Federal Investments are the Foundation for State and Local Early Care and Education Programs

FIRST FIVE YEARS FUND

Our nation depends on child care. Today, 26.8 million people—16% of the U.S. workforce—rely on child care to work or attend school. But the high cost and limited supply of quality child care across the country have created serious challenges for many families. The COVID-19 crisis not only brought into sharp focus how essential child care is to our economy, but also the fragility of our current system. For decades, the federal government has been the entity providing the majority of public funding needed to undergird a complex and fragmented child care system—even with the growing support of committed governors, local elected officials, business, and philanthropy.

Over the past three decades, state and local policymakers across the country, motivated by the necessity of providing workforce supports for parents, an increased understanding of the importance of early brain development, as well as the economic returns made by investing in early learning, have dramatically increased their investments in early care and education (ECE). However, federal investments made through large program funding streams and tax credits to families and businesses still provide the crucial foundation upon which these state and local investments are built.

Specifically, this brief explores just how foundational federal investments are and how they:

- Provide the primary source of funding for public ECE programs
- Support an ECE infrastructure that benefits children in care and their families
- Leverage state, local, and other investments
- Offer stability in challenging economic times
- Advance the research and development of innovative solutions to new challenges
- Present opportunities through the tax code

FEDERAL FUNDS ARE THE PRIMARY SOURCE OF FUNDING FOR PUBLIC ECE PROGRAMS.

Annually, nearly $22.2 billion in federal funds go to programs that support the care and education of children from birth through age five, compared to roughly $11.8 billion in state and local government spending on similar programs.

The federal role in early childhood differs from how it is embedded in public primary and secondary education, also referred to as “K-12”. In K-12, federal funds account for less than 10% of government funding, with state and local funding each make up about 45%. State and local funds cover most of the operating costs for K-12 schools, while federal funds typically supplement state and local dollars to fund specific programs or improve equity for underserved student populations. In contrast, federal funds encompass a much larger portion of funding for early childhood programs, making the federal role in ECE more akin to areas such as health and welfare, where federal funds provide a foundation on which state and local investments can build, while allowing state policymakers flexibility to design their own programs. Because federal funds provide this crucial foundation in “normal” times, they are even more essential during times of crisis or instability.

FEDERAL FUNDS SUPPORT AN ECE INFRASTRUCTURE THAT BENEFITS CHILDREN AND THEIR FAMILIES.

Federal funds do not just finance direct early learning and child care services for children and families, they also fund infrastructure that supports quality and delivery of state, local, and privately-funded ECE programs. This infrastructure provides a flexible platform to foster and sustain state ECE systems.

For example, the Child Care and Development Fund (CCDF) is the primary federal funding source for child care, providing subsidies that help low-income, working families access care. CCDF consists of two federal funding streams: the Child Care and Development Block Grant (CCDBG) and the Child Care Entitlement to States (CCES). CCDBG is subject to annual appropriations, while CCES consists of entitlement funds under the Social Security Act. Because CCDF is not a term established in statute or regularly used outside of the federal government, the entire program is often referred to as the "Child Care and Development Block Grant" or just "CCDBG." The Administration for Children and Families (ACF) administers CCDBG dollars, which are allocated to states, territories, and tribal entities based on a formula. States use this funding to support child care infrastructure that benefits all working parents and their children—not just those receiving a subsidy. States use CCDBG to cover the costs of state child care licensing systems, which monitor health and safety in child care settings, as well as state-level systems that help cultivate the supply and quality of care. This foundation allows states to target their additional investments and align specific state needs and priorities.

States also have considerable flexibility in how they use CCDBG to support early learning systems, which enables state and local officials to utilize the funding to meet the needs of their specific ECE systems in times of crisis. While states have strategically utilized one-time/temporary federal COVID-19 pandemic relief funds to support and stabilize the child care sector, it is abundantly clear that ongoing funds are necessary to respond to the magnitude of unmet need that already existed and will continue to persist.

Early Head Start-Child Care Partnerships (EHS-CCP) is another example of a program that maximizes federal dollars by reaching more children across settings. Early Head Start is a federal program that provides comprehensive child development and family support services to infants and toddlers under age three, pregnant women, and their families experiencing poverty. EHS-CCP is an innovative, competitive federal grant program that allows Early Head Start grantees to partner with local child care providers, both in-home and center-based, to improve the quality of infant/toddler care while leveraging the flexibility of CCDBG to expand the capacity and benefits of these programs. The ability to bring together the strengths of Early Head Start and child care improves the quality of care across communities, benefitting **all** infants and toddlers in the care of participating providers since program enhancements support all enrolled children. This can be seen in program-wide improvements like infant/toddler dental, health, and mental health services, facilities improvements and professional development for teachers.

CCDBG and EHS-CCP together provide direct services to approximately one million young children in need of quality ECE each year. While only a fraction of eligible children are directly served with current funding levels, the programs provide a framework on which states design and build the rest of their ECE systems, benefitting millions more children. Federal programs like CCDBG and EHS-CCP lay the groundwork with health, safety, and quality standards, while leaving room for states and localities to best meet the unique needs of families.

FEDERAL FUNDS LEVERAGE STATE AND LOCAL INVESTMENTS.

Federal funds not only account for the lion's share of ECE spending, but also encourage state investments. For example, most federal spending for child care requires state matching and "maintenance of effort" (MOE) funds that states must invest to draw down federal funding. In FY2023, $11.57 billion in CCDBG spending leveraged an additional $2.12 billion in state financing. Similarly, states receiving federal funds through the Maternal, Infant, and Early Childhood Home Visiting (MIECHV) program are required to provide state MOE funds. In FY2018, $400 million in federal MIECHV funds leveraged an additional $82.3 million in state funds. Some states spend more than the required match, and many would continue to invest in ECE even without these requirements. States can also leverage Temporary Assistance for Needy Families (TANF) program funding to support state ECE initiatives. States may transfer up to 30% of their TANF funds to CCDF, allocate TANF funds directly to child care services (including Head Start and Pre-K), and count spending on child care as contributions to TANF MOE requirements. In FY2021, states used $7.83 billion of their federal TANF funds for early learning and care. Federal funding and policies play an important role in incentivizing and leveraging state investments in the face of competing fiscal priorities.

The Preschool Development Grant Birth through Five (PDG B-5) program, a $315 million competitive grant program, empowers state governments to better leverage federal, state, and local ECE investments to create more efficient and effective systems. By aligning existing programs, coordinating ECE programs and services, and using data for continued improvement, this funding supports states in considering the full range of programs, services, and funding streams that support children from birth through age five and their families. PDG B-5 represents a unique opportunity for the federal government to leverage the central role of states in leading ECE coordination and quality efforts.

FEDERAL FUNDS OFFER STABILITY IN CHALLENGING ECONOMIC TIMES.

Federal funds also play a crucial role in sustaining ECE funding during challenging economic times. When the economy is weak, states face a double whammy of decreasing revenues combined with greater demand for public services. Most states are required to balance their budgets, placing fiscal pressure on state budgets and leading to spending cuts. Because states do not have the same constitutional obligations to provide ECE that they do for K-12 schooling, state ECE funding is vulnerable to cuts when states face economic headwinds—even though families' and children's needs are likely increasing. At times like these, only the federal government has the fiscal capacity to provide additional funds needed to sustain ECE services and meet increased child and family needs.

Following the 2008 financial crisis, for instance, increased federal funding for CCDBG and Head Start played a vital role in sustaining access to ECE for many families in the face of state budget cuts. Even with this support, access to ECE fell during the recession and did not fully rebound in some states. According to the National Institute for Early Education Research (NIEER), 64% of states (including DC) that had public preschool programs in 2007-2008 spent less per child on state funded preschool in the 2018-2019 school year than they did before the Great Recession, adjusting for inflation. Even a decade after the recession, states have struggled to raise per-child spending on public preschool programs back up to pre-recession levels, and subsequently program quality and access in many states have also failed to fully recover. Without federal intervention, the damage would have been far worse.

Federal mandatory dollars also play an important role in stabilizing ECE systems. While most federal ECE programs are subject to appropriations, funds from the Child Care Entitlement to States (CCES) are mandatory, meaning funding is set by statute and not subject to the annual appropriations process. Funds from CCES remained at a level of $2.917 billion from FY2002 to FY2020. In March 2021, the American Rescue Plan Act (ARPA) amended Section 418 to provide permanent annual appropriations of $3.55 billion for FY2021 and beyond. Mandatory dollars allow states to make long-term investments and are particularly helpful when states have ongoing costs.

Federal funds have always been critically important to support states, families, and ECE providers, and are particularly necessary now as the country navigates the after-effects of COVID-19 and contends with rising costs. Federal relief funding has served as a critical lifeline that the nation's early childhood sector desperately needed. In addition, it demonstrated what states can do when equipped with additional resources. However, these funds were temporary—significant and permanent federal investments are needed to truly stabilize the sector for ECE providers and families.

FEDERAL FUNDS ADVANCE RESEARCH AND DEVELOPMENT OF INNOVATIVE SOLUTIONS TO NEW CHALLENGES.

Federal funds have long supported innovation in ECE. Availability and flexibility in federal funding allow state and local governments to pursue innovations in ECE service delivery and coordination to meet the needs of their local communities. Federal agencies also fund research on best practices that support quality in federally-funded programs and also benefit the broader field.

Educare schools are an example of high-quality, comprehensive ECE programs benefiting from federal funding. Educare schools support children experiencing poverty from infancy until they enter kindergarten, connecting with community-based programs to help children and families access additional resources they need to thrive. To achieve Educare's model, the schools blend and braid federal funding from Head Start and CCDBG with other public and private funding streams—including state pre-K and school district dollars, university partnerships, and philanthropic investments. Educare also conducts research using a three-tiered approach that benefits the children and families, the schools, and the research community at large. Each Educare school evaluates classroom quality indicators as well as child and family outcomes, which support continuous program improvement and provide families with information to help them support their children's learning. The longitudinal research contributes to a national body of evidence on beneficial and cost-effective strategies to improve ECE programs and, in turn, improve child and family outcomes. Even with this expansive funding structure, the basis of Educare's instructional approach and quality standards is the federal Head Start model. Thanks largely to its strong and stable federal funding, Educare's high-quality schools serve as a model for other ECE programs around the country.

On a broader scale, federal relief funding during the COVID-19 pandemic was integral in helping programs find innovative ways to meet families' needs. COVID-19 forced state and local governments to respond to challenges they had never faced before. An additional $2 billion for Head Start allowed some programs to offer new supplemental summer programming to help incoming kindergarteners who missed out on early learning due to coronavirus closures prepare to succeed in school. These efforts, as well as novel approaches that some states put in place with the additional CCDBG funds, have helped recruit and retain the early learning workforce, while also offering models that can be expanded to improve child outcomes well into the future. Some strategies include states paying providers based on enrollment rather than attendance to improve program stability, and providing grants to support providers' on-going operating costs.

THE FEDERAL GOVERNMENT OFFERS OPPORTUNITIES THROUGH THE TAX CODE.

The federal tax code can provide relief for families with young children. While most federal early childhood spending is targeted to programs and services for low-income families, one provision in the tax code – the Child and Dependent Care Tax Credit (CDCTC) – is specifically designed to help working families with the cost of work-related child care expenses. The CDCTC allows families to claim a percentage of dependent care expenses for children under age 13 depending on a family's adjusted gross income. The CDCTC varies between 20% and 35% of qualified expenses up to $3,000 for one child or $6,000 for two or more children. By increasing families' purchasing power, these tax credits help families afford child care.

Through ARPA, the CDCTC was temporarily expanded in 2021 to provide relief to substantially more families. Among other changes, ARPA importantly made the tax credit fully refundable and increased the amount of expenses that were eligible for the credit to $8,000 for one qualifying individual and $16,000 for two or more qualifying individuals. These provisions provided much-needed improvements to help reach more families. However, now that these expansions have expired, working families may receive a smaller credit, and low-income families without tax liability will be unable to access the CDCTC. FFYF has recommendations for Congress to strengthen the CDCTC by expanding its value and making it fully refundable to ensure it reaches the families who would most benefit.

Another key opportunity available through the tax code is the Employer-Provided Child Care Credit under Internal Revenue Code Section 45F, often referred to as "45F." 45F is a federal tax program meant to encourage businesses to invest in child care for their employees. Under 45F, employers are eligible for a nonrefundable tax credit of up to 25% of qualified child care expenditures and 10% of qualified child care resource and referral expenditures. The credit is capped at $150,000 per year. Offering child care assistance can be an effective recruitment and retention tool for employers, and doing so provides a convenient and much-needed service for employees. However, data indicate that in its current form, the 45F credit is rarely claimed, signifying that changes to the policy may be worth considering to better incentivize employers to support child care access.

Finally, an exclusion for employer-provided child and dependent care assistance, known as Dependent Care Assistance Program (DCAP), is an employer-sponsored program that helps families pay for child care by providing reimbursements for up to $2,500 annually ($5,000 for married couples) to employees who pay for dependent care, usually through a flexible spending account (FSA). Employees are allowed to deduct dependent care expenses from their paycheck on a pre-tax basis. However, DCAP is disproportionately accessible to higher-compensated employees at larger companies. Low-wage employees and service industry workers have significantly lower access to DCAP and current limits have failed to keep up with the rising costs of child care. Reforms to the program could incentivize more businesses to establish DCAP benefits, such as by providing tax credits for startup costs, similar to incentives for small business pension plans.

A STRONG FOUNDATION OF FEDERAL FUNDING IS ESSENTIAL.

Federal support is foundational and crucial, now more than ever. These investments support the availability of high-quality, affordable, and accessible child care for working families in every state. The COVID-19 pandemic posed previously unseen challenges for families, businesses, and local, state, and federal governments, bringing to light the fragility of our ECE systems. Early childhood programs need ongoing support to weather current economic headwinds and meet the needs of children, parents, providers, and employers. Because federal ECE funds provide the foundation for other state and local investments, they are essential to enable state and local policymakers to support children, families, and early childhood providers.