FUNDING CHILDCARE: EFFECTS ON LABOUR FORCE PARTICIPATION, FAMILY INCOME, AND GOVERNMENT FINANCES

CIRANO note based on a report written by de Nicholas-James Clavet and Jean-Yves Duclos, June 2014

Government funding of childcare (CC) makes a significant contribution to the attainment of various social objectives in Quebec and across Canada. This article provides evidence for the impact the three main mechanisms of CC government funding in Quebec (the provincial tax credit, the federal income tax deduction, and direct subsidies to early childhood centres) have on family income, women's labour force participation, and provincial and federal public finances. Unlike in the existing Canadian literature, this impact is estimated using a structural model of labour supply that explicitly incorporates families' work-leisure preferences. The model also takes into account the provincial and federal tax and transfer systems, the impact of fixed costs associated with working, the variability of CC costs, and the distribution of the socio-demographic characteristics of Quebec families. Government funding of CC increases family income significantly (after taxes, transfers, and CC expenses); its impact on incomes and labour-market participation rates is also greater for single mothers than for women in two-parent families. Cuts to public CC funding would generate substantial savings for the provincial government but would have little impact on the federal government. The latter would actually experience a decline in revenues (net of transfers to taxpayers) amounting to $14.9 million, while the provincial government would save $536 million by eliminating CC subsidies. These somewhat surprising results are due to a steep decline in labour market participation that substantially offsets the savings we would observe in the absence of compensating behavioural adjustments. Thus, for the federal government, the overall funding of CC generates more in revenues than it costs in taxes. This is not only because the government of Quebec contributes the lion's share of these investments, but also because public CC funding provides a strong incentive for women's labour force participation, reduces transfers to individuals, and increases income tax revenues.

From the perspective of financing, current CC funding mechanisms appear relatively efficient: Cancelling any one of them would result in forgone household income far exceeding the corresponding net increase in government revenues. In fact, they promote work and the production of market goods and services rather than in-kind services in the form of home-based childcare.

One of the key lessons of this work is that the funding of CC by one level of government often has a significant impact on the financial situation of another level of government. For example, when the provincial government chooses to directly fund daycare services at seven dollars per day, the federal government benefits by a significant decrease in the cost of its federal childcare deduction; this communicating-vessels effect is also apparent in a decline in transfers as well as an increase in revenues to the federal government following a rise in women's labour-market participation. This crossover effect between different tiers of government may undermine the overall efficiency of CC funding measures, since the fiscal and social benefits arising from more generous funding of CC are not necessarily all taken into consideration by the level of government that is assuming the cost.

The full study (French only) is available on CIRANO's Website at:

http://www.cirano.qc.ca/pdf/publication/2014s-26.pdf