years, child care subsidies for low-income families have increased by ____%; funding for prekindergarten has more than doubled; federal Head Start funds have increased; the Dependent Care Tax Credit has been expanded; a new career development system has been established; funds have been allocated for practitioner training, education, and wage supplementation; and infrastructure supports such as facilities finance and resource and referral have been put in place.

The step is to craft a financing strategy that not only leverages the additional dollars needed to make high-quality early care and education available to all, but also allows existing funds to work together as a cohesive whole. Can New York State ensure that funds are available for families, programs and the infrastructure? We are well on our way. The next steps are crucial ones.