



Equal Access?

**Appropriate and affordable childcare
for every child**

**Kate Stanley, Kate Bellamy
and Graeme Cooke**

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30-32 Southampton Street, London WC2E 7RA
Tel: 020 7470 6100 Fax: 020 7470 6111 www.ippr.org
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About the authors

Kate Stanley is an Associate Director at ippr and Head of Social Policy. Kate's research interests lie primarily in children and family policy, youth policy, disability and welfare reform. Recent publications include: *Daddy Dearest? Active fatherhood and public policy* (October 2005), *Sanctions and Sweeteners: Rights and responsibilities in the benefit system* (December 2004) and *The Family Report 2003: Choosing happiness?* (November 2003). Prior to joining ippr, Kate worked for Save the Children UK, the international NGO Response International, the Planned Parenthood Association of Ghana, and for an MP in Westminster.

Kate Bellamy has worked for the Fawcett Society, leading their work on women's economic welfare, since May 2004. Fawcett is the UK's campaign for equality between women and men. Kate is also Co-Chair of the Women's Budget Group, a collective of feminist economists and researchers, policy experts and activists. Previously, Kate has worked as a Project Manager for the Women's Budget Group, on secondment to HM Treasury managing a gender analysis project, as a Policy Officer (Gender and Criminal Justice) at the Fawcett Society and as a research assistant at ippr.

Graeme Cooke is a research assistant in the Social Policy team at ippr. Previously he spent two years as Senior Parliamentary and Policy Officer at 4Children, and has worked on childcare and early years policy for the Local Government Association. He gained a First Class degree in Social and Political Sciences from the University of Cambridge, and has also spent four summers as a playworker on a Local Authority-run Playscheme.

Executive summary

Since 1997 the Labour government has embraced the childcare and early years agenda as none before it, extending new opportunities to more children and their families. A doubling of childcare places, Sure Start (the Government's flagship early years programme), free part-time early education, tax credits and the Childcare Bill are all reshaping the community landscape and re-casting the public and political discourse.

However, despite this progress, children cannot access services equally, with those standing to gain the most often the least able to benefit. This report identifies affordability and a lack of appropriate provision as key barriers to access, particularly affecting many of the most disadvantaged children: those in workless, low income or lone parent households, and those in families facing high childcare costs (perhaps because a child has a disability or Special Educational Needs, or where there are three or more children).

This report argues that the Government's objective should be a system that promotes child development, supports complex family lives, and enables parental employment as the best route out of poverty. However, without significant increases in spending over the coming years it is difficult to see how the Government can shape a childcare and early years system that combines quality, affordability and appropriateness for all children and families. Each family's childcare needs are likely to be various and shifting, within a childcare market characterised by a diversity of providers. Therefore, we need a policy approach and funding system that reflects both this context and our progressive goals.

We argue that to deliver this, increased resources overall are essential, and that they should be balanced between directly supporting providers on the 'supply side' and improving the effectiveness of tax credits to parents on the 'demand side'. Strategic supply-side subsidies are essential to drive up quality, promote sustainability, and support childcare where the costs and barriers for particular groups of children are high. The majority of new spending should be channelled here. In addition, tax credits could allow resources to be targeted while making the market responsive to parental choice. We also argue that the heavily restricted system of entitlement excludes many disadvantaged children, while failing to provide the stable support that would maximise parents' options and employment potential.

We highlight a package of five key areas for action:

- 1. Access to childcare support should be simplified, widened, and not dependent on the employment status of a child's parent.** Entitlement to support with childcare costs should be linked to Child Tax Credit rather than Working Tax Credit – creating a simpler, fairer system, where children's access to childcare is not wholly dependent on their parent's working status. This would open up potential eligibility for tax credit support to up to 4.7 million additional families, enabling more children to access beneficial services, while supporting more parents to make stable childcare arrangements that boost their capacity to work. Families not in paid work should be eligible for up to 50 per cent of full support – reflecting their different childcare needs, opening up the benefits of high quality services to disadvantaged children, while maintaining a clear financial advantage for employment. We project that this reform could cost around an extra £2 billion a year.

To further improve demand subsidies, the Government could also consider: raising the income level at which eligibility for childcare support begins to taper off; creating a new upper limit for families with three or more children; and adding a childcare premium to the disabled child element of Child Tax Credit.

- 2. Additional direct spending on provision and infrastructure is essential to improve quality, support sustainability, and to ensure families facing higher barriers can access appropriate childcare.**

Targeted subsidies to providers are essential for raising quality and incentivising and sustaining appropriate provision for children that the market is unlikely to cater for alone – with local authorities playing a pivotal role. Priorities should include promoting:

- Registered Childminders and other home-based childcare options
- Services that are culturally sensitive and proactively reaching out to black and minority ethnic families
- Provision that is appropriate for children with a disability or Special Educational Needs.

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3. **Parents need to be empowered with more and better information about local childcare services, child development issues and financial support.** This is vital for shaping a responsive childcare market where parents exercise 'voice' and 'choice' over services. Children's Information Services need to be made central to local childcare strategies, with proactive engagement and dissemination to increase the reach and visibility of childcare information.
 4. **The relationship between childcare and early years and employment policy needs to be rethought within the context of a holistic and personalised work and welfare agenda.** There is a need to move beyond crude financial equations to consider how public policy can best support each step along the pathway to paid work and beyond. Childcare policy must be linked closely to work-life balance strategies to give parents greater control and choice over their economic and caring roles.
 5. **Ongoing research, analysis and evaluation are needed to inform future policy developments and spending choices.** We need a firmer evidence base on the long-term impact of childcare, right across the age range, for individuals and wider society. Further research should also assess the relative strengths and weaknesses of various supply- and demand-side strategies, including how they interact with each other.

Childcare and early years policy is approaching a critical cross-roads. Despite major progress, it remains an emerging sector, with shallow roots and inconsistent coverage. Society has undergone a revolution in working patterns and family lives, and we now know how important children's early years are to their future life chances. But will politicians and policymakers respond? The Comprehensive Spending Review offers an opportunity to embed childcare and early years at the centre of a progressive, enabling welfare state fit for the 21st century: striking at child poverty, boosting the life chances of all children and enabling all parents to flourish in both their professional and family lives.

1. Introduction

All children stand to benefit from high-quality childcare and early years services.¹ These can enhance both immediate wellbeing and later life chances. This Government is the first to fully recognise this, developing a 10-Year Strategy and committing significant spending to improve the quality, affordability, accessibility and flexibility of childcare and early years services (HM Treasury 2004). The strategy recognises that high-quality care can have a particularly positive impact on the life chances of disadvantaged children. Benefits include promoting cognitive development, enabling parents to take up employment and thereby increase household income, and creating opportunities for children to mix with peers from a variety of social groups.

However, despite a recognition of need, and strong foundations being laid, there are several flaws in the Government's current strategy that mean disadvantaged children, who stand to make the greatest gains from high-quality childcare and early years services, are often the least likely to be able to reap the benefits. If these flaws are not addressed, maximum value will not be derived from public spending, and childcare and early years will fail to realise its potential contribution to achieving social justice through improving children's life chances and supporting parental employment.

The key question addressed by this report is: **how can we best ensure that those children who stand to benefit most from high-quality childcare and early years services are able to access them?** It identifies two particular barriers to meeting this goal: the *affordability* and *appropriateness* of provision. This report highlights the need for new strategies to address these barriers in order to achieve the Government's core objective that: 'all families who need provision will have access to an affordable, flexible, high quality childcare place that meets their particular circumstances' (HM Treasury 2004), and it suggests a number of potential ways forward.

A key policy moment

We are at a particularly critical stage in the evolution of childcare and early years services, making this an especially important moment to address these issues head on. Firstly, money is being spent on the childcare and early years infrastructure now, and it will become increasingly difficult and costly to undo mistakes in the future. Secondly, resources have been allocated to implement the 10-year strategy up to 2007/08, but a number of the major advances are envisaged for delivery beyond this time frame. Therefore, the outcome of the Comprehensive Spending Review in spring 2007, setting spending levels up to 2010/11, will be absolutely crucial in determining the success or failure of this agenda.

While government support for childcare and early years has risen rapidly over recent years, this has not matched the growth in policy ambition and expectation. In a tight fiscal climate, resources available to the Chancellor are likely to be limited (Robinson forthcoming). It is, therefore, timely to make the strongest case for why precious additional spending should be diverted towards childcare and early years services. Despite the power of this case, we can expect that resources will continue to be sub-optimal, at least in the short to medium term. This means we need to engage in a secondary debate: how do we ensure that existing resources are spent most effectively so that the marginal pound makes the greatest impact?

Challenges to the childcare agenda

There is huge potential to anchor childcare and early years at the centre of a modern, progressive welfare state. However, despite the gains of recent years, progress remains partial, and the consensus around the importance of this policy agenda is still new and emerging. This fragile consensus is under threat from a number of angles. One is the contention that an overly uniform and prescriptive approach has promoted

1. In this report we employ the commonly used term 'childcare and early years services', while acknowledging the potential deficiencies in this narrative. Moss (2006) argues that traditional discourses of 'childcare' imply the commodification of a discrete household task. Care is seen as a private responsibility met mainly through the for-profit childcare market, with a limited state role confined to regulating the market and facilitating participation. A 'pedagogical' discourse, on the other hand, understands the service as a complement to, not a substitute for, the home, offering children qualitatively different experiences and relationships. In this conception, the role of childcare in enabling parents to work is incidental to the overriding purpose associated with child, family and community development.

(female) employment at the expense of parental choice and (maternal) care. This view is reflected in a speech by the Shadow Chancellor George Osborne MP:

‘Some on the left use this fact [declining social mobility] as evidence that all young mothers should work and the government must provide all childcare. As Gordon Brown put it in December, when it comes to balancing work and family life, only the state can guarantee fairness. His eyes lit up when he called the provision of childcare for children up to 48 months ‘a whole new frontier of the welfare state’. At its worst it is a vision of a Brave New World: rows of mothers at work and rows of tiny children in uniform state-run nurseries. A real nanny state. Instead, I believe that every family wants something different from childcare. Each has different needs, different desires and different decisions to take. You cannot impose a one-size-fits-all model of childcare provision.’ (Osborne 2006)

At first glance, this appears to be a stinging attack on the Government’s approach. Yet, in many ways, it is a criticism of means rather than ends.²

Firstly, that the current mix of policy and spending is not yet extending genuine choice to all families, in the spheres of both employment and childcare. Secondly, that progress – and in some cases rhetoric – to date has created some perverse incentives in the system, largely where policy initiatives have begun but are not yet complete. This suggests that the only real danger for the policy agenda itself – and for the Government, politically – is that its vision fails to be fully realised, or its ambitions are only partially delivered.

The mixed interim findings from the National Evaluation of Sure Start, a long-term research study into the Government’s flagship early years programme, pose a second challenge to the childcare agenda. They point to a number of positives and some negative impacts so far. However, many of these services are still bedding in and the majority of the impacts are very small in magnitude (Melhuish *et al* 2005). The Government and its supporters need to hold their nerve, wait for longer-term findings, while using the on-going evaluation to inform future policy and practice development, focusing on ensuring that the most disadvantaged families access these services.

The third threat to our fragile consensus is the perception that, as far as childcare and early years is concerned, ‘the job is done’. Investment has been made, a strategy has been put in place, and a delivery programme is underway. However, those closely involved in this agenda, including the children and parents still not able to benefit, know this is a process begun but far from complete. Political focus – especially in the higher echelons of Government – is often transitory. Public service debate still defaults to health, education and crime. Our aim here is to show that, in the 21st century, childcare and early years services should rank alongside these top public policy concerns, especially for those interested in social justice, but that renewed focus and investment is essential to making that happen.

In order to contain the scope of this short-term study, this report does not explore in detail the important issues relating to enhancing the skills and qualifications of the childcare and early years workforce, which are crucial to driving up the quality of services. Needless to say, it is implicit throughout that delivering high-quality provision is an absolute prerequisite to reaping maximum impact, especially for the most disadvantaged groups. We hope to address the issues pertaining to the childcare and early years workforce in a further report to be published by ippr.

This report is organised as follows: Chapter 2 briefly outlines recent developments in the childcare and early years system, providing the context for Chapter 3, which sets out our assessment of the key challenges and potential fault lines in the current strategy. Chapter 4 then goes on to consider the implications of this analysis for future spending and policy direction, including a framework for rethinking spending. Finally, Chapter Five concludes with a set of key proposals to ensure all children are able to access childcare and early years services within an equitable system that can benefit every child.

2. The main exception being Osborne’s suggestion that Labour envisages a system dominated by ‘state-run’ nurseries. In fact, 85 per cent of current provision is run by the private and voluntary sectors, and the Childcare Bill legislates for a mixed economy of provision.

2. Developments in childcare and early years services

The importance of childcare and early years provision

Previously, ippr has argued that investment in childcare and early years services should be a priority for anyone interested in achieving social justice. This has been based on two key policy drivers – boosting child outcomes and developing a flexible, responsive and equitable labour market – both of which are central to reducing child poverty, improving life chances and promoting social mobility (Pearce and Paxton 2005).

There is an ever-strengthening body of evidence demonstrating the disproportionately positive impact of high-quality childcare and early years experiences in promoting child development.³ Findings from the Effective Provision of Pre-School Education (EPPE) study show that children's achievement in language, reading and numeracy increased in proportion to the number of months they spent in pre-school. For example, at age five, the average difference in child development between those who had attended pre-school compared with their non-attending peers was four to six months.

Evidence also suggests that disadvantaged children in particular can benefit significantly from good-quality pre-school experiences, especially where the early years setting caters for children from a range of social backgrounds (Sylva *et al* 2004).

Early investment in children's lives can also be justified on grounds of economic efficiency. Positive changes to children's life-course direction can be achieved at a lower cost the earlier interventions are made. A longitudinal study of children participating in the Perry Pre-school programme in the US, which provided high-quality centre-based care for three- and four-year-olds from low-income families in Michigan in the 1960s, suggests that, for every US\$1 spent on a disadvantaged child in the early years, US\$7 could be saved in the long run, through reduced spending on remedial education, healthcare and crime (Carneiro and Heckman 2003).

Such research on the positive and enduring impact of intervening early in children's lives is especially significant given the strength of social class as a predictor of school performance and later outcomes. Leon Feinstein's analysis of the 1970 British Cohort Study found that, even at 22 months, social class was a strong predictor of cognitive skills (Feinstein 2003). As children got older, this trend only intensified, with early high achievers from disadvantaged families tending to be overtaken, between the ages of five and ten, by early poor achievers from higher social class backgrounds. Evidence also suggests that social mobility stalled during the late 1970s and 1980s, reversing post-war progress towards weakening the link between child outcomes and parental background (Pearce and Paxton 2005).

Conclusive judgement on the impact of Labour's mix of childcare, education, welfare and social policies on those growing up since 1997 is still premature. New pupil-level data does show that the social class attainment gap at age 11 did not reduce between 1998 and 2004, despite the biggest progress overall being made by schools with the most disadvantaged intakes (Kelly 2005). However, international evidence suggests that declining social mobility is not an inevitable trend. Analysis points to a correlation between investment in universal childcare and early years systems and a breakdown in the influence of social class on educational attainment in states where social mobility has increased (Esping-Andersen 2005).

Very young children: contentious research

It is important to recognise that research into the impact of childcare and early years provision does not reach simple or universally applicable conclusions. Some recent contributions to the debate (for example, Biddulph (2006)) have raised concerns about the impact of non-parental childcare for children under three. Biddulph draws on evidence from the National Institute of Child Health and Human Development (NICHD) in the US, which suggests prolonged periods of group care can have detrimental emotional and behavioural impacts for very young children. For instance, in its 2004 findings, the NICHD study found that 17 per cent of children who had been in 30 hours a week of daycare demonstrated behavioural problems, compared to six per cent of those who attended fewer than 10 hours a week of daycare.

3. or more detail see evidence from the Effective Provision of Pre-School Education project <http://k1.ioe.ac.uk/schools/ecpe/eppe/index.htm> and the National Evaluation of Sure Start www.ness.bbk.ac.uk/ (accessed May 2006).

British researchers have questioned the transferability of US findings to the UK context (where the child to staff ratios tend to be higher and the quality of care lower), and other studies of very young children in group-based care have only identified a slightly higher incidence of aggressive or anti-social behaviour in some children within the context of beneficial outcomes for all from high-quality provision (for example, interim findings from the Families, Children and Child Care Study – see www.familieschildrenchildcare.org/fccc_frames_home.html). None of this research presents conclusive evidence of significantly negative impacts, though it does suggest that very prolonged periods of poor-quality care for very young children (under 18 months) can have some negative impacts on behaviour and socialisation.

Mixing, matching and widening options

Some commentators and elements of the media have misrepresented these findings to give the impression that all childcare is damaging, and that parents (especially mothers) in paid work are harming their children. The reality is that very few children are left in formal childcare for 30 hours a week from a very early age. The majority of families mix and match a combination of formal and informal care, and the evidence from EPPE and elsewhere is that this is beneficial for children's cognitive and social development (especially after their first birthday). From the age of three, and possibly even two, the benefits of high-quality childcare and early years services on both cognitive and emotional development are clear – with the most disadvantaged benefiting most.

It is important to recognise that the purpose of the early years and childcare system is to support families and enable them to thrive, and that this will mean different things for different families at different stages. For many families childcare is a necessity rather than a choice: especially lone parents or those on low to middle incomes who need to work and do not have a resident partner or informal networks of support to rely on. So our objectives should be to widen options for families and promote opportunities for children to flourish. This is the context in which we make our argument for extending and improving the childcare and early years system. Crucially, in all cases, the quality of care is paramount, making the childcare workforce a major policy priority.

Importance for the labour market

Childcare and early years services also have a central role in shaping a progressive labour market, maximising productivity and promoting gender equality. States with high levels of social protection, good childcare and early years provision, and flexible working policies also tend to have the highest rates of female labour market participation. The absence of appropriate and affordable childcare in the UK is frequently cited as a barrier preventing women from working, especially among lone parents (for example, Bell *et al* (2005)). A recent survey for the DfES found that 41 per cent of parents felt there was insufficient childcare available locally, and 10 per cent of those not working cited the cost of childcare as the primary reason (Bryson *et al* 2006).

As ippr has recently argued (Stanley 2005), an emerging agenda around fatherhood, and the increasing role of fathers as carers as well as breadwinners, is also a crucial aspect of achieving gender equality in the home as well as in the workplace. Given the complexity of modern families, and the patchwork of paid employment and domestic responsibilities put together by both parents, high-quality, affordable and appropriate childcare will be increasingly important in enabling choice, autonomy and equality for both men and women.

Long-term economic gains

Finally, there is an emerging body of evidence suggesting that investment in high-quality childcare and early years provision is likely to precipitate significant long-term gains for post-industrial societies, where human capital is central to driving economic growth. A cost benefit analysis by PricewaterhouseCoopers calculated that overall economic gain in the region of one to two per cent of GDP was plausible, given higher female employment rates and the increased productivity of today's children when they become adults (Hawksworth 2004).

Similar work has been carried out in the US, again based on the Perry Pre-school Programme. On-going research has identified levels of educational attainment 0.9 years greater for participating children compared with their non-attending peers. Researchers at The Brookings Institute have extrapolated out these findings to look at the potential impact of a federal programme of universal, high-quality early years

care. While their findings should be treated with some caution, given the range of variables at play, they estimate that additional GDP growth in the region of 3.5 per cent (in a range from 1.3 per cent to four per cent) could be accrued from such a policy by 2080 – worth around US\$2 trillion to the economy at 2005 prices, and netting the Federal government an additional US\$400 trillion per year (Dickens et al 2006).

In addition, Heckman and Masterov have argued that there are considerable long-term productivity gains for societies that invest in young children – from enhanced human capital (including cognitive and non-cognitive skills), reduced crime, and the positive consequences of preventative support being provided for families facing challenging home environments (Heckman and Masterov 2004).

A new set of priorities and shifting attitudes

A confluence of factors – strong evidence on the benefits of early intervention for individuals and wider society, stalling social mobility, rising female employment, the growth in lone parent families, and new conceptions of gender roles – carve out a new sphere of legitimate concern for government, and a new set of priorities for progressives. Closely linked to these developments are shifting public attitudes to family life and to public spending on childcare provision that enables women to work.

The proportion of people saying they believed government should help with childcare costs for single parents with school-aged children rose from 52 per cent in 1994 to 62 per cent in 2002, against the grain of general trends in attitudes to welfare spending. As Table 2.1 shows, almost three-quarters agreed that the government should provide money to help with childcare for single mothers with a young child, with almost half agreeing similar support should be provided to married mothers (Taylor-Gooby 2005).

Attitudes to paid work and parental relationships appear to be shifting as well. In 1998, 69 per cent of women thought that a working mother could establish a warm and secure relationship with her children, compared to less than 50 per cent in 1983 (Jarvis *et al* 2000). Additionally, the proportion believing that a women’s primary role is to stay at home and provide domestic support for a male breadwinner has halved during the past 15 years from about a third to a sixth (Taylor-Gooby 2005).

Table 2.1: Government should provide money to help with childcare for...

	Single mother, child under school age	Single mother, child at school age	Married mother, child under school age
Agree	73.2%	60.7%	49.8%
Neither agree nor disagree	11.4%	17.1%	18.9%
Disagree	10.8%	16.2%	24.8%

Source: Taylor-Gooby 2005

There is a powerful combination of political, economic, social, demographic and attitudinal factors that give prominence to the current debate about childcare and early years policy. Given the direction of these trends, the salience of these issues is only likely to increase in future years. Indeed, underpinning and uniting the twin objectives of improving child outcomes and promoting higher and more equitable employment is the Government’s own ambition to abolish child poverty within a generation. Despite considerable progress in lifting around 700,000 children out of poverty, recent figures revealed that the first interim target had been missed. Getting back on track to delivering on this totemic agenda therefore requires a redoubling of efforts over the next five years, with childcare and early years policy undoubtedly having a central role to play.

Policy and practice developments since 1997

The past nine years have witnessed far-reaching changes to the childcare and early years system in this country. This has been achieved through a number of high-profile strategies and significant spending, in the region of £17 billion overall. In political terms, the Government has opened up what the Prime Minister has called ‘a new frontier of the welfare state’ (Blair 2005). Childcare and early years is now centre stage in the political battleground, demonstrated palpably by the attention it has received from the new Conservative leadership (Osborne 2006). There is growing evidence that this agenda has strengthening

public policy roots as well, with a major implementation plan in operation, backed up by ambitious targets for delivery and rollout over the coming years (DfES and DWP 2006).

1998 - The National Childcare Strategy

Prior to 1997, childcare and early years did not feature significantly on the public policy radar, being seen largely as part of the private family domain and beyond the direct concern of the state. According to this logic, if rising maternal employment created an increased demand for childcare, the market would respond. The outcome of this philosophy was a growth in the high-value private daycare sector, supporting affluent parents to work. However, this laissez-faire strategy underplayed the positive impact of high-quality childcare and early years services for all children, especially the most disadvantaged and those with specialist needs, as well as restricting the employment aspirations of many low- and middle-income parents (particularly mothers).

In response to this policy failure, the Government published the first-ever National Childcare Strategy in 1998, identifying four key weaknesses in the childcare market: variable quality, high costs, lack of availability and poor information. It proposed a range of national initiatives and targeted interventions to tackle these problems:

- The creation of over 500 Sure Start Local Programmes, offering integrated early education, childcare, parenting support, employment advice and health services.
- Twenty-five Early Excellence Centres, piloting innovative approaches to integrating early education and care. (This was followed by the Neighbourhood Nurseries Initiative, launched in 2000, with the aim of creating 45,000 childcare places in the 20 per cent most deprived areas).
- Plans to guarantee a free part-time early education place for all four-year-olds, and, in time, extend this to three-year-olds as well.
- More out-of-school childcare places, particularly in disadvantaged areas, funded through the National Lottery's New Opportunities Fund.
- A new national helpline providing childcare information, and a Children's Information Service in every local authority area.
- Investment in the training and development of the childcare workforce, and targeted recruitment into the sector.
- Financial assistance towards the costs of childcare via the childcare element of the Working Families Tax Credit – latterly replaced by the Working Tax Credit.

2003 - Every Child Matters

The Government published the Every Child Matters green paper in September 2003, in response to the inquiry by Lord Laming into the death of Victoria Climbié. This set out the case for systemic change in the support offered to children, with the aim of integrating services from Whitehall right through to the frontline, with the needs of the child at the centre throughout. The goal was the creation of a universal framework of support, with a strong emphasis on prevention and early intervention.

This green paper placed childcare and early years at the heart of the Government's strategy to improve children's life chances, with plans to deliver integrated services to children and families through Children's Centres and extended schools. It also highlighted significant areas for improvement in the current childcare and early years workforce. Many of the proposals included in the green paper were legislated for in the Children Act 2004, and are subsequently being implemented through the on-going Every Child Matters: Change for Children programme.

2004 - The 10 Year Strategy for Childcare

Following a major inter-departmental review, the Government published Choice for Parents, the Best Start for Children, its 10-Year Strategy for Childcare, alongside the Pre Budget Report in December 2004. This sought to promote flexibility, accessibility, affordability and quality within the childcare market, setting out key milestones for the future. Within the context of the Every Child Matters agenda, it reaffirmed the

Government's dual aims of supporting parents to work and helping them balance this with their family lives, while advancing the social and educational outcomes of children, particularly those from more disadvantaged backgrounds. The strategy proposed a range of key measures:

Flexibility and accessibility

- The creation of 3,500 Children's Centres – one for every community – by 2010, extending the Sure Start approach from a targeted to a universal programme.
- Free part-time early education places for three- and four-year-olds extended to 15 hours per week for 38 weeks a year from 2010. A long-term goal of 20 hours a week was also set, alongside new opportunities for parents to use their free entitlement flexibly.
- An out-of-school childcare place for all children aged three to 14, from 8am to 6pm every weekday for 48 weeks of the year.
- Plans for a new duty on local authorities to ensure sufficient childcare to meet the needs of working parents.

Quality

- Reform of the regulation and inspection regime for early years and childcare, including the creation of a single quality framework for children from birth to five, fully integrating early education and care.
- A new Transformation Fund of £250 million over two years from April 2006, to support local authorities in developing high-quality, affordable and sustainable childcare.
- Measures to improve the childcare workforce, including an objective for all full-day care settings to be professionally led by 2015.

Affordability

- An increase in the maximum support towards childcare costs available through the childcare element of the Working Tax Credit from £135 to £175 a week for one child, and from £200 to £300 a week for two or more children from April 2005.
- From April 2006, an increase in the proportion of childcare costs eligible for support through tax credits from 70 to 80 per cent.
- A series of pilots aimed at testing innovative approaches to addressing problems of accessibility and affordability for parents on lower incomes living in London.

2005 - Childcare Bill

The first-ever piece of legislation devoted entirely to childcare and early years was introduced into Parliament in November 2005, and is expected to receive Royal Assent in summer 2006. This Bill aims to implement key elements of the 10-Year Strategy, enshrining in law the state's legitimate and beneficial role in children's earliest years. Alongside major reforms to the regulation and inspection regime – including the creation of a new Early Years Foundation Stage – the Bill places local authorities firmly in the lead in developing and facilitating the local childcare market. Key measures include:

- A duty on local authorities to improve the outcomes of all children under five and to close the gap between those with the poorest outcomes and the rest. This should be achieved, in part, by ensuring early childhood services are integrated, proactive and accessible.
- A duty on local authorities to secure, 'so far as is reasonably practicable', sufficient childcare to enable parents to work, or undertake training as a means to work. In fulfilling this duty, local authorities must have specific regard for the needs of low-income parents and children with a disability. Detailed guidance on the practical implications of this duty is still being developed, but it will not constitute an individual childcare guarantee for every parent. Nor will authorities be required to create or sustain provision where the market, supported by tax credits and other existing interventions, is unable to do so. Local councils' task will be to strategically manage the local childcare market, offering support and co-ordination to a diversity of providers.

- A further duty on local authorities to ensure the provision of information, advice and guidance to parents and providers – strengthening the role of Children’s Information Services.

Policy progress and current spending

Given this ambitious policy framework, what has the Government delivered for children and families so far, and what further progress is it committed to making in the coming years? Table 2.2 briefly sets out the main areas of progress since 1997, followed by the key policy targets for the coming years.

Date	Policy delivery and commitments
Now	<ul style="list-style-type: none"> ● 1.2 million childcare places are now available, a doubling of total capacity since 1997. ● 800 Children’s Centres are now up and running, reaching around 650,000 children. ● Every three and four year old is entitled to 12.5 hours a week of free early education for 38 weeks a year (from this April), with almost every eligible child taking up at least a part of this offer. ● Support towards the cost of childcare is available through the childcare element of the Working Tax Credit. ● 5,000 schools are engaged in the extended schools programme. ● The Childcare Bill is due to receive Royal Assent in summer 2006.
By end of 2006	<ul style="list-style-type: none"> ● Every three and four year old entitled to 12.5 hours a week of free early education for 38 weeks a year. ● An increase in the proportion of childcare costs covered by the childcare element of the Working Tax Credit from 70 to 80 per cent. ● 1,000 Children’s Centres established. ● 2,500 schools offering core extended activities.
By end of 2007	<ul style="list-style-type: none"> ● Children’s Centres reaching around 1,250 communities. ● Over 7,500 schools delivering core extended services. ● Three- and four-year-olds in pathfinder local authorities able to access 15 hours of free early years provision flexibly. ● Two-year-olds in pilot areas receiving free part time early years provision.
By end of 2008	<ul style="list-style-type: none"> ● Majority of new Childcare Bill duties to become operational (subject to parliamentary approval). ● 2,500 Sure Start Children’s Centres up and running. ● Half of all primary and a third of secondary schools delivering the core extended offer. ● Increasing numbers of three- and four-year-olds able to access their free early years entitlement flexibly.
By end of 2010	<ul style="list-style-type: none"> ● 3,500 Sure Start Children’s Centres in operation – one for every community. ● All three- and four-year-olds entitled to 15 hours a week of free, flexible early years provision, for 38 weeks a year. ● All schools to be offering access to a range of extended services from 8am to 6pm, 48 weeks a year.
2015	<ul style="list-style-type: none"> ● ‘All working parents able to access affordable childcare to enable them to make sensible decisions about balancing work and family life.’ (DfES and DWP 2006) ● Long-term goal of 20 hours free early years entitlement for all three- and four-year-olds.

There has been a substantial increase in government spending on childcare and early years to support this rapid rise in policy ambition – from a little over £1 billion in 1996/7, rising to around £5.5 billion by 2007/8. Looking ahead, the Government claims that future targets, including the new duties on local authorities and a major programme of workforce development, are all funded within existing resources. This is disputed by the Local Government Association and many within the childcare sector. Either way, a number of the objectives in the childcare strategy and the Bill are due to be delivered beyond the timescale of the current spending review period (up to 2007/8), placing great significance on the outcome of the Comprehensive Spending Review in 2007.

Investment into the childcare market is channelled through a range of funding streams, both to increase the supply and quality of local childcare and to provide purchasing power to parents to help make childcare more affordable. Spending on both the supply and the demand side aims to increase parental choice – not only between different childcare providers, but also over how modern families choose to balance their economic and caring roles.

Traditional debates on childcare funding have tended to revolve around a simplistic distinction between ‘supply-side’ and ‘demand-side’ spending. This has often conflated two separate arguments, which confuse competing claims over the most appropriate and effective funding model. These are, firstly, whether investment should be channelled to parents (demand) or providers (supply), and, secondly, whether money should follow the choices made by parents as childcare consumers (demand) or be directed according to some other more prescriptive criteria, such as by area or where it is perceived to be most needed (supply).

For example, in the case of the free early years entitlement, funding follows the choices made by parents. However, the money is channelled directly to the provider. So, is this an example of a supply-side or a demand-side funding stream? Clearly these are not zero-sum choices. However, it is important to draw out these distinctions to ensure we develop a policy and spending model that uses funding to realise the Government’s vision in the most effective and efficient way. We shall return to these conceptual questions in later chapters. However, for ease of comparison, we draw a distinction here between which agents – parents or providers – receive government funding.

Supply-side spending

Supply-side spending refers here to all funding that is channelled to the providers rather than the users of childcare and early years services.

- *General Sure Start Grant:* Following the rationalisation of a number of funding streams, this grant to local authorities covers the vast majority of funding for childcare, Sure Start, Children’s Centres and extended schools. In 2006/7 this will be worth £1.4 billion (falling to £1.3 billion in the following year). This does not include funding for the free early years entitlement. Additional support to schools to develop their extended core offer is being made through the Standards Fund, the Schools Standards Grant and the Dedicated Schools Grant.
- *Universal early years entitlement:* £2.9 billion was allocated to local authorities to support the delivery of free early years provision in 2005/6 (DWP 2005). The free universal offer was originally funded through the Nursery Education Grant and has been subject to a number of terminology changes since then. From April 2006, it will be known as the Early Education Funding (EEF) stream as part of the Dedicated Schools Grant (DSG). Take-up rates of the free part-time universal offer are very high, with almost every three and four year old benefiting from at least part of their entitlement.
- *Transformation Fund:* This funding stream was announced alongside the 10-Year Strategy and aims to support local authorities and providers to increase the quality of the childcare workforce without passing on the associated costs to parents through increased fees. There will be £250 million available from 2006/7 to 2007/8.
- *Childcare Affordability Programme:* This is a £33 million initiative, jointly funded by the London Development Agency and the DfES, to test innovative approaches to making childcare in the capital more affordable. Running from 2005 to 2008, it aims to subsidise 10,000 full-day care places for low-income families by capping prices to no more than £175 a week (the one-child upper limit of the childcare element of the Working Tax Credit).
- *Others:* Funding to develop and sustain childcare and early years provision has been drawn from a diverse range of sources over recent years, including the National Lottery, New Deal for Communities, New Deal for Lone Parents and the Neighbourhood Renewal Fund. It is difficult to distinguish precisely how much of this money has been used directly to fund provision, though it is small compared to the main supply-side funding streams. As childcare and early years services become increasingly mainstreamed, the proportion of this ‘informal’ or ‘cross-over’ spend is likely to decrease.

Total supply-side funding is expected to reach £4.4 billion in 2007/8.

Demand-side spending

Demand-side spending refers here to any funding that is channelled to parents, as users of childcare and early years services, rather than to providers.

- *The childcare element of the Working Tax Credit (WTC)*⁴: This is the Government's primary mechanism for putting purchasing power into the hands of parents, with the aim both of making childcare more affordable and creating incentives for the market to respond to parental choice. Spending through this tax credit amounted to around £880 million in 2004-05, the equivalent of £2 million a day (Brewer *et al* 2005; DfES and DWP 2006). Projections suggest that, by 2007/8, awards will total over £1 billion a year (HM Treasury 2004). In December 2004, spending on the childcare element of WTC was more than 16 times greater than its equivalent in November 1998 (Brewer *et al* 2005). Support through the childcare element of the Working Tax Credit can be claimed on any formal, registered or approved childcare.⁵
- *Employer-supported childcare*: Since April 2005, employers have had the option of offering staff up to £50 per week of support towards the costs of registered childcare, free of tax and National Insurance Contributions. Budget 2006 increased the level of support available up to £55 a week, as well as making £16 million available over the next two years to enable small- and medium-sized businesses to establish workplace nurseries.
- *Care to Learn*: This scheme provides additional support with childcare costs to parents under the age of 20 who are in work-related training.

Total demand-side funding is projected to reach around £1.1 billion in 2007/8.

4. From 2003 this replaced the Children's Tax Credit and the Working Families Tax Credit, both introduced in 1999.

5. See Annex A for a full breakdown of the different types of childcare eligible for support through the tax credit system (and through employer-supported childcare schemes). See Annex C for more details on eligibility and payment of tax credit support.

3. Barriers to equal access: causes and consequences

There is broad political consensus that childcare and early years is an emblematic social policy priority for the early 21st century. Giving every child a fair chance to succeed and promoting labour market opportunities and flexibilities are central to shaping a progressive, enabling welfare state in the context of a post-industrial capitalist society. As we have shown in the previous chapter, this Government has made considerable strides forward over the past nine years. From a progressive perspective, the key challenges for the next phase will be to promote the quality of services and to ensure that all children and families are able to benefit, especially the most disadvantaged.

In this context, there is strong evidence to suggest that key elements of the current configuration of policy and funding are poorly equipped to achieve these goals. We have identified two key barriers to equitable access – affordability and appropriateness – which are increasingly restricting the effectiveness of government policy. This is especially significant when many of the children currently benefiting the least are often those who stand to gain the most. These weaknesses are also likely to sow the seeds of any future substantive political challenge to what the Government is trying to achieve.

Affordability

Childcare and early years services have been made more affordable for more families thanks to additional supply-side and demand-side funding. Supply-side spending has increased the number of places available and attempted to reduce the structural costs of childcare. However, despite investment in developing the capacity and infrastructure of the childcare market, fees to parents have increased rapidly and remain high. The typical cost of a full-time nursery place for a child under two is now £142 a week.⁶ So, while supply has increased, demand has grown faster, and 'operating costs' are high and probably rising.

Support through the Working Tax Credit

The Government's main instrument to tackle direct cost barriers has been providing financial support to parents to help them meet their childcare fees.⁷ This has been done through the childcare element of the Working Tax Credit, available to qualifying parents in paid work, who use formal, registered childcare.⁸ Over 374,000 families now benefit from some support – over seven times the number helped by the childcare disregard under Family Credit prior to 1997. Between November 1998 and December 2004, the average award doubled in real terms, and more than eight times as many families are now in receipt of financial help with childcare costs (Brewer *et al* 2005).

However, flaws in the system are becoming increasingly apparent, with only 25 per cent of lower-income families saying that affordability in their area is 'very' or 'fairly good' (compared to 45 per cent of those on higher incomes), and 11 per cent of parents not using childcare citing affordability as the reason (Bryson *et al* 2006). Key factors here are the tight taper within the tax credit system, which restricts the amount of support available; complexity within the system, which hampers take-up and reduces transparency; and – perhaps most significantly – the eligibility criteria, which severely limits the number of families entitled to any support at all.

The childcare element of the Working Tax Credit is significantly more generous than its predecessor, which, at its peak, was worth, on average, just £22 a week (DWP 2005). However, while the maximum allowance is now theoretically far higher (80 per cent of £175 per week for families with one child and of £300 per week for those with two or more children), the average claim is just £49.80 per week (HMRC 2006a). This is because restricted eligibility means that, even for families who are able to make a claim (and have), the tax credit taper limits the proportion of costs they are entitled to support towards as their income increases.

6. See Annex B for a more detailed breakdown of childcare costs, including some evidence that prices are beginning to stabilise.
7. By being offered free to all three- and four-year-olds, the universal part-time early years entitlement is clearly a further significant tool in reducing affordability pressures for eligible parents.
8. See Annex C for a detailed account of how the Working Tax Credit (and the Child Tax Credit) operate, and what support different families are entitled to.

The latest statistics show that, of the families in receipt of childcare tax credit support, just 11 per cent were eligible for support towards £150 or more of childcare costs per week (subject to the then 70 per cent allowance), with less than a third (30 per cent) having £100 or more per week of costs eligible for assistance. By contrast, nearly half of all families benefiting (46 per cent) were eligible for support on only £60 per week or less of childcare costs, with over 12 per cent of claimants eligible for assistance on less than £20 per week of costs (HMRC 2006a). While many families claiming support will use part-time or sessional childcare, and thus not face full-time costs, it is clear that the tight taper within the tax credit system restricts the amount of childcare support available to many families.

Despite the extra assistance now theoretically available, research suggests that only 15 per cent of couples and 24 per cent of lone parents received help through the childcare element of the Working Tax Credit in 2004, with 20 per cent of low-income parents still meeting all their childcare costs themselves (Daycare Trust and Moss 2004).

Other figures paint an even less positive picture. A recent parental usage survey estimated that 3.42 million families used formal childcare at some point in 2004, yet in that same year just 268,000 (or seven per cent of that total) received support through the childcare element of Working Tax Credit (Bryson *et al* 2006; HMRC 2005). While nearly two-thirds of families (64 per cent) received Child Tax Credit that year, just 27 per cent also received Working Tax Credit. Only 11 per cent of those who received Working Tax Credit were in receipt of the childcare element – suggesting coverage of just three per cent of all families (Bryson *et al* 2006).

Challenges around the implementation and administration of the tax credit system also militate against its effectiveness as a tool to tackle affordability pressures. The complex method of assessing eligibility and entitlement inhibits take-up and reduces transparency. Calculations depend on a combination of parental employment status, type of childcare used, level of household income, numbers of children, and formal childcare costs. This makes it difficult for parents to see what they are, or might be, entitled to (restricting the efficacy of tax credit support as an employment incentive).

Many parents are unaware of what support is available to them, and language barriers can also restrict awareness of tax credits (Bryson *et al* 2005). Anecdotal evidence from Children's Centre managers suggests that childcare workers spend a considerable amount of time helping parents fill in the requisite tax credit forms. Also, well-publicised problems in the administration of tax credits – inflexibility in responding to changes in family circumstances, and overpayment followed by calls for repayment – inhibit their impact further.

Evidence from the National Centre for Social Research suggests that the capacity of tax credits to improve affordability for parents depends heavily on the local economy. While they can be effective in areas where living costs are relatively low and employment rates high, they work far less well in areas where living costs are high and parental employment is irregular and unpredictable (Dickens *et al* 2005). Evidence also suggests that the majority of recipients are on middle to higher incomes, with the largest net beneficiaries from the tax credit being families in the seventh income decile (Brewer *et al* 2005).

Key groups missing out

Affordability is clearly a concern across the childcare market, not least given the potential trade-off with the goal of raising quality (which, without government intervention, pushes up unit costs further). However, it is worth picking out a number of key groups for whom current strategies are working least well, despite them often needing the most assistance.

Children living in workless households

The main demand subsidy is only available to parents in paid work – the strongest articulation of the Government's labour market objectives in relation to childcare.⁹ This is based on the assumption that children in workless households do not, by definition, have childcare needs. This employment rationale is given further force by the so-called 'sufficiency' duty in the Childcare Bill, which will require local authorities to meet the childcare needs of 'working parents' only (or those in training as a mean to work).¹⁰

9. Families where only one parent works at least 16 hours per week may be entitled to Working Tax Credit support, but they are not eligible for the childcare element – disadvantaging children in these households (see Annex C for further details).

10. This labour-market driven approach is not absolute, of course; three- and four-year-olds benefit from free part-time early education irrespective of their parents' employment status.

The problem with linking the main affordability strategy to paid work is that it further disadvantages the already disadvantaged – turning John Rawls’ classic justification of inequality benefiting the least well-off entirely on its head (Rawls 1971). Nearly 1.8 million children live in families where no one is in paid work, and around half of children in poverty live in workless households (DWP 2005).

If we believe that high-quality childcare and early years services bring benefits to children – for their social, emotional and educational development – it is very questionable why any element of the funding system should hamper usage among those who stand to benefit most (accepting that some spending is not directed in this way, that is the universal free entitlement). Additionally, childcare is not purely a service designed to cover defined periods of parental employment. The current funding system prevents many children from gaining the benefits of ad hoc or occasional childcare opportunities, which also provide parents with valuable periods of respite.

There are also real doubts about whether providing support with childcare costs to parents only once they are actually working is an effective employment incentive. Supporting parents back into the labour market (or maybe into a job for the first time) requires personalised and sensitive support.¹¹ Also, complexity and a lack of transparency make it very difficult for parents considering paid work to calculate whether or not – and by how much – they might be financially better off. Barriers to paid work are inherently complex and personal, and it is difficult to make general assumptions in this area. However, 48 per cent of non-working parents said that they would consider employment if they could arrange good quality, affordable and flexible childcare (DfES 2006b). Therefore, providing the financial means to afford childcare only once a parent is in paid work will always appear perverse to those for whom arranging suitable childcare is a prerequisite to taking up a job.

Children living in large families

Support through the childcare element of the Working Tax Credit now covers 80 per cent of childcare costs at two rates. These are £175 a week for one child and £300 a week for two or more children. There are no significant economies of scale in using formal childcare, so costs for two children are likely to be approximately twice as great as for one, and so on.¹² Therefore, families with more than two children with childcare needs are likely to face the prospect of a weekly childcare bill well above the maximum eligible amount – making it unaffordable for many. This disadvantages these children who are likely to miss out on the benefits of childcare, as well as constituting a considerable employment barrier for their parents (juggling childcare and paid work will already pose extra practical challenges for large families). This is an especially important group given that, while only a third of children live in families with two or more other siblings, half of all those in poverty live in such larger families (DWP 2005).

Lone parent families

Forty-two per cent of children in poverty live in lone parent households, making them a key group in the Government’s child poverty agenda. Affordability pressures that restrict take-up of childcare disadvantage these children in two key ways. Firstly, by not adequately supporting their parents to work where they are able to and, secondly, by reducing their access to high-quality opportunities, whether or not their parents are in paid work. Despite increasing the proportion of lone parents in paid work by around 11 per cent since 1997, the lone parent employment rate still lags considerably behind that of parents in couple households (56 per cent compared to, for example, 71 per cent of married or co-habiting mothers) and is low compared to other comparable European states.

High childcare costs, and the weaknesses of an ‘in-work’ system of childcare support, pose particular challenges to lone parents. Household incomes are likely to be lower than for couple families, while, given the absence of a second resident carer, childcare needs (both to facilitate parental employment and at other times) are likely to be greater.

The Government has come under some criticism for being seen to ‘push’ lone parents into paid work – by suggesting that employment is the only realistic route out of poverty, and implying that paid employment is an essential part of being a good parent. The rhetoric has, at times, been overly prescriptive, and paid

11. The Government has accepted this logic in part by linking the work of JobCentre Plus closely with emerging Children’s Centres and by extending the Childcare Bill duty to those training as a means to work. Various Department of Work and Pensions pilots, offering extra childcare support and earning-subsidies to lone parents moving into work, recognise some of these difficult ‘transitional’ issues. However, they do not amount to a comprehensive or integrated employment/childcare strategy.

12. With the caveat that childcare costs can vary considerably depending on the age of the child.

work may not always be the best option – or even possible – for a significant minority of lone parents. That said, for those who can, paid work is an effective route out of poverty, and so the childcare strategy should enable rather than inhibit this. In addition, affordable childcare can offer essential respite for lone parents, and invaluable social and educational opportunities for children, in households where paid work is not reasonably possible (for example, because there are a number of young children or the parent has a disability).

High childcare costs and restricted access to subsidies mean that children living in lone parent households – often with the greatest needs and the most to gain – are less likely to be able to benefit from high-quality childcare. A recent study found that between 2001 and 2004 there was a 10 per cent growth in formal childcare use among couple families, compared to just a five per cent rise among lone parent families (Bryson *et al* 2006).

Working families on low incomes

Even if parents are able to claim the maximum support available for childcare costs through the Working Tax Credit, they will still be required to pay a proportion of fees themselves. This could be making up the final 20 per cent of costs not covered by tax credit support (potentially £35 per week for one child, £60 a week for two or more children), plus any additional fees charged above the current weekly limits. In addition, as pointed out earlier, only a very small percentage of families – around 10 per cent – are eligible for somewhere approaching the maximum support, leaving the majority of parents with a high percentage of costs to meet themselves. These difficulties will particularly affect working families on low incomes, and other families facing particularly high childcare costs. Evidence suggests that increases in both the supply of childcare places and tax credit support are disproportionately benefiting middle- and higher-income families.

Recent research shows that, in a given week, 52 per cent of families with a yearly income of £32,000 or more had used formal childcare, compared to just 31 per cent of those earning under £10,000. Within increasing use of formal childcare across the board, figures also revealed that between 2001 and 2004 there was a 10 per cent rise in usage in affluent areas compared to only a five per cent rise in the most deprived areas (Bryson *et al* 2006). Given that affordability is a major factor affecting parents' childcare use, we can reasonably expect this to be significant explanatory factor in these figures, meaning that families on lower income are disproportionately missing out.

Families facing higher cost barriers

Some families face structurally higher childcare costs, which create particularly acute affordability pressures – children with disabilities or special educational needs, very young children, families living in high-cost areas such as London, parents working atypical hours, and families living in rural communities. The Working Tax Credit is poorly equipped to respond to each of these particular needs. It would be impossible to reform the tax credit system to take account of every individual family's circumstances – and greater tailoring brings with it additional complexity.

Therefore, these are areas where it is likely that increased supply-side investment – to incentivise appropriate provision and reduce upfront childcare costs where the market fails to meet priority areas of need – will be crucial. Factors restricting the accessibility of childcare for some of these key groups – that go beyond just affordability – are considered in greater detail below.

Appropriateness of provision

While affordability acts as a general restriction on childcare use, a lack of appropriate high-quality provision can cause an additional barrier to access for particular children and families. This is especially the case for two groups: children from black and minority ethnic (BME) families and children with disabilities. The challenges facing these children are closely related to high childcare costs and affordability, but there is evidence to suggest that financial pressures (on both the supply and demand side) do not capture all the obstacles restricting childcare use in these cases.

Children from black and minority ethnic families

Levels of formal childcare use differ markedly by ethnicity. In 2002, 81 per cent of black parents, 70 per cent of Asian parents and 71 per cent of parents from other minority ethnic groups used formal childcare,

compared with 87 per cent of white parents (Daycare Trust 2003). Research suggests that Pakistani and black African families are the groups least likely to use formal childcare (Bryson *et al* 2005). Lower levels of usage are preventing many children from gaining the social and developmental benefits of high-quality childcare and may also be hindering the employment opportunities of BME parents.

Explaining variations in use of formal childcare is complex and requires a range of cultural and economic factors to be assessed. Research by the National Centre for Social Research (Bryson *et al* 2005) suggests that:

- High levels of childcare use among white families may reflect their higher incomes and the relatively high proportion of mothers in paid work (though much of this is part-time), while high usage among black Caribbean families is thought to be linked to high levels of lone parenthood and full-time maternal employment.
- Relatively low levels of use among Pakistani and black African families may reflect both circumstances (low maternal employment, low levels of lone parenthood, tendency to have other adults living in the household) and preferences (such as for parental/familial childcare based on cultural or religious factors).
- Black children are most likely to be receiving only formal childcare, due to high levels of lone parenthood and maternal employment. However, Early and Burchinal (2001) suggest that this may also reflect preferences among black parents for childcare with an 'educational' element. Contrastingly, white parents are more likely to cite 'trust' and 'affection' as reasons for choosing a childcare provider, hence their greater preference for informal care, often by grandparents.

This NCSR research suggests that childcare use among BME groups is closely related to patterns of maternal employment, and, hence, cost and affordability. White women are most likely to be economically active, with 71 per cent in some kind of paid employment. Of black Caribbean women, 65 per cent are economically active, with a greater proportion in full-time paid work (45 per cent compared to only 38 per cent of white women). Pakistani and Bangladeshi women are much less likely to be economically active, with only 28 per cent and 16 per cent respectively in paid employment (Lindley *et al* 2004). Lower rates of maternal employment both restrict access to childcare opportunities among some BME children, while suggesting that current policy is failing to provide a strong work incentive. BME households are over-represented in the lowest income groups, and some groups (especially South Asian families) are more likely to have large families.

Black parents are more likely than white parents to report unmet demand due to reasons of affordability, while they are least likely to say they have enough information about local childcare services (Bryson *et al* 2005). Fifty-three per cent of black parents said too little information was available about childcare services, compared with 45 per cent of white parents (Daycare Trust 2004). It has also been suggested that the overwhelmingly white childcare workforce (96-98 per cent) presents a barrier to usage among BME families. Some research has shown that the presence of staff from parents' own ethnicity is important, particularly among Asian and Muslim mothers, and especially where language is an issue. However, other studies suggest that the ethnic origin of childcare staff is not a major concern for parents (Bryson *et al* 2005).

The Government has recently announced that local authorities will be required to support the recruitment of ethnic minority staff into childcare settings and monitor progress in doing so. In addition to workforce issues, there are important cultural factors which affect participation rates in formal childcare among BME families, involving both family attitudes to paid work and care, as well as the effectiveness of local providers in offering services that reach out and cater for minority communities.

Interestingly, black families living in deprived areas are more likely than other black families to use formal childcare, while the opposite is true among white families. This may reflect the fact that black families living in deprived areas have benefited strongly from targeted interventions such as Sure Start Local Programmes and the Neighbourhood Nurseries Initiative, due to their lower average incomes and the likelihood of black families being headed by a lone parent (Bryson *et al* 2005).

Overall, there are significant variations in the levels of formal childcare usage among families from different ethnic groups. However, there are no simple explanations for this phenomenon. High childcare costs, a work-based entitlement to subsidies and variable levels of maternal employment are clearly important, as are high rates of lone parenthood among black African and Caribbean families, and the typically larger family size of many Southern Asian communities. In addition, subtler issues such as the availability of appropriate provision and differing levels of demand for formal childcare (affected, in part at

least, by cultural and attitudinal factors) appear to be significant. Taken together, these issues pose particular challenges to the Government's current childcare strategy, especially given the relatively higher rates of economic and educational disadvantage faced by children from BME families.

Services for disabled children

The population of disabled children in the UK is large and growing. There are currently 720,000 disabled children under 16 in the UK (five per cent of all children), with a 62 per cent increase since 1975. Of these, 111,000 children are severely disabled, and 17,500 families have more than one disabled child (Strategy Unit 2005). In addition, 1.9 million children in England and Wales have special educational needs (SEN), with one in 30 entitled to additional support through a statement (Payne 2004).

Despite the large numbers of disabled and SEN children, there continues to be a lack of appropriate childcare provision to meet their needs. Research by the Daycare Trust (2004) found that 69 per cent of parents with disabled children reported difficulties finding suitable childcare. Many childcare settings claim to be able to accommodate children with disabilities and SEN – but many are only actually able to offer one such place (National Audit Office 2004). Since September 2002, all childcare and early years settings have been required to comply with the Disability Discrimination Act, but evidence suggests this is not yet enabling all children with a disability or SEN to access childcare – hampering their own personal, social and educational development as well as their parent's capacity to undertake paid work.

There are a number of factors that restrict childcare use among children with disabilities and SEN, which are closely related to cost and affordability pressures, but not entirely explained by these factors. Disabled and SEN children may have additional practical and learning needs, which are not routinely met by childcare providers. They may also require a higher staff to child ratio than is regularly provided, and staff may need specialist skills or training.

Research by the National Centre for Social Research (Bryson *et al* 2005) also finds that parents of children with SEN are more likely to report difficulties in arranging transport to and from childcare settings and in finding information about the availability of appropriate places. All these factors mean that childcare for disabled children can be expensive, rare and hard to access. There is also evidence that disabled children are subject to active discrimination by both carers and other parents, creating yet another barrier to their use of childcare (Daycare Trust 2004).

High costs are a particular problem for parents of disabled and SEN children. It is estimated that 55 per cent of families with a disabled child live in poverty (Mencap 2003). While childcare costs are often up to three times the levels faced by families with no disabled children, parents with disabled children are more likely to be unemployed and live on a low income (Joseph Rowntree Foundation 1998). Given the additional caring responsibilities for parents of disabled children, there are often considerable practical and emotional barriers to paid work. Therefore, these families are not able to receive support through the current demand-side subsidy, restricting both access for children and opportunities for periods of respite care for families.

In 2004 only eight per cent of lone mothers in receipt of the disabled element of Child Tax Credit were getting any support from the childcare element of the Working Tax Credit – compared to over half of lone mothers in receipt of Working Tax Credit and 24 per cent of all lone mothers (Women's Budget Group 2005). In defending its position on childcare for disabled children, the Government has pointed to Sections 17 and 18 of the Children Act 1989, which enable local authorities to provide direct childcare support to 'children in need', including those with a disability. However, the continuing lack of access for disabled children suggests that this legislation has had little practical impact.

The Government has partially acknowledged the particular barriers restricting childcare use among children with disabilities and SEN, directing £21.8 million in 2004-05 specifically to enable local authorities to improve their services. All childcare settings that provide early education places are now required to have a SEN Co-ordinator (SENCO), and every local authority is required to have an area SENCO for every twenty non-maintained settings. A further measure that ministers hope will improve access is the 'specific regard' local authorities will have to have for the needs of disabled children in meeting the new 'sufficiency duty' in the Childcare Bill. Again, however, both the Local Government Association and disability charities argue that, without extra money to increase and improve the supply of appropriate places, this duty is in danger of having limited impact.

Children living in rural areas and whose parents work atypical hours

There are two further groups who face particular barriers to childcare use, beyond the general affordability issues identified earlier. Families living in more rural or remote locations can expect to encounter two additional challenges in accessing appropriate childcare. Firstly, transport is likely to be more costly and less convenient, with parents having to travel further to find their nearest suitable provider. Secondly, rural or remote providers are likely to serve a 'natural' catchment area consisting of fewer children and families – increasing unit costs per child.

Similar kinds of barriers are faced by children whose parents work atypical hours (in other words, outside of 9am to 5pm on week days, or at weekends). There is a real lack of provision operating beyond normal office hours, severely restricting access for these families. Where appropriate childcare does exist, fees are often disproportionately high. Targeted investment is needed to increase the supply of appropriate provision, and reduce structural costs. However, it is important to consider the most appropriate type of providers for these groups. For example, in many cases, childminders – providing individual or small group care on domestic premises – are likely to offer a more flexible option.

In addition, since April 2005, home-based childcare outside the Ofsted framework has been eligible for registration with the Childcare Approval Scheme¹³. This has opened up tax credit eligibility to parents using childcare in their own home from an approved carer (who has an up-to-date Criminal Records Bureau check and has passed basic first aid and child development courses). This has begun to bridge the philosophical divide between formal and informal provision. However, so far, the scheme has had a low profile, with relatively low rates of participation. Latest figures from the DfES for April 2006 show that just 1,797 individuals are registered on the Childcare Approval Scheme, with a further 868 awaiting approval (DfES 2006a).

13. See Annex A for further details on the Childcare Approval Scheme

4. Rethinking childcare spending

The Government's twin objectives – investing early to give children the best start in life, and empowering parents with enhanced choices about how to balance their economic and caring roles – carry broad support across both the electorate and the political spectrum. This rapidly emerging consensus is one of the most striking aspects of recent developments, and offers the potential to mould a powerful and enduring coalition to embed childcare and early years at the heart of a modern welfare state. The Childcare Bill will give childcare and early years strong legislative roots, with a major new role for 'enabling' local authorities to ensure improved services and outcomes for local children.

In *Social Justice: Building a Fairer Britain*, ippr identified investment in childcare and early years as a major priority for the achievement of social justice (Pearce and Paxton 2005). This was set firmly within the context of a wider debate about the development in the UK of a progressive 'Anglo-social' welfare model, combining economic growth with the pursuit of social justice. Ippr's goal then, as now, was shaping a system that benefits every child (especially the most disadvantaged), that genuinely enables parental choice for all, and that embodies progressive values of equity and social justice throughout. Drawing on our earlier analysis, it is clear there are major barriers to access for many children. Overcoming these challenges will require significant additional investment over the long term. Beyond this are crucial – and, as yet, poorly scrutinised – questions of how best to configure spending, given the range of objectives we seek from childcare and early years policy.

Moving beyond traditional supply-side versus demand-side debates

The various merits of a demand-side versus a supply-side funding model have dominated much of the policy debate around childcare and early years in recent years. This has tended to revolve around competing claims from those supporting either a system driven by tax credits paid to parents, or direct government support to providers. To their opponents, tax credits are seen as an inadequate response to the challenges of affordability and sustainability, while being poorly targeted at driving up the quality of services. They provide neither a secure funding base for providers, nor do they offer any meaningful incentive to set up new services. In addition, they are viewed by some as being a complicated and imprecise policy instrument, suffering from low take-up rates, restricted eligibility and maladministration.

Supporters of direct government investment in provision point to international evidence that this has been the dominant funding model in states with advanced childcare and early years systems, such as Sweden, Denmark and France. By comparison, tax credit funding is more typical of countries with lower quality, patchier systems, such as the UK and US (where childcare has traditionally been viewed as a predominantly private commodity). Direct government support is seen as being a more effective means to promote quality and sustainability, channelling resources to meet priority areas of need.

Conversely, defenders of tax credits – including the broad government line – argue that they enable resources to be targeted to particular families while put real purchasing power into the hands of parents, forcing the market to respond to parental choice. Where challenges remain – on quality, affordability, sustainability, appropriateness, etc – this relates to issues of implementation (take-up rates, eligibility, administration issues, and so on) rather than the policy rationale itself. Those who caution against a wholly 'supply-side' approach argue that it is prone to inefficiencies, falling prey to producer interests, and being insufficiently responsive to parental choice. Virtually no one argues for an *entirely* demand-side driven approach. For example, while the Government has a strong ideological commitment to tax credit funding of childcare, around four fifths of existing spending is channelled directly to providers.¹⁴ The area of contention has been over the proportions of current and future spending devoted to these alternative strategies – and the effectiveness of the competing approaches.

14. Over the past nine years, the Government has substantially increased investment on both 'supply' and 'demand' strategies. In fact, according to the distinction drawn in Chapter 2, by 2007/08, 80 per cent of government investment will be spent directly on setting up and sustaining childcare and early years provision, with just 20 per cent being channelled to parents in the form of tax credits. However, it should be noted that this proportion shifts dramatically if the universal free part-time early years entitlement is counted as a demand-side strategy, given that investment is stimulated by parental demand and follows parental choice. With this distinction, supply-side investment accounts for just 27 per cent of government spending, compared to 73 per cent on the demand side.

As Chapter 2 alluded to, these claims and counter claims have tended to produce an increasingly sterile debate, obfuscating some of the subtler arguments at play. Put briefly, a more sophisticated analysis might consider *to whom spending is directed* (parents or providers), and *according to what criteria* (following parental choices or by a more prescriptive allocation, such as area- or needs-based). A further confusion arises from the conflation of these debates with the efficacy of tying demand-side subsidies to parental employment – as is currently the case with the childcare element of the Working Tax Credit (but need not necessarily be so).

It is therefore critical to unpick the various ‘outcomes’ or objectives we seek from government spending, and then see whether supply-side or demand-side strategies are likely to be most effective¹⁵ in each case – rather than looking at the childcare and early years market as a single homogenous whole. The analysis below, and summarised in Table 4.1, seeks to do this, revealing that different objectives will be most effectively met by a variety of funding arrangements. We begin with affordability and appropriateness, then go on to consider wider issues addressed in Chapters 2 and 3 that are intrinsic elements of a holistic policy approach to achieving a childcare and early years system accessible to all.

Affordability

Demand: Directly channelling support to parents offers the potential to target funding at those who will find childcare least affordable. This can increase purchasing power and parents’ ability to pay. However, because the current tax credit strategy is tied to parental employment, many of the most disadvantaged children living in workless households miss out. There are weaknesses in the current systems of administration and implementation, which hamper effectiveness (restricting both take-up and the proportion of costs parents can claim support towards). Additionally, there is a danger that demand-side subsidies simply push up market prices rather than reduce the costs faced by parents (Daycare Trust and Moss 2004). This is particularly the case given that local childcare markets tend to be ‘imperfectly competitive’ – that is, there are a limited number of providers that a given family could realistically be expected to travel to or use.

Supply: Directly supporting capacity and infrastructure structurally reduces the proportion of costs borne by parents. Also, in the absence of appropriate provision, questions of affordability are irrelevant. The universal part-time entitlement for three- and four-year-olds (where funding follows parental choices but goes to providers) has achieved very high take-up rates, with no direct costs passed on to parents. This approach could be extended to all childcare – either through the state acting as direct provider or by block purchasing places – making services free to parents. However, childcare places are not the same as school places. It is not a compulsory service for all. Therefore, guaranteeing a free full-time place for every child would be an inefficient use of resources, not least by providing a large subsidy to those on high incomes (while failing to reflect the reality of families’ particular childcare needs and usage).

Appropriateness

Demand: Increasing purchasing power enhances parents’ ability to access childcare services. However, in addition to the problems identified above, at present tax credits are a general subsidy, rather than being targeted at particular groups, such as those identified in Chapter 3, who face higher costs and other non-financial barriers.¹⁶ Targeting particular groups with an enhanced demand-side subsidy would be complicated and subject to problematic definitional issues (for example, how would you define ‘atypical hours’ exactly? Would offering extra support to BME families contravene equalities legislation?).

The exception is for children with a disability or SEN, where there could be a case for an additional demand-side supplement. Overall, however, demand-side subsidies have limited use when there is a lack of appropriate provision available to purchase, and they are much less effective than supply-side measures in stimulating new provision (see below), especially for those high cost/high barrier groups.

Supply: Direct, targeted spending is a more effective and straightforward way to address the lack of appropriate provision for particular high cost/high barrier groups, such as BME children, children with a disability or SEN, or those living in rural areas or whose parents work atypical hours. Supply-side spending will be needed to fund the additional resources and expertise associated with operating provision for such groups (such as additional staffing, transport costs, or increased overheads).

15. Based on the distinction between supply- and demand-side measures set out in Chapter 2.

16. There is an additional disabled child element as part of the Child Tax Credit.

Quality

Demand: Demand subsidies help parents to meet childcare costs, but only for existing services at market prices. Any increase in the overall level of spending into the sector through tax credits will not be directly targeted at driving up quality (such as through improving the qualifications, skills and pay of the childcare workforce) and tends to *increase* market prices. At present, a lack of accessible information about the varying quality of local childcare inhibits the effectiveness of ‘parental purchasing power’ as an instrument to incentivise quality improvements. Research actually suggests that parents tend to be poorly informed about the long-term benefits of high-quality care, so may ‘under-invest’ in quality childcare when given a choice (Sylva *et al* 2004). Better information – coupled with fewer affordability pressures – would empower parents to use their consumer power more effectively here (favouring high-quality provision and disfavouring low quality).

Supply: Operating independently, the market will seek the lowest price – often at the expense of quality. Improving quality across the board requires additional investment into the sector, specifically targeted at achieving this aim. Better enabling parents to use their (limited) purchasing power to favour quality providers is always likely to be a secondary policy instrument. Therefore, this is an area where intervention in the market for a particular purpose is both justified and necessary. The Government itself acknowledged that supply-side spending increases its leverage over quality in the 10-Year Strategy (HM Treasury 2004), and the Transformation Fund is a practical recognition of this – offering a potential model for future spending.

Choice and flexibility

Demand: Tax credits can be a strong symbol of parental choice, enabling them to put together a package of childcare that is appropriate for their family, in a mixed economy of providers. They put purchasing power (and real cash) into the hands of parents, incentivising the market to respond to parents’ needs, choices and tastes. However, they only widen and enable flexibility and parental choice for those who are eligible, where a variety of providers exists, where parents are informed consumers, and when the system functions effectively and equitably.

Supply: Genuine choice and flexibility can only be enabled where there are sufficient, affordable and appropriate services for parents, as consumers, to choose between. What parents may, in reality, want is a ‘good local childcare provider’. However, few children will be using childcare in a permanent, full-time way that is comparable with schooling. Families have vastly different needs and so are well-served by a diversity of providers and types of childcare. Services entirely planned centrally, or according to some prescriptive criteria, would not be sufficiently flexible to respond to parents’ diverse, complex and shifting needs.

Start-up

Demand: Theoretically, tax credits increase both parental spending power and overall resources in the childcare market. This, in turn, creates new opportunities and incentives for potential providers to enter the market – once latent parental demand for services has become actual demand (by being financially enabled). However, due to the way the current system operates (by being heavily sensitive to fluctuations in income and employment status) tax credits do not provide a strong incentive for prospective providers to enter the market. They do not provide a stable and reliable funding stream on which a prospective provider would look to base a sound business plan (and, in any case, money from this source would only become available once the provision was up and running).

Supply: Evidence suggests that the vast majority of new provision has emerged as a result of pump-priming through direct supply-side subsidy. Examples include the Neighbourhood Nursery Initiative, Sure Start Local Programmes, childminder start-up grants, and Children’s Centres. The rapid expansion of the school-aged childcare sector from 1999 was driven by targeted supply-side grants through the New Opportunity Fund’s (NOF) ‘Out of School Hours Childcare Programme’. The exception to this rule may be middle-to-high income areas with high levels of stable employment, where the prospect of tax credit subsidy plus the ability to charge high fees can provide a sufficient incentive for prospective providers to enter the market. In the most affluent areas, the market tends to respond naturally to parental demand at high prices, even in the absence of any supply-side support – as the composition of the childcare market prior to 1997 demonstrates.

Sustainability

Demand: While there are major doubts about the effectiveness of demand subsidies to incentivise new provision, there is more reason to think that they could – theoretically – play a part in promoting sustainability for existing providers. Increasing parents' 'ability to pay' can increase overall resources into the sector and may offer scope for providers to charge fee levels that are affordable while also being financially sustainable. However, as they currently operate, tax credits often fail to provide that consistency and reliability of support (for parents and, in turn, providers). This is due to stop-start payments for parents on the margins of the labour market, other aspects of restricted eligibility, as well as administration and implementation problems. Current government policy relies on tax credits as the long-term vehicle for ensuring sustainability. However, as the system currently operates, there are real doubts about whether this is an effective policy mechanism.

Supply: The sustainability crisis facing the childcare and early years market is both economically inefficient and damaging for children and families. For every two places that opened between 1997 and 2003, one has closed. A recent parliamentary answer revealed that closure rates have not improved since then. Between April 2003 and September 2005, 606,425 new places opened, while 389,055 closed (a closure rate of 64 per cent). The turnover rate for Ofsted-registered childcare providers was 17.7 per cent in 2004, compared to 14 per cent for small businesses (HM Treasury 2004).

We would not accept this turnover rate in school places or hospital beds. In areas where costs are high and parental income and employment are low, it is increasingly clear that targeted and on-going subsidies are essential to meet this identified public need. A recent evaluation of the third round of NOF's 'Out of School Hours Childcare Programme' (which targeted disadvantaged areas) found that 41 per cent of providers believed that their sustainability was dependent on on-going grant support (Big Lottery Fund and SQW Ltd forthcoming). That said, 85 per cent of the daycare market is in the private and voluntary sectors. Somehow 'nationalising' childcare would be a waste of public money, politically unpopular, and damaging to a market where diversity is beneficial. This should not preclude 'the state' – via local authorities – directly providing where the market is failing to respond to an unmet demand, but this must 'add value' rather than duplicate current provision.

There is tentative evidence from recent research by the CBI and the National Day Nurseries Association that increased government activity in the childcare market is putting pressure on some existing private providers. Given that the sector is undergoing a considerable expansion, some overlap and asymmetries are probably inevitable while the market rationalises to achieve a better balance between supply and demand. Some competition in the childcare market can be beneficial, and government intervention is required to address long-standing social and economic needs that the market alone failed to meet (especially in areas of disadvantage). However, the danger of permanent 'oversupply' or disruptive competition highlights the key strategic role for local authorities in providing information, advice and support to parents and providers, while working to ensure a healthy and sustainable balance between local supply and demand.

Detailed guidance on the new duties in the Childcare Bill is still being developed, with some uncertainty about how these will work in practice and what they will mean for parents. As the commitments in the childcare strategy continue to be rolled out, the Government will need to keep the progress of local authorities in delivering on these duties under review.

Supporting parents into paid work

Demand: In theory, the prospect of financial support towards the cost of childcare provides an incentive for parents to go out to work. Where suitable childcare provision is available (and this is not always the case), tax credits can have an impact. However, further to the analysis set out in Chapter 3, an 'in-work' tax credit model has major weaknesses, given that support only comes on stream once employment has begun, while arranging suitable childcare is usually a prerequisite to paid work. Transitions in and out of employment can cause great financial and emotional upheaval for families, and an 'in-work' tax credit model is inflexible and often poorly suited to offering the kind of consistent support that is needed.

Supply: Affordable, appropriate and high-quality childcare can remove a key barrier to paid work (especially for primary carers). Parents looking to move into employment require confidence and certainty that they can access appropriate and affordable provision. They also need to know that the extra pressures and the loss of time with their children associated with paid work will bring clear and significant financial

rewards. Achieving such consistency and reassurance during such difficult transitional periods suggests a key role for direct support to providers to increase capacity, quality and stability in the childcare market.

Supporting parents to stay in paid work

Demand: For parents in stable employment and with suitable childcare arrangements, demand-side subsidies can be invaluable in helping them with their childcare costs, thereby enabling them to maintain their job (both practically and economically) and reap the benefits for themselves and their children. However for parents on the fringes of the labour market entitlement to tax credit support is ‘stop-start’ under the current system. As the Government itself acknowledges, ‘this can mean the loss of a childcare place, which disrupts the continuity of care for their child, and may make it more difficult for the parent to move back into work’ (HM Treasury 2004).

Supply: Maintaining the stability and improving the quality of services is crucial if parents are to retain confidence in using childcare while they work. However, once parents are in paid work, with childcare arrangements in place, the justification for employing demand-side subsidy becomes much stronger.

Objective	Demand-side	Supply-side
Affordability	<ul style="list-style-type: none"> - Allows resources to be targeted - Increases parental purchasing power - Children in workless or ineligible households miss out - Complex administration and restricted eligibility reduces effectiveness - In danger of just pushing up prices 	<ul style="list-style-type: none"> - Structurally reduces proportion of parental costs - Where places are provided for free, take-up is high - Childcare market not directly comparable with schools: guaranteeing a full-time place for every child would be inefficient
Appropriateness	<ul style="list-style-type: none"> - Increases general purchasing power - Unable to address higher barriers faced by key groups in need - Little use in absence of appropriate provision 	<ul style="list-style-type: none"> - Direct, targeted investment needed to support higher cost appropriate provision where the market is unlikely to respond
Quality	<ul style="list-style-type: none"> - Extra spending not directly targeted at improving quality - Lack of information inhibits use of parental purchasing power as an incentive to improve quality 	<ul style="list-style-type: none"> - Improving quality, such as through workforce development, requires targeted interventions
Choice and flexibility	<ul style="list-style-type: none"> - Enables parental choice, allowing families to put together a package of care - Can incentivise the market to respond to meet parents’ needs 	<ul style="list-style-type: none"> - Genuine choice and flexibility requires sufficient supply of appropriate, affordable childcare - Each family’s childcare needs are different and shifting: a diverse childcare market is essential
Start-up	<ul style="list-style-type: none"> - Provides little incentive to prospective providers as resources only become available once provision is in use - Does not provide a sufficiently stable or reliable funding stream on which to base a business plan 	<ul style="list-style-type: none"> - Vast majority of new provision created by direct injections of capital (and often revenue) spending - Only exceptions are affluent areas with high and stable employment levels
Sustainability	<ul style="list-style-type: none"> - Increasing parent’s ‘ability to pay’ could increase resources into sector, allowing providers to charge sustainable prices 	<ul style="list-style-type: none"> - Childcare market faces sustainability crisis, especially in disadvantaged areas - Where costs are high and employment/incomes low, on-going subsidies are essential.

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	- In practice, tax credits are failing to provide a consist and reliable funding source (due to administration problems, restricted eligibility, poor take-up, etc)	- State monopoly of childcare services inefficient and ineffective
Supporting parents into paid work	- In theory, prospect of help with childcare costs may provide a work incentive - Employment criteria means resources only come on stream once parents are in work – poorly suited to supporting transitions into employment	- Affordable, appropriate childcare removes a barrier to paid work, so increasing capacity and stability in market is key - Parents need confidence in childcare arrangements, and transparency about the financial implications of taking up a job
Supporting parents to stay in paid work	- For working parents, with childcare arrangements in place, tax credits can be a major support with their costs - For parents on fringes of labour market, support is 'stop-start', disrupting childcare arrangements	- Maintaining stability and improving quality in the childcare market is crucial to maintaining parental confidence

What this analysis demonstrates is that we are seeking a childcare and early years system that delivers a number of objectives, some of which sit in tension with each other. Differing funding arrangements are likely to be variously more or less effective in achieving each of these objectives. In some cases, the practical operation of the current funding strategy seems to be holding back progress, whereas, in other areas, more fundamental weaknesses exist.

It is also notable that, for each objective, there is rarely one clear-cut policy solution for all times and places, suggesting the need for combinations of various approaches or hybrid strategies. Equally, none of the areas highlighted above can be analysed in isolation from the rest; all will impact on the others. However, breaking down childcare and early years policy in this way suggests very strong reasons for rethinking the principles of spending – both current and future – to meet the Government’s identified goals.

Potential policy options

Based on our analysis of policy priorities and funding mechanisms, there is a range of potential options for the next stage:

a) Reform the childcare element of the Working Tax Credit

Maintain the broad 80 per cent supply-side, 20 per cent demand-side split, so that the bulk of new spending is channelled into directly supporting capacity and infrastructure. Retain the childcare element of the Working Tax Credit. However, reform eligibility, coverage and administration.

- Raise the proportion of costs covered to 100 per cent, raise the upper limit for two children and add in a new top limit for larger families.
- Soften the tax credit taper so that a higher proportion of parents are able to claim support towards a higher proportion of their childcare costs. Increase the level of disregard for fluctuations in parental income.
- Improve the effectiveness of demand-side subsidies by simplifying the process of applying and claiming support, so as to increase take-up and reduce overpayments, fraud and administrative burdens on providers.

Some of these changes may reduce the level of ‘personal tailoring’ within the tax credit system. However, there would be advantages in increased simplicity and transparency; leaving directional supply-side spending to tackle particular barriers to affordable and appropriate provision. In addition, a more co-ordinated and high-profile campaign could be launched to increase the take-up of tax credits. This could engage Children’s Information Services, JobCentre Plus, schools and childcare providers in offering very

practical and proactive support to parents, while empowering them with better information and greater opportunities to voice their needs and interests as consumers.

b) Redirect tax credit payment to providers

In addition to the measures outlined in a), all funding, including that which follows parental choice, such as the childcare element of the Working Tax Credit, could be channelled directly to providers. The advantage of such a reform would be to increase funding stability for providers, while retaining the benefits of a parental choice model (as is currently the case for the universal free early years entitlement). This would also reduce some of the administrative complexities and waste in the system.

Anecdotal evidence suggests that not all the money paid to parents through the childcare element makes it through to providers, pointing to the dangers of fraud in the current system. While parents who currently receive tax credit support would see a cash reduction in their income from this change, they would see a concurrent drop in their childcare costs. A very similar reform has been introduced from April 2006 in New Zealand for both pre-school and out-of-school care, alongside significant increases in the levels of subsidy available (an element of which is also now available to out-of-work parents)¹⁷.

c) Decouple demand-side subsidies from parental employment - link entitlement to the Child Tax Credit

Given that childcare and early years services are a crucial weapon in achieving social justice, the conception of 'need' must broaden to encompass all children, not just those whose parents are in paid work. Indeed, there are good reasons for thinking that children in workless families or with parents on the fringes of the labour market, who are more likely to live in poverty and face a range of associated disadvantages, are those whom the strategy should be particularly targeting. The contradiction inherent in a labour-market-driven approach is laid bare in the Childcare Bill. This will place local authorities under a duty to improve the outcomes of all children, and reduce the inequalities in those outcomes, while simultaneously linking the new duty to ensure sufficient childcare to the needs of *working* parents only¹⁸.

Traditional critiques of a labour-market-linked strategy have tended to be conflated with criticism of demand-side subsidies per se. However, linking eligibility and payment of childcare support to the Child Tax Credit would allow the advantages of a demand-side subsidy to be maintained, while severing the link between a child's access to support and their parents' employment status. Child Tax Credit is currently available to all families with children right up to over £50,000 a year on the income scale, with good coverage rates (5.7 million families benefit, compared to 1.6 million receiving Working Tax Credit). Given that movement in and out of work would no longer affect a *child's* eligibility, claiming support could be far simpler, providing greater certainty and stability for parents and providers.

One critique of such a change would be the fear that it would reduce work incentives. At present, one advantage to parents of working is that they can then access support for childcare costs through Working Tax Credit. However, there are real doubts as to whether an 'in-work' model of support provides an effective employment incentive. Confidence and trust in using appropriate, affordable and high-quality childcare is what parents need as a prerequisite to entering paid work. The prospect of financial support, with little transparency and much complexity, that only becomes available after beginning a job, is not an incentive (especially for those who have been detached from the labour market for some time). For parents, especially those on low pay with unstable employment situations, the 'stop-start' nature of childcare support can mean that losing their childcare place comes with losing their job – causing disruption for children and making it even harder for them to move back into work.

The current system does not support transitions through training and into paid work, and, in many cases, increases uncertainty. Making all families eligible for support towards childcare costs could, in fact, enhance employment potential, increase investment into the sector and remove the current discrimination against certain children based on the working status of their parents. Such a reform would not alter the role of

17. For more information on the recent New Zealand reforms, see: <http://labour.org.nz/policy/families/2005policy/workingfor-families/index.html>, www.workingforfamilies.govt.nz/, and www.workandincome.govt.nz/get-assistance/extra-help/childcare-oscar-subsidy.html (all accessed May 2006).

18. In response to such criticisms, ministers have pointed to the universal measures in the childcare strategy that do benefit all children. However, this does not, in itself, justify a separate policy instrument that least benefits the worst-off.

Working Tax Credit overall as an employment incentive and an income boost for working families. It would simply remove the link between Working Tax Credit and eligibility for childcare support, massively increasing choice and flexibility – allowing all children to benefit and enabling parents to mix and match childcare to suit their family’s needs.

d) Extend the free universal offer and/or cap parental fees

A different philosophical approach to proposals a) to c) would be to cap current spending on tax credits, believing them to deliver maximum utility at their existing levels. Additional overall funding could then be used exclusively to increase the proportion of supply-side spending. This could be used to fund extensions to the universal offer, either by increasing the number of eligible hours, or making it available to children beyond just three and four year olds.

Alternatively, a more interventionist approach would be to place an absolute cap on the level of fees that could be passed on to parents (on a sliding scale), with the state block-purchasing childcare places from a range of quality providers. This approach has been used effectively in Sweden, and is similar to the conceptual framework of the London Development Agency’s Childcare Affordability Programme, as well as the Transformation Fund. This fund offers direct financial support to providers to increase the quality of the workforce without passing on additional costs to parents, while, in return, stipulating a maximum fee level that can be charged (linked to the upper limits of the childcare element of the Working Tax Credit). Extra government spending could be used to extend and deepen such a strategy.

e) Guarantee a childcare place for every child

The new duty in the Childcare Bill will require local authorities to ensure sufficient childcare to meet local needs (albeit for working parents, and only where this is ‘reasonably practicable’). However, as noted earlier, childcare needs are not directly comparable to schooling. It is not a compulsory service, and each individual family will have particular childcare needs (that are likely to shift repeatedly over time). Therefore, it would be inefficient to *provide* a childcare place for every child without finding out what individual parents actually want or need.

One alternative option would be to extend the principle of proposal d), by widening the spirit of the Childcare Bill duty, with sufficient funding, to effectively guarantee a childcare place for every child (within certain parameters, such as numbers of hours, location, type of provider, etc). Under the Bill’s new duties, local authorities will be required to carry out regular and detailed assessments of local childcare supply and parental demand. This will give authorities rich data concerning childcare needs in their area. The state could then guarantee supply by block purchasing the necessary places – incentivising new and specialist providers into the market where needed (Pearce and Paxton 2005).

There could then be a range of possible mechanisms for enabling parents to access these places. These could include providing them universally free; ‘selling’ them on a means-tested basis, with only more affluent parents charged fees; or using a reformed tax credit system to target resources once supply-side funding had brought down the structural costs. Some of these options could imply a relative rebalancing of resources from demand-side to supply-side mechanisms. They all require significantly increased overall resources into the childcare and early years sector.

5. Conclusions – equal access for every child

Looking to the next phase for childcare and early years, policymakers are faced with a radically different context compared with 1997. Then, the challenge was to carve out a new area of legitimate government action, and to support rapid expansion from a very low base. Now, the challenge is to establish childcare and early years as an enduring and unquestioned part of the modern welfare state. This means ensuring every child is able to access services that are high-quality, appropriate and affordable, while enabling families to decide how to balance their economic and caring roles. At the next general election, the education and health systems are sure to come under attack. However, no one will call for schools or hospitals to be scrapped. The same cannot yet be said for childcare, Children’s Centres and extended schools.

In *Social Justice – Building a Fairer Britain*, ippr argued that, in the long term, we should move towards a universal system of childcare and early years where the state block-purchases childcare places from a range of providers. The Government could then set tariffs for parents, on a means-tested basis, depending on their income, with affluent parents meeting a sizable proportion of costs themselves (Pearce and Paxton 2005). Such a policy and spending approach should remain our aspiration, but, given where we are now, what are the immediate priorities to ensure wider and more equal access to childcare and early years services?

Debate has tended to focus on counter-posing traditional conceptions of ‘supply’- versus ‘demand’-side funding strategies – that is, whether spending should be channelled to providers in grants or to parents through tax credits. However, as we have argued, a more sophisticated approach recognises the need to combine the best of each to achieve a childcare and early years system that serves a number of purposes. Supply-side spending increases capacity, supports sustainability and helps to improve quality, while reducing structural costs to parents. For reasons of equity and efficiency, the majority of new investment should be targeted here. That said, in a mixed economy, where families’ needs are likely to be diverse and often shifting, demand-side strategies also have an important role to play in enabling parental choice and flexibility. At present, however, the effectiveness of tax credits is hampered by a perverse parental-employment criteria, restricted eligibility, low take-up and complexity.

Beyond this, the *direction* of funding, on both the supply and demand side, is up for grabs. A sizable proportion of spending needs to be directed centrally, such as for workforce development, and to incentivise appropriate services that the market is unlikely to provide. However, some funding could follow parental choice but go directly to the provider – as is the case with the free universal entitlement (supply), or the New Zealand tax credit model (demand).

The need for investment

Drawing on our earlier analysis of the scale and nature of the challenges, it is difficult to see how the Government can ensure equal access to affordable, appropriate and high-quality childcare and early years services without significant additional investment. Scope for higher levels of public spending in the UK is limited, and resources in the next spending review round will be tight (Robinson forthcoming). However, as we argued in Chapter 2, there is evidence to suggest that childcare and early years is an area where public support for increased government spending is strong and growing (Taylor-Gooby 2005). Beyond this, a combination of factors has created a moment of political opportunity: there is little argument over the socio-economic rationale for action, broad support for the Government’s vision, and considerable consensus on the remaining challenges.

The task ahead is not to create a specific number of additional childcare places or providers, but to drive up quality across the board and open up access to more children by adding capacity in key areas and tackling the affordability challenge. It is not possible to accurately cost each of our proposals, not least because many are interdependent and will play out variously in different contexts. For example, to thrive in their new leadership role, local authorities need to support providers and shape their local childcare market according to particular local needs. However, with the 2007 Comprehensive Spending Review rapidly approaching, we propose a number of key measures that will promote quality, tackle affordability and increase the availability of appropriate provision, within a simpler, more flexible system that improves child outcomes while supporting parents to work.

Key recommendations

1. Access to childcare support should be simplified, widened, and not dependent on the employment status of a child's parents. Entitlement to support with childcare costs should be linked to Child Tax Credit (CTC) rather than Working Tax Credit (WTC).

This would potentially open up eligibility for tax credit support to up to 4.7 million new families by extending entitlement to children whose parents do not work, or who are otherwise not eligible for the childcare element of the Working Tax Credit.¹⁹ More children would be able to access beneficial opportunities, while more parents would be supported to make stable childcare arrangements that boost their capacity to work. Linking entitlement to CTC would be likely to boost take-up (CTC reaches 79 per cent of eligible families compared to 56 per cent for WTC), while increasing simplicity and payment stability – entitlement would not be wholly subject to transitions in and out of the labour market, and payment of the childcare element is already decoupled from the rest of WTC, by being channelled to the main carer – who also receives CTC.

Families not in paid work should be eligible for up to 50 per cent of full support – reflecting their different childcare needs, opening up the benefits of high-quality services to disadvantaged children, while maintaining a clear financial advantage for employment. WTC would continue to act as an employment incentive by topping up low incomes for those in work, while families currently entitled to WTC but not the childcare element (for example, because only one parent works at least 16 hours per week) should also be entitled to support on a 50 per cent basis. Based on current average weekly claims, this would enable these families to pay for around nine hours of childcare per week (in addition to the free part-time entitlement for three- and four-year-olds) – potentially making the crucial difference for parents needing that extra support to prepare for work or access respite care (especially those with children under three or at school).²⁰

We project that this reform could cost around an extra £2 billion a year (subject to significant variables set out in Annex D). To further improve demand-side subsidies, the Government could also consider raising the income level at which eligibility for childcare support begins to taper off, creating a new upper limit for families with three or more children, and adding a childcare premium to the disabled child element of CTC.²¹

2. Additional direct spending on provision and infrastructure is essential to improve quality, support sustainability, and to ensure families facing higher costs and barriers can access appropriate childcare.

Demand-side subsidies can never be the whole solution, and increased supply-side investment is essential to raise quality without further compromising affordability. For some children and families, the market is always less likely to secure appropriate childcare, at affordable prices. In such cases, strategic, and potentially on-going, supply-side spending is needed to stimulate and sustain appropriate services (including for providers operating in disadvantaged areas).

Focus should also be given to supporting the development of different forms of childcare that cater for particular practical needs or cultural requirements:

- **Registered childminders** and other **home-based childcare** can offer the flexible and individual care that many children need and parents want. Childminders should be supported through quality-assured childminder networks to ensure they are integral to local childcare markets, while promoting sustainability and quality among providers. More focus is needed on ways to **bridge the divide between formal and informal care**, which can often appear arbitrary and perverse to parents. Opening up childcare subsidies to anyone, with no controls or quality checks, would be dangerous for children and a poor use of public money. However, the profile of voluntary 'light-touch' schemes²², which open

19. This would include families in work but not entitled to Working Tax Credit, and those receiving Working Tax Credit but not eligible to the childcare element (for example, if only one parent in a couple household is working at least 16 hours per week). See Annex C and D for further details.

20. Fifty per cent of the weekly claim is £25.90. Average hourly childcare costs based on the Daycare Trust 2006 Annual Childcare Costs Survey.

21. It is not possible to project the impact of these changes due to the number of potential variables at play.

22. At present, this refers to the Childcare Approval Scheme (and various Quality Assurance programmes). However, at the time of publication, the future of these schemes is uncertain. Subject to Parliamentary approval, the Childcare Bill will create a new 'Ofsted Childcare Register' which will enable 'later years providers' – for children aged eight and over – to voluntarily join a register of approved providers that are eligible for tax credits. There are indications that this new Register will effectively replace the Childcare Approval Scheme.

up eligibility for tax credits, should be significantly raised to encourage carers to sign up and benefit.

- Childcare and early years services must be **culturally sensitive and proactively reaching out** to promote access among black and minority ethnic families. This requires subtle and context-specific approaches, successful examples of which already exist. Sure Start Stamford Hill in North London has a central 'hub' located at the heart of a large council estate, linked closely to two 'spokes' – based in local Orthodox Jewish and Muslim community centres. Active local management boards have shaped services according to community needs – while drawing on the strong traditions of self-help and social capital present in the local communities.
- Additional spending should be targeted at **increasing the number of appropriate childcare places for disabled children**, especially during school holidays. More help with transport is needed so that school-aged children can get to and from childcare settings, and improved information services are required so that parents can access suitable provision.
- More should be done to **engage employers** with the business case for childcare – including promoting the support they can offer to employees with their childcare costs and through the development of on-site provision (which is often where working parents feel most comfortable leaving their children).

To deliver on the new duties in the Childcare Bill, local authorities must take a strong leadership role across all these issues, fostering positive partnerships among the public, private and voluntary sectors. Councils must be properly funded and supported to succeed in their new role, with none being allowed to use caveats in the Bill – such as the 'reasonably practicable' clause – as an excuse for inaction. The Government should review implementation of the Childcare Bill, especially the role and progress of local authorities, within three years.

3. Parents need to be empowered with more and better information about local childcare services, child development issues and financial support.

This is a vital element of shaping a responsive childcare market, where parents exercise 'voice' and 'choice' over services (and the benefits of a demand-side subsidy are maximised). Children's Information Services should be properly funded and brought centre stage within local childcare markets. They should employ more proactive engagement and dissemination strategies to increase the reach and visibility of childcare information. These should involve greater use of the internet (building on the Ofsted and 'childcarelink' websites²³), other new technologies, as well as more traditional, universal outlets, such as schools and GP surgeries.

4. The relationship between childcare and early years and employment policy needs to be rethought within the context of a holistic and personalised work and welfare agenda.

More sophisticated thinking is needed on work transitions for parents, moving beyond crude financial equations, to consider how public policy can best support each step along the pathway to paid work and beyond. Removing the employment criteria for tax credit support will enable parents to make stable childcare arrangements *prior* to finding work or training – and then to keep them through periods of unemployment. In addition, a more personalised set of levers – linked to accessible community services like Children's Centres – are needed to enable parents to prepare for paid work, find and move into a job, and flourish in their careers. Childcare policy must also be integrated closely with broader work-life balance strategies to give parents greater control and choice over their economic and caring roles.

5. On-going research, analysis and evaluation are needed to inform future policy developments and spending choices.

There is a need for an even firmer evidence base concerning the long-term impact of high-quality services on children across the age range, as well as their contribution to social mobility, life chances and related social and economic challenges (such as productivity, enhancing human capital and family wellbeing). Building on the analytical framework set out here, further research should also be carried out into the relative strengths and weaknesses of different supply- and demand-side strategies, including how they interact with each other²⁴.

23. www.ofsted.gov.uk provides a source of all registered provision, including inspection reports. www.childcarelink.gov.uk is a national portal linking all the local Children's Information Services. (Both accessed May 2006.)

24. Evaluations of the London Development Agency's 'Childcare Affordability Programme' will provide invaluable data. Similar projects to test funding strategies and their impact on various actors in the childcare market (including parents and providers) should be major priority.

Annex A: Types of registered childcare and early years provision

Service	Description	Age range catered for	Cost per week*	Type of provider
Registered childminders	Self-employed child carers who provide care for more than two hours per day. They are registered with Ofsted and inspected once a year. Care is normally in the childminder's own home and hours tend to be flexible.	Children aged 7 or under	£90 – £140 for a full-time place	Private
Day nurseries	Provide full- or part-time places for children below compulsory school age. All nurseries are registered and inspected by Ofsted. They are generally open 8am to 6pm.	0 to 5 years	£100 – £170 for a full-time place. Costs are reduced for three- and four-year-olds who claim their free entitlement in such provision	Public, private or voluntary
Pre-school playgroup	Provide play and education sessions lasting about three hours. Playgroups are registered and inspected by Ofsted.	2 to 5 years	£3 – £6 per session.	Private or voluntary
Early education and nursery classes	Nursery schools are usually open in school hours during term time. Children attend all day or on a sessional basis before they start compulsory education. Some primary schools also offer reception and nursery classes.	3 to 4 years	Free, through the universal part-time entitlement	Public
Out of School Clubs	Group-based childcare operating before and after school and during the holidays.	5 to 14 years (provision catering for children under 7 must be registered with Ofsted)	£41	Public, private or voluntary sector

* Typical rates per week, according to Daycare Trust annual survey of childcare costs, 2006

In addition to the providers detailed above, there are two other (non-compulsory) schemes that enable parents using such childcare provision to benefit from tax credits:

- **Childcare Approval Scheme:** this is a voluntary scheme operating in England for home-based childcarers not legally required to register with Ofsted. In order to be approved, carers must be: aged 18 years or over; have either a recognised childcare qualification, or have attended a valid induction course; hold a first aid certificate that is less than three years old; and have an up-to-date Criminal Records Bureau check. Approval on the scheme lasts for 12 months at a time and enables parents using such childcare to claim tax credits towards their costs.
- **Quality Assurance (QA) Schemes:** these enable childcare providers not legally required to register with Ofsted (those operating for less than two hours a day, less than five days a year, or exclusively for

children aged eight and over) to open themselves up to tax credit eligibility. There are over fifty QA schemes that bear the 'Investors in Children' kite mark, and many providers within the Ofsted framework also work towards achieving this, as it demonstrates especially high-quality services.

NOTE: subject to parliamentary approval, the Childcare Bill will bring about significant changes in the regulation of childcare and early years services. In the future, any 'early years provider' (for children from birth to five years old) will be required to register with Ofsted and deliver the Early Years Foundation Stage. 'Later years providers' will be subject to a separate regulation regime. Those providing care for children under the age of eight will be required to register on the new Ofsted Childcare Register (which enables parents using such services to claim tax credit support towards childcare costs). For those providing care to older children, joining the Ofsted Childcare Register will be voluntary. The future of the Childcare Approval Scheme, and the various QA schemes, within this new regulatory regime is still unclear.

Annex B: Childcare costs survey

A survey on the costs of childcare published in 2006 revealed that formal care still remains prohibitively expensive for many families. Two-thirds of parents reported a lack of affordable, quality childcare in their area. The survey also revealed:

- The cost of a typical full-time nursery place in England has increased by 27 per cent in the last five years. The rise outstrips inflation by nearly 20 per cent. However, price inflation had slowed considerably over the last 12 months.
- A typical full-time nursery place for a child under two in the UK now costs £142 a week, the equivalent of over £7,300 a year. This compares with average earnings of £431 a week last year.
- The highest childcare costs in the survey were found in London and southeast, with a nursery place for a child under two typically costing £197 a week in inner London. This is the only region of the country where there has been no increase in childcare costs in the last 12 months. The lowest nursery costs were in the Midlands and the Northeast.
- For the first time, the highest recorded childcare costs in the survey were charged by childminders operating in London or the South East, rather than day nurseries. However, the average costs of childminders were lower, at £130 a week.
- Over recent years, childcare costs have risen considerably faster than inflation. The largest increases last year were in Wales with a seven per cent rise, and Scotland with an eight per cent, compared to just two per cent in England.

This annual survey is based on findings from 150 out of 200 Childcare and Children's Information Services in Great Britain, based on 50 hours a week in a nursery or with a childminder, and 15 hours a week at an out-of-school club.

For more details, visit: www.daycaretrust.org.uk/mod/fileman/files/Childcare_Costs_Survey_2006.pdf

Annex C: Working Tax Credit and Child Tax Credit

Working Tax Credit (WTC):

Working Tax Credit provides in-work support for low-paid working adults. Families with children, and workers with a disability, are eligible for WTC where at least one adult works 16 hours per week. Workers with no children and no disability are only eligible if they are aged over 25 and work at least 30 hours per week.

WTC is made up of a number of components. There is a basic element, with an extra payment for couples with children and for lone parents, as well as an additional payment for those working at least 30 hours per week (30 hours in total for couples). WTC also includes supplementary payments for disability, severe disability and those over 50 returning to paid work.

The childcare element of WTC is available to lone parents working 16 hours or more per week and to couples where both parents work 16 hours or more per week (or if one is incapacitated and, thus, unable to care for children). This element is payable until the September following the child's 15th birthday (16th birthday for disabled children), and care must be given by approved or registered providers. The childcare component provides up to 80 per cent of eligible childcare expenditure of up to £175 per week for families with one child or £300 per week for families with two or more children – subject to a means test and a tight tapering away of support as household incomes rise. Unlike the rest of WTC, this element is paid directly to the main carer (as with Child Tax Credit).

Child Tax Credit (CTC):

Child Tax Credit is paid on top of child benefit and directly to the main carer in the family. It is made up of a number of elements: a family element, a baby element (for those with a child under the age of one), a child element, a disabled child additional element and a severely disabled child supplement. Entitlement to CTC does not depend on employment status, but does require that the claimant is responsible for at least one child under the age of 16 (or aged between 16 and 18 and in full-time education). Changes in family circumstances (such as a single claimant becoming part of a couple, or vice versa) must be reported to HM Revenue and Customs.

Assessments and payments:

Child Tax Credit and Working Tax Credit are subject to a single means test operating at the family level. Households with pre-tax family income (excluding other benefits) below £100.11 per week (or £266.77 for families eligible for CTC, but not WTC) are entitled to maximum support. For family income above £100.11 per week (or £5,220 per year), CTC and WTC awards are tapered away at a rate of 37 per cent. The main WTC entitlement is withdrawn first, *then the childcare element of WTC*, and, finally, the child and disability elements of CTC. The family element of CTC, however, is not withdrawn until pre-tax income exceeds £958.91 per week (or £50,000 per year), and even then only at a rate of one in 15.

Child Tax Credit	Working Tax Credit
5.5 million families in receipt	1.6 million families in receipt
1.4 million entitled, but not claiming	1.2 million entitled, but not claiming
79 per cent take-up rate	56 per cent take-up
£15.6 billion spent	£8.6 billion spent
£2.3 billion unclaimed	£2.4 billion unclaimed

(Source: HMRC 2006b)

Annex D: Projected cost implications of tax credit reform proposals

Present and potential future eligibility to tax credit support

At present, 5.7 million families with children are in receipt of either Child Tax Credit (CTC) or Working Tax Credit (WTC), of which, 3.5 million are couple families and 2.2 million are single parent families. This breaks down as follows:

In-work families with children	= 4.33 million
Receiving CTC AND WTC	= 1.6 million
Receiving CTC NOT WTC	= 2.7 million
Out-of-work families with children	= 2 million
Receiving CTC	= 1.4 million
Receiving other benefits (currently receiving Income Support/Job Seekers Allowance, but due to be migrated to CTC)	= 0.6 million

Support with childcare costs though the childcare element of the Working Tax credit is currently being provided as follows:

- 374,000 families are benefiting from support.
- 23.4 per cent of eligible families claimed support (374,000 out of potential 1.6 million in receipt of Working Tax Credit).
- The average weekly claim is £49.80 per week (£880 million in total annual costs).
- If every potentially eligible family claimed the average weekly costs for 48 weeks per year under the present system, the aggregate annual costs would be £3.8 billion.

(Source: HMRC 2006a)

Therefore, under the current system, there are 1.6 million families in paid work with children receiving Working Tax Credit, with those where both parents work at least 16 hours per week eligible for support with childcare costs through the childcare element. Linking entitlement to childcare support to eligibility for Child Tax Credit instead would potentially open up access to at least an additional 4.7 million in three new groups:

1. The 2.7 million families in work currently receiving CTC but not WTC.
2. The two million families not in work and either currently (or soon to be) receiving CTC. Our proposals would extend childcare support to these families at 50 per cent of the full weekly entitlement limits. For example, under the present system, this would be 80 per cent of £87.50 for one child or £150 for two or more children.
3. Those couple families currently receiving WTC but unable to claim the childcare element because both parents do not work at least 16 hours per week. This group will be in the range of 374,000 to 1.6 million. However, it is not possible to put a precise figure on this group. Support to these families should also be extended at a 50 per cent rate.

Projected future costs

Drawing on the figures above, and subject to the significant assumptions set out below, we project that the proposed reform could cost around *£2 billion extra per year*. This figure is based on the following calculation:

In-work families:

631,800 new claimants eligible for full support (23.4 per cent of 2.7 million newly eligible families, based on current take-up rates).

£2,390.40 average annual cost per claimant (based on current average weekly tax credit claim of £49.80, for 48 weeks per year)

Projected annual cost = 631,800 x £2390.40 = £1.510 billion

Out-of-work families:

468,000 new claimants eligible for 50 per cent of full support (23.4 per cent of 2 million newly eligible families, based on current take up rates).

£1243.20 average annual cost per claimant (based on 50 per cent of current average weekly tax credit claim, £25.90, for 48 weeks per year)

Projected annual cost = 468,000 x £1243.20 = £0.559 billion

So, projected total annual cost = £1.510 billion + £0.559 billion = £2.069 billion

Assumptions

Demand subsidies are, by definition, open-ended. It is very difficult to accurately project the financial implications of tax credit reform, given that the outcome is heavily dependent on how individuals react to such changes. Our projections are based on a number of assumptions which we believe are reasonable, while acknowledging that, in practice, there is a significant margin for error.

- Projections are based on current levels of take-up.²⁶ While we would hope that take-up among families using formal childcare increases, many newly eligible families will not do so. For example, Child Tax Credit is payable to families with at least one child aged up to 16 years old (or 18 if they are in full-time education). Clearly, as children get older, their need for formal childcare reduces significantly. As a guide, around 40 per cent of the children for whom Child Benefit is claimed are aged 11 or over. Even among those families with younger children, many will use part-time, occasional, or sessional care, limiting their tax credit claim.
- We assume that families will claim support for 48 weeks of formal childcare in a year, however, in practice, many families will use far less – reducing their annual tax credit bill significantly.
- Softening the tax credit taper, raising the proportion of costs covered, including a new upper limit for large families, and including a disability premium could all, potentially, enable families to claim greater support, thus increasing the average weekly award.
- There are currently 1.4 million families eligible for Child Tax Credit and another 1.2 million eligible for Working Tax Credit who are not claiming the support to which they are entitled. This may change in the future.
- We have not projected future costs for the third newly eligible group identified above – those families currently benefiting from Working Tax Credit, but not eligible for the childcare element – as it is not possible to ascertain how many families this concerns. Given the different childcare needs facing these families, where one parent is not in paid employment, and the need to maintain financial incentives for paid employment, support for these families should be extended at the 50 per cent rate.

26. Take-up, here, is calculated as the proportion of those families in receipt of Working Tax Credit who also claim support through the childcare element. This is only an approximate figure given that some of those families not receiving childcare support will not actually be eligible as they do not have two parents working at least 16 hours per week.

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