AMERICAN EXPERIMENT

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Dear Members of the Taxes Committee:

My name is Martha Njolomole, and I am an Economist at Center of the American Experiment. I thank you for the opportunity to provide comments on bill SF 0009. While well intentioned, this bill will elongate the state government's tab without doing much to reduce the cost of childcare for parents in Minnesotans. The bill merely transfers expenses to taxpayers, while at the same time potentially raising childcare prices in the state and complicating the tax code.

The childcare crisis is government made

Certainly, parents in Minnesota have trouble accessing affordable high-quality childcare. But this is mainly due to excessive government regulation. Compared to other states, Minnesota has stricter regulations, which raises the cost of providing care, thereby raising prices for parents, making childcare here less affordable than in other states.

Compare Minnesota to South Dakota, for example. While Minnesota requires daycare centers to have 1 teacher per 4 infants and limits group sizes to 8, in South Dakota centers can have 1 teacher per 5 infants with no limits on group sizes. Moreover, in south Dakota, center teachers are only required to be 18, while in Minnesota, they must have a bachelor's degree or equivalent. But even with a bachelor's degree, they must have over a thousand hours of experience in childcare work.

Result? While Minnesota households state median income pay about 22 percent of their income to keep their infant in a licensed center, North Dakota Households with state median income only pay about 12.5 percent of their income. Strict staff-child ratios and group size limits as well as stringent hiring requirements raise the prices of childcare in Minnesota, something which the research evidence agrees on.

A study by the Mercatus Center at George Mason University, for example, found that that reducing the number of infants per staff by one would increase the cost of childcare between 9 and 20 percent. The study also found that "requiring lead teachers to have at least a high school diploma is associated with an increase in childcare costs for infants of between 25 and 46 percent, or between $2,370 and $4,350 per year, per child. The cost of care for 4-yearolds shows a similar effect, with a high school diploma requirement raising costs by between 22 and 40 percent."[1]

[1] Diana W. Thomas and Devon Gorry, "Regulation and the Cost of Child Care," August 2015, Mercatus Working Paper, available at https://www.mercatus.org/system/files/ Thomas-Regulation-Child-Care.pdf

Another study by V. Joseph Hotz and Mo Xiao found that reducing the number of infants per staff by one reduces the number of providers by 10 percent.[2] And a 2004 study by Janet Currie and V. Joseph Hotz also found that low-income kids tend to be priced out of the market due to stringent education requirements, high staff-child ratios, and frequent inspections of facilities. Similarly, a 2004 study by Randall Heeb and Rebecca Kilburn found that reducing the number of children allowed per staff by two for all ages and all states increased the cost of center-based childcare by 12 percent, resulting in eight percent fewer kids in centers and one percent fewer mothers working.[3]

A recent study conducted by the American Experiment also found that if Minnesota were to increase the number of infants that a teacher can take care of by one, the annual cost of center-based infant care would decrease by nearly $3,000. Costs would also decrease if the state were to loosen other rules, like group size limits and teacher hiring qualifications.

Much like rising prices, research has also found that tougher regulations are to blame for low wages in the childcare industry. According to research by David M Blau, regulations lower wages for childcare workers because parents are usually unwilling for the higher prices that come with such tough regulations causing workers to absorb the costs.[4]

Public spending won't solve the crisis

Spending more money on childcare therefore would not reduce the cost of childcare since it does not address the root cause of this crisis — government overregulation. Instead, more public funds will merely transfer the bill on to taxpayers. Additionally, if parents are not paying for any or part of childcare costs, they will demand more of it than before which will raise prices even further, potentially putting a strain on the state budget.

Tax credits are an expense. And Minnesota currently spends more in per capita and inflation adjusted terms than it has ever done at any time in history. Minnesota not only spends highly than it has done in the past, but it also spends more compared to other states. American Experiment estimated that in 2019, for example, Minnesota's total state and local government direct expenditure per capita was $12,800, 14th highest in the United States. Commensurate, Minnesotans paid some of the highest taxes in the country to maintain that spending. In 2019, Minnesotans paid 10 percent of their income in state and local taxes — the sixth highest rate in the country.

Adding more spending to the budget — one that will likely only grow in the future — will only bloat the state budget, and likely necessitate tax hikes in the future in times of recessions when tax revenues are unable to cover spending liabilities.

Tax credits are especially problematic

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[2] V. Joseph Hotz and Mo Xiao, "The Impact of Regulations on the Supply and Quality of Care in Child Care Markets," American Economic Review, Vol.101, No.5 (2011): pp 1775-1805. https://pubs.aeaweb.org/doi/pdfplus/10.1257/ aer.101.5.1775

[3] Randall Heeb and M. Rebecca Kilburn, "The Effects of State Regulations on Childcare Prices and Choices," Rand Corporation Working paper, January 2004, available at https://www.rand.org/content/dam/rand/pubs/working_ papers/2004/RAND_WR137.pdf

[4] David M. Blau, "Unintended Consequences of Child Care Regulations," Journal of Labor economics, Vol.13, No.3 (2007): p. 513-538. https://doi.org/10.1016/j.labeco.2006.01.003

But while spending won't do much to solve the affordable childcare crisis, tax credits are an especially problematic solution to the crisis for numerous reasons.
For one, tax credits do not go to those who need them most — namely low-income parents with young children. This is because low-income parents most often utilize what is referred to as Family, Friend and Neighbor care (FFN). For that reason, they rarely utilize formal care compared to higher-income parents, so they would be behind. While to some extent this might have something to do with lack of affordable options, it is also about preferences.

In their 2021 Home Building Survey, American Compass found that lower-class families — those with less than a college degree and with incomes less than $30,000 — and Working class families — those with no college degree and with incomes below $70,000 — show a higher preference for parental care than another type of care. Asked about their preferred care arrangements, low-class and working-class families would rather one parent stay at home and provide care. Only less than 20 percent of each preferred an arrangement where both parents worked, and children received formal paid care.

In contrast, middle and upper-class families prefer formal paid care to other types of care arrangements. One possible explanation for this preference gap is potentially the fact that most poor mothers work nonstandard schedules, which calls fall for flexible care — something that formal paid care cannot accommodate. But all in all, poorer families simply have lower demand for formal childcare.

Not to mention that about 30 percent of Minnesotans already don't pay income taxes. Expanding tax credits will increase the proportion of Minnesotans not subject to income taxes, making our system even more reliant on the few rich who contribute most income tax revenues. This is an unsustainable arrangement, however, especially considering that Minnesota loses high-income, high-skilled individuals to other states.

Additionally, tax credits also carve out complexities in the tax system that need not be there. While they do reduce the tax burden for some taxpayers, they do so in a distortionary way. They are a way of redistributing income from high-income taxpayers to low-income taxpayers, and not an efficient way to cut taxes, unlike uniform rate cuts across the board.

The Legislature should focus on loosening regulations

Childcare is expensive and hard to find because of excessive regulations. Instead of throwing billions at the problem, the legislature should instead tackle the root cause of the crisis and loosen rules that raise the price of care or make it hard for provider to stay in the market.

Sincerely,

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