State Financing Strategies for Early Care and Education

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Families are struggling to find affordable, quality child care.

- Child care tuition is rising faster than inflation and is straining the budget of families across the economic spectrum.

- Cost-reducing efforts such as business coaching for providers and sharing services **do work, but only marginally**— not nearly enough to close providers' budget gap.

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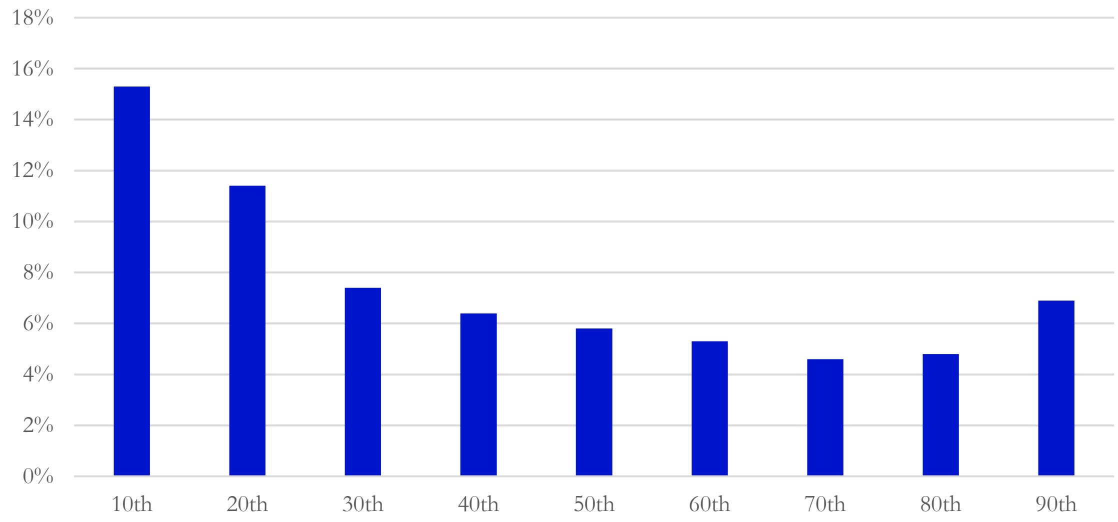
Child care businesses are finding it more difficult than ever to recruit and retain staff.

- Low wages make recruitment and retention difficult
- Child care workers have long been among the lowest-paid in the economy
  - 97% of jobs pay more than child care
- Wage expectations have shifted in the last 5–10 years → the broader entry-level job market is paying more, making child care careers even less desirable

Low-wage jobs are paying more: Real wage growth across the wage distribution, 2019–2024



Source: EPI analysis of the Current Population Survey Outgoing Rotation Group microdata, EPI Current Population Survey Extracts, Version 1.0.61 (2025a), https://microdata.epi.org.

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The need for better wages for child care staff is the primary driver of the affordability crisis for families.

- Staffing costs make up 70-80% of expenses for providers
  - Child-to-staff ratios are driven by children's needs; can't reduce staffing without reducing quality of programs

- Families are already struggling to afford care; providers can't raise costs to raise wages

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Public investment helps bridge the gap between what child care costs to provide and what parents can afford to pay.

Incremental fixes aren't enough; the scale of the challenge requires new funding. **There are two pathways we can invest in child care:**

Demand

- Helps some (but usually not all) eligible families afford care
- Tools include vouchers, subsidies, and tax credits
- Requires accurate rate-setting (true cost of care and market price)

Supply

- Strengthens providers and stabilizes the workforce
- Expands access and improves quality system-wide
- Tools: foundational contracts, salary supplements, operational grants

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Federal Child Care Funding History

Earliest federal investments

Title XX (1975)

- Grants or contracts for whole programs
- Subsumed by Social Services Block Grant; in FY22 only $156 million spent on child care

Child and Dependent Care Tax Credit (1976)

- Value was approximately $3.5 billion in FY22

CCDBG (1990)

- Emphasis on parent choice
- Primarily voucher-based
- Federal funding was $11.3 billion in FY22
- TANF funds are also used for child care; $2.4 billion in FY22

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The federal emphasis, especially since the 1990s, has been on **demand side strategies** — supporting parents' ability to purchase care in the market.

Supporting Demand: Using Market Prices and Cost of Care to Set Rates

Historically, the federal Administration for Children and Families (ACF) has guided states to focus on comparing reimbursement rates to **market prices.** Now, federal regulations also require states to look at the **cost of providing services.**

	Prices	Costs	
Tool used	**Market Rate Survey**	**Basic Cost Analysis**	**"Cost of Quality" Analysis**
What it answers	How much are providers **charging private-pay families** for care?	How much does it cost providers to operate their programs while **meeting required health and safety standards**?	How much does it cost providers to operate their programs with **high quality and adequate compensation**?
Why we use it	To understand the extent to which subsidy rates allow parents to **access the full market** of available care	To understand the extent to which subsidy rates and market rates allow providers to **cover the current cost** of care	To understand the funding that will be needed to **sustainably implement high quality** services

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Prices and costs together give an understanding of how well the child care market is functioning. Demand-side strategies work best for a well-functioning market.

	How we know whether the market is functioning well		Rate setting implication
✓	The child care market is functioning well when:	Providers are able to charge private-pay families sufficient fees to cover their full costs	Subsidy rates should focus on ensuring families have access to the largest proportion of the market possible
⊘	The child care market is NOT functioning well when:	Providers are NOT able to charge parents high enough fees to cover the cost of providing high quality services	Setting subsidy rates to match market rates will not be enough to support the viability of the child care market

Some states have made big leaps forward with a primarily demand-side approach

Vermont

- Subsides for families up to 500% of FPL
- Rates set by cost of care
- Funded through a payroll tax

New Mexico

- Child care will be free for all
- Voucher-based payment system
- Funded by oil & gas; Land Grant Permanent Fund and trust

However, a fully demand-side approach can be problematic if you are not able to subsidize the vast majority of the market.

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Supply-side investments: Foundational Funding

Several states have fully scaled-up innovative approaches to funding the supply of child care.

ME: Salary Supplements

- Monthly payments of $X to $X based on qualifications, paid through the employer

IL: Smart Start Workforce Grants

- Classroom-level grants of $24-27,000 per year, paid quarterly in advance
- Programs must meet wage floors for teachers and assistants

MA: Commonwealth Cares for Children (C3) Grants

- Provider-level grants designed to offset operational costs
- $275 million investment in FY25

DC: Pay Equity Fund

- Provider grants; programs must meet high wage floors for teachers and assistants
- Funded by tax on high-income residents

The key for effective child care funding design is to **both:**

- Invest in demand-side strategies.
- Invest in supply-side strategies.

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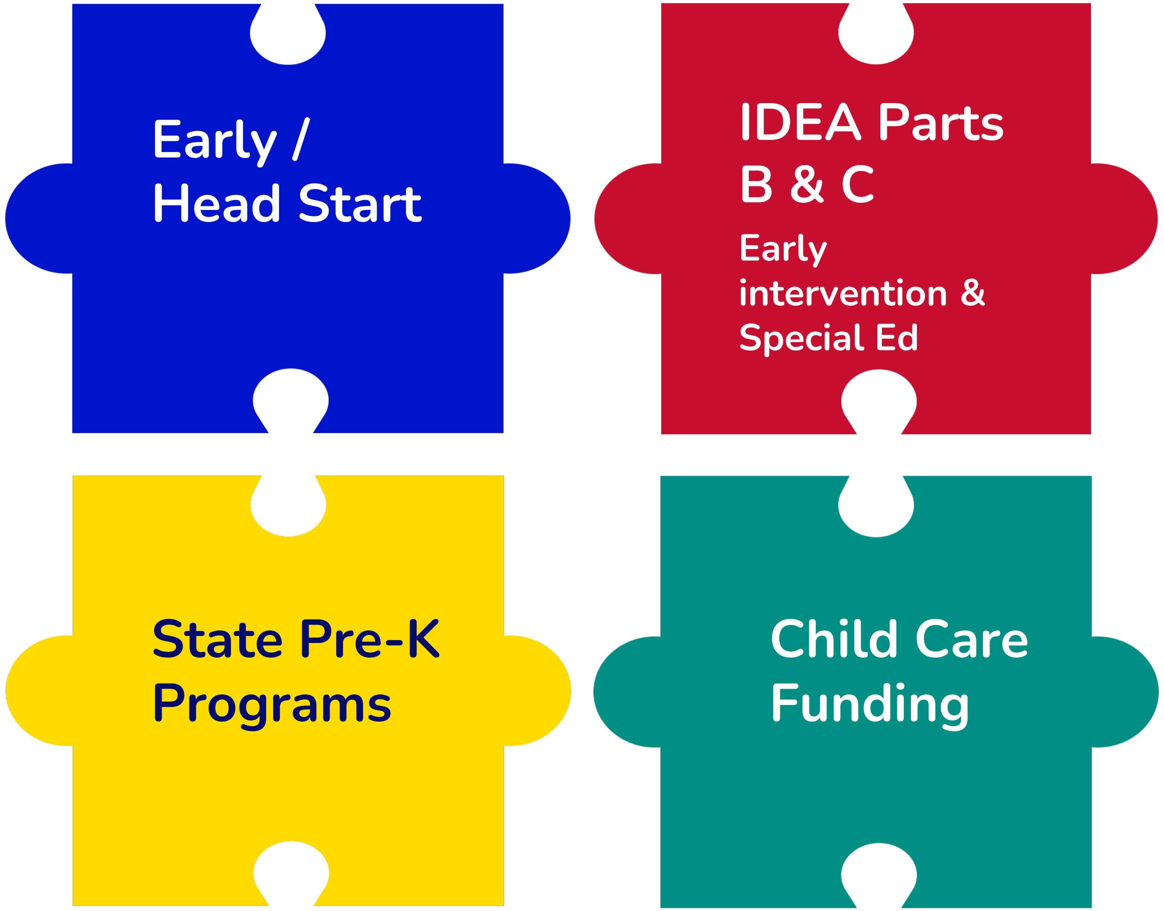
The bigger early childhood funding picture: Multiple funding streams

- 4 different purposes
- 4 sets of standards and requirements
- 4 different bureaucracies working in silos

These pieces don't fit together well, but they are all important to take into account when building your state's strategy for funding child care.



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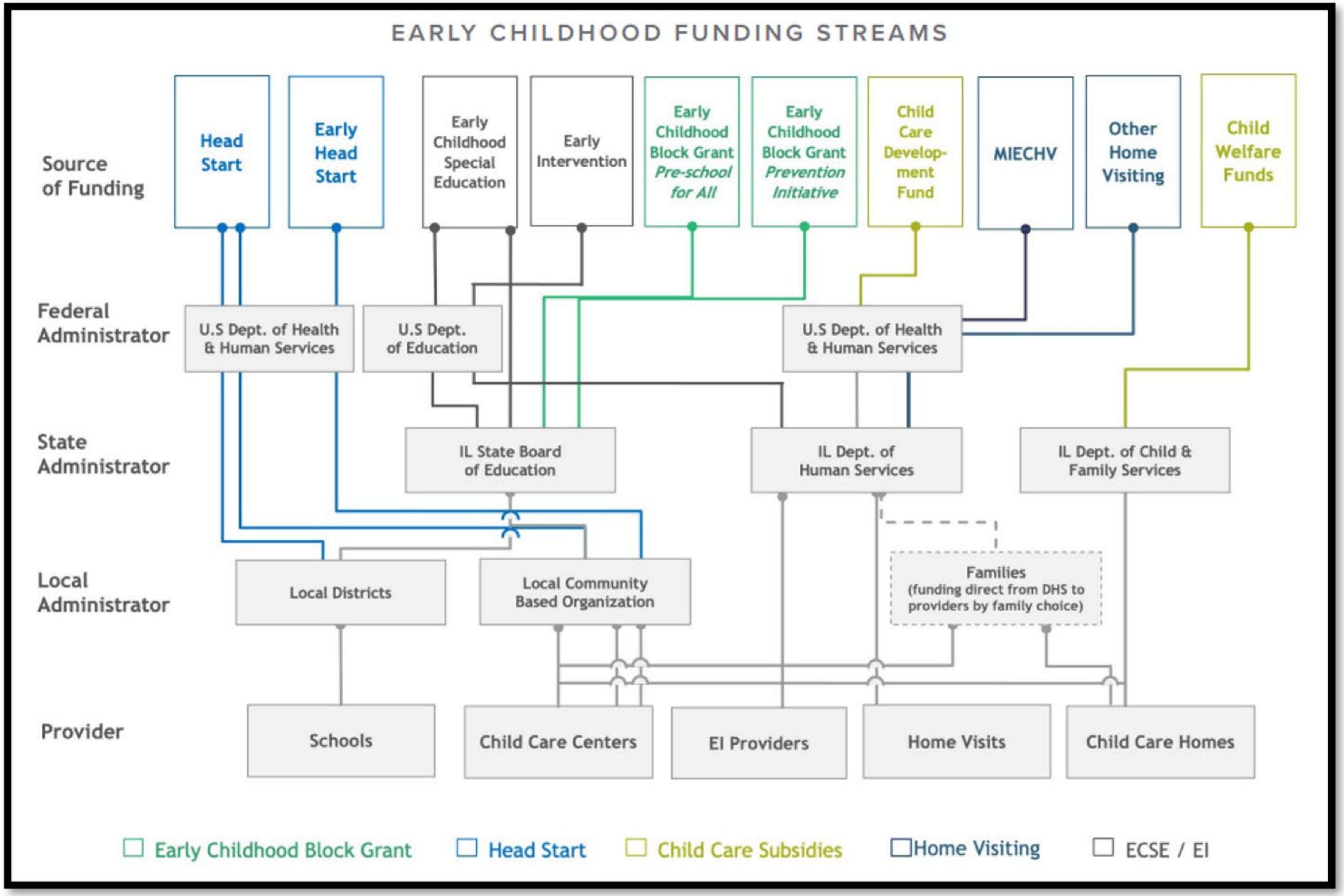
Coherent early childhood funding strategy can be difficult because of fractured governance.



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The role of business in funding child care

Employer-based child care has historically been most successful for large companies.

- The administrative cost and complexity of voluntary employer-based investment can be prohibitive for smaller companies.

Employer investment is especially helpful for ensuring the unique needs of their workforce are met.

- Care for children of shift workers or weekend care
- Back-up care for children who are sick, etc.

Some states have aimed at pooling employer investments in innovative ways:

- Tri-share models, where employers, parents, and the state share the cost of a child care slot
- Tax credits for investing in CCR&Rs and other supports for child care providers

The role of local investment

Education

- Schools already subsidize much of early education and out-of-school-time care.
- As K-12 enrollment declines over time, there may be opportunities for school systems to take on more of the cost of ECE.

Dedicated funding streams for early education and care

- Many cities and counties have developed local funding streams.
- These interact with state and federal funds in complex ways — intentional coordination is key!

Local economic development and workforce agencies

- Agencies and business can play a key role in growing supply through facilities support.
- They can also prioritize the child care workforce in apprenticeships, etc.