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Designing public subsidies for private markets: Rent-seeking, inequality and childcare policy

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Introduction

The ‘radical marketisation’ of the childcare sector has coincided with its rapid expansion, which has largely been driven by the increased labour force participation of women and the growth of generous public subsidies for private provision in recent decades. The childcare sector includes early childhood education and care (ECEC), outside school hours care and family day care. In 2018, there were 18,699 government-approved service providers catering for almost 1.3 million (31 per cent of) children aged from newborns to 12 years (PC various years). In 1988, it was estimated that government-funded ECEC services assisted only 73,883 (2.3 per cent of) children in the same age group (AIHW 1993: 127, 133). Over a similar period, the sector has been transformed by the shift to for-profit provision, with the proportion of childcare places offered by private for-profit centres surging from 22 per cent in 1991 to around two-thirds in 2020 (ACECQA 2020; Brennan 2007: 216).

The radical marketisation of the childcare sector has been the subject of mixed assessments. The Productivity Commission (2017: 61) enthusiastically promoted the ECEC market as evidence of ‘the value that

user choice and competition can have in human services'. Yet, mounting evidence supports persistent concerns about limits to the availability and affordability of quality childcare services as profits for providers have soared in the past two decades (Brennan 2014; Hill and Wade 2018). There is wide recognition that the public subsidies for child care—which are the largest source of funding for the sector—have contributed to both inefficiency, by placing few limits on the rent-seeking of for-profit providers, and inequity, through recent reforms that have cut support for some low-income households. While correct as far as it goes, this assessment of public subsidies overlooks important differences between the design of the policy instruments enacted by successive governments to subsidise child care and how these different policies have interacted with the private market.

This chapter examines the subsidies for child care that successive federal governments have enacted since the mid-1980s, comparing and contrasting policy designs. It proceeds in four sections. The first classifies the childcare sector using Gingrich's (2011) typology of social service markets and highlights the role of public subsidies. The second section explains the policy-instruments approach, which recognises the tools of statecraft to be social as well as technical devices, and which underpins my analysis of the different designs for childcare subsidies. The third and major section charts the evolution of public subsidies for child care, highlighting the political choices behind the design of tax expenditure, cash benefit and rebate policy instruments. The fourth section concludes that childcare policies that more closely resemble direct expenditures have been less inefficient and more equitable than those that possess features of tax expenditure. A short Epilogue considers the implications of temporary measures for child care introduced in the initial stages of the Covid-19 pandemic.

A 'private-power' market? Rent-seeking in the childcare market

To provide context for my analysis of public subsidies, this section draws on Gingrich's (2011) typology to classify the structure of the childcare market and discusses how the design of some public subsidies has the potential to exacerbate rent-seeking.

Gingrich (2011) contends that existing social service markets do not resemble the 'free-market' model that animates neoclassical economics and much policy discourse. Instead, she argues that social service markets are institutions that organise behaviour through competitive mechanisms that vary in both structure and outcomes. The structure of this competitive mechanism 'follows from how the "demand" side (users and purchasers) and the "supply" side (producers) interact to both deliver and distribute services' (Gingrich 2011: 19). Her typology differentiates between six ideal welfare market models that vary systematically along both the *allocative* dimension, which entails how costs are shared between service users and the state, and the *productive* dimension, which involves how control over production is distributed between service users, the state and private service providers (non-profit and for-profit) (Gingrich 2011: 9). While the allocative dimension relates to the distributive outcomes of a social service market, the relationship between the two dimensions has a bearing on the quality and efficiency of services produced.

The institutional structure of the Australian childcare market conforms to what Gingrich (2011) terms the 'private-power' model. Consistent with the allocative dimension of this model, the costs of childcare services delivered by private providers (for-profit and non-profit) are shared between service users and the government. Public subsidies cover a substantial proportion but not the full price of child care for most service users, with the rate of benefits for parents and guardians calculated according to family income, the price of childcare services and hours of care (Services Australia 2021). The productive dimension of the childcare market is also consistent with the private-power model because the control private providers have over the design of services and price is subject to little oversight and few constraints from the state and consumers (Hill and Wade 2018). As a result, the quality and efficiency of childcare services are reliant on competition between providers for consumers. Gingrich (2011: 17) argues that private-power markets 'promise innovation but face the risk of rent-seeking and uncontrolled cost-cutting at the expense of efficient or high-quality production'. At the same time, this market model may make it difficult for consumers to access affordable and high-quality services if providers are relatively free to charge additional fees on top of public subsidies.

The vulnerability of private-power markets to rent-seeking is relevant to the childcare sector. Rent-seeking occurs when large private organisations use their market power in political processes to gain advantageous public policy settings that reinforce their economic interests (Stiglitz 2013: 48). As Stiglitz notes, rent-seeking can involve:

> hidden and open transfers and subsidies from the government, laws that make the marketplace less competitive, lax enforcement of existing competition laws [and regulations], and statutes that allow corporations to take advantage of others or to pass costs on to the rest of society. (2013: 48)

Not only does rent-seeking further concentrate wealth and economic advantage, it also tends to divert resources away from productive activities and thereby disadvantages other stakeholders (Stiglitz 2013: xxxiii). Rent-seeking benefits private sector providers in social service sectors (such as child care), while the costs are borne by the state, the community and households.

Public subsidies as 'policy instruments'

There are wide concerns that the series of public subsidies for child care enacted by governments of both major persuasions since the mid-1980s have contributed to rapid fee inflation and rent-seeking. Despite these concerns, key differences in policy design have affected the equity of these subsidies and their susceptibility to rent-seeking. What appear at first to be relatively minor differences have had significant impacts, particularly as childcare coverage has expanded and, with it, the cost of public subsidies. To better understand these differences and their impacts, this chapter draws on insights from the policy-instruments approach to classify and analyse patterns in the design of public subsidies over time.

Policy-instrument analysis starts from the proposition that policies can be classified into groupings that have common features that reflect meaningful trends in design. Since there is no consensus on the level(s) of abstraction at which policy instruments should be analysed, it is necessary to define the concept and clarify which of the numerous available frameworks is employed (see Howlett 2019; Salamon 2001; Vedung 1998). A policy instrument is defined here, following Salamon (2001: 1641–42), 'as an identifiable method through which collective action is structured to address a public problem'. Salamon understands policy instruments as 'identifiable methods' of public action that share a set of common design features that are typical of practice but may vary in certain manifestations. Salamon posits that, as methods that structure collective action, policy instruments are institutions that routinise patterns of social behaviour.

And, by highlighting that policy instruments are collective actions that respond to public issues, he acknowledges that they may impact the behaviour of state agencies, private entities and households.

Policy instruments are understood from this perspective to be technical, social and political devices. As technical devices, they establish the parameters of the roles, and the extent of accompanying responsibilities, that various actors and organisations have at all stages of a program, from design to delivery (Salamon 2001: 1627). By establishing these parameters, a policy instrument is also a social device that structures 'specific social relations between the state and those it is addressed to, according to the representations and meanings it carries' (Lascoumes and Le Gales 2007: 4). Lascoumes and Le Gales (2007: 4) contend that policy instruments 'structure policy according to their own logic', regardless of the specific aims stated, because these tools of public action reflect different understandings of policy problems and serve to organise social behaviour. It follows that policy instruments are also political devices because their designs elevate certain interests over others by allocating costs and benefits, expanding or contracting the roles of different policy actors, and reflecting specific ideas related to different viewpoints on the social issue and how to respond to it (Salamon 2001: 1628).

To analyse trends in the policy instrument design of public subsidies for child care, I draw on the tax expenditure – direct expenditure continuum proposed in joint research with Spies-Butcher (see Stebbing and Spies-Butcher 2010). This continuum positions fiscal policy instruments that deliver support for individuals and families according to how directly public expenditure is allocated for public accounting purposes. Direct social expenditures, such as public services and cash transfers, that are funded from general tax revenue and/or involve services delivered by the public sector occupy the left end of the continuum. Tax expenditures, such as tax exemptions and tax rebates, that are selective tax discounts that have similar budgetary effects to direct expenditures, but which channel funding to private provision, occupy the right end (Stebbing and Spies-Butcher 2010: 590). In the middle of the continuum, there are hybrid policies—such as rebates and subsidies—that exhibit features of both direct and indirect policy instruments. This continuum is useful to understand trends in public subsidies for child care, as direct expenditures, tax expenditures and hybrid policies have all been employed.

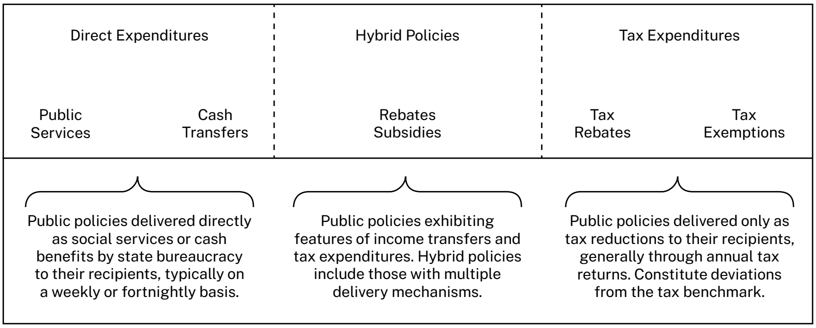

Figure 8.1 The continuum of direct expenditures and tax expenditures
Source: Adapted from Stebbing and Spies-Butcher (2010).

The relative position of a policy on the tax expenditure – direct expenditure continuum affects its visibility and distributive effects (Stebbing and Spies-Butcher 2010: 591). Direct social expenditures are typically framed (in Australia) as redistributive government-funded benefits that target most support to poorer and lower-income households. These policies involve highly visible budget appropriations that are routinely captured in public accounting processes. In contrast, tax expenditures are generally framed as incentives that give taxpayers back their own money to promote certain behaviours or compensate particular groups. These policies may not be redistributive, and often provide flat-rate or regressive benefits (Stebbing and Spies-Butcher 2010). Tax expenditures often lack transaction trails and have low visibility in public accounting processes, thus avoiding regular oversight (ANAO 2008).

In sum, this continuum postulates that policies with designs closer to direct expenditures are both more visible and more equitable than policy designs resembling tax expenditures. Deviations from these trends are not unexpected when analysing recent subsidies for child care, however, since policy instruments are among multiple factors that can influence policy design (Howlett et al. 2018). Other factors that can influence (but not determine) the impact of policy design on equity and service price include both the feedback effects (path dependence) of earlier policy designs, the political appeal of particular frames, and broader changes to the structure of the sector (Hacker 2004). To account for these multiple factors, my analysis of childcare subsidies tracks the impact of policy instrument design alongside the legacy of previous policy settings and the marketisation of the sector.

Subsidising private care: A policy history of public subsidies for child care

This section examines how the different policy instruments selected to subsidise child care since the mid-1980s have affected the equity of social benefits and the potential for rent-seeking in a rapidly changing sector. My account starts with a brief overview of the federal government's childcare policies in the 1970s. However, the main focus is the mid-1980s to the present day, as this period coincides with the shift to the enduring demand-driven policy approach that allocates funding to ECEC services based on the number of children enrolled and the rapid marketisation of the childcare sector.[1] When tracing the reform path of public subsidies over this period, my analysis considers the policy instruments that successive federal governments have selected and the implications of broader changes to what Gingrich (2011) terms the allocative and productive dimensions of the childcare sector. After briefly charting developments before the mid-1980s, the analysis charts the policy instruments recently used to subsidise child care (see Figure 8.2).

Early childcare subsidies

Initially, the policy instruments that subsidised child care had a supply-side design that financed non-profit providers, albeit via the mechanism of block grants to the states, to purchase facilities or reduce fees paid by families (Hill and Wade 2018). In 1972, Commonwealth financial support for centre-based child care was introduced by the McMahon Coalition government to shore up the supply of quality care for children in special need, especially children from low-income families with working mothers. The government allocated $6.5 million to non-profit providers, including services operated by local governments, using the policy instrument of direct grants to fund the building of facilities and recurrent grants to meet staffing costs (SSCCA 1998). In 1974, Commonwealth financial support for non-profit providers was expanded by the Whitlam Labor government, which extended block grants to the states to cover child care in non-profit centre-based services and to other forms of child care such as family day care and outside school hours care (SSCCA 1998). The Fraser

1 Despite some overlap, demand-driven funding that is calculated in relation to the number of children enrolled is distinct from demand-side funding that is paid to parents who access child care.

Coalition government targeted funding for child care, reducing overall funding and limiting support for preschools to block grants for the states, while introducing grants to non-profit services for fee relief to cover low-income families (at the discretion of centre managers) (SSCCA 1998). These public subsidies directly supported non-profit childcare providers allocated via block grants to the states and a submission-based approach with community groups requesting support from the Commonwealth Government.

The Hawke Labor government made incremental changes to the childcare subsidies during its first term in office. After its election in 1983, the Hawke government, in partnership with the states and territories, allocated further funding using direct grants for non-profit providers to establish more than 6,000 childcare places (McIntosh and Phillips 2002). At the same time, the government replaced the submission-based approach with a needs-based system that targeted capital and recurrent grants at localities that had a high proportion of working parents, fewer existing childcare services and lower household incomes (SSCCA 1998). This was followed in 1984 by a commitment to establish a further 20,000 childcare places (Brennan 1998: 176). These reforms largely maintained the supply-side policy instruments for existing non-profit providers to assist with staff salaries, despite increasing provision and greater targeting. These reforms also did not change the structure of the childcare sector, which was still dominated by non-profits and did not have features associated with markets.

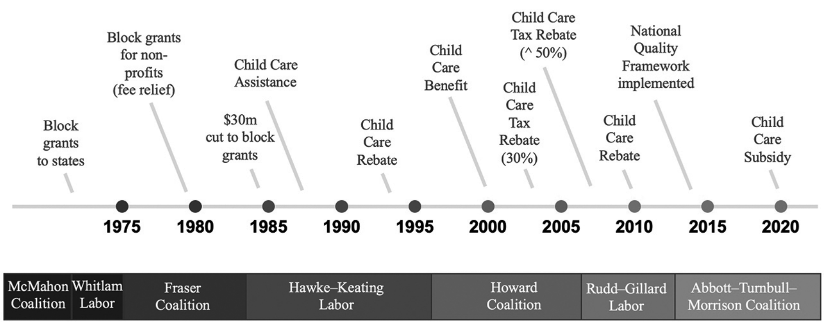

Figure 8.2 Childcare subsidies: A timeline of recent policy instruments

Source: Based on author's research.

Childcare assistance: A targeted industry subsidy for non-profit services

As Labor's ideological position increasingly favoured neoliberal ideas that prioritised marketised policy solutions, the Hawke government overhauled childcare subsidies in the mid-1980s. First, the government cut back subsidies for non-profit services. Later, it introduced a new 'demand-driven' approach to targeting fee relief.

In the May 1985 minibudget, the government tightened fiscal policy as a response to the current account deficit crisis, cutting expenditure on childcare subsidies by $63 billion (a reduction of about 40 per cent) (Brennan 1998: 180; Kelly 1994: 205). This included the retrenchment of block grants to the states that allocated $33 million per year for preschool services and the reduction of subsidies directed to non-profit providers by $30 million (Brennan 1998: 180). Senator Don Grimes, the community services minister, justified these cuts by arguing that existing childcare subsidies were poorly targeted. He claimed eligible families accessing full fee relief in childcare services could receive a benefit 12 times the value of the family allowance,[2] while 90 per cent of children aged under five had no access to the subsidies (Brennan 1998: 182–83).

In 1986, the Hawke government renamed fee relief Child Care Assistance and established a new funding formula that extended support to all non-profit providers and targeted additional fee relief to low-income households. Child Care Assistance was simpler than the previous grant system and more redistributive, as a targeted subsidy that allocated funding to providers based on the number and age of children enrolled from lower-income households (Brennan 1998: 183). Although the government claimed the new formula was both fairer and simpler, controversially, the new funding instrument severed the link between childcare subsidies and staffing profiles. As Brennan (1998: 183–84) documents, previous supply-side funding had subsidised 75 per cent of award wages and had thereby enabled childcare services to retain experienced and qualified staff who received higher wages. Because it no longer automatically covered all children receiving child care in a service nor insulated non-profit providers from wage increases, the new demand-driven instrument effectively halved the recurrent subsidies received by most non-profit

2 A modest payment to all parents, usually mothers, which was at that time universal (AIHW 1993: 9).

childcare centres. Childcare services, as the government acknowledged, could address the shortfall by hiring less-qualified staff and/or raising fees. This resulted in many centres substantially increasing fees, which offset the government's increases to fee relief.

The Hawke government's reforms to the childcare subsidies reoriented what Gingrich (2011) terms the allocative and productive dimensions of social service markets. These reforms lowered the ceiling on public financial contributions to some centres because the demand-driven subsidy standardised the support for services with similar profiles of users, regardless of staff qualifications and experience. At the same time, the new demand-driven funding instrument shifted responsibility for meeting the costs of better-qualified and more experienced staff to service users. These reforms also rearranged the productive dimension of the childcare market by reducing government control over service delivery by giving service providers greater scope to reorganise their operations to reduce costs and employ less-qualified staff. The changes to both dimensions of the childcare market had the potential to increase competition among non-profit providers for service users, while removing the financial incentive to retain experienced and qualified staff. This was not lost on unions and childcare professionals, who claimed the reforms put service quality and industrial conditions for staff second to expanding the sector (Brennan 1998: 185).

Towards a two-tier scheme? The industry subsidy and the cash rebate

Despite proposals by senior ministers in the late 1980s to introduce a voucher system paid to parents, the Hawke and Keating Labor governments continued to expand the scale and scope of demand-driven operational subsidies to providers for the remainder of their terms in office. In 1988, the Hawke government established the National Child Care Strategy (NCCS), which committed to creating 30,000 new childcare places at non-profit services (including 20,000 places in outside school hours care) (SSCCA 1998).[3] In the leadup to the 1990 federal election, the government announced the NCCS would create a further 50,000 childcare places over the following six years and, in a break with

3 The Hawke government also offered incentives for employers to establish childcare services for their employees in the late 1980s, but this will not receive special attention here as these kinds of services have not accounted for a significant share of the market.

past practice, it extended Child Care Assistance to for-profit service providers (Brennan 1998: 186). And, in 1993, the Keating government introduced the Child Care Rebate, which represented the first childcare benefit paid to service users (families) and announced the New Growth Strategy to support the creation of 354,500 new childcare places in non-profit care by 2001 (SSCCA 1998). While the initial NCCS represented an incremental expansion of state support, the decisions to both extend support to for-profit providers and introduce the rebate shifted the coordinates of childcare policy.

The Hawke government's decision to extend Child Care Assistance to for-profit childcare services was a watershed moment that considerably expanded public funding and underpinned the longer-term transformation of the sector. Overturning decades of bipartisan support for restricting public subsidies to non-profit services, this policy change followed intensive lobbying from commercial industry groups and advocacy from the Australian Council of Trade Unions (which had previously opposed this change) leading up to the 1990 election (Brennan 1998: 200). The government justified this change as necessary due to the ongoing undersupply of child care and so as not to disadvantage families with children placed in for-profit services who would otherwise qualify for Child Care Assistance (Brennan 1998: 201). This change also appealed to the government as it encouraged women's labour force participation and child care was prioritised by women in working-class electorates (Brennan 1998: 196). Senior members of the government were on the record as supporting the extension of subsidies to commercial child care on efficiency grounds, as for-profit services had lower average fees than their non-profit counterparts (Brennan 1998: 90).[4] At the same time as it extended them to for-profit services, the government announced that receipt of the subsidies was conditional on services complying with a new national accreditation system (SSCCA 1998). This was at least partly to assuage non-profit providers' concerns about the policy change prioritising low-cost childcare services at the expense of quality (Brennan 1998: 193).

The Keating government's Child Care Cash Rebate was layered on to Child Care Assistance, meaning it operated alongside the existing policy rather than changing it. The rebate departed from previous subsidies in two main respects, in that it was not means tested and it was delivered

4 As Brennan (1998: 191–92) notes, cost comparisons did not take into account the different services provided, or the client groups supported, by for-profit and non-profit child care.

using a policy instrument that disbursed benefits directly to families with children rather than to service providers. The Child Care Cash Rebate provided a flat 30 per cent rebate for a family's work-related childcare expenses for a child aged from newborn to 12 years who paid between $16 and $110 per week, excluding fees covered by Child Care Assistance (AIHW 1995: 122). Annual limits for the cash rebate were set at $1,466 for one child and $3,182 for two or more children (AIHW 1995: 122). The cash rebate was administered via Medicare offices and extended public subsidies to child care delivered by relatives or friends, provided they were registered with the Health Insurance Commission (McIntosh 1997). The cash rebate considerably expanded eligibility for public childcare subsidies to higher-income households; it was less equitable than earlier policies, not only because of its flat-rate benefit, but also because poorer families typically had lower out-of-pocket costs than higher-income earner (SSCCA 1998). Nevertheless, the overall distributive effects of childcare subsidies remained equitable, since almost three-quarters of expenditure was allocated via Child Care Assistance (AIHW 1995: 128).

When establishing the Child Care Cash Rebate, the Keating government reframed child care as a work-related issue concerning families rather than a welfare issue involving support for lower-income groups. Minister for Family Services Rosemary Crowley declared the cash rebate would:

> make child care more affordable and increase the choices for Australian families … Child care is no longer a welfare issue. It is an economic issue and now an integral part of the government's approach to building a highly skilled and adaptable workforce. (SSCCA 1998)

The design of the cash rebate reinforced this framing of child care in two main ways. On the one hand, the cash rebate was administered via health agencies, which set it apart from social security and Child Care Assistance. Although a tax rebate would also have not been administered via social security, the government favoured a cash rebate because of concerns the former policy would have regressive benefits (SSCCA 1998). On the other hand, the cash rebate reinforced the emphasis the government placed on promoting choice because benefits were delivered to families rather than to childcare services. As Hill and Wade (2018) claim, this is consistent with the government's 1993 National Competition Policy reforms, which sought to activate service users as consumers to encourage competition between childcare services.

The Hawke and Keating government reforms contributed to the rapid transformation of the childcare market from the early 1990s. The reforms modified the allocative dimension of the childcare market by fostering the unprecedented growth of public subsidies due to extensions to a wider array of service providers and users, with state expenditure more than doubling in real terms between 1988 and 1994 (AIHW 1995: 127). Still, there were limits to the subsidies a family could claim each week and no price controls, so the state's expanded financial role did not control families' potential out-of-pocket expenses. The reforms of both Labor governments underpinned changes to the productive dimension of the childcare market by increasing the appeal of commercial child care to families and private investors (Hill and Wade 2018). Although capital grants and operational subsidies were reserved for non-profit providers, commercial child care had fewer barriers to market entry as it was not subject to the planning regime for non-profit services (Brennan 1998: 215). Under these policy settings, for-profit childcare services more than tripled the number of places offered (from 32,000 to 121,600) between 1991 and 1997, whereas non-profit provision stagnated (increasing from 42,000 to 46,300 places) over the same period (Brennan 1998: 214). The rise of commercial child care made the sector increasingly reliant on competition for affordable quality services, but the continuing shortage of child care exposed service users and the government to the risk of rent-seeking.

Entrenching private provision: Two tiers of childcare policy

The Howard Coalition government pursued no fewer than three sets of reform to childcare policy that aligned with its shorter-term fiscal strategies during its 11-year tenure. First, after taking office during 1996 with the budget in deficit and a commitment to reduce public spending, the government reduced public expenditure on child care through increased targeting and reduced subsidies. Second, in 1999, as part of its household compensation package for the new Goods and Services Tax (GST), the government repackaged 12 existing family support policies into three benefits, one of which was the means-tested Child Care Benefit. Third, in 2004, with the budget in surplus during the first phase of the mining boom, the government introduced the Child Care Tax Rebate as a second subsidy to assist families with mounting childcare expenses. Although the distributive effects of each set of reforms varied, the Howard government consistently favoured policy settings that prioritised for-profit provision.

The Howard government's first set of reforms sought to contain expenditure on subsidising child care. Child Care Assistance was targeted by limiting the subsidy to 50 hours of work-related care or 20 hours of care for non-work purposes and by reducing the income thresholds of the means tests applied to families with two or more children (Baxter et al. 2019: 8; McIntosh 1997).[5] The Child Care Cash Rebate was partially means tested by reducing the rebate to 20 per cent for higher-income earners (Baxter et al. 2019: 8). In 1998, the administration of both these public subsidies was transferred from health agencies to the new Commonwealth services delivery agency, Centrelink, and benefits were paid fortnightly in arrears to families (AIHW 1997: 104). At the same time, despite promising to retain them in the 1996 election campaign, the Howard government retrenched the operational subsidies for non-profit services citing the rationale that this measure would increase competition with for-profit services (Brennan 1998: 223; McIntosh 1997). It also dismantled the New Growth Strategy of the Keating government, redirecting $11 million to expand child care in rural locations (McIntosh 1997). The Howard government also capped the growth of private childcare places at 7,000 per year in 1998 and 1999 (Brennan 1998: 223). Shifting the design of the childcare subsidies from the left to the centre of the direct expenditure – tax expenditure continuum (Figure 8.1), these reforms limited the subsidies to payments that partially reimbursed service users, which increased the costs borne by non-profit services and families.

The Howard government's second set of reforms formed part of the rationalisation of family support when introducing the GST in 2000. Both Child Care Assistance and the Child Care Cash Rebate were replaced with a new payment named the Child Care Benefit. Retaining many design features of Child Care Assistance, the Child Care Benefit was a means-tested benefit paid to eligible families with children placed in approved services that subsidised up to 50 hours of work-related care if parents met the activity test of 15 hours per week or 20 hours for other purposes (AIHW 2001: 170). The Child Care Benefit had a progressive structure and was indexed; low-income households earning up to $29,857 received up to the full rate of $129 per week, at which point a taper rate applied until households earned $85,653 and received the minimum rate up to $21.70 per week (AIHW 2001: 170). Although framed as a cash

5 It should be noted that although, on paper, 50 hours of child care covers five eight-hour working days a week and one hour on either side of a shift, private services typically charged families for the full operating hours rather than an hourly rate for care.

payment, the Child Care Benefit was a hybrid policy primarily delivered as an upfront reduction of childcare fees (94 per cent of families opted for the payment to go directly to their provider in 2001), but families could also choose to receive it as a lump-sum cash refund at the end of each financial year (AIHW 2001: 170). This benefit increased the amount of financial assistance available to lower-income families than earlier childcare subsidies, as part of the government's compensation package for households aimed at reducing political opposition to the new GST (Brennan 2014: 156; Smith 2004: 149).

The Howard government's third set of reforms introduced the Child Care Tax Rebate, which was announced during the 2004 election campaign by the Coalition parties amid rising out-of-pocket childcare expenses for families with children (Brennan 2007). Reviving many aspects of the Keating government's Child Care Cash Rebate, the Child Care Tax Rebate provided a flat-rate 30 per cent tax rebate on out-of-pocket childcare costs up to $4,000 per year per child (Brennan 2007: 222). Like the earlier cash rebate, the tax rebate offered most benefit to high-income families with the largest out-of-pocket childcare expenses. However, the Child Care Tax Rebate could could only be claimed by one parent on their annual income tax return as a tax offset that reduced the taxes owed (Baxter et al. 2019: 9). The rebate reduced the incentive for services to constrain childcare fees because it was claimed on an annual basis and had no weekly limit. The tax rebate was also more inequitable than the cash rebate because 'low-income families will miss out if [the] amount for which they are eligible is greater than the tax bill' (Brennan 2007: 222). Families thus had to earn a taxable income to receive any benefit. And, while one parent in a couple could transfer the unused balance of the tax rebate to their partner, single parents did not have this option. Recognising this inequity, the government transformed the tax rebate into a hybrid policy in 2007, by allowing families to claim it as a cash payment via the Family Assistance Office at the end of the year, which meant low-income families could receive their full entitlement (AIHW 2007: 37).

By the end of its term, the Howard government restored the two-tier structure of childcare subsidies it had dismantled a mere seven years earlier. After initially requiring higher-income families to take on greater responsibility for financing child care by targeting public subsidies at lower-income groups and reducing the hours to which they applied, the government gradually expanded the allocative role of the state by increasing financial assistance to support lower-income groups via the first tier of the

Child Care Benefit and to families using child care across the income distribution with the second tier of the Child Care Tax Rebate. The overall distributive effects of these subsidies were progressive—estimated to cover 80 per cent of childcare expenses for lower-income earners and around 39 per cent of the costs for higher-income earners (McIntosh 2005). Yet, as with previous subsidies, these policies placed a ceiling on the state's financial contributions to child care without imposing price controls, leaving families ultimately responsible for out-of-pocket expenses from rising fees.

The Howard government's policies are widely recognised to have further entrenched for-profit services as the dominant mode of provision in the childcare market (Sumsion 2012: 209; Newberry and Brennan 2013). The Howard government also reduced the state's limited involvement in the productive aspect of the childcare market by retrenching the capital grants and subsidies for non-profit providers and dismantling the few planning restrictions that remained, thereby leaving the location and size of (for-profit and non-profit) childcare operations 'up to the market' (Baxter et al. 2019: 8). Under these policy settings, the childcare market became more concentrated as it expanded, with large commercial and corporate operators increasing their profitability and market share. This was exemplified by the rise of ABC Learning, which became the largest publicly listed childcare corporation in the world and accounted for more than 20 per cent of childcare places offered across Australia at its peak in the mid-2000s (Sumsion 2012: 209). Press and Woodrow (2009: 236) argue the sheer scale of ABC Learning's operations allowed it (and other corporate providers) to dominate the childcare market, reducing consumer choice because its strategy of saturating services in particular locations meant it effectively became the only provider available. The combination of a market dominated by corporate child care and generous public subsidies left both the government and families highly exposed to the rent-seeking of private service providers.

Renovating the second tier: From a tax rebate to a cash rebate

The Rudd and Gillard Labor governments (2007–13) changed both tiers of childcare funding, aiming to address cost-of-living pressures by reducing the out-of-pocket costs for families accessing care. As part of its election platform targeting voters from middle-income households, Labor

promised to increase the Child Care Tax Rebate from 30 to 50 per cent of out-of-pocket childcare fees and to make the rebate payable to families each quarter, to reduce the delay in refunds (Bongiorno 2008: 600). Daniels (2008: 87) claims the tax rebate design and potential to increase women's workforce participation meant it was not framed as 'middle-class welfare' in public debate. The Rudd government delivered on its election commitment in the 2008–09 budget, increasing the rebate to 50 per cent of out-of-pocket expenses and raising the maximum annual payment from \$4,354 to \$7,500 per child in care (Daniels 2008: 87).[6] The increased generosity of the Child Care Tax Rebate was partially offset by the removal of the Child Care Benefit's minimum payment for higher-income earners. As the design of the Child Care Tax Rebate had the potential to delay receipt of the refund to 18 months, the government made the refund available on a quarterly basis to remove a potential work disincentive for low-income families (Daniels 2008: 88). In 2009–10, the Gillard government converted the tax rebate into a cash rebate that was renamed the Child Care Rebate, due to concerns about the administrative burden for families and services. This made the benefit payable on a fortnightly basis and incorporated the payment into routine budgetary processes.

Leaving the two-tier structure of childcare policy they inherited intact, the Rudd and Gillard governments' incremental reforms increased the state's already significant allocative role by expanding the rate and ceiling of the Child Care (Tax) Rebate and reducing the administrative burden in accessing it. These reforms facilitated the rapid growth of the state's financial commitment to child care, from \$3.2 billion in 2007–08 to \$7.7 billion in 2015–16—an increase of 137 per cent in real terms (Baxter et al. 2019: 10). By 2016, almost all families accessing child care received some benefit from public subsidies; while 98 per cent of families accessing child care received the Child Care Benefit and/or the Child Care Rebate, 72 per cent of families received both (Brennan and Fenech 2014). However, as the reforms focused on expanding the second-tier rebate, households with middle and high incomes benefited most; households on lower incomes came to pay a larger share of their income for child care than higher-income earners between 2007 and 2015 (Hill and Wade 2018). Like previous public subsidies, the reforms limited the financial obligations of the state without imposing price controls or limiting the

6 Initially, the Rudd government announced the Child Care Tax Rebate would be indexed annually, but the \$7,500 annual limit was frozen until 2017 (Baxter et al. 2019: 9).

out-of-pocket expenses of households. Brennan (2014: 157) argues the generosity of the Child Care Rebate exacerbated the potential for fee inflation as it effectively guaranteed public funding of half of any increase.

The Rudd and Gillard governments increased state control over the productive aspects of the childcare market but retained the firm commitment of their predecessors to private provision. On the one hand, the government increased the regulation of the childcare sector through the new National Quality Framework (NQF) implemented in 2014. The NQF was linked to accreditation and, without accreditation, providers could not offer care eligible for the Child Care Benefit and rebate (Brennan and Fenech 2014). With the aim of driving quality improvement under the NQF, childcare services are evaluated using standardised assessment items and the results are published on a government website (Brennan and Fenech 2014). The NQF also increased the qualifications required of staff for services with 24 or more childcare places (Brennan and Fenech 2014). Although non-profit services tended to outperform for-profit providers, evidence suggests this oversight has improved quality across the sector (see Cortis et al. Chapter 1, this volume; Hill and Wade 2018). On the other hand, following the collapse of ABC Learning at the height of the GFC in 2008, the Rudd government funnelled $56 million to finance the continued operation of the centres until they were purchased by Goodstart, a non-profit consortium (Sumsion 2012: 211). This affair highlighted the ongoing role of the government in managing the risk of failure in the childcare market, given the broader economic consequences and the government's determination to avoid owning childcare services. It also resulted in the proportion of for-profit long-day childcare centres falling, from 88 to 66 per cent in 2009 (Brennan and Fenech 2014).

Back to the 1980s? The Child Care Subsidy

The Abbott and Turnbull Coalition governments (2013–18) enacted sweeping reforms of childcare subsidies to address persistent problems limiting parents' workforce participation (Beutler and Fenech 2018: 20). Tasked with investigating issues confronting the childcare sector and proposing reform, the Productivity Commission (2014: 19–20) found widespread accessibility and affordability issues (estimating 165,000 parents were unable to work longer hours due to the unavailability of suitable child care) and recommended combining the two public subsidies into one to simplify and better target support. In 2015, the

Abbott government responded with the Child Care Assistance Package. This package had three main components to be implemented in 2017 (Beutler and Fenech 2018: 17). First, it replaced the Child Care Benefit and Child Care Tax Rebate with the Child Care Subsidy (CCS), which was paid directly to childcare providers on the basis of the number of hours accessed by enrolled children. Second, it established the Child Care Safety Net, which targeted support to families with an Additional Child Care Subsidy and a program of grants for services in disadvantaged localities. Third, the Nanny Pilot Program trialled subsidising child care provided by nannies in the home. The Turnbull government revised the Child Care Assistance Package into the Jobs for Families Child Care Package in 2017, reducing the scale of the nanny pilot and delaying the introduction of the first and second components until 2018.

The CCS further expanded public support for child care at a cost of $7.7 billion in 2018–19. The subsidy is paid directly to approved childcare providers (removing the option for families with children to claim the benefit directly) to cover a proportion of the hourly fees for eligible families (Frydenberg and Cormann 2019: 5–10). Compared with the two subsidies it replaces, the CCS covers a higher proportion of fees for all but the highest-income earners, with a taper rate gradually reducing from 85 per cent for households earning less than $68,183 to 0 per cent for those on annual incomes of $352,453 or higher. The CCS has also removed the annual cap on the total benefit subsidised for households with incomes up to $188,163 and increased the cap to $10,373 per child for households earning between this amount and $352,453.

Despite expanding public support for families, the CCS is designed to constrain the state's financial liabilities for each unit (hour) of child care provided. It introduces 'hourly rate caps' indexed to the consumer price index (CPI), which sets the maximum hourly childcare fees to which the subsidy applies. In contrast to previous subsidies that were calculated as a percentage of childcare fees, the hourly fee cap places a clear limit on the subsidy the state will pay per hour of child care regardless of its actual cost. Childcare fee increases above the CPI now need to be absorbed by households as growing out-of-pocket expenses. The CCS retains an income test that reduces the percentage of the hourly rate cap that is subsidised for families with higher combined incomes (see Table 8.1). It also sets an annual cap (per child) when families have a combined annual income of more than $188,163 (Services Australia 2021), and it reduces the childcare hours subsidised for some families by increasing the limits of

the activity tests, which are calculated in relation to 'recognised activities' such as paid employment and education. Although these features limit the financial cost to the public purse, the CCS still exposes the childcare market to fee inflation and rent-seeking because it does not impose limits on the user fees private providers charge to families.

While the focus of reforming childcare policy had long been on increasing the workforce participation of parents, the CCS goes further in making receipt of childcare subsidies conditional on parents meeting activity tests.[7] The subsidy halves the amount of subsidised care for parents or primary carers with household incomes of less than $68,163 per annum who undertake less than eight hours per fortnight of approved activities (such as paid or unpaid work, education or training and/or volunteering), from 48 to 24 hours per fortnight. Otherwise, all parents (or primary carers) with household incomes of $68,163 or more are required to undertake at least eight hours of approved activities each fortnight or to fall into a safety-net category to be eligible for between 36 and 100 hours of subsidised child care over the same period.[8] This measure retains the maximum limit of 50 hours of subsidised care per week of the policies it replaces, but this is only available for families in which all parents undertake more than 48 hours (rather than 30 hours) of approved activities each fortnight.

The Abbott and Turnbull governments' reforms continued to expand the state's allocative role in the childcare sector, but the increased conditionality of the CCS has restructured the distributive effects of public support even though most families benefit. The CCS provides most benefit to single-parent families and couples with both parents undertaking more than 48 hours of recognised activities per fortnight in stable employment and with low to medium household incomes, as these groups receive higher discount rates on childcare fees and face no annual cap on benefits (Beutler and Fenech 2018: 18). The CCS has mixed distributive effects for higher-income earners because it increases the annual cap on total benefits and reduces the rate of the fee discount. The CCS reduces the benefits received by families with parents or primary carers that have no

7 The CCS is calculated in relation to the hours of approved activity the parent or primary carer with the fewest hours undertakes, the new hourly fee cap that sets the maximum hourly rate that will be subsidised for different types of child care and their household income.

8 In other words, parents with household incomes of at least $68,163 who do not meet the activity test receive no subsidised care (rather than up to 48 hours per fortnight), while those earning above this amount who undertake activities of up to 16 hours per fortnight can access 12 fewer hours of subsidised care per fortnight (36 hours rather than 48 hours).

or low hours of recognised activities. More concerning, however, is the fact the CCS reduces the benefits for disadvantaged families with low incomes and/or insecure employment with variable hours of work who do not meet the activity tests, including Indigenous Australians (Brennan and Adamson 2015: 12).

The Abbott and Turnbull governments' reforms largely retained the state's limited role in the productive aspect of the childcare market. They did increase the involvement of the state at the margins through the establishment of the Community Child Care Fund—a competitive grant scheme to which private providers could apply for assistance when setting up operations in disadvantaged, regional and/or remote locations (Morrison and Cormann 2016). Since the total amount allocated by the fund is $110 million per annum since 2016, its overall impact on the childcare market has been limited. The Coalition governments' reforms continued the trend of increasing the public subsidies for child care by federal governments over the previous three decades, which ensured the sector remained attractive to private investors and shored up financial ratings agencies' classification of child care as a blue-chip investment. So, despite their significant expenditure in the childcare market, governments' main instruments to influence service delivery remain the accreditation process and the NQF.

There is growing evidence to suggest that in shoring up the appeal of childcare services to private investors, the public subsidies are contributing to rent-seeking. On the one hand, the childcare market is both highly consolidated and highly profitable, particularly in centre-based long day care. In this market segment, large organisations that operate 25 or more services make up only 1 per cent of childcare providers but offer 33 per cent of places (ACECQA 2020). As noted above, commercial childcare providers have been rated as blue-chip investments, with substantial property assets and $992 million in profits during 2016–17 (Hill and Wade 2018). On the other hand, growth in childcare fees continues to outstrip inflation, even as public subsidies rapidly increase. Baxter et al. (2019: 15) estimate childcare fees increased by 3.8 per cent, on average, in real terms each year between 2007 and 2017. More recently, as the government financed a further $543 million to reach a total of $8.1 billion in public subsidies during 2018–19, childcare fees increased by an average of 4.9 per cent (while the CPI rose by 1.9 per cent) in the same year (Morrison and Cormann 2018; Frydenberg and Cormann 2019; DESE 2021).

At the same time, the capacity of the NQF to lift service quality is limited by persistent issues with affordability and accessibility. Affordability has been undermined by rapid fee inflation not absorbed by rises in public subsidies (Hill and Wade 2018). The Melbourne Institute estimated median expenditure per hour of child care rose 51 per cent in real terms for families between 2004 and 2017 (Wilkins et al. 2019: 20).[9] Accessibility remains an issue, even though coverage has increased to 53 per cent of couples and 41 per cent of single-parent families (Wilkins et al. 2019: 11). In addition to cost barriers, the availability of child care remains an issue for families—particularly outside school hours (Hill and Wade 2018).[10] The Australian Bureau of Statistics (2018) estimates additional child care was required for about 373,000 (or 9.3 per cent of) children in 2017. Although non-profit and for-profit services have increased NQF ratings recently, childcare quality concerns are supported by research finding that public (state and local government) and non-profit providers consistently offer higher-quality services than for-profit providers (see Brennan 1998, 2014; Hill and Wade 2018). In 2019, 25 per cent of for-profit private providers across the childcare sector were 'working to meet' the NQF, while only about 14 per cent of non-profit and 9 per cent of public providers received a similar rating (ACECQA 2020).

Conclusions: Policy design and public subsidies for the childcare market

Since the 1980s, Labor and Coalition governments have expanded the scale and scope of public subsidies for the private provision of child care to address persistent accessibility and affordability issues as increasing demand has continued to outstrip growth in the sector. Along with the decision to extend public support to for-profit services, the shift from supply-side to demand-driven subsidies initiated by Labor and continued under the Coalition has received bipartisan support for almost three decades. Yet, the policy instruments selected by the various governments—subsidies, cash benefits, cash rebates and/or tax rebates—have coincided with their distinct policy priorities, varied distributive effects and different levels of susceptibility to rent-seeking. Although not reducing every difference to

9 Baxter et al. (2019: 22) show that 57 per cent of families with an employed parent who do not access child care report they do so because of difficulties meeting costs.

10 Baxter et al. (2019: 51) found half of services had difficulties meeting parent requests for child care outside usual operating hours (before 6am and after 6pm).

the choice of policy instrument, there are clear patterns in the distributive effects of these subsidies and their susceptibility to rent-seeking by private providers that underline how instrument choice has had a bearing on policy design.

The distributive effects of the childcare subsidies have varied according to the position of a policy on the tax expenditure – direct expenditure continuum. Direct expenditure programs such as Child Care Assistance, the Child Care Benefit and the Child Care Subsidy that are highly visible in public accounting processes have had the most equitable benefit structures of the demand-driven public subsidies for families with children for whom all parents are in stable and secure employment. The conditionality of the Abbott–Turnbull governments' Child Care Subsidy, and the activity tests enacted by the Howard government for Child Care Assistance and then the Child Care Benefit, have nevertheless been sources of inequality for disadvantaged families on low incomes with casual, insecure and/or irregular work. As the only tax expenditure that has been used to subsidise child care, the Child Care Tax Rebate was less visible in public accounting processes and has been inequitable because it functioned as a second-tier subsidy that provided most benefit to families on middle to higher incomes who had higher out-of-pocket expenses. Because the rebate was administered via the tax system, lower-income households were unlikely to have high enough tax obligations to receive the full benefit and were more likely to find the delay accessing any benefit via annual tax returns difficult. The distributive effects of the two hybrid policies—the Child Care Cash Rebate and Child Care Rebate—were less inequitable than the tax expenditure, but also benefited households with higher incomes as second-tier policies that covered expenses not covered by existing direct expenditure programs.

The susceptibility of the childcare subsidies to rent-seeking by private providers also differed with the position of a policy instrument on the tax – direct expenditure continuum. Direct expenditure programs that were highly visible, including Child Care Assistance and the Child Care Benefit, had limited exposure to rent-seeking, partly because they were targeted at lower-income households with limited capacity to pay high out-of-pocket costs and disincentives to do so, as well as the annual caps on total benefits.[11] The current Child Care Subsidy is more complicated; although

11 However, to the extent that families reduced or stopped using child care due to disincentives, it is likely to have had other economic consequences such as decreased economic activity due to lower participation rates, particularly among women, and increased gender inequity by reducing women's choices.

hourly fee caps and lower discounts for higher-income households reduce public liabilities, there are few limits on the out-of-pocket payments required of households in a market with inadequate supply.[12] The hybrid policies, including the Child Care Cash Rebate and Child Care Rebate, had the highest susceptibility to rent-seeking of those examined because there were only annual limits placed on the rebates and they were layered on to existing direct expenditures with which they operated in tandem. As a result, fee increases would be partly absorbed by the rebates until the annual limit was reached and higher-income households that benefited most from these programs could more readily absorb any remaining out-of-pocket expenses.[13] The Child Care Tax Rebate tax expenditure had less visibility and seemed most susceptible to rent-seeking as a policy that benefited higher-income earners who had the greatest capacity to pay.

It should be emphasised that my claim is that policy-instrument choice is a factor that has a bearing on the policy design of childcare subsidies but does not determine their specific features. This is because policy design is a political and social process in which the choice of instrument can reflect as well as shape the political preferences of the governments that deploy them. In other words, my claim is not that policy-instrument choice has a uniform bearing on the specific design features of a policy, such as its distributive effects or the potential for rent-seeking. It follows from this that some policy designs are likely to deviate from the features commonly associated with the policy instrument. What my analysis does show, however, is the childcare subsidies that have been delivered via policy instruments with a more equitable structure do not involve clear trade-offs with service quality or efficiency and may have fewer effects on fee inflation than the less-equitable policy instruments.

The lack of clear economic benefits for the childcare market from the series of public subsidies has coincided with what Newberry and Brennan (2013) term the 'radical marketisation' of the sector and the rapid consolidation of for-profit organisations as the dominant service providers. The marketised childcare sector, which has been classified here as a private-power market, has the potential to foster innovation, but it

12 It is too early to assess the longer-term impact of this policy given its recent introduction, particularly as the initial reduction in inflation was followed by substantial fee increases (as noted earlier in the chapter) and the unfolding economic consequences of the Covid-19 pandemic complicate matters.

13 The hourly fee caps that were introduced with the CCS could be incorporated into the design of rebates, but the flat-rate structure of both policies would have less-equitable effects than the CCS.

is also prone to rent-seeking if commercial profit-maximising entities gain too much control over production. Considering the wide range of policy instruments that have been used to subsidise fees in the past three decades, my analysis has provided further evidence of the unsuitability of demand-driven public subsidies to control fees in a market with this structure, especially when the priority has been to constrain the growth of public expenditure rather than ensure service quality or set limits on the out-of-pocket expenses for households that access child care.

Epilogue: Temporary universal child care during a global pandemic

During the writing of this chapter, the temporary measures for child care that were introduced in response to the Covid-19 pandemic both reaffirm the government's central role in the sector and point to potential avenues for reform. The Morrison Coalition government took the unprecedented step of reconfiguring the Child Care Subsidy early in the pandemic, making public financial support to providers during the lockdown conditional on them offering eligible families free child care for three months from April 2020. The reconfigured CCS provided childcare operators with up to half of the fees they received before the pandemic by replacing demand-driven payments with a 'business continuity payment' (Klapdor 2020).[14] At the same time, many private childcare services were also eligible for the temporary JobKeeper benefit that paid $1,500 per fortnight for each eligible employee; to qualify, the turnover of non-profit services had to decline by at least 15 per cent and that for for-profit services had to fall by 30 per cent (Klapdor 2020).

These fiscal stimulus measures reaffirmed the government's central role in managing the risk of failure in the childcare sector. During the early stages of the pandemic, many families unenrolled their children from child care or kept them at home because of health concerns, school closures and/or financial insecurity (Klapdor 2020). Some families who made this choice continued to pay a gap fee to private childcare services to avoid losing their child's place, given the unresolved issues with both accessibility and

14 This was calculated as half the fees families paid (up to hourly rate caps) during the fortnight before 2 March 2020. Similar temporary arrangements were put in place for childcare services during subsequent state-level lockdowns in Victoria and New South Wales.

affordability discussed in this chapter. The childcare sector (like many others) was ill equipped to respond to the financial challenges presented by low attendance and high unenrolment rates, with Early Childhood Australia estimating that 650 childcare services (mostly outside school hours care) had closed by April 2020 (Hurst 2020). In these conditions, the Morrison government's policy response averted market failure, in a similar but distinct way to the Rudd government's response to ABC Learning's failure during the GFC. The government's intervention provided greater certainty for families, workers and providers, as well as avoiding the potential economic impacts that the collapse of the childcare sector would have had during the pandemic and the recovery.

Although clearly responding to the unique circumstances presented by the Covid-19 pandemic, the Morrison government's fiscal stimulus measures for the childcare sector point to potentially promising avenues for future reform. In particular, the temporary changes to the CCS meant families using childcare services received free universal child care (provided activity tests were met) for three months. These changes demonstrated how the 'hourly rate caps' of the CCS and regulatory tools could be employed to require private services to meet conditions that improve equity and reduce potential rent-seeking in return for cash subsidies. There are many possible reform paths here, all of which require careful consideration and further public investment. Incremental reform to the CCS could involve placing a ceiling on the out-of-pocket expenses that private services are allowed to charge families to remain eligible for public subsidies, whereas more ambitious reforms could require services to not charge gap payments to lower-income families and provide incentives to reduce or abolish out-of-pocket expenses for all families.

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