A new social contract in the childcare system: Driving up standards through ambitious new conditions on public funding for childcare [1]

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Executive summary

Our early years education and childcare system provides a vital service: the care and education of our youngest children, as well as being a tool to enable parents to work. Westminster's plans to inject billions into the English system mean the taxpayer will have an 80% stake in it by 2025, up from 50% now.

What will we get for our money?
First, while the expansion will lower costs for many parents, it maintains the inadequate funding rates for the 3–4-year-old offer, which has led providers to charge parents more in order to cross-subsidise losses. But just as importantly, by preserving the underlying logic of the system – a lightly regulated market with underfunded subsidies – the changes risk exacerbating existing problems like unaffordable costs, sufficiency gaps, low worker pay and variable quality. This is because simply putting more money into subsidies ignores the dynamics and structure of the market. They are that:

- most providers are privately run, with lax financial regulation, some excess profiteering and risks of sufficiency gaps if precariously financed providers fail
- well-documented issues like variable quality and poor worker pay and conditions will continue without robust and ambitious standards, controls and sufficient funding to ensure they are delivered
- local authorities are unable to manage local markets effectively without the knowledge, resources and powers to do so, which can result in sufficiency gaps and persistently poor-quality provision.

In the main, the expansion will subsidise support for parents already using the system rather than creating new demand, so the Government needs to improve the system we already have rather than rapidly increasing the number of providers within it.

Recommendations
First, the Government needs to fund so-called 'free hours' at cost. Then policy-makers should turn to the governance, management and regulation in the market. This means taking seriously the fact that childcare is a market and regulating it like one, in the interest of parents, children and workers, and creating a new framework of obligations and incentives for private providers to be real partners in delivering a crucial public good.

We propose a new social licensing model for the early years education and childcare market, where ambitious standards for all providers are a condition of receiving public funding. These should be designed through engagement with providers, parents, local authorities and workers, and should focus on:

- worker pay and conditions
- driving up quality standards, including for children with special educational needs and disabilities (SEND)
- value for money, including financial transparency and potential profit caps.

Responsibility for monitoring and enforcing conditions would lie with the Office for Standards in Education, Children's Services and Skills (Ofsted) and local authorities, and conditions would be placed on providers who deliver the Government's 'free hours' scheme. Local authorities would take on a stronger 'market shaping' role, managing sufficiency and helping improve quality locally, while Ofsted would take on more financial monitoring powers.

This is a 5-year vision for the childcare system, to ensure there is enough time to engage the groups affected and mitigate the risk of providers exiting the market and leaving unintended sufficiency gaps. Transitional arrangements like common-sense financial controls on the largest providers, measures to increase pay for the poorest paid, and bolstering local authority resources, should be implemented sooner.

There is significant precedent for this system here and abroad, from the common-sense controls placed on non-profit providers in the

childcare market, to the prudential regulation the Care Quality Commission (CQC) and Ofsted are undertaking in care markets, to the 'Partnership for the Public Good' reforms in Ireland that match ambitious conditions with enough funding to act as an incentive.

What will this cost?

The costs of this new system will depend on the minimum standards the Government thinks providers should be achieving. Expecting providers to bear the costs of conditions without financial support will undoubtedly lead to unaffordable parental costs, closures and sufficiency gaps. Many new conditions, like prudential regulation, will have no cost and will increase value for money as profits are ploughed back into the system, while higher worker pay across bands would cost an estimated £2.3 billion per year. Funding better management of the market will also incur costs – around £250 million to ringfence local authority early years budgets and £10 million to resource a prudential regulation function within Ofsted.

Initial funding in support of market reforms could be made cost-neutral by reinvesting existing spending currently committed to tax-free childcare, expected to be around £600 million in 2023/24 but likely to rise to more than £1 billion a year (in today's prices) over the medium term. This could fund at least a top-up of the lowest-paid workers to the Living Wage, implement reforms to boost inclusion for children with special education needs (SEN), resource local authorities and fund an expanded prudential regulation team at Ofsted.

As the Government becomes the primary funder of childcare over the next two years, there is a distinct opportunity to take the reins of the market and unleash social value – and a real risk of the problems not being addressed and worsening, with effects on sufficiency, quality, worker outcomes and value for money.

Related link: Why those profiting from childcare in England need to be kept in check [3]

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