Intelligence MEMOS

From: Alexandre Laurin

To: Canadian Parents and Governments

Date: September 16, 2019

Re: **GIVING PARENTS MONEY DIRECTLY THE BEST APPROACH TO FINANCING CHILDCARE**

There can be many reasons for society to subsidize parents for the cost of child care. The financial hurdle for a parent considering the merits of working versus staying at home to care for young children can be extremely high — especially at lower levels of family income, where incremental work hours are taxed heavily.

Mothers, in particular, are hard-hit by absence from the workforce and face larger wage penalties the longer they are away from paid work.

For economists, the main motivation for subsidizing child care is to encourage parents to participate in the workforce, thus boosting the economy through higher household incomes. As an added bonus, the extra income generates increased tax revenues, substantially offsetting the initial cost of the subsidy for governments.

Child care then is beneficial to families and the broader economy. So now the question becomes: What is the best approach to subsidize child care? Should we give money directly to parents, or indirectly through a centralized system of licensed daycare centres offering spaces at a subsidized cost?

Although both systems have their own advantages, a tax-based incentive, such as Ontario's CARE credit, or federally, a potential generous refundable tax credit for child-care expenses as suggested here, would be the most promising approach for Canadians.

The financial hurdle for a parent considering the merits of working versus staying at home to care for young children can be extremely high — especially at low to average levels of family income. The tax burden doesn't help either. This is where putting money directly in the hands of families helps.

Take, for example, an Ontario family of four with two young children and the father earning $50,000. The mother is considering taking on some work earning $25,000, but would lose around 45 per cent of it to taxes and income-tested benefit reductions.

If children need to be placed into daycare, at say, an annual cost of $7,000 per child, she would lose another 40 per cent of her pay to daycare costs, net of the benefit of the existing tax deduction, sucking up almost 84 per cent of her gains.

The new CARE credit starting this year in Ontario will help, giving her back 23 per cent of her income, for a total hurdle of still about 60 per cent of her income. The CARE credit, costing the Ontario government $400 million or more per year when fully implemented will help create a hybrid system of both cash inducements for parents and targeted price subsidies at some licensed centres.

Compared to a more centralized and rigid model of heavily subsidized licensed child care centres, decentralizing the provision of child care by giving money directly to parents provides the advantages of competitive consumer markets: greater choices, innovation in staffing, various facility types, and more flexible hours and modes of care.

By subsidizing child care in all settings, a decentralized approach is also fairer for parents requiring flexible hours. Only a limited number of licensed centres in Ontario offer evening and weekend care; a stark contrast to home providers, of whom more than a quarter offer evening or weekend care.

Another advantage of tax-based cash inducements is the potential speed of implementation and the low cost of administering the program through the tax system.

For the federal government in particular, looking for effective ways to make a difference, offering a tax-based cash incentive, such as a refundable child care credit would make the most sense. Ottawa taxes incomes much more heavily than provinces. Therefore, it also stands to collect much more extra taxes from the employment boost a credit would generate.

In a previous study, Kevin Milligan and I estimated that replacing the inadequate federal child care expense tax deduction by a generous refundable tax credit would encourage many stay-at-home mothers to take on paid work and remain employed over the long term, alongside increasing government revenues.

Federally, such a scheme could "pay-for-itself" over the long term, especially after adding in the fiscal dividends for the provinces of extra tax revenues at no cost to them — dividends that could be invested in their own child-care systems.

In light of these advantages, I find that financial support to parents via the tax system is the most promising approach for the federal government to subsidize the cost of child care.

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