

Intelligence MEMOS



From: Tammy Schirle
To: Canadians Concerned About Childcare
Date: September 8, 2021
Re: **WHEN MARKETS FAIL: THE CASE FOR GOVERNMENT SUPPORT FOR CHILDCARE**

It's easy to find an economist who likes well-functioning, perfectly competitive markets. I'm one of them.

Some markets for goods and services are best left to work on their own, with nothing more than the proverbial invisible hand to guide them. But can the market for early learning and childcare (ELCC) services be left to the invisible hand? Unfortunately no, because in childcare we need a few things to be true.

First, parents need to easily see the quality of the services, and the prices charged by various providers. Prices can be found with a bit of research, but can a parent know the quality of services when shopping?

One could ask: do you offer a strong curriculum, or will you plop my kid in front of YouTube all day? Clearly there is an asymmetric information problem here. Without experiencing the services, it is difficult to find out the true quality. In the case of services for young children unable to communicate their daily experience, quality can remain even more unobservable.

In this context, childcare quality is not easily contractible, and a for-profit private sector firm's profit incentives weaken high quality service when that quality is largely unobservable. This, simply put, is one starting point for understanding why private markets for ELCC fail.

To overcome the problem of asymmetric information, many parents rely on the word of other parents or personal networks to find quality care within the private sector (And we've all known many fabulous private sector providers.) Many parents will seek out not-for-profit providers, who work with different incentive structures and often have broader organizational goals that support quality care.

So, our first market failure leads to a second obstacle preventing the ELCC market from being perfectly competitive – to ensure the health, safety, and protection of children, ELCC providers need to meet licencing and operating requirements, which in turn inhibit free entry to the market. Existing providers can't easily alter how many spaces are available in their centres while meeting safety requirements. Getting rid of standards could increase private sector supply, but it won't be the supply parents want, and we simply return to the asymmetric information problem.

That's one of the challenges for the supply side; on the demand side, one might be concerned that high quality ELCC services are expensive, and low-wage parents can't afford it.

When markets work well, a redistribution policy that offers an unconditional cash transfer to families can be useful, allowing parents to use the money to purchase the services that best suit them.

Why might that be insufficient? First and foremost, there is this problem where the market fails to function well and the supply problem will remain.

Meanwhile, in many families, the lower earner would most likely be first choice for the job of ELCC provider, and that lower earner is almost inevitably Mom. While Mom might want to set out on a paid career, with long-run goals in mind, the family might be reluctant to take that path, preferring to use the cash elsewhere. It is always a negotiation. More targeted policies that directly subsidize the cost of ELCC services would help, improving Mom's negotiating position while ensuring access to high quality services for the kids.

With all of this, and more, in mind, there has long been a push for governments to intervene in the provision of ELCC services (the supply side) and ensure its affordability (the demand side.) In recent weeks, most provinces and one territory signed funding agreements with the federal government to address issues of affordability, quality, and quantity of childcare spaces. Provinces are able use the funding for ELCC services tailored to suit the needs of their parents, supporting a range of options including building childcare centres, or funding home-based care, and family day homes. The money could be used to encourage providers to innovate, by offering non-standard hours or more inclusive programming. There are big gaps in the existing system, and there's an opportunity here to change that. Proposals to simply pay parents do not address the system's market failures around both quantity and quality of supply

I will leave it to others to remind you of economic growth to be gained when all parents have the services they need so they can choose whether to participate in the labour market, or of the benefits of early learning for child development. For today, I'm just thinking about how poorly this market functions on its own. It's time to address that.

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