Jonathan Simons | January 2016

TIME TO CARE

Why the 30 hours free childcare offer could be transformational

A Policy Exchange Policy Bite

Policy Exchange

The Government's Childcare Bill will, if passed, double free childcare available for almost all working parents of 3 and 4 year olds to 30 hours a week from September 2017 (with some areas piloting it in September 2016). This offers a large financial benefit (approximately £5,000 a year) to eligible families – around 600,000 of them.

But more significant than the immediate financial benefit is the way in which the funding offers a chance for early years education to develop into a mature public service market. This Policy Bite sets out how this could work and what further policy work remains to be done.

What does the provision of childcare in England look like currently?

At present, the provision of childcare in England is a complex picture. This complexity can sometimes mask from what is by historical standards a large and rising sum of expenditure, particularly in a time of declining budgets across many areas of the public sector. Total Government spend on early years education will increase from £5bn in 2015-16 to over £6bn by 2019-20 at the end of this Spending Review period.

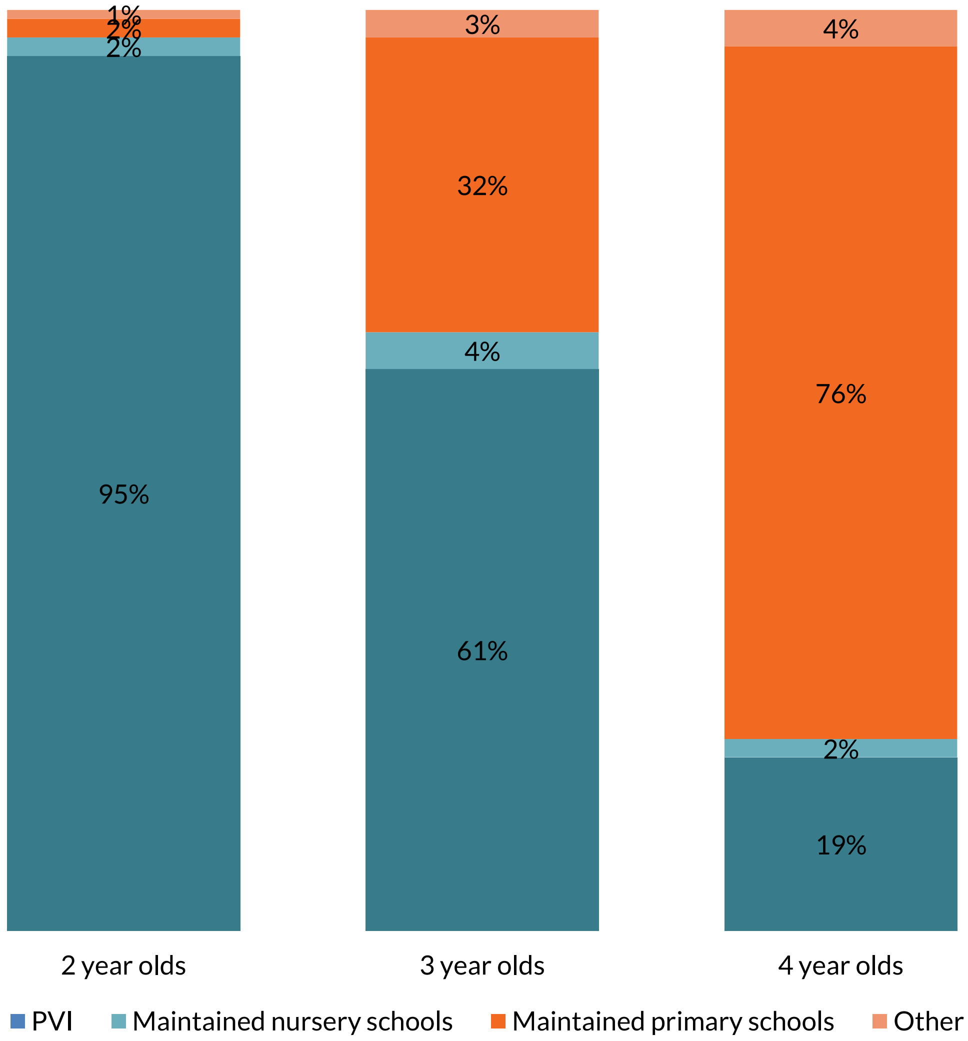
Table 1: Annual Government funding on early years via various routes, 2015/16 and 2019/20, £m[1]

Expenditure line	Annual spending in 2015/16, £m	Annual spending in 2019/20, £m
Universal Credit	0	1508*
Tax Credits	1276	0
Tax Free Childcare	0	807
Employer Supported Childcare	820	390
Free childcare for 2 year olds / 3 year olds / 4 year olds	2855	3933
Workplace nurseries	100	100
Total	**5051**	**6738**

**This is tax credits and universal credit joint expenditure, before UC is fully rolled out*

The pattern of provision is also mixed. Almost all (95%) of eligible 2 year olds access their free hours via PVI providers, as well as 61% of 3 year olds, falling to 21% of 4 year olds as children shift to reception classes in maintained schools (which does not count for statistical purposes as taking up the free hours childcare entitlement).

Figure 1: Proportion of children taking up funded early education places by type of provider, England, 2015



Note that this graph shows type of provision only amongst those accessing their free entitlement, take up of which is almost universal for 3 year olds (94% of the total cohort) and 4 year olds (99%), but only 56% of 2 year olds (which is not a universal offer).

The increasing prominence of childcare as an issue for government

This mixed picture reflects the relative lateness with which government came to have a role in this policy area. As recently as 1990 there were just 59,000 nursery places in England and Wales, compared to 1.7 million now (counting only those funded in part by the taxpayer). 1988 saw the first national childcare strategy in the UK, the 1989 Children Act required councils to provide daycare "as appropriate", in 1994 tax relief for childcare was introduced, and the Nursery Education and Grant Maintained Schools Act 1996, building on the 1989 Act, was the first serious attempt by government to actively intervene and increase the supply of childcare in a more managed way (followed shortly by further early years provisions in the 1998 School Standards and Framework Act, far better known for its implications for schools).[2]

Relatedly, there has also a lack of clarity and coherence with which past interventions have been introduced, which have always needed to recognise the mixed nature of the market, and as such have hopped between demand side and supply side incentives in an effort to integrate with patterns of provision.

Part of this mixed picture also reflects ambivalence amongst some politicians and policy thinkers – particularly those from different groupings broadly within the Right – around government's role in childcare and early education. Some socially conservative thinkers[3] argue that what should be supported are families looking after their own offspring, which will always be preferable to the state looking after other people's children. Alongside that, some free market thinkers believe that government intervention and spending in this area is likely to be expensive, of poor quality, and will crowd out more efficient family, voluntary and civil society action.[4] Such approaches are not unique to the UK – in the US there is an equal or even stronger resistance to intervention in this area.[5]

I do not share that scepticism. There seem to me good reasons: economic reasons, social reasons, equity reasons – why it is important to have a more consistent pattern of provision and certainty for parents as taxpayers, should they wish to use it. This does not mean, however, that the government has to be the main *supplier*, or even the main *commissioner*, but does reflect a belief that the government ought to be the main *funder*.

The possible transformational impact of 30 hours free childcare

The current fractured system is delivering both an increase in places and quality. Latest figures show there were around 230,000 more childcare places in 2012 than in 2009 (a 12% increase) and the number of providers offering places under the various entitlements has continued to increase. There has been a significant increase in the take up of childcare provision in low and middle income areas. In August 2015, 85% of providers on the early years register were rated good or outstanding for overall effectiveness, and ratings for providers in the most deprived areas have improved from 59% good or outstanding in 2010 to 79% in 2015. The Government has also recently announced that the hourly funding rate for providers will increase.[6] However it is true to say, and all political parties would acknowledge, that there remains some way to go to deliver on an ambition of universally accessible, affordable, high quality childcare.

The issue of the structure of the provision and funding patterns is at the route of some of these weaknesses with the current system. Specifically, the fractured and mixed model of providers means that the incentives for improvement, especially as pushed by government, are weaker than they would ideally be - because the supply side is so varied and will therefore both have different needs and indeed respond in different ways to any one single improvement policy. Similarly, the small size of many providers means the sector is likely to be more inefficient in use of funds than it ought to be, as exemplified by a wide variance in the responses to the call for evidence on the costs of providing one hour of childcare.[7]

This, then, is where the 30 hours is really (potentially) transformational. For given that the mean hours of formal childcare for 3 and 4 year olds that is consumed is 25 hours a week (and around 20 hours a week for 0-2 year olds)[8], a universal offer for 3 and 4 year olds of 30 hours free childcare for working families (or almost universal, given some constraints on eligibility by minimum hours worked and maximum salary earned) **would effectively make government the monopoly buyer and funder of this childcare for working families in this country.**

We would, in other words, nationalise childcare.

"Quel horreur!" would be the response from many. And indeed, it is unlikely the government would ever describe the 30 hours as having this effect. But that is, in practice, what it could be argued would happen for 3 and 4 year olds[9].

But let's take it from another perspective. Imagine a hypothetical system in which all provision was delivered by a range of independent providers, both large and small. Parents would have free choice of where to go, via a voucher system that covered their costs, effectively commissioning their own provision, and with the market responding to supply and demand. The voucher would be funded and paid for by government, with an element of top up funding allowed if needed. In parallel, there would be a small, entirely private market, for a proportion of the cohort that wished it. **This sounds much like the type of Friedman style school choice theory advocated by free marketers across the Western world.[10] And this is also what the new emerging childcare market would resemble.**

A mature public services market

A maturing of the childcare market into this type of provision sounds quite a lot like the current schools system in England. Parents express a choice (technically a preference) for the school they wish their child to attend and the funding for that pupil follows them to the school. For secondary pupils, the majority of schools they attend are Academies, independent (but not profit making) institutions. All schools receive funds only if pupils choose to attend them. And the independent school market operates in parallel for around 7% of the cohort.

The parallels aren't exact – top up funding isn't allowed for core 5-16 year old state education (though charging is allowed for ancillary services such as textbooks, and also extended extracurricular provision), and a substantial minority of secondary schools and the vast majority of primary schools are still state maintained, although it is the explicit policy of the Government (and long standing position of Policy Exchange) that all providers should in time become independent Academies.

My point here is that the approach which the 30 hours of childcare promises is a chance to move the 3-4 childcare market more closely to the evolving 5-16 schools market – which is a mature public service market that has continued to develop in this way since Local Management of Schools was introduced in 1988. **In other words, a move in childcare that could be termed nationalisation, when underway in a similar fashion for 5-16 education is often called privatisation!**

This divergence of descriptions simply reflects the change in position of these systems from their earlier starting points. With regard to the 5-16 market, government is liberalising the supply side to meet an already liberal demand side. Within the 3-4 childcare market, Government would be nationalising the demand side, and liberalising (or keeping liberal) the supply side to respond to this demand.[11] But both systems will end up in a similar position: government *funding* provision, but not *supplying* it or even (in most cases) *commissioning* it.

Furthermore, this shift actually reflects broader emerging best practice within other mature, public service markets. The NHS runs increasingly on a tariff based system, where providers are paid a fixed sum to deliver an episode of care. This tariff has two main benefits.

- Firstly, it prevents cost inflation on the provider side - something which is an underappreciated risk in the childcare market at present. The Family and Childcare Trust annual survey, for example, shows that the cost of sending a 2 year old to nursery has risen by 5.1% last year, and for 3 and 4 year olds by 4.1%. In total the cost of a 25 hours a week nursery place for a child under two has increased by 32.8 per cent over the last Parliament.[12] At a time when inflation has been low across the economy, and pressures on cost drivers such as wages and land costs have been mostly subdued (outside of regional hotspots), this is something that needs to be borne in mind.
- Secondly, a tariff lessens a race to the bottom and cost cutting approach to competition, which runs the theoretical risk of harming outcomes. Unlike in the NHS, a childcare provider can be for profit, so they do face an incentive to eliminate costs. But a tariff means there is no incentive to lower headline hourly rates in order to secure more market share (as parents bring a fixed voucher sum with them) so there is a greater incentive to compete on non price factors – range of activities, quality of staff, operation of premises, and the like.[13]

Policy implications

So the 30 hours offer, if it moves childcare more to a tariff based model of competing independent providers within a more or less fixed cost system driven by parental demand, could be transformative. To build on this change to a mature public service market, and really make this system work effectively, however, there are more things which would ideally exist, and which Sam Gyimah and his team might want to consider alongside and following the presumed Royal Assent for the Bill. These include:

- **Greater transparency of data, for commissioners and users.** Depending on the type of public service market, the balance of data will veer between the two groups. For institutions where there is no new market entry, such as hospitals, provision is professionally commissioned and users choose from within a fixed group. In this instance, commissioners require data (on e.g. financial performance) and users require a different set of data (on e.g. clinical standards) For most childcare settings, especially PVI, the balance is almost entirely towards the users, who will act as de facto commissioners in their choices of where to spend their vouchers. Ofsted reports exist for all registered settings as well as some EYFS data. But there is a real paucity of other supporting data that might be used by commissioners, as well as potentially users, which is applicable to maintained settings (including children's centres and maintained nurseries). Policy Exchange work on Children's Centres from the end of 2013, for example, identified that most centres were not accurately collecting and reporting comparable baseline data, or transparent about the extent to which they were delivering the types of interventions set out in the Allen Review of Early Intervention . Similarly, the extent of financial information for maintained early years settings is considerably less than that required of maintained schools – and as the collated information produced by DfE in response to the call for evidence in costs of childcare across all settings, this paucity of data spans the sector. Government should consider what it can do in terms of transparency of data – not least to help settings benchmark themselves against others when it comes to things like hourly costs and delivering consistent practice.

- **Relatedly, more fine grained data on capacity within a Local Authority area**. LAs are under a duty to secure sufficient places within their area, and this data must be reported annually, by law. The latest Family and Childcare Trust data shows that actually 57% of LAs are already failing to meet that requirement to secure sufficient places (and indeed only 136 councils even audited their supply in 2015). But even where data shows sufficiency across an area, that often hides massive variance of provision.

For example, it is common for some settings to be heavily oversubscribed, whilst others remain almost empty due to parental choices. Simply ensuring total sufficiency of provision does not adequately meet parental demand – something that has been recognised in the school sector with the introduction of the Free Schools policy which recognises that choice between underperforming institutions is no real choice at all, and that new entrants should be able to meet a need even where there is spare capacity in the system if no one wants to go there.

- **Incentives to drive efficiency and grow**. The 30 hours tariff ought to act as a significant driver of efficiency because it will require participating settings to configure childcare for that hourly rate, with little opportunity to cross subsidise. But part of what might hamper that efficiency drive is, as suggested above, a real paucity of existing data to allow settings to work out where they are being less efficient than others and where they ought to look to make changes. But alongside this efficiency driver, government might like to think about drivers to grow. Again using the NHS as a parallel example, one innovation which has been introduced in recent years is known as the Best Practice Tariff (BPT), which pays settings an enhanced rate for agreeing to deliver care according to best practice clinical guidance. Such a model within childcare could, for example, pay a slightly higher hourly rate for settings which deliver Early Intervention Foundation type interventions for families in high need, or which demonstrate good outcomes for their children on any of a wide range of outcomes that could be agreed and verified.
- **Actions and incentives to improve settings via collaboration, merger or exit**. As Ofsted regulated institutions, institutions can be shut down if providing a wholly inadequate education or preventing a safeguarding risk (both of which are fortunately extremely rare) Again, it should be stressed that given the autonomy of many providers, government rightly has fewer levers over patterns of provision than they do with maintained settings. But there may be some sensible things which they can do to nudge greater collaboration and grouping of settings, either in a group to share costs, or where a setting has been found to require improvement. There ought to be scope for higher performing primary schools, maintained settings and indeed PVI providers to seek to group together underperforming settings under their wings (either through formal merger, takeover, or just some

sort of sponsorship arrangement), again much as has happened in the schools sector, and to be encouraged or incentivised to do so.

- **Improvements to the qualifications, training and development of the workforce** – the sector is unanimous in recognising that *high quality* childcare and early education is what matters, and that the quality of workforce is what delivers that. The Nutbrown review laid out a series of recommendations, many of which have been taken forward, and the quality of staff (using qualifications as a proxy) is rising. But more could be done and the Childcare Minister Sam Gyimah is exactly right to commit, as a priority, to "a workforce strategy [where] I will explore how we can develop a career structure for all staff, as well as put in place a clear career path for apprentices in the sector."[14]

- **Flexibility of provision** – DfE have recently launched a consultation on parents having a right to request that their child's school stays open late, providing childcare for over 5s (which could and probably would be delivered by a third party). We know that around half of all primary schools in England (and more than 8 out of 10 of prep schools) already offer a longer day[15]. The DfE's Spending Review settlement also allocated around £50m capital to be spent on additional nursery places. It would seem sensible to use this funding to create more settings co-located with, and sometimes overseen by, primary schools – something which offers huge potential for both early years settings and children within them, and which Policy Exchange has long advocated. This funding, together with additional funding to incentivise new free schools in the primary phase to build space for early years, should also be used alongside greater nudges to incentivise collaboration between highly performing primary schools and underperforming early years settings in appropriate circumstances, as discussed above.

Taken together, the Childcare Bill outlines the starting point for what could be a strong programme of reform for the sector –above all, through the creation of an effective and efficient public service market for early years provision.

Endnotes

[1] Data provided by Department for Education

[2] Summarised in Policy Background of Family and Childcare Trust, "Childcare Costs Survey 2015"

[3] For example, see Laura Keynes, "The Conservative government offers little to socially conservative women" http://www.conservativewoman.co.uk/laura-keynes-the-conservative-government-offers-little-to-socially-conservative-women/

[4] See Ryan Bourne, "How the Conservatives are presiding over the nationalisation of childcare" http://www.conservativehome.com/thecolumnists/2015/02/ryan-bourne-how-the-conservatives-are-presiding-over-the-nationalisation-of-childcare.html

[5] For example, see Cato Institute, "The advancing nanny state: why the government should stay out of childcare" http://www.cato.org/publications/policy-analysis/advancing-nanny-state-why-government-should-stay-out-child-care

[6] The national average rates for both two-year-olds and three- and four-year-olds will increase by at least 30p per hour. For three and four year olds the national average rate will increase from £4.56 to £4.88, including the Early Years Pupil Premium. For two year olds it will increase from £5.09 to £5.39. DfE, "Childcare Bill: Policy Statement"

[7] The Government's response to the consultation is a masterpiece in Whitehall understatement. It includes the following lines: "*The quality and completeness of the evidence submitted was wide ranging. The majority of responses listed the factors which providers perceive to be their main areas of expenditure, but these were often not supported by figures. This means that we have been unable to understand which costs are as a result of delivering the entitlement and which are not." "While we have been able to identify what providers perceive to be their main areas of expenditure, we were unable to determine from the responses what providers' unit costs were." "It is also important to note that the areas which providers perceive to be the main areas of expenditure might not be necessarily be the areas where they incur most of their costs.*" DfE, "Analysis of responses to the call for evidence on the cost of providing childcare"

[8] DfE, "Childcare and early years survey of parents 2012-13", table 2.8, published June 2014. This data is produced every two years and so is latest available data until June of this year when 2014-15 data will be published.

[9] The 3 and 4 year old childcare remains the focus of this paper, precisely because of the differential in the volume and coverage of free hours between this group and for 2 year olds. There is no likelihood at current time that the 2 year old offer will become a universal one (either in hours or in coverage) though it may be that in future years the impact demonstrates that a case could be made for that, funding dependent.

[10] "*You cannot make a monopolistic supplier of a service pay much attention to its customers' wants – especially when it does not get its funds directly from its customers. The only solution is to break the monopoly, introduce competition and give the customers alternatives. A voucher system is such a solution. It would enable all parents to choose the schools their children attend.*

Under such a plan, parents would receive vouchers corresponding to all or part of the amount that the state or local community is committed to spending to provide public schooling for their children. These vouchers could be used only for schooling — in either public or private schools. The source of public funds would remain the same as it is now — the taxpayers. The key difference from the present system — and it is a crucial difference — is that parents, and not government bureaucrats, would decide what schools their children attend. In the process, they would also decide which schools get more funds and which less". Friedman, "Busting the school monopoly", Newsweek 1983. Accessed from http://www.edchoice.org/who-we-are/our-founders/the-friedmans-on-school-choice/article/milton-friedman-on-busting-the-school-monopoly/

[11] To complicate things slightly government is still operating a demand side subsidy via tax free savings for private funding of childcare through the new Tax Free Childcare Scheme.

[12] Family and Childcare Trust, "Childcare Costs Survey 2015"

[13] For a more extensive discussion of the benefits of competition, and the advantages of non price competition in public quasi markets, see former No 10 Special Adviser Sean Worth's extensive work for Policy Exchange from 2013, "Better public services: a roadmap for revolution"

[14] Sam Gyimah speech to Family and Childcare Trust conference, 4 December 2015

[15] Policy Exchange, "Only a matter of time", August 2014