Can child care and pre-K help reduce inflation? [1]

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Source: Brookings
Format: Article
Publication Date: 2 Jun 2022

AVAILABILITY

EXCERPT

Inflation has recently emerged as the top economic concern in the U.S. The Federal Reserve is now raising interest rates in an attempt to curb inflation, but their job would be easier, and the risk of a recession reduced, if we could directly address some of the job market bottlenecks that are contributing to inflation. This phenomenon has been called "the Great Resignation" – where there are too few workers to fill currently available jobs – because some have left the labor market, while others are reluctant to accept or keep jobs there. The aging of the U.S. population and a recent decline in immigration compound these effects.

In his Wall Street Journal op-ed on May 31, President Biden listed a number of ways to reduce inflation – and one of them was cutting the cost of child care to families, so that the parents of small children could more easily enter the workforce. Indeed, his Build Back Better (BBB) agenda included policies such as greater access to child care and universal pre-K for all 3- and 4-year-olds, policies with the potential to boost labor supply and potentially reduce inflation. That legislation remains in limbo because of the opposition of Senator Joe Manchin (D-WV). But if it had been enacted a year ago, it could have made a difference – not just to the well-being of families and children but even to the inflationary pressures that have now emerged, pressures fueled in part by a lack of workers to produce the products and services people want.

To be sure, the war in Ukraine, supply-chain problems, and earlier stimulus packages such as the American Rescue Plan (which left many consumers with extra cash) are part of the problem. But what's happening in the labor market is almost unprecedented. Employers simply cannot find enough workers. Reported job vacancies now exceed the number of unemployed workers by over 5 million. That is forcing employers to raise wages and prices, adding to inflation. As Domash and Summers (2022) have shown, vacancy rates are very highly correlated with inflation and are currently the highest on record since the series began in 2000.

One way to address the problem is to entice more women off the sidelines and back into the labor force. Many of them dropped out of the labor force during the pandemic, and their employment still falls further short of pre-pandemic levels than does employment among men. But the U.S. has a longer-term problem, unrelated to the pandemic. Compared to other advanced nations, women work less in the U.S. and that's partly because the U.S. provides so little support for child care, early education, and paid leave. With more such supports, more women would work, producing more of what people want, and potentially limiting inflationary pressures.

In this brief, we examine this issue in an attempt to determine whether and how much reducing child care costs might reduce overall inflation. We come to three conclusions.

First, we believe that more child care of the kind proposed in Build Back Better would increase female labor force participation and raise the nation's output and income. Had it been enacted last year, and fully paid for, it might also have reduced inflationary pressures somewhat by allowing more women to remain in the labor market and easing worker shortages this year and in 2023-24. However, our rough calculations suggest that any such effects would likely be very modest. One reason is because any increase in the number of people at work would be partly offset by extra spending out of newly earned income. More importantly, as we argue below, fighting inflation is not the primary reason to enact such legislation.

Second, and on a more positive note, we show that the kind of child care subsidies included in the Build Back Better legislation would have had a big impact on family budgets and well-being by reducing existing child care expenses, especially for the most disadvantaged, thereby freeing up income for other purposes – including offsetting the effects that inflation is having on these families' budgets.

Third, and over the longer run, we show that child care policies and pre-K, by increasing female employment, would spur more economic activity. This added activity would provide families with greater income and governments with a little more revenue.[1] Combined with new investments in the quality of child care and in pre-K, the Build Back Better proposals could also improve the life trajectories of children, and their future productivity and incomes as well.

Female Labor Force Participation

Women's participation in the labor market changed fairly little between 2000 and 2019. It then declined sharply during the pandemic as shown in Figure 1 and has subsequently recovered although, at this writing, not to its pre-pandemic level in 2019.

Figure 1: Female labor force participation (ages 25-54), 1980-2020

During the pandemic, between February 2020 and February 2022, the labor force participation of women fell by 1.3 percentage points while that of men fell by 1.0 percentage point. Many analysts (e.g., Albanesi and Kim, 2021) attribute the impact of the pandemic on women's employment primarily to their greater responsibilities for the care of children. With schools and child care centers closed, many women had little choice but to remain at home.[2] Some left the labor force and may now be reconsidering the decision of whether or not to work – in fact, about half of workers report they are rethinking the job they want post-pandemic. The pandemic was a wake-up call on the importance of women's employment to the health of the economy and to the role of schools and child care centers in making their contributions possible.

Women are now the primary breadwinners in over 40 percent of all families. Many are single parents, and the rest are married but make more money than their husbands or partners. Even before the pandemic, women faced a serious "time squeeze" because of their dual roles as breadwinners and caregivers. In fact, virtually all of the increase in real middle-class incomes over the past four decades was due to women entering the labor force and earning more as they moved up the occupational ladder. In the absence of their earnings, real middle-class incomes (incomes for the middle 60 percent of the population) would have stagnated over those four decades (Figure 2). In sum, women have become essential to a family's economic well-being.

As women's entry into the workforce slowed in America after 2000, participation rates continued to rise in other advanced economies as shown in Figure 3, with the result that other countries now have rates that are 5 to 8 percentage points higher than in the U.S.

Figure 3: Female labor force participation (ages 25-54) in select OECD countries, 1980-2020

Of 22 OECD member countries, U.S. prime-age female participation fell from 6th to 21st between 1990 and 2020.[3] While there are many possible reasons for the higher participation rates of women in some other countries, the biggest difference between the United States and our international counterparts is probably the lack of family-friendly policies. The U.S. is the only advanced democracy without a statutory federal right to paid leave; it provides very low levels of support for child care and early education, and it expects employees to work longer hours per year than in most of Europe. Looking at child care subsidies as a proportion of GDP, the U.S. ranks 35th out of 37 countries according to the OECD. In terms of investments in pre-K, it ranks below 40 other countries.

For these reasons, it is not surprising that women in the U.S. have greater difficulty meeting the competing demands of the workplace and the family. Blau and Kahn (2013) find that America's lack of family-friendly policies can explain almost 30 percent of the shortfall in women's participation between 1990 and 2010 relative to other OECD countries.

Child Care

In 2016, 40 percent of children under the age of 6 were cared for by their parents while the other 60 percent were in a variety of care arrangements, with most paying for this care.[4]

Child care is very expensive. On average, a family has to pay 18 percent of their income for an infant and 13 percent for a toddler in licensed care. The monthly cost varies from about $800 to about $1200 for children under 6, with infants costing more than preschoolers. High quality licensed care – meaning care in which salaries are aligned with kindergarten teacher compensation and in which staff/child ratios and group sizes are consistent with best practice in the field, costs even more: from $1500 to $2200 per month.

Child care is not just expensive but often hard to find, especially for those with nonstandard hours or living in "child care deserts." Given the costs and the difficulties of finding good care, many mothers choose not to work, or work only part-time. For these reasons, we believe more women would work, or work additional hours, if more high-quality child care and other supports such as paid leave were available. Indeed, the research literature supports this view and we discuss the evidence in more detail below.

It should be noted that any increase in demand is likely to raise the costs of care, especially if it is high quality. Right now, child care workers are in short supply. Without more infrastructure and a better-paid child care workforce, it will be hard to scale up the existing system in line with any new demand without a further deterioration in quality. For that reason, any ramp-up in government spending on child care needs to also include investments in the child care work force and the supply of facilities. The Biden proposal does include such investments, but we are cognizant of the fact that those investments will take time to bear fruit and that any downward effect of higher labor force participation on inflation could be partially offset by potential bottlenecks in the child care sector itself as well as by any increase in spending on the part of families induced by their higher earnings.

Relatedly, pre-K slots are also in short supply. Although 44 states now provide some kind of pre-K program it is not always full-day or available to three-year-olds. The result is that about half of 3- and 4-year-olds remain unserved with children from lower-income families the least likely to be enrolled. Although there is still some controversy about the effects of both pre-K and child care on child development, most researchers believe that high-quality programs lead to better outcomes later in life, such as an increase in high school and college graduation rates, and higher earnings. And whatever the effects of early education and care on child outcomes, it enables more women to work and thus brings more income into the family.

Build Back Better

By calling for more paid leave, preschool, and child care, the Build Back Better bill aimed to make it easier for women to combine work and caring for their families, reduce the strain of child care costs on families, and to support the healthy development of children.

The Biden child care proposal provides subsidies to parents using any form of licensed care. The amount of the subsidy varies with income. The formula is complex and depends on family size and state of residence, but child care would essentially be free for families below about

$75,000 in annual income and phase out entirely for those with incomes above about $250,000. No family would have to pay more than 7 percent of their income for child care. The program requires states to opt in and to pick up a share of the costs with the state share rising over time.

As detailed below, we estimate that the proposal will cut child care costs by nearly two-thirds. When we add in the fact that pre-K will be free for three and four-year-olds, and that they represent about a third of all children under 6 (and about one-sixth of those not currently enrolled), the costs of care are further reduced.

Predicted Impacts of Biden Child Care Plan on Labor Force Activity, GDP and Inflation

By how much would the Biden child care plan have reduced inflation if it had been enacted when it was first proposed in the fall of 2021? And by how much could new subsidies for child care still help to contain inflation while increasing labor force participation and income for families with children?

We begin with its likely impact on labor force activity and GDP, which we can predict with some confidence and accuracy; we then speculate about its possible effects on inflation.

Labor Force and GDP

Table 1 contains the results of our calculations on how Biden's plan would affect labor force activity and GDP. First, we draw two estimates from the literature on the elasticity of maternal labor supply with respect to a reduction in child care costs. The first estimate is the midpoint of a range of estimates in a paper by Taryn Morrissey (2017), which reviews various estimates of the elasticity of maternal labor supply with respect to child care in the U.S. and abroad over several decades; the likely range in her paper is .05 to .25, and so the midpoint is .15 – implying that a 10 percent reduction in child care costs would raise maternal employment (total hours worked) by 1.5 percent. The second elasticity estimate is drawn from a recent paper by the National Women's Law Center and The Center for Social Policy at Columbia University, and it is approximately .25.[5]

Next, we calculate the reduction in child care costs that the Biden plan would generate. Since it effectively reduces child care costs by 100 percent for low-income families (those with 75 percent or less of median family income), by 82 percent for middle-income families (those with incomes of 75 to 150 percent), and by zero for high-income families (with incomes 150 percent of the median or higher); a weighted average of these reductions comes to a 65 percent decrease, which we use with both elasticity estimates.

The elasticities imply that such a reduction in child care costs would generate increases in labor supply of 10 percent and 17 percent for mothers of younger children – i.e., those at ages 12 or less. In both cases, we assume that these increases could apply to labor force participation (or the extensive margin of labor supply) or to full-time work among those in the labor force (the intensive margin), or both – neither study estimates elasticities separately for the two kinds of responses.

Since the mothers of younger children constitute approximately 28 percent of all women, the predicted impacts on the employment of all women are about 3 and 5 percent respectively, while predicted impacts on all employment (including both men and women) are about half as large – or 1.5 to 2.5 percent. (Note that our estimates of the increase in female labor force participation are in the same range as the gap in this same metric between the U.S. and other advanced countries that provide such child care assistance.)

Finally, using .6 as the labor share of GDP, we predict that such labor supply increases would raise GDP by .9 to 1.5 percent.
Region: United States [2]
Tags: child care [3]
market [4]
economics [5]
