Funding the Fundamentals
A Primer on Early Care and Education Funding for Public Health Practitioners
ACKNOWLEDGMENTS

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EXECUTIVE SUMMARY

Child care is critical to the health and economic well-being of American families. Children form fundamental social and educational skills during their pre-kindergarten years. Children who develop these skills in well-structured programs tend to earn better grades in school and are more likely to graduate from high school and college. According to a 2015 report commissioned by the Committee for Economic Development, the organized child care sector provides care for 10.7 million children and – for one third of U.S. families with a working mother – enables mothers to participate in the labor force. Some studies have found that a dollar spent on specialized, high-quality child care programs can yield as much as five to seven times that amount by increasing parents’ productivity, keeping students in school and out of prison, and promoting local economic development.²,³

In addition to developing social and educational skills, child care settings play an important role in helping children establish healthy habits that will last a lifetime. All children deserve to grow, learn, and play in healthy environments that:

- offer nutritious foods and establish healthy eating habits
- provide safe and appropriate activities
- support learning and proper brain development
- establish healthy eating habits
- strengthen motor skills and provide opportunities for physical activities

While parents, guardians, and families have tremendous influence in all these areas, many children spend the majority of their waking hours, eat more of their meals, and participate in more physical activity while cared for by someone other than their primary caregiver or parent. Consequently, child care providers have a major influence on children’s health.

The goal of this report is to help public health advocates and educators gain a high-level understanding of the early care and education (ECE) financing landscape and the pressures faced by providers and regulators. To that end, we examine the sources of public financial support for ECE programs. Although we focus primarily on federal funding sources, we examine state financing as well. We specifically highlight healthy eating and physical activity (HEPA) standards linked to federal funding programs; the obesity prevention and childhood nutrition communities may find this information particularly useful.

We begin with a brief summary of the regulatory framework for ECE programs. We then discuss financing for ECE programs, beginning with an overview of the largest federal programs. Next we examine the most commonly used state funding mechanisms, highlighting two innovative approaches that use financing to improve quality in programs serving low-income children. We conclude by providing information about additional resources for ECE financing.
ACRONYMS USED IN THIS REPORT

Throughout the paper, we use acronyms which may not be familiar to those who do not work on ECE-related issues. Their meanings are spelled out below:

<table>
<thead>
<tr>
<th>ACRONYM</th>
<th>Meaning</th>
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<tbody>
<tr>
<td>AHA</td>
<td>American Heart Association</td>
</tr>
<tr>
<td>CACFP</td>
<td>Child and Adult Care Food Program</td>
</tr>
<tr>
<td>CCDBG</td>
<td>Child Care and Development Block Grant</td>
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<tr>
<td>CCDF</td>
<td>Child Care and Development Fund</td>
</tr>
<tr>
<td>CDCTC</td>
<td>Child and Dependent Care Tax Credit</td>
</tr>
<tr>
<td>ECE</td>
<td>Early Care and Education</td>
</tr>
<tr>
<td>ESEA</td>
<td>Elementary and Secondary Education Act</td>
</tr>
<tr>
<td>FSA</td>
<td>Flexible Spending Account</td>
</tr>
<tr>
<td>HEPA</td>
<td>Healthy Eating and Physical Activity</td>
</tr>
<tr>
<td>HHS</td>
<td>U.S. Department of Health and Human Services</td>
</tr>
<tr>
<td>IDEA</td>
<td>Individuals with Disabilities Education Act</td>
</tr>
<tr>
<td>LEA</td>
<td>Local Education Agency</td>
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<tr>
<td>QRIS</td>
<td>Quality Rating and Improvement System</td>
</tr>
<tr>
<td>RWJF</td>
<td>Robert Wood Johnson Foundation</td>
</tr>
<tr>
<td>SEA</td>
<td>State Education Agency</td>
</tr>
<tr>
<td>SIB</td>
<td>Social Impact Bond</td>
</tr>
<tr>
<td>SSBG</td>
<td>Social Services Block Grant</td>
</tr>
<tr>
<td>TANF</td>
<td>Temporary Assistance for Needy Families</td>
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<tr>
<td>USDA</td>
<td>U.S. Department of Agriculture</td>
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INTRODUCTION

Partly in response to the nation’s childhood obesity epidemic, public health and ECE experts, along with policymakers at all levels of government, are increasingly interested in implementing evidence-based strategies that promote both academic achievement, physical health, and social and emotional wellbeing among very young children. For example, the Robert Wood Johnson Foundation (RWJF), which has pledged to invest more than $1 billion in childhood obesity prevention by 2025, identifies “ensur[ing] that all children enter kindergarten at a healthy weight” as one of its top priorities. While ECE settings provide a tremendous opportunity to influence children’s health, many child care programs struggle to secure the public or private funding needed to deliver high-quality services that promote lifelong health. (Pre-kindergarten programs, connected to school districts, typically have access to more stable funding.) The largest source of revenue for the sector is parent fees. Funding from government or philanthropy comprises only about 43 percent of total industry revenues and is typically focused on children from poor or working-class families. In many states, the market price of high-quality child care rivals that of a college education, forcing many parents and guardians to turn to less expensive care providers whose care may not be as high-quality.

Before moving into a discussion of financing mechanisms it is important to define key terms. Different terms are used to describe the care young children receive before they start kindergarten. These terms include “early learning”, “early learning and development,” and “early care and education.” Stakeholders working on nutrition and physical activity interventions, including RWJF and the American Heart Association (AHA), use the term “early care and education” (ECE). To be consistent with RWJF, AHA, and others, we too use the term “early care and education” throughout this document. Moreover, using a definition from Alliance for Early Childhood Finance, we define ECE as all formal settings that offer direct services to groups of children ages five and under. Some programs take the names provided by their primary funding source, such as “Head Start” and “Pre-Kindergarten.” These services may be in centers, schools, or homes, and they must comply with requirements and standards imposed by regulations and by their programmatic sources of funding (such as Child and Adult Care Food Program (CACFP) nutrition requirements, if they receive funds through CACFP). For the purposes of this report, the term ECE does not include care provided by family, friends, or neighbors.
HOW ARE ECE SETTINGS REGULATED?

Financing and regulation of child care settings are connected as certain funding streams place specific requirements on providers and some regulations incorporate standards from federal or state programs. With the exception of school-based pre-kindergarten programs (which are typically overseen by local education authorities such as a school district), child care is primarily regulated at the state level. Most states hold child care programs accountable for meeting quality standards. They do this by linking facility licensing or registration to the fulfillment of standards, or by connecting public dollars to a Quality Rating and Improvement System (QRIS). While a thorough examination of child care licensing and QRIS is beyond the scope of this paper, we provide an overview below.

Child care occurs in a wide range of settings in the United States, including child care centers, family child care homes, and private homes or other settings where informal care is provided by family, friends, and neighbors.*

Child care centers are tax-paying or nonprofit businesses that offer care and early education to children in a group setting. Some centers have a particular specialty. For example, they may provide care for children with disabilities or mild illnesses, or they may provide care during unusual hours. If child care centers are in operation more than three hours a day on a regular basis, states typically require that they be licensed in accordance with minimum health and safety standards. In some states, however, certain programs are ‘license-exempt’ (e.g. those operated by a religious organization or school).

In family child care homes, groups of children receive care from one or two caregivers in a home-based setting. State regulation of family child care homes varies widely. For example, in some states a home that serves as few as two children must be licensed, while in others only homes that care for more than four children must be licensed. Some states do not regulate family child care homes at all. In a handful of states, family child care homes are encouraged to participate in provider networks that offer various trainings to help professionalize caregiving. Common training topics include: health, safety, and nutrition; child development and learning; and collaboration with families. In addition, as many child care providers need support with basic business practices, provider network staff can provide technical assistance with such tasks as preparing a business plan, operating policies and procedures, setting up a budget, and fulfilling insurance requirements.

In-home care may be provided by live-in and part-time babysitters, nannies, and housekeepers. These care providers are not usually regulated, though some states require them to adhere to certain standards or undergo background checks if they receive state subsidies.

Finally, informal child care is provided by friends, neighbors, relatives, and other non-professionals; few states regulate informal care.

* Because states and the federal government vary somewhat in how they classify different types of child care, no single set of terminology exists. This paragraph and Table 1 reflect common—if not universal—terminology, drawing on information from Child Care Aware of America, the American Academy of Pediatrics, the National Association for the Education of Young Children, and the National Head Start Association.
<table>
<thead>
<tr>
<th>TYPE OF CARE</th>
<th>DEFINITION</th>
</tr>
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<tbody>
<tr>
<td><strong>Child Care Center</strong></td>
<td>A child care center provides child care services for a fee in a nonresidential setting. Child care centers are usually licensed by the state, although some states exempt certain kinds of child care centers from licensing. A license-exempt child care provider is an entity legally operating a child care program that is exempt from state or local licensing regulations. Typically, these types of providers are public or private schools (both of which adhere to Department of Education regulations, not state licensing requirements) or religious institutions.</td>
</tr>
</tbody>
</table>
| **Head Start Center**     | Head Start (and Early Head Start) is a federal program that provides comprehensive developmental services for low-income preschool children and social services for their families. Head Start centers are a subset of licensed Child Care Centers. Federal grants are awarded to local public or private non-profit agencies. Head Start takes a comprehensive approach to meeting the needs of young children. There are four major components to Head Start:  
  - **Education:** Providing a variety of learning experiences to help children grow intellectually, socially, and emotionally.  
  - **Health:** Providing health services such as immunizations; dental, medical, and mental health services; nutritional services; and early identification of health problems.  
  - **Parent Involvement:** Involving parents in the planning and implementation of activities.  
  - **Social Services:** Providing outreach to families to determine what services they need.  |
| **Family Child Care Home**| A family child care home provides, for a fee, child care services, including early learning opportunities, for children who are not related to the child care provider(s), in a residential setting (usually the provider’s own home).  |
| **Pre-Kindergarten (Pre-K) Program** | Pre-K programs are a distinct group of programs designed specifically to prepare preschoolers for kindergarten. All pre-K programs have three characteristics in common. They (1) are governed by high program standards, (2) serve four year olds or sometimes both three and four year olds, and (3) focus on school readiness. They are typically offered by public or private schools. |
LICENSING

There are no nationally applicable federal standards for child care, although certain federal funding streams, such as Head Start, do include performance standards for participating providers.11 States are responsible for establishing regulatory requirements for child care providers. These regulations typically address health and safety standards, physical facility capacity and standards (including space per child), equipment standards, caregiver-per-child ratios, and caregiver qualifications, such as training certifications and clean criminal clearances. Effective licensing schemes have two components: strong program requirements and strong oversight provisions. According to a 2013 50-state analysis of state licensing policies, program requirements and oversight provisions vary significantly from state to state.12 Across the board, more stringent requirements could improve health outcomes, but would likely increase overall costs and drive up market prices, which are already more than most families can afford. (Limited research exists on this topic.)

Depending on state law, some cities and counties can enact child care regulatory requirements for their local jurisdiction. In Florida, for example, the state law and regulations act as minimum standards. Individual counties may choose to enact their own standards, provided that they exceed the state minimums and that the state Department of Children and Family Services approves the local standards.13 Similarly, New York City sets licensing standards for its child care centers,14 and Jefferson County, Alabama established new standards in 2015 which are higher than state standards.15

Licensing can be used to enforce HEPA provisions in child care settings. Nutrition and physical activity requirements vary widely between states. For instance, in 2012, 34 states required at least some providers to follow CACFP guidelines as part of licensing requirements. Of those 34 states, only 20 imposed this condition on all ECE providers (i.e., both centers and in-home care).16 While nutrition has always been a concern for ECE regulators and providers (mostly in the context of poverty and hunger), obesity prevention in the early childhood context is a relatively new concern. Public health advocates should be cognizant of this when evaluating HEPA standards in licensing and federal programs.
While licensing standards establish minimum requirements for child care settings, the focus in most states is on safety, not on the quality of the teaching and learning environment. In the 1980s, amid increasing focus on school readiness, nongovernmental organizations such as the United Way began to set their own standards for quality child care settings based on research in early learning and development. The QRIS concept evolved from this work and more than two-thirds of all states and the District of Columbia operate them statewide and nearly all other states are planning or piloting them. QRIS programs are a comprehensive, structural approach to assess and incrementally improve the quality of child care. Since the first statewide QRIS program was implemented in 1998, 44 states and the District of Columbia have put QRIS in place.

While QRIS standards vary from state to state, they have several features in common. State (or, in some cases, local) agencies typically establish graduated standards of quality and use those gradations to assign a ‘Star’ or quality level to participating programs based on some form of assessment or compliance verification. Additionally, many states provide funding for technical assistance, professional development, and, in some cases, financial incentives to help child care providers achieve these standards. However, the amount of dollars spent on these services varies widely between states.

Because QRIS is increasingly used as a means to ensure accountability for school readiness, the standards often have an early learning focus. For example, QRIS standards typically include: staff qualifications, curriculum and learning activities, family engagement, and individual child assessment. Most QRIS programs do not include HEPA standards. However, a few states have recognized the link between healthy weight and school readiness. Nine states have set QRIS standards for nutrition and physical activity. Two of these states, Arizona and South Carolina, have created their own monitoring systems and have integrated the evaluation of HEPA standards into their monitoring tools. States that use a standard assessment tool would have to add to or change the assessment process in order to add HEPA standards; obesity prevention advocates should keep in mind the burden this might represent to state administrators and providers alike.

RESOURCES ON QRIS:
1. ACF QRIS Resource Guide
2. QRIS Network website
3. Altarum Institute report: State Efforts to Address Obesity Prevention in Child Care Quality Rating and Improvement Systems
FEDERAL FUNDING FOR ECE PROGRAMS

In 2014, the Government Accountability Office concluded that the federal child care financing system in the United States was “fragmented” and “may not serve children and families as efficiently and effectively as possible.” Approximately 45 different federal programs fund child care or related services for children ages zero to five. This paper describes seven of the most significant existing ongoing programs: Head Start (including Early Head Start), the Child Care and Development Fund (CCDF), Temporary Assistance for Needy Families (TANF), the Individuals with Disabilities Education Act (IDEA), the Social Services Block Grant (SSBG), Title I of the Elementary and Secondary Education Act (ESEA), and the Child and Adult Care Food Program (CACFP). The first six programs are the largest sources of federal funding for child care. The seventh, CACFP, provides funding to child care centers and other participating providers that in turn serve more than 3.3 million children (and 120,000 adults) with nutritious meals and snacks each day (as a component of day care). Table 2 summarizes these federal programs.

### TABLE 2: MAJOR FEDERAL FUNDING SOURCES FOR EARLY CHILDHOOD EDUCATION PROGRAMS*

<table>
<thead>
<tr>
<th>PROGRAM</th>
<th>POPULATION SERVED</th>
<th>FUNDING LEVELS</th>
<th>FUNDING MECHANISM</th>
<th>FEDERAL NUTRITION AND ACTIVITY REQUIREMENTS**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Head Start &amp; Early Head Start</td>
<td>Low income children ages 0-522</td>
<td>$8.6 billion (2014)23</td>
<td>Grants to organizations that meet federal performance standards.24</td>
<td>High</td>
</tr>
<tr>
<td>Child Care &amp; Development Block Grant</td>
<td>Ages 0-1325</td>
<td>$5.21 billion (2015)26</td>
<td>Block grants to states for subsidies (mostly vouchers) to help low-income parents pay for child care, and for investments in child care quality improvement. States must establish minimum standards and monitoring requirements for providers that receive public funds.27</td>
<td>Low</td>
</tr>
<tr>
<td>Temporary Assistance for Needy Families</td>
<td>Very low income families28</td>
<td>According to the GAO, $2.6 billion of the TANF allocation was spent on child care in 2012.29</td>
<td>Block Grants to states for a host of services, including child care. States that use TANF for child care may choose to transfer up to 30% of funds to CCDBG and up to 10% to SSBG. Or they may spend some TANF dollars directly on child care.30</td>
<td>None</td>
</tr>
<tr>
<td>Individuals with Disabilities Education Act (Part B, Sections 619 and 611 are the relevant provisions.)</td>
<td>Children ages 3-5 with disabilities21</td>
<td>$353 million (2015)32</td>
<td>Grants to states for early childhood special education services.33</td>
<td>Moderate</td>
</tr>
<tr>
<td>Social Services Block Grant (SSBG)</td>
<td>States’ discretion34</td>
<td>HHS reports that $296 million of SSBG was spent for child care in 2012.35</td>
<td>States may choose to use these funds to support child care.34</td>
<td>None</td>
</tr>
<tr>
<td>Elementary and Secondary Education Act (Title I, Part A)</td>
<td>Low income children36</td>
<td>$15.5 billion (2015)32</td>
<td>Apportionments to states for public schools. Fewer than 2.5% of funds currently used for preschool.37</td>
<td>None**</td>
</tr>
<tr>
<td>Child and Adult Care Food Program</td>
<td>Children ages 0-12; children ages 12-18 in special circumstances; low-income adults with disabilities and seniors38</td>
<td>$3.13 billion (2015 est.)39</td>
<td>Grants to states:40</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

* This table was prepared in 2015.
** Programs with a “high” nutrition and activity requirement have specific criteria for food service and physical activity to which program participants must adhere. “Moderate” programs have specific criteria for food service or physical activity, but not both. “Low” programs provide some inducement or broad requirement for nutrition or activity, but leave states considerable latitude in interpreting these requirements. These labels do not necessarily signify the adequacy of the programs’ standards.
*** ESEA funds may be used for school nutrition programs—in compliance with USDA rules—if no other funds are available, but the program itself contains no standards.

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Head Start and Early Head Start

The Head Start program, authorized by the Head Start Act, is run by the Office of Head Start within the Department of Health and Human Services (HHS). For fiscal year 2014, it had a budget of more than $8.6 billion and served approximately one million children, primarily from families living below the poverty line. Early Head Start, a subset program, serves pregnant women and children up to age three. In 2014, Congress appropriated $500 million to expand access to high-quality early learning and development opportunities for infants and toddlers through Early Head Start, including a new Early Head Start-Child Care (EHS-CC) Partnership Grants initiative. The White House has emphasized the importance of high-quality child care for the nation’s youngest children, and this expansion represents part of President Obama’s initiative to increase access to child care. Partnership grants are intended to offer additional funding and support for market-based child care programs that agree to serve Early Head Start-eligible children and meet federal performance standards.

HHS awards Head Start and Early Head Start funds directly to public and private non-profit and for-profit agencies around the country. Grantees must provide “comprehensive child development services,” including foundational literacy and problem-solving skills, and must comply with state and local licensing regulations as well as stringent federal performance standards.

>> Nutrition and Physical Activity Standards

Currently, federal performance standards require all Head Start grantees to: 1) work together with parents to identify children’s nutritional needs and support their physical development; 2) adhere to federal nutrition standards and serve foods that are “high in nutrients and low in fat, sugar, and salt”; 3) offer meals and snacks (including breakfast for children who have not eaten when they arrive at the program site) that provide one third to two thirds of the children’s daily nutritional needs (depending on whether they participate in part- or full-day programs); 4) ensure that meal and snack periods contribute to the development and socialization of children; and 5) promote each child’s physical development by providing an opportunity for outdoor and indoor active play. Although physical development is addressed in the Head Start regulations, providers are not required to meet specific targets for moderate-to-vigorous physical activity, nor are there regulations that address screen time. In June 2015, the Office of Head Start proposed new performance standards to govern the program and issued them for public comment. The new standards would strengthen the health-related provisions in the Head Start regulations, including those that address HEPA, but in their current form they would not add specific targets for physical activity or limit screen time.
The Child Care and Development Fund (CCDF)

As noted above, the CCDF awards block grants to states, which then provide child care subsidies to low-income families, as well as funding for child care providers to undertake quality improvement activities. CCDF subsidies may support care for children up to age 13, but about two-thirds of the children served are under age six. It is the primary federal funding stream for child care in the United States. CCDF offers broad guidance and flexibility to states for creating both the child care assistance program and a program of basic regulation for child care operations. In 2015, CCDF’s budget was $2.36 billion.

The Child Care and Development Block Grant Program (CCDBG) is administered by the HHS Office of Child Care. HHS awards CCDBG funds based on a three-part formula that considers the number of children under age five in a given state, the number of children eligible for reduced-price school lunches in the state, and the state’s per capita income.

In order to receive federal funding through CCDF, states must prepare triennial plans for the Office of Child Care. These plans essentially serve as the state application for CCDF funds. The plans provide a description of, and assurances about, the State’s child care subsidy program (including rates, eligibility requirements, and expenditures), standards (including compliance with federal requirements for program monitoring), and quality improvement activities. The HHS Office of Child Care reviews the plans and, if they are approved, funds are awarded for the next fiscal year. As noted earlier, most states use CCDF funding to administer child care assistance via vouchers that follow the child to whatever provider is selected by the parent, and families are typically permitted to choose any licensed provider.

When CCDBG was reauthorized in 2014, new quality set aside provisions moved the floor for quality set aside from 4% for general purposes and 3% for infant toddler to 7% general and 3% infant toddler for years 2015 and 2016; 8% and 3 % respectively for 2017 and 2018 and 9% and 3% respectively for 2019. The quality set aside dollars fund much of the work related to HEPA standards.

〉〉 Nutrition and Physical Activity Standards

The programs that ultimately receive CCDF funds are not bound by any specific federal rules pertaining to nutrition and physical activity. In their CCDF plans, states set their own nutrition and physical activity standards for child care providers. Also, each state’s CCDF plan must include an assurance that the state will disseminate “research and best practices concerning children’s development, including . . . physical health and development (particularly healthy eating and physical activity)” to parents, the public, and providers.

As noted above, CCDBG was reauthorized in 2014 and for the first time includes provisions for child care provider training on healthy eating and physical activity as an allowable activity for quality improvement and permit states to make healthy eating and physical activity a part of their health and safety requirements. In addition to the quality set aside provisions, the sections of the law related to training provide an opportunity to include descriptions of how a state will include HEPA in its standards; and the section which addresses consumer education sets forth requirements that state administrators must provide information to consumers about CACFP, WIC and other social service programs, so that parents and providers are informed of nutrition programs that may help families.
Temporary Assistance for Needy Families

Temporary Assistance for Needy Families (TANF) is a block grant awarded to states and administered by the Office of Family Assistance within HHS. Although most TANF dollars are used to fund cash assistance for extremely low-income families, states may use TANF for a range of other services, including child care. States are permitted to transfer up to 30 percent of their TANF block grants to CCDF or they may choose to spend an unlimited amount of TANF funds directly on child care for needy families. In fiscal year 2013, states used $2.5 billion in TANF funds to pay for child care. However, the Center for Budget and Policy Priorities notes that the percentage or amount of TANF funds states allocate to child care varies widely. For example, California spends 12 percent of its TANF allocations on child care, while Vermont spends 31 percent.

>> Nutrition and Physical Activity Standards

There are no specific nutrition or physical activity standards associated with TANF, but TANF funds transferred to CCDF are subject to the latter’s nutrition and activity standards.
Individuals with Disabilities Education Act (IDEA)

The IDEA provides funding and establishes standards for states, school districts, and public agencies to provide early intervention, special education, and related services to eligible children with disabilities. State education agencies (SEAs) receive this funding, and distribute grants to local education agencies (LEAs) and educational service agencies. The responsibility for implementing IDEA lies with the Office of Special Education within the U.S. Department of Education.

Part B of the law lays out the processes that grantee school systems must use to identify and educate children ages three to 22 with disabilities, and authorizes state-level grants. Part B, Section 611 authorizes funding to students aged 3 to 21, while Section 619, the Preschool Grants Program, is targeted specifically at children aged 3 to 5. It is intended to help states ensure that all preschool-aged children (three–five years of age) with disabilities receive special education and related services. Section 619 funds do not cover the full cost of preschool for a child, and the federal government is the “payor of last resort” for IDEA-funded child care, meaning that states must first attempt to draw on other public and private funds. Funding for Special Education Preschool grants, authorized by Part B of IDEA, was $353 million for fiscal year 2015. Part C of IDEA covers early intervention services—such as physical therapy or psychological care, but not standard education or child care—for babies and toddlers with disabilities or developmental delays.

**Nutrition and Physical Activity Standards**

Within IDEA’s provisions on early intervention services, there are regulations which lay out the types of nutrition services funded under the law. These include developing and monitoring appropriate plans to address the nutritional needs of eligible children, and making referrals to appropriate community resources to carry out nutrition goals. Federal regulations also require states that provide physical education to non-disabled children to offer similar services to disabled children who attend public school. The regulations contain no specific guidelines for intensity or duration of activity.
Title I of the Elementary and Secondary Education Act

Title I, Part A, of the Elementary and Secondary Education Act (ESEA) provides grants to local education agencies (LEAs). The appropriation for Title I grants to LEAs is $14.4 billion for fiscal year 2015. Administered by the Office of Elementary and Secondary Education within the U.S. Department of Education, Title I provides flexible funding that may be used for a range of strategies to raise student achievement in high-poverty school districts and schools. Some school districts use Title I funds to support pre-kindergarten programs for children. The Department of Education defines these programs as follows: “A Title I preschool program is a preschool program for which an LEA or school uses Title I funds, in whole or in part, to improve cognitive, health, and social-emotional outcomes for eligible children below the grade at which an LEA provides a free public elementary education.” About 2.5 percent of children enrolled in Title I-funded programs are preschoolers.

In 2014, the Departments of Education and Health and Human Services awarded 18 states over $260 million in competitive Preschool Development Grants in an effort to “lay the groundwork” for Preschool for All. The 2015 ESEA reauthorization includes additional funds for preschool development grants.

>> Nutrition and Physical Activity Standards

In certain circumstances, funds can be used for nutrition support services, subject to the general requirements of the school lunch program, if recipients demonstrate that nutrition services are not available from another source. There are no related provisions for physical activity that apply specifically to ECE settings.
Child and Adult Care Food Program

The Child and Adult Care Food Program is one of the U.S. Department of Agriculture (USDA)'s child nutrition programs. It provides aid to child and adult care institutions and to family or group day care homes for the provision of food to children under age 12, older adults, and chronically impaired disabled persons. The program had a budget of $3.13 billion in fiscal year 2015.39 Administered by the Food and Nutrition Service of the USDA, the program serves children in a range of child care settings, ranging from child care centers to homeless shelters. The portion of the program relevant to this report provides reimbursement for meals and snacks served by child care providers caring for low-income children ages five and under. Typically CACFP is administered by SEAs but often there are sponsorship agencies to administer programs and “sponsor” family child care providers.

>> Nutrition Standards

CACFP recipients must adhere to a set of age-specific nutrition standards. A proposed rule to update the standards makes changes consistent with recommendations by the Institute of Medicine, including increasing whole grain requirements and limiting milk to low- or non-fat options.73 The proposed rule also encourages a number of nutrition-related best practices that, while optional, are encouraged by USDA. The best practices range from offering at least one serving of dark green vegetables, red or orange vegetables, and legumes per week, to not serving fried and pre-fried foods.73 The final rule updating the standards—expected in 2016—will enhance the health not only of children in child care facilities that participate in CACFP, but also of those children in states that require all providers to abide by CACFP nutrition standards. (The requirement may be enforced by making adherence to CACFP standards a condition for licensing, or in some other way.)
FEDERAL TAX SUBSIDIES FOR CHILD CARE

Congress and states have also established several tax credits to help mitigate the cost of child care, which are discussed in brief here, and in more detail in Appendix 1. Federal tax programs include the Child and Dependent Care Tax Credit and the Dependent Care Exclusion. The actual financial benefit of these credits is quite small when compared to the market price of child care, and because they require families to spend dollars on child care and then wait for the benefits upon filing taxes at the end of the year, wealthier taxpayers are often better positioned to take advantage of them.

The Child and Dependent Care Tax Credit (CDCTC) allows taxpayers to deduct between 20 percent and 35 percent of eligible child care expenses, depending on their total income. Taxpayers must have the providers’ social security number or tax ID number to claim the tax credit. This requirement can serve as a barrier to claiming the credit in some cases. A wide range of expenses can qualify toward CDCTC, so long as their “primary function is to assure the [child’s] well-being and protection.” For instance, although the cost of food or clothes would not be an eligible expense, daycare fees or even payments to an individual babysitter qualify. Lower-income families are rarely able to take full advantage of this nonrefundable credit (see explanation of “nonrefundable” below), since the amount they might claim generally exceeds how much they owe in taxes. Indeed, in 2014, taxpayers with incomes over $100,000 received about $2.85 billion in child care tax credits, while those earning under $100,000 received a comparatively small $1.7 billion.

Under the provisions of the Dependent Care Exclusion, the IRS allows employers to operate programs, akin to health flexible spending accounts (FSAs), through which employees can set aside up to $5,000 of pre-tax salary to pay child care expenses. Like the CDCTC, child care FSAs are of limited use to lower-income families. They are available only as employer-sponsored programs, and many lower-wage and hourly employers may not offer FSAs. Moreover, because FSA dollars are exempted from income taxes, they provide a larger relative tax break to higher earners subject to higher tax rates.

States and the federal government award both refundable and nonrefundable tax credits. Both credits reduce how much a taxpayer owes. A nonrefundable tax credit can reduce an individual’s tax liability down to zero, but taxpayers forfeit the additional value of a nonrefundable credit if it exceeds their total tax liability. Conversely, taxpayers receive the full value of a refundable credit, even if their credit exceeds how much they owe in taxes.

As an example, imagine that an individual owes the federal government $1,500 in taxes, and she has $2,000 worth of tax credits. If the credits are nonrefundable, she’ll pay nothing in taxes for that year, but she won’t collect the $500 difference between the credit and her liability. But if the credits are refundable, the IRS will write her a check for $500.
LOUISIANA’S TAX CREDITS

In 2008, Louisiana implemented School Readiness Tax credits, which have improved the quality of child care available in Louisiana and resulted in millions of dollars of new investments in child care quality. The School Readiness Tax credits are five different credits that target distinct stakeholders:

1. The Child Care Provider Credit is an income tax credit available to child care providers whose facilities have a Quality Start rating of at least two stars. The credit is refundable and available to both for-profit and non-profit child care providers.

2. The Credit for Child Care Directors and Staff is an income tax credit available to child care directors and staff with certain state-approved credentials. The credit is refundable.

3. The Child Care Expense Credit is an income tax credit available to families who incur child care expenses for children under age six enrolled in child care facilities with a Quality Start rating of at least two stars. This credit is refundable, and particularly helpful for families earning $25,000 or less, who can receive a maximum of $2,100 for each eligible child.

4. The Business-Supported Credit is an individual or corporate income tax credit or corporate franchise tax credit available to businesses that pay eligible child care expenses to child care facilities with a Quality Start rating of at least two stars. The credit is refundable.

5. The Resource and Referral Agency Credit is a dollar-for-dollar individual or corporate income tax credit or corporate franchise tax credit for businesses that make donations or pay fees, up to $5,000 per tax year, to child care resource and referral agencies. It is refundable.

According to the National Women's Law Center, which analyzed the tax credits by looking at data from 2008 to 2011, there is compelling evidence that the tax credits improved the quality of child care in Louisiana, particularly for low-income families, and that the tax credits raised awareness among providers and parents about the importance of high-quality child care. For a detailed analysis of the child care tax credits in Louisiana, see Extra Credit: How Louisiana is Improving Child Care, National Women's Law Center, 2015, www.nwlc.org/resource/extra-credit-how-louisiana-improving-child-care.
STATE FUNDING FOR ECE PROGRAMS

The state and federal funding systems for ECE programs are similar in their complexity and lack of cohesiveness. In general, states lack long-term, stable funding that is sufficient to meet the needs of low-income families. In addition to funding from the federal programs discussed above, the most common types of state funding used to support child care programs are general aid through a state's general fund, specific aid from a special tax earmarked for ECE initiatives, and tax credits. At the state level, the types of programs that are classified as ECE for budget purposes include subsidized child care, pre-kindergarten, and early literacy and parental support programs. Sometimes state budgets combine ECE programs with out-of-school time (OST) programs for school-age children. (OSTs are programs that provide care for school-age children before or after the regular school day and during the summer.)

Unlike a number of the federal programs described above, state funding streams typically do not have specific HEPA provisions. However, at the state level, HEPA provisions can be linked to licensing requirements and QRIS initiatives.

Sources of State Funding

The Center for Law and Social Policy analyzed federal spending on child care subsidies in 2012 (the latest year for which data were available) and found that federal funding for child care generally decreased over the past decade. At the state level, however, the picture is slightly better. In 2014, the National Conference of State Legislatures surveyed 20 state legislative fiscal offices and found state appropriations to ECE programs remained stable or increased slightly. As the country continues a slow but steady economic recovery and more policymakers become familiar with the literature on the importance of nurturing brain development in the earliest years of life, the trend of increased investments in ECE programs at the state level may well continue.

General Funds

Typically state general funds (or general revenues) provide most of the state financing for ECE. The general fund is a state government’s principal fund for financing state government programs. Primary sources of revenue for the general fund are personal income and sales taxes; the major uses of the general fund dollars are education, health and human service programs, and correctional programs.

States’ general fund spending on ECE programs varies widely. For example, California has the largest state preschool program in the county, which is not surprising given the size of the state. Its FY 2015-16 budget earmarks $2.8 billion for child care and preschool programs, with $977 million coming from the general fund. In comparison, Arizona appropriated only $9 million in general funds for child care and preschool programs in FY 2015, though Arizona also has a voter-approved initiative that uses tobacco taxes to fund ECE initiatives and raises approximately $120 million a year for ECE programs. Like other programs supported by discretionary general funds rather than dedicated funding streams, ECE programs are vulnerable to cuts during annual budget appropriations. Funding cuts make it difficult to maintain and grow ECE programs.
Specific State Aid

States can also fund ECE programs by earmarking revenues specifically for this purpose. Typically, these funds come from tobacco taxes and lottery revenues, license fees, and other special taxes. The National Conference of State Legislatures surveyed 20 state legislative fiscal offices about their 2014-2015 appropriations for a variety of ECE programs. For a breakdown of how these 20 states fund ECE programs, see an analysis completed by the National Council on State Legislatures in 2014. California serves as a specific example. In 1998, California enacted a tax on tobacco products to fund early childhood programs, including school readiness initiatives for children ages birth to five (known as First 5 California). In FY 2013-14, First 5 programs received $431 million from the tax. Other states that use tobacco tax dollars for ECE funding include Kansas and New Mexico. Georgia and Nebraska are among the states that use lottery funds for ECE programs.

State Tax Credits

Many states also use tax credits to offset the cost to families of ECE programs. While tax credits do not increase state revenue, they can increase funding for ECE programs, depending on how they are structured. States have structured ECE tax credit programs in a variety of ways to make child care more affordable for families or to incentivize the private sector to provide care. For example, Louisiana provides credits for families, providers, teachers, and businesses. (Tax credits for businesses typically provide credits to businesses that provide or subsidize child care for their employees.) South Carolina provides tax credits for families and businesses, but the family credit is non-refundable, meaning that the neediest families—those with little or no tax liability—are not eligible. If a family has not paid enough taxes to qualify for a refund, they are not eligible for this credit.
PAY-FOR-SUCCESS MODEL AND UTAH

Social Impact Bonds (SIBs), also known as Pay for Success financing, establish a contract between a private funder such as an investment bank and a public entity such as a state or local government. The private funder invests in a specific approach to addressing a social problem and agrees to pay the costs of implementing that approach, which is expected to ultimately result in public sector savings. SIBs operate over a fixed period of time but do not offer a fixed rate of return. Repayment to investors is contingent upon specified social outcomes being achieved. SIBs for early childhood interventions thus far have focused on pre-kindergarten initiatives and home visiting programs. This is because research has shown that effective early childhood programs not only produce long-term benefits for children but can also demonstrate some returns fairly quickly, so investors can expect to be repaid within a five-year window.

A recent program in Utah demonstrates SIBs' potential to support pre-kindergarten. In 2013, the United Way of Salt Lake partnered with Goldman Sachs and investor J.B. Pritzker to expand the Utah High Quality Preschool Program. The investors’ $7 million social impact bond expanded the program to serve an additional 600 children, all of whom were at high risk for being placed in special education or remedial classes once they started school. The program aimed to leverage private funding to support preschool programs at a lower risk and cost to government partners and non-profit sponsors. For every year that a child in the program does not require special education through sixth grade, the investors receive a success payment of $2,470, plus a five percent base interest rate, for a total payment equal to what the state would otherwise spend on each child. After the sixth grade, the payments drop to $1,040 per child per year.

The state of Utah did not take a role in the 2013 partnership. But in 2014, the state legislature passed the Utah School Readiness Initiative. This law created a School Readiness Board which can enter into pay-for-success contracts with private entities to provide funding for early childhood education programs. Funded initially with $3 million from the state’s general fund, the goal of the legislation mirrors that of the United Way’s demonstration project. The initiative leverages private funding to support preschool programs at a lower risk and cost to the state. Investors’ loans are repaid only if students who have been identified as likely candidates for special education in elementary school do not need those services once they start school.

Despite the positive Utah experience with SIBs, national experts caution that using SIBs to fund services beyond preschool for four-year-old children will be challenging for several reasons. First, successful SIB financing typically requires that dollars be linked to a single intervention that clearly facilitates a specific outcome, according to established research. Yet the services children need are multi-faceted; and isolating service delivery to one particular intervention is difficult. Second, SIB investors typically seek a mere two-to-three year time period between the intervention and measurable outcomes - which is not realistic for many early intervention services. Third, SIBs typically support a fairly small per-child expenditure. Given that the per-child cost of high-quality ECE is high, SIBs are unlikely to be a significant financing strategy for direct services.
Relationship to School Financing Formulas

Because annual state appropriations for ECE programs are generally not reliable, some experts recommend tying ECE, specifically pre-kindergarten care, to school financing formulas.97 State school finance formulas take many forms, but most look at the per-pupil costs of providing an adequate education and then apply cost adjustments for geographic differences among districts and number of high-need students enrolled.98 Because funding formulas are based on per-pupil costs, funding will increase when enrollment increases. This creates a certain amount of stability for pre-K programs that are covered by public school funding. Oklahoma, which was the first state in the nation to offer universal pre-K, has taken this approach and is frequently cited as model of effective pre-K financing and administration.99

LOCAL FINANCING MECHANISMS

Many communities have put local initiatives in place to increase access to affordable child care. Given that high quality child care leads to better job prospects in the long term for the children who receive the care - as well as in the shorter term for their parents, who can work while their children are in care - some communities invest in child care as part of their urban planning and community economic development activities.100 Examples of local funding that can be used to build or sustain child care programs include redevelopment funds (also known as tax increment financing), Community Development Block Grant funds (federal funds which are administered by localities for community development projects), and developer impact fees (a charge on new development to pay for related amenities).100,101 These funding sources are usually administered at the local level and typically provide business development support for providers rather than financial support for families seeking child care.
CONCLUSION

The ECE landscape is complicated. As one commentator noted: “The child care industry in the U.S. consists of a large network of mostly very small businesses. Most child care providers are home-based businesses operated by a sole proprietor. However, most children are served by larger, more organized child care centers.” There is wide variation across states in terms of the types of providers operating, amount of revenue produced per child care establishment, average earnings of workers in the child care sector as well as how providers are regulated. Providers typically have to blend multiple sources of funding to offer full-day care, which creates challenges with managing and administering funds. At the federal level, various agencies administer myriad programs whose goals and provisions often overlap. At the state and local level, tremendous variations in local needs and funding mechanisms make it all but impossible to create a “one size fits all” prescription for ECE funding reforms.

Nevertheless, at the federal, state and local levels, there are opportunities to incorporate stronger HEPA requirements into child care standards. Child care providers are critically important allies when it comes to helping children establish healthy habits. Connecting HEPA requirements to ECE financing either through regulation or incentives, can help to promote wide-spread change.

However, as public health advocates consider interventions to create healthier child care settings, it is important to be aware of the financial reality for most ECE providers. Across the board, regardless of the funding source, early childhood care and education is underfunded. Federal and state programs offset modest costs, but even the most generous programs targeted at very low income families fall far short of meeting the full cost of high quality child care. Tax credits tend to provide greater benefits for higher-income individuals who can afford to spend more on child care in the first place. Faced with high costs, most families are not able to access high-quality child care. Unfortunately, ECE financing systems are unlikely to become less complex in the near future. Therefore, public health advocates who wish to work on ECE-related issues need to understand these systems to the best of their ability, and ensure that - to the maximum possible extent - existing funding sources create incentives and training for providers to incorporate healthy practices into the delivery of care.
APPENDIX 1: FEDERAL BENEFITS FOR ECE

Child & Dependent Care Tax Credit (CDCTC)

The IRS grants nonrefundable tax credits for care expenses for children under age 13. Taxpayers must have the providers’ social security number or tax ID number to claim the tax credit. This requirement can serve as a barrier to claiming the credit in some cases. Taxpayers may claim between 20 and 35 percent of eligible expenses, depending on their total income. A wide range of expenses can qualify for CDCTC, so long as their “primary function is to assure the [child’s] well-being and protection.” For instance, although the cost of food or clothes would not be an eligible expense, daycare fees or even payments to an individual babysitter qualify.

The CDCTC is subject to some important limitations. Because its explicit purpose is not to fund child care, but to enable parents to be gainfully employed, taxpayers may only claim the credit for expenses incurred while they were working or actively searching for work. Also, a maximum of only $3,000 worth of expenses for a child—or $6,000 for families with multiple children—are eligible for the credit. A one-child family eligible for the full CDCTC would therefore be able to claim a maximum of 35 percent of $3,000, a total of $1,050—well below the average price of child care even in those states where it is most affordable.

These limits are not indexed to inflation, so they decline in value every year until Congress chooses to revise them.

In practice, lower-income families are rarely able to take full advantage of this nonrefundable credit, since the amount they might claim generally exceeds how much they owe in taxes. The Tax Policy Center estimated that in 2013 the largest average child care credits went to families making between $100,000 and $200,000 per year. Indeed, in 2014, taxpayers with incomes over $100,000 received about $2.85 billion in child care tax credits, while those earning under $100,000 received a comparatively small $1.7 billion. Much smaller numbers of lower-income families tend to claim the credit, probably because they struggle to navigate the tax system and because they rely more heavily on informal caregivers who may be reluctant to provide their personal information to the IRS for reporting purposes.

President Obama has proposed expanding the CDCTC, doubling the maximum eligible expense to $6,000 for one child (with a family maximum of $8,000) and modifying its income requirements so that families with income as high as $120,000 per year would be able to claim 50 percent of their expenses as a credit. While Republican leaders considered the President’s plan “something that could be looked at in the overall context of simplifying our tax code and bringing rates down for everyone,” it has seen little movement in Congress to date. Two bills are pending in the Senate and one in the House—including one proposal that would link the CDCTC to inflation—but neither has gained significant support or advanced through the legislative process.
Dependent Care Exclusion

The IRS allows employers to operate programs, akin to health FSAs through which employees can set aside a portion of “pre-tax” salary to pay child care expenses. These accounts may be specific to dependent care, or they may be “cafeteria plans” under which employees may choose from a suite of benefits, including dependent care. Employees can withhold up to an annual maximum of $5,000 from their salaries, and they forfeit any unspent funds at the end of the year.

Child care FSAs are subject to many of the same limitations as the CDCTC. FSA funds can only be used for eligible expenses, such as child care center fees or payments to a family child care or in-home provider for whom a social security or federal tax ID number can be provided. Taxpayers are not permitted to count funds spent through an FSA towards the CDCTC. For instance, a one-child family that allocated only $1,750 in FSA funds but incurred $3,000 in child care expenses could claim, towards the CDCTC, a percentage of the additional $1,250 they spent, and a two-child family that set aside the full $5,000 in an FSA but ended up spending $6,000 on child care could claim a percentage of the additional $1,000. Given the complexity of the system, most families choose to take advantage of either one program or the other (but not both), depending on their income and how many children they have.

Like the CDCTC, child care FSAs are of limited use to lower-income families. They are available only as employer-sponsored programs, and many lower-wage and hourly employers may not offer a generous benefit package that includes FSAs. Moreover, because FSA dollars are exempted from income taxes, they provide a larger relative tax break to higher earners subject to higher tax rates. President Obama’s proposed tax reforms around child care expenses would eliminate the FSA program in favor of a more generous CDCTC, but, as noted above, these reforms have little political momentum.
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