"Aging Americans and a Waning Workforce: Demographic Drivers of our Deficit"
Joint Economic Committee, Wednesday, November 15thth 2023

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Summary

The US budget is not age neutral. A person's net contribution to the budget, either through the revenue they contribute via taxes or the outlays they receive via benefits, changes over their lifetime. Were the population steady—all birth cohorts identically sized with the same life expectancy—demographics would have a limited effect on the budget. However, we know that is not the case. Nearly 80 years ago, the US experienced a period of elevated fertility. Today, the US is in a period of depressed fertility.

This testimony approaches demographics and the deficit in the simplest terms: individuals are on average net positive contributors to the government while they are working and on average net negative contributors when they are not.

If one generation is smaller than a preceding one, than the smaller generation must work more to contribute the same amount in taxes. Thus, policy's aim is either to i) create more workers or ii) create same-sized generations. I refer to these in turn as labor supply policy and fertility policy, and urge consideration of both.

In this written testimony, I elaborate on three key points. To start, I discuss the context for labor supply policy and fertility policy, respectively, and end with an overview of what that policy could look like.

1. Labor supply is historically high for prime-age workers, but prime-age workers are a smaller share of the working age population, necessitating the need for labor supply policy.
2. Post-Baby Boom fertility was stable but has been experiencing a15-year decline, necessitating the need for fertility policy.
3. The relationship between demographics and the deficit is moderated by policy, which like labor supply and fertility, must transition.

I discuss numerous policies. These policies vary in the depth of their evidence base as well as their accompanying concerns. Childcare, a policy that sits at the nexus of labor supply and fertility, has a preponderance of both evidence and concerns. I address several of these separately in a FAQ. I have previously discussed several of these policies in testimony before a separate Congressional committee, and this testimony has a high and intentional overlap. For all figures, the source of the figure and the series are listed in the figure notes for ease of replication.

As a labor economist, the policies with which I am most familiar is labor policy. I discuss some fertility policy but stress my accounting is far from exhaustive. A separate policy avenue related to demographics is to minimize the fiscal cost of aging, which I do not address at all.

Table of Contents

Key Point 1: Labor Supply in Transition

The **labor force** is a technical term, not subject to alteration or alternatives, based on the work activity of an individual as reported in surveys. An individual is in the labor force if they are working (employed) or actively looking for work in the most recent four weeks (unemployed).

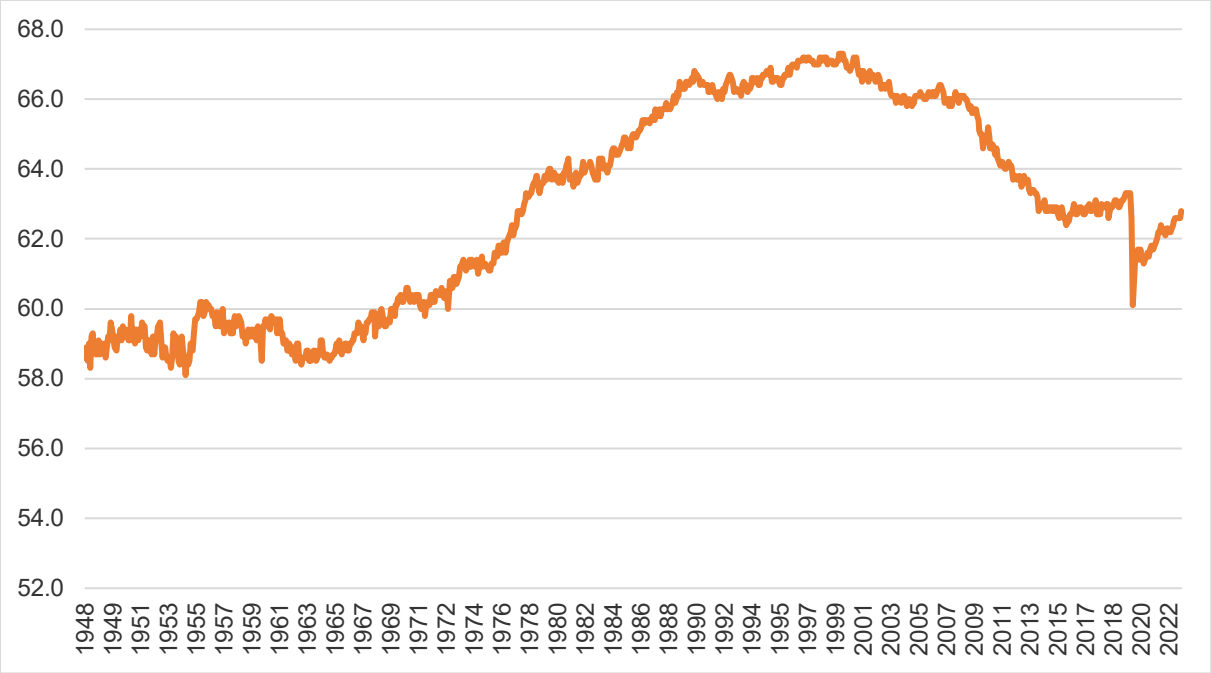
The **labor supply** is a looser term. It refers to the set of people who are willing to supply their labor—who can and want to work.

The labor supply is the pool of potential workers while the labor force is a count of current workers. For policy, labor supply is the target and labor force participation is the measurable outcome.

The Historic Decline In Labor Force Participation

The United States is entering its third decade of declining labor force participation. Since 2000, the overall civilian labor force participation rate—measuring the share of adults 16 and older who are working—fell from a peak of 67.3 to its current level of 62.8. Even though participation has nearly recovered the pandemic-related decline, it is still well below prior levels.

Figure 1. Labor force participation rate, 1948-2023



Source: Bureau of Labor Statistics, Current Population Survey, Series LNS11300000

The civilian labor force *level* is growing, from 142 million in 2000 to 167 million as of last month. The problem isn't fewer workers, but fewer people working as a share of the (growing) population.

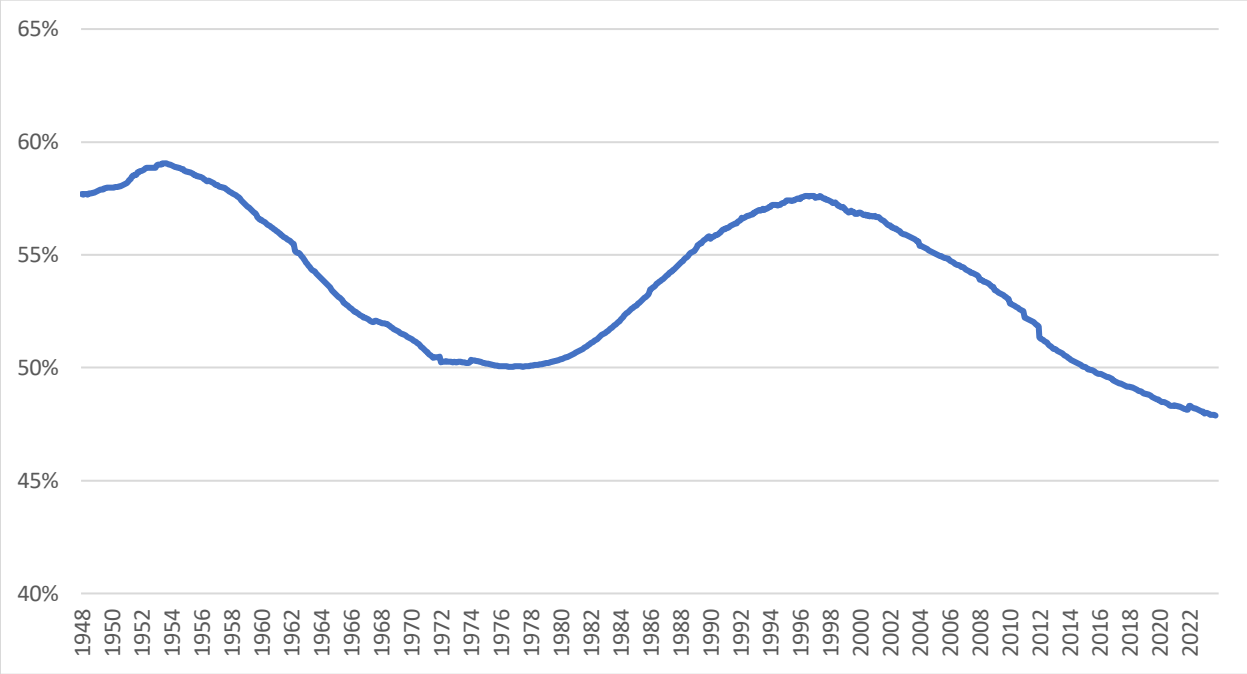
The reason for this is demographic.

Economists refer to ages 25-54 as the "prime-age," the period in which an individual is most likely to be working—schooling is complete and retirements have not begun. The total share of the working-age population (16+) that is prime-age (25-54) has fluctuated with changing patterns in the birth rate.

The Baby Boom was an 18-year period,1946-1964, in which the US experienced elevated birth rates. Individuals born during this time are known as Baby Boomers. They are disproportionately large relative to younger and older birth cohorts and as they aged into adulthood, they increased the number of prime-age individuals in the economy.

For most of the 1970s, about half of the working-age population was in their prime-age. That share grew steadily until 1996, when it peaked at 58%. It has fallen steadily since, falling below 50% in 2015 and continuing to decline to 48%, where it is today.

Figure 2. Prime-age population as a share of working-age population, 1948-2023



Source: Bureau of Labor Statistics Series LNU00000000 LNU00000060

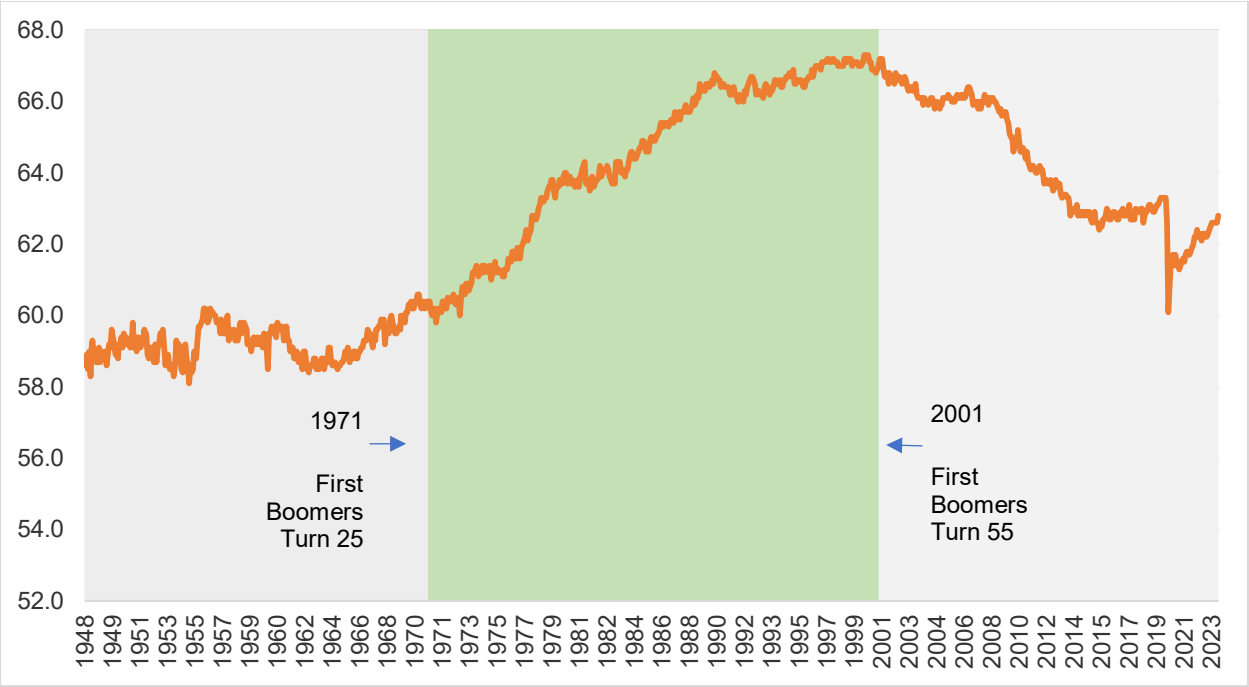
The patterns of labor force participation reflect the trends of prime-age individuals in the population. Consider, the trend in labor force participation has three periods.

- 1948 - 1970 (flat)
- 1971 - 2000 (rising)
- 2001 - 2022 (falling)

These periods correspond to specific ages of the Baby Boom population.

When labor force participation was flat, the Baby Boomers were young. In 1971, the oldest Baby Boomer turned 25 and was followed by nearly 30 years of rising participation as successive years of Baby Boomers entered and stayed in prime age. But in 2001, the oldest Baby Boomer turned 55, leaving the prime age, and successive years of Baby Boomers did as well, pulling down overall labor force participation as they slowly aged out of working.

Figure 3. Labor force participation rate, prime-age era of Baby Boomers, 1948-2023

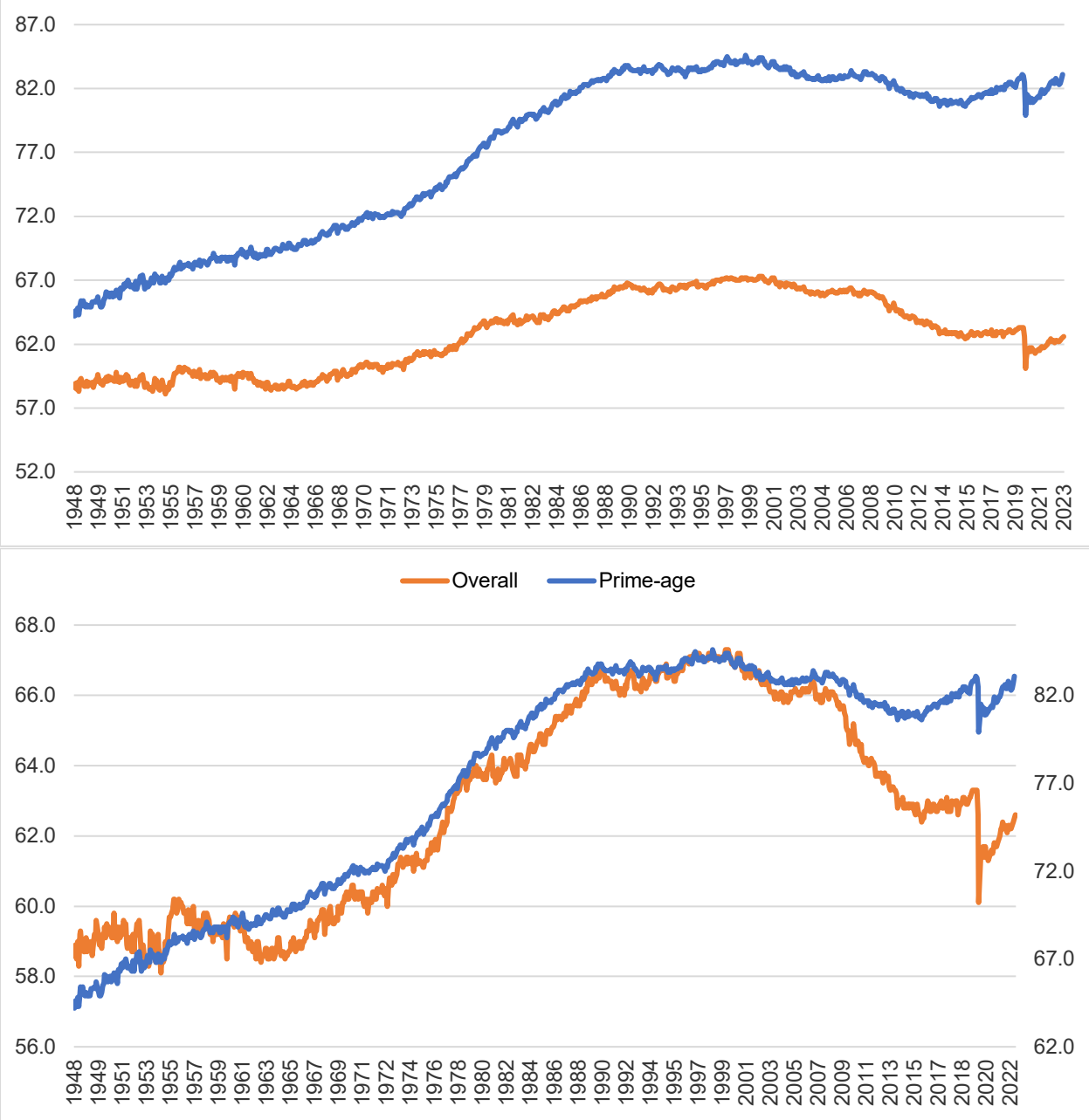


Source: Bureau of Labor Statistics, Current Population Survey, Series LNS11300000

The decline in overall labor force participation is predicted by a disproportionately large group within the population leaving the prime age.

However, it should be noted that that trends *within* prime-age workers are different. Prime-age participation has grown steadily, largely due to women, since 1948. It fell after the Great Recession but since recovered. Prime-age workers are working as much as they ever did, there just aren't as large of a share of the population as they used to be.

Figure 4. Overall (16+) and prime-age (25-54) labor force participation, 1948-2023, shown on single axis (top) and double axes (bottom), 1948-2023



Source: Bureau of Labor Statistics, Current Population Survey, Series LNS11300000 LNS11300060

Put differently: Among prime-age workers—the age group with high labor force participation—the US is at the highest level of labor force participation its even been. But prime-age workers are a smaller share of the population, so overall participation is still declining.

Implications for Policy

These labor force trends have numerous implications for labor supply policy, the name for policy that targets individuals who typically do not work and brings them into the labor force.

First, it explains why the necessity of labor supply policy is a recent phenomenon. Between 1971-2001, the Baby Boomers size and age and the increase in women working led a strong trend in participation that obviated (at least on a macro level) the need for a supply policy.

Second, it explains why the necessity of labor supply policy has been delayed. The need began in 2001, but with a weak business cycle followed by a terrible recession, the structural headwinds to labor supply were dominated by the cyclical ones. However, as the labor market has now made two recoveries that have tended to full employment—the period just before the pandemic and the recovery from the pandemic recession—the structural trend is more apparent.

Third, it makes clear that increases in participation need to come from prime-age workers. Age discrimination against older workers is a problem, and workers who want to work for additional years should be able to do so. But adding a few years of participation to an aging population is not sufficient to buck the trend they leave in their wake.

Labor supply policy cannot fully counter demographics, but it should at the very least take demographics into account.

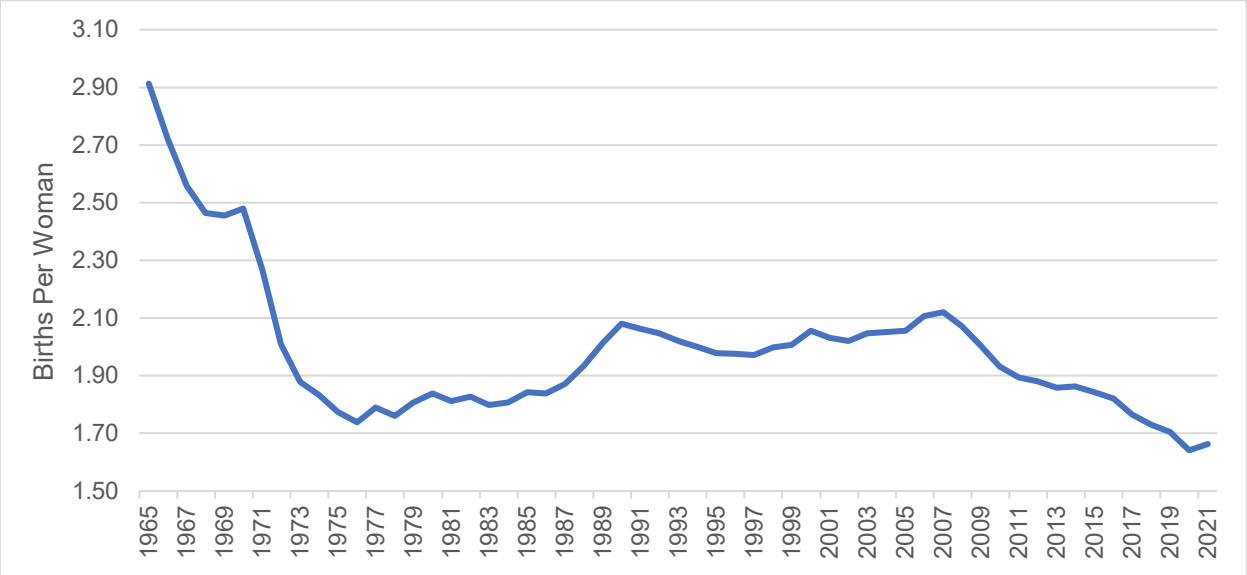
Key Point 2: Fertility in Transition

The Historic Decline In Fertility

Following the Baby Boom of 1946-1964, fertility in the US fluctuated from 1.7 to 2.1 children per woman. However, since 2007, the fertility rate has been on a 15-year sustained decline. Part of this is due to the Great Recession, as fertility often falls when the economy is weak, but even as the labor market recovered, fertility did not. 2021 recorded the lowest fertility rate in over 80 years, at 1.64 births per woman.

(This decline is similar when measured in terms of total births per 1000 women in a given year, which fell from a post-Baby Boom average of 68 births per 1000 women per year to 56 in 2022.)

Figure 5. Number of births per woman, post-Baby Boom, 1965-2022



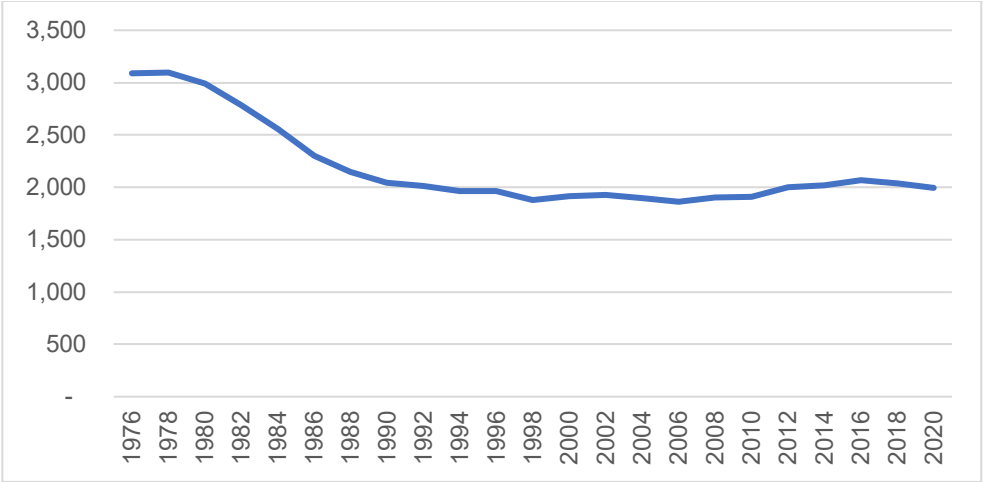
Source: World Bank

The decline in fertility since 1965 is attributed to numerous causes, and the decline since 2007 to those causes and others. No one factor explains changes in fertility on its own, and many factors can explain part of the story, at least part of the time. For example, a reason for the drop in fertility through the 1970s and 1980s was a falling teen birth rate. But by 2007, the teen birth rate was already low and does not explain the subsequent decline as much.

Nor is the post-2007 decline irreversible. Fertility intentions—the number of children that women say they want to have—have changed much less than fertility itself. Some of the current decline may in fact be a delay. This notion is supported intuitively by a few data points.

First, measures of cumulative fertility are more stable than measures of current fertility. Since 1990, the number of children ever born per 1,000 women age 40-44 has averaged around 2,000. This statistic looks at successive cohorts of women who are in their early 40s and counts the total number of children they. That measure has not seen the same decline found in counts of births in a given year.

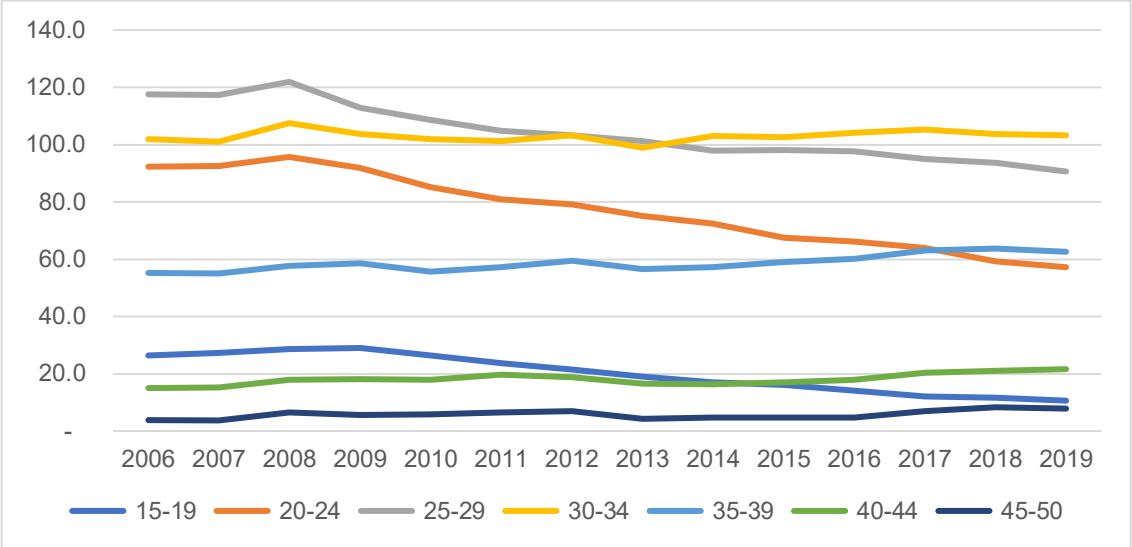
Figure 6. Number of Children Ever Born per 1,000 Women Age 40-44, Select Years 1976-2020



Source: U.S. Census Bureau Fertility Historical Time Series, Table H2.

Second, current fertility trends vary by age group. Fertility is declining for women in their 20s, flat for women in their early 30s, and increasing for women in their late 30s and early 40s. Women of older ages are having more children, supporting the narrative of delayed fertility.

Figure 7. Births in the Last 12 Months per 1,000 Women, by Age, 2006-2019



Source: U.S. Census Bureau Fertility Historical Time Series, Table H3.

Finally, a delay in childbearing is in line with other milestones, including marriage and homeownership, that are also happening later than is historically typical for young people today.

Whether it is an intended delay or a permanent deferral, evidence is emerging that over the past 15 years the decline in fertility is partly driven by economic constraints—families want children, but are not necessarily financially stable enough to have them, or would like more children, but do not think they can afford to have them.

Some of the economic constraints are easily identified. Parents report consistently in surveys that they cannot afford to have more children, even though they would like to. For its 2021 annual report, for

example, American Compass found that roughly half of American families did not meet their desired fertility and, for lower-, working-, and middle-class respondents, a third stated the reason was cost. A separate poll in *The New York Times* broke out the reasons for not having additional children into more detail, allowing parents to select multiple options. By far, the reason most cited for not having more children was: "child care is too expensive," selected by 64% of parents.

Some of the economic constraints are harder to define. Confidence in economic status is important to fertility behavior—encapsulating not just the economic security of parents but the economic security they feel they can provide to children—but there is no single indicator of it.

The 21st century is an economic era marked with uncertainty and lack of success for many. Researchers attempting to estimate the economic status of children relative to their parents have found that just half of individuals born in the 1980s were doing better than their parents by age 30, compared to 80 or 90 percent doing better in generations prior.

Since January 2000, the US labor market has been in a "recession jobs deficit"—when the labor market is recovering from a recession and has fewer jobs than when the recession started—in 57% of all months. The majority of the time, the US labor market has been playing catch up. Many younger workers felt that catch up through reduced job opportunities and slow wage growth during their formative early work years.

Table 1. Ages of Young Workers during the Three Most Recent Recessions and their Labor Market Recoveries

Birth Year	**Current Age**	**2001 Recession Ages** *Dot Com bubble – 46 months for labor market to recover*	**2007 Recession Ages** *Housing bubble, housing crisis, financial crisis – 77 months for labor market to recover*	**2020 Recession Ages** *Pandemic – 30 months for labor market to recover*
1978	45	23-27	29-35	42-44
1983	40	18-22	24-30	37-39
1988	35	13-17	19-25	32-34
1993	30	8-12	14-20	27-29

Source: Author's calculations.

The current decline in fertility is not a function of a radically changed attitude towards having children; the vast majority of Americans either have, or want, children. Some type of hesitation, concern, or constraint is at work that delays or defers fertility. There is no single cause or narrative as to what that is, but evidence points to economic factors as being a significant contributor.

Implications for Policy

Fertility policy does not need to change preferences, but circumstances. Although there are numerous other factors that determine fertility, such as finding a partner, the economics of having a child are an appropriate policy target. Not only are they supported by evidence to be a cause for fertility's decline, much of fertility's economics—from the direct cost of children to the economic security of parents—have clear targets for policy intervention and reasonably malleable outcomes.

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Key Point 3: Policy in Transition

Demographics and the Deficit

The question at issue in this hearing is the relationship between demographics and the deficit. In some ways, this framing is mismatched. Demographics concern the very long-term changes in our population, spanning births to deaths, that manifest over decades. The deficit, on the other hand, is an annual calculation.

Yet, the US budget is not age neutral. A person's net contribution to the budget, either through the revenue they contribute via taxes or the outlays they receive via benefits, changes over their lifetime. Were the population steady—all birth cohorts identically sized with the same life expectancy—demographics would have a limited effect on the budget. However, we know that is not the case. Demographics have shifted over the past 80 years, meaning that demographics move the budget and, by extension, the deficit.

This testimony approaches demographics and the deficit in the simplest terms: individuals are on average net positive contributors to the government while they are working and on average net negative contributors when they are not. Rather than identifying specific deficit effects, this simple approach is also more wholistic, thinking about the direction of demographics and the budget rather than the degree.

If one generation is smaller than a preceding one, than the smaller generation must work more to contribute the same amount in taxes. Thus, policy's aim in this case is either to i) create more workers or ii) create same-sized generations. I refer to these, respectively, as labor supply policy and fertility policy.

In the subsequent sections I make recommendations in these areas, with this caveat:

As a labor economist, I can speak with expertise on labor supply policy. And because one key economic cost to having children—and therefore a contributor to fertility declines—is the fall in wages and difficulty in maintaining employment experienced by mothers, I can also speak to some aspects of fertility policy. However, the policies I discuss should not be considered exhaustive of a comprehensive fertility policy. Similarly, I do not discuss the spending side of demographics. Aging, and the management of health spending on the elderly population, is the other half to my simple assessment of the relationship between demographics and deficits. But, there is an overlap between aging policy and labor supply policy: one cost of aging is the loss to the labor market of adult children who stop work to take care of sick or dying parents. I discuss these workers as part of labor supply policy.

Labor Supply Policy

Prime-age labor force participation is at a historic high; for the most part, people who can work are working. To increase the number of workers, policy must target people who can't work, who do not typically or frequently supply their labor, who are often not considered workers.

There are myriad ways to increase the number of workers and endless potential policies. From an effectiveness perspective, a labor supply's policy salience is the degree to which those non-workers can be successfully drawn into work. From the budget's (or deficit's) perspective, the key aspect of a worker is how long they work, to maximize their time as a net contributor and minimize their time as a net receiver. This is the best "bang for the buck" labor policy. Policy should thus prioritize individuals who 1) are most likely to come back to work and 2) will work for a long time.

In a word: dropouts. Individuals who used to work, but because of some experience (either acute or chronic), no longer do so. This type of labor supply policy is also called retention policy or attachment policy: keeping workers in the labor force through periods in which they are most likely to leave.

Those experiences are:

- Job elimination – different from losing a job due to cyclical economic conditions, an individual's occupation is greatly reduced or eliminated from the economy, often due to technological progress.
- Health shock to self – a severe health issue, either acute or chronic, causes a worker to leave or lose their job, either because they need to address their health needs or, because of the change to their health condition, they can no longer work in their prior job or any job.
- Health shock to family member – a severe health issue, either acute or chronic, of a partner, parent, or child, causes a worker to leave or lose their job in order to caregive for their family member.
- Incarceration and/or criminal record – an individual with a criminal record who has served time (if application) is unable to find work.
- Having a child – a parent, often the mother, stops working after she has a child.

These experiences are not identical in how they result in a permanent exit from working. It could be that the exit happens immediately, it could be that the exit is after a prolonged period of unemployment following the experience, it could that the experience causes a preference to leave, it could be that the experience creates a constraint that prevents staying.

The table presents policy that could address retention in each instance.

Table 2. Summary of Retention Policy by Instigation of Dropping Out

Instigation of dropping out	Retention policy
Job elimination	A **long-term unemployment and retraining program** for job losers that helps them transition occupations after a long period of unsuccessful search. This may include: - Job search counseling - Relocation assistance - Long-term raining support - Cash benefits and access to services
Health shock to self	A **paid medical leave** program that provides the worker with a share of their typical pay for absences up to a certain length (sometimes called short-term disability). A **job protection** program that prevents them from losing their job (with more coverage than the current protections of FMLA). A **job search credit** if they do lose or leave their job and want to rejoin the workforce. **Accommodation** on the job for a medical condition or disability: - Paid sick days - The right to work part-time - The right to flexible work arrangements (concerning scheduling and remote policy)
Health shock to family member	A **paid family leave** program that provides the worker with a share of their typical pay for absences up to a certain length.

	A **job protection** program that prevents them from losing their job (with more coverage than the current protections of FMLA). A **job search credit** if they do lose or leave their job and want to rejoin the workforce. **Accommodation** on the job for continued caregiving needs: - Paid sick days - The right to work part-time - The right to flexible work arrangements (concerning scheduling and remote policy)
Incarceration and/or felony conviction	A **long-term unemployment and retraining program** for job losers that helps them transition occupations after a long period of unsuccessful search. This may include: - Job search counseling - Relocation assistance - Long-term raining support - Cash benefits and access to services **Records** clearing process.
Having a child	A **paid family leave** program that provides the worker with a share of their typical pay for absences up to a certain length. A **job protection** program that prevents them from losing their job (with more coverage than the current protections of FMLA). A **job search credit** if they do lose or leave their job and want to rejoin the workforce. **Accommodation** on the job for continued caregiving needs: - Paid sick days - The right to work part-time - The right to flexible work arrangements (concerning scheduling and remote policy) Affordable, accessible, high-quality **childcare** through age 5.

Several of these policies are duplicative; what would help one group retain labor force attachment would likely help other workers outside of it experiencing a completely different reason for separation. There is room for very tailored policy. To start, however, the labor market needs the basic infrastructure of retention, comprising:

- Job protection
- Accommodation policy
- Paid medical leave
- Paid family leave
- A long-term unemployment and retraining program
- Job search credit
- Childcare
- Records clearing

The evidence in support of these policies being successful is varied, primarily because the US lacks them on a national level. Affordable and accessible childcare (discussed at length in the FAQ) has a large evidence base that supports the conclusion that it increases the labor force participation. Paid sick days' support is smaller though consistent. A long-term unemployment and retraining program has little precedent (aside from Trade Adjustment Assistance) in the US, neither does a job search credit.

But this is a new era in policy for a truly challenging demographic transition and the policy response cannot be limited to *only* those tried and tested before.

That is especially true in the case of fertility policy.

Fertility Policy

It would be remiss in any discussion of fertility, even if I cannot speak with expertise on health or medical policy, to fail to bring up maternal mortality. The risk of childbirth is growing sharply and last year reached the highest levels since 1965. Maternal mortality was 32.9 deaths per 100,000 live births in 2021, up from 17.4 in 2018. Since 2000, maternal mortality in the US has risen 78%, while it has been falling in most other countries. It is 3-10 times higher here than in peer countries in Europe. This is an emergency.

On to fertility policy.

Policy aimed at reducing the economic constraints that may curtail fertility has two targets. The first is reducing the financial cost of childbirth—having a kid is expensive. The second is reducing the labor market cost of children—having a kid can make it difficult to maintain employment and even if maintained can greatly reduce earnings.

Out-of-Pocket Cost of Childbirth

The cost of childbirth is high. The average out-of-pocket costs for pregnancy and delivery for a woman with private health insurance is $2,854; is slightly less if the pregnancy resulted in a vaginal delivery and slightly more if it was c-section. This does not include out-of-pocket spending on fertility care or assisted reproduction, which affects 1 in 5 women trying to get pregnant, but which is not required to be covered by health insurance in all states, and even ten years ago was estimated to be upwards of $16,000 per transfer. If she does not have paid family leave through her state or her employer, a delivering mother will also lose income until she returns to work, if she chooses to do so. If she is not covered by the Family Medical Leave Act, she could lose her job altogether.

Labor Market Cost of Children

Work, and a mother's interaction with the labor market, is permanently altered after having a child. The "child penalty," or the amount wages are reduced after having a child, is estimated to be a 20-30% reduction in *lifetime* earnings. Part of this reflects constraints and barriers. Employers are not required to make accommodations to the schedules or work situations of new mothers. There is little public investment in childcare, which rivals college tuition and mortgages in costs and has limited availability. In order to work around these difficulties, mothers may change their job, their career trajectory, or opt to leave the labor force altogether.

Part of the change to labor market outcomes of mothers also reflect changing preferences after having a child, like wanting to work less, wanting a less competitive or demanding job, wanting more flexibility. But it should be stressed, those preferences are at least in part a function of the constraints and barriers currently in place. A woman may not want to work after having a child. Or, a woman may be open to working after having a child, but find it so difficult, they prefer to opt out.

The table presents policy that could address fertility-related costs by type of cost.

Table 2. Summary of Cost-Related Fertility Policy by Type of Cost

Area	Policy
Health costs	**Eliminate all out-of-pocket costs** for pregnancy, delivery, and postpartum care. Require complete **coverage of infertility**. Expand coverage to **visiting nurse** programs.
Lost earnings	A **paid medical leave** program that provides the worker with a share of their typical pay for absences up to a certain length (sometimes called short-term disability). A **paid family leave** program that provides the worker with a share of their typical pay for absences up to a certain length. A **job protection** program that prevents them from losing their job (with more coverage than the current protections of FMLA).
Lost labor force participation	A **job search credit** if they do lose or leave their job and want to rejoin the workforce. **Accommodation** on the job for continued caregiving needs: - Paid sick days - The right to work part-time - The right to flexible work arrangements (concerning scheduling and remote policy) Affordable, accessible, high-quality **childcare** through age 5.

Because one key cost of children is the affect being a mother has on women's career and earnings, labor supply directed towards mothers is very similar to the fertility policy directed to labor market costs.

Again, there is room for much more tailored fertility policy (and medical and health policy, which I do not discuss at all). But like labor supply policy, policy changing some of the infrastructure around fertility can have broad benefits. That infrastructure includes:

- Elimination of out-of-pocket costs
- Infertility coverage
- Visiting nurse
- Paid medical leave
- Paid family leave
- Job protection
- Job search credit
- Accommodation policy
- Childcare

The other economic factor in fertility is economic security and confidence, a much more inchoate concept and therefore more difficult policy target. I do not suggest policy here mainly for brevity; building the economic security of a generation is a topic beyond the scope of the issue of demographics and deficit.

The Base

The policies I have presented here I do not claim to be exhaustive or comprehensive of mitigating large demographic influences on the budget or, within that, generating sufficient labor supply or increasing fertility to replacement levels. I would describe what I discuss here as the base—the policy necessary to support demographic transitions but not completely answer them. Not for nothing did labor supply policy and fertility policy have overlaps: paid medical leave, paid family leave, job protection, job search credit, accommodation policy, and childcare.

As mentioned previously, childcare is among the more effective but controversial policies listed, and the remainder of the testimony is organized as an FAQ to discuss it.

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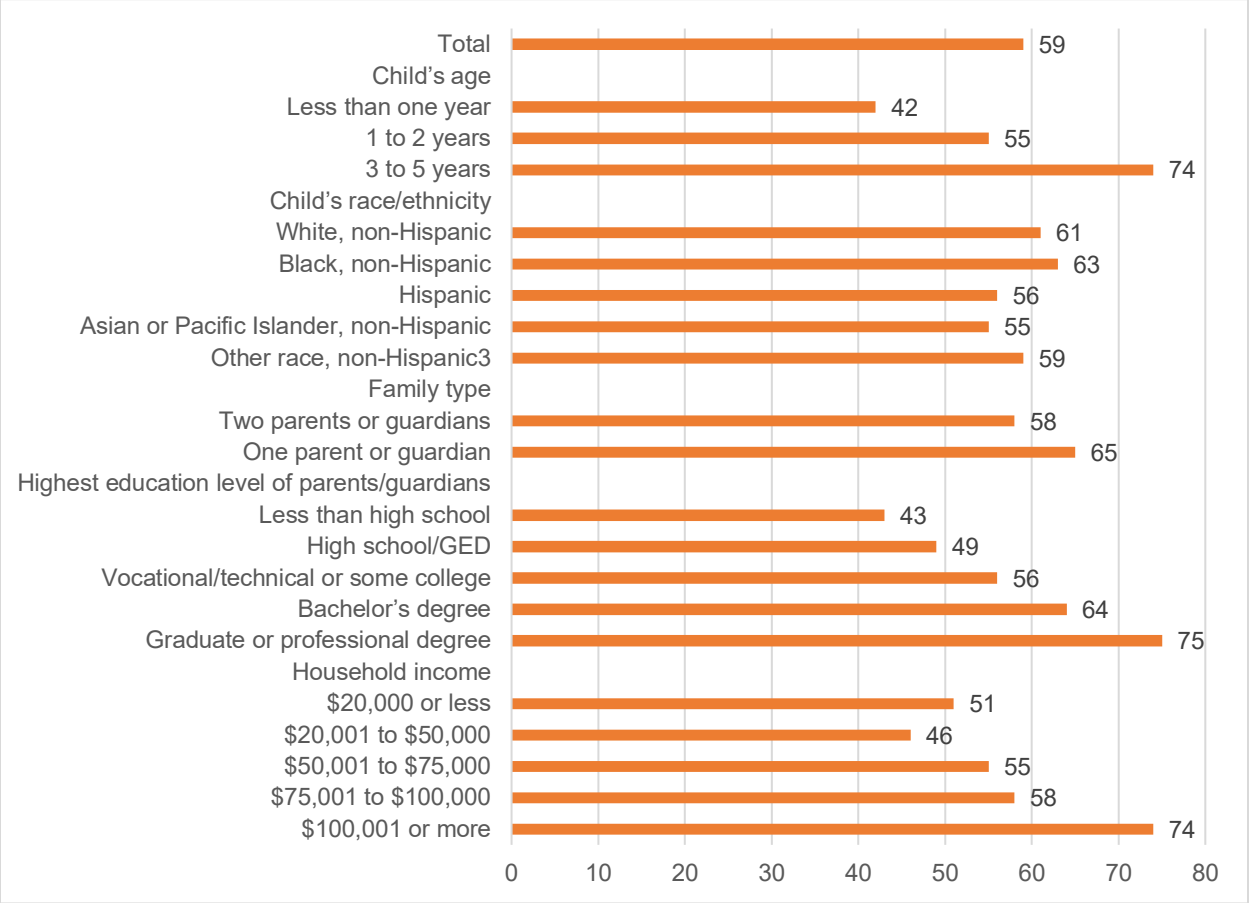
FAQ 1 Why does childcare require policy intervention?

The paid, private provision of childcare in the United States comprises center-based and home-based providers who follow local regulation as to staffing and safety (e.g. the ratio of staff to children under care by age). In addition, many children are also cared for in informal arrangements, such as with a nonparental family member or friend.

The National Center for Education Statistics estimates that in 2019, the most recent year of data, 12.5 million children who were i) age five and under and ii) not yet in kindergarten were regularly cared for by a nonparent, representing 59% of children. This share ranged from 42% of children under 1 to 74% of children 3-5. The use of nonparental care increases with parents' education and income.

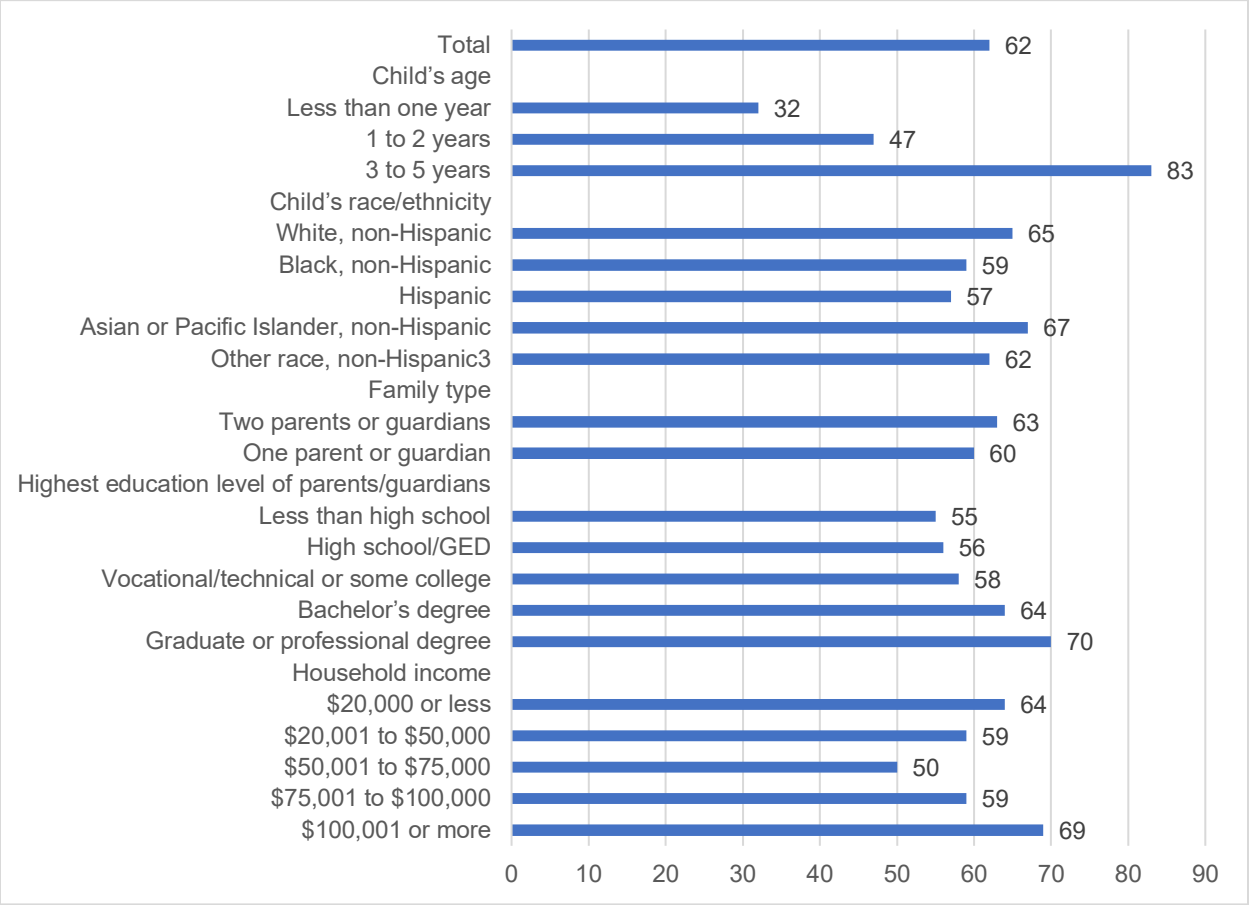
Figure 8. Share of children participating in weekly nonparental care arrangements (from birth through age 5, not yet in kindergarten), 2019



Source: U.S. Department of Education, National Center for Education Statistics. (2021). Early Childhood Program Participation: 2019 (NCES 2020-075REV), Table 1.

Of those in nonparental care arrangements, the majority—62%—are in center-based care. Again, this increases with the age of the child, from 32% of children under 1 to 83% of children 3-5, and increases slightly, though less dramatically, by parents' education. By parents' income, on the other hand, the share of children in center-based care is highest amongst the poorest (64% for parents with $20,000 or less in income) and richest (69% for parents with more than $100,000 in income). This dip for middle-income households likely reflects that they are earning too much money for a subsidy, but not enough to afford care.

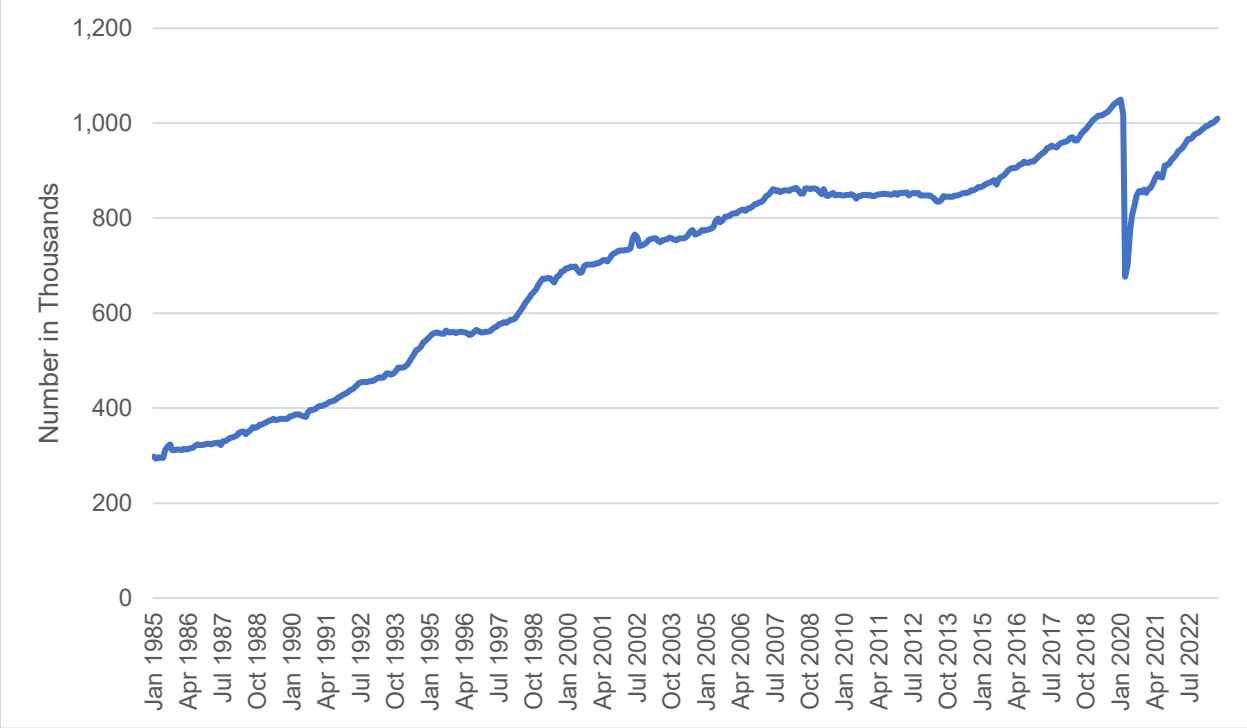
Figure 9. Share of children in weekly nonparental care arrangements in center-based care (from birth through age 5, not yet in kindergarten), 2019



Source: U.S. Department of Education, National Center for Education Statistics. (2021). Early Childhood Program Participation: 2019 (NCES 2020-075REV), Table 1

The childcare sector employed about a million workers as of August 2023, nearly recovering it's prior, pre-pandemic employment peak. The pandemic hit childcare hard. The sector shed 34% of total employment—one in three jobs—in the first month of the pandemic.

Figure 10. Total employment in the childcare sector, 1985-2023



Source: Bureau of Labor Statistics, Current Establishment Survey, series CES6562440001.

Those workers are not well compensated. According to the Bureau of Labor Statistics' Occupational Employment and Wage Statistics, the median childcare worker earned $14.49 an hour in 2022, for an annual income of $30,140. For reference, that is about the median hourly wage and income for:

- waiters and waitresses ($14.00 and $29,120),
- maids and housecleaners ($14.40 and $29,960),
- dishwashers ($13.98 and $29,080), and
- fast food and counter workers ($13.43 and $27,930).

It is about half what a kindergarten teacher makes ($60,490).

What Makes a Market Failure

A market failure has no single definition, marker, or indicator. It describes a situation in which the market fails to efficiently deliver a good or service. Childcare exhibits four features of market failure.

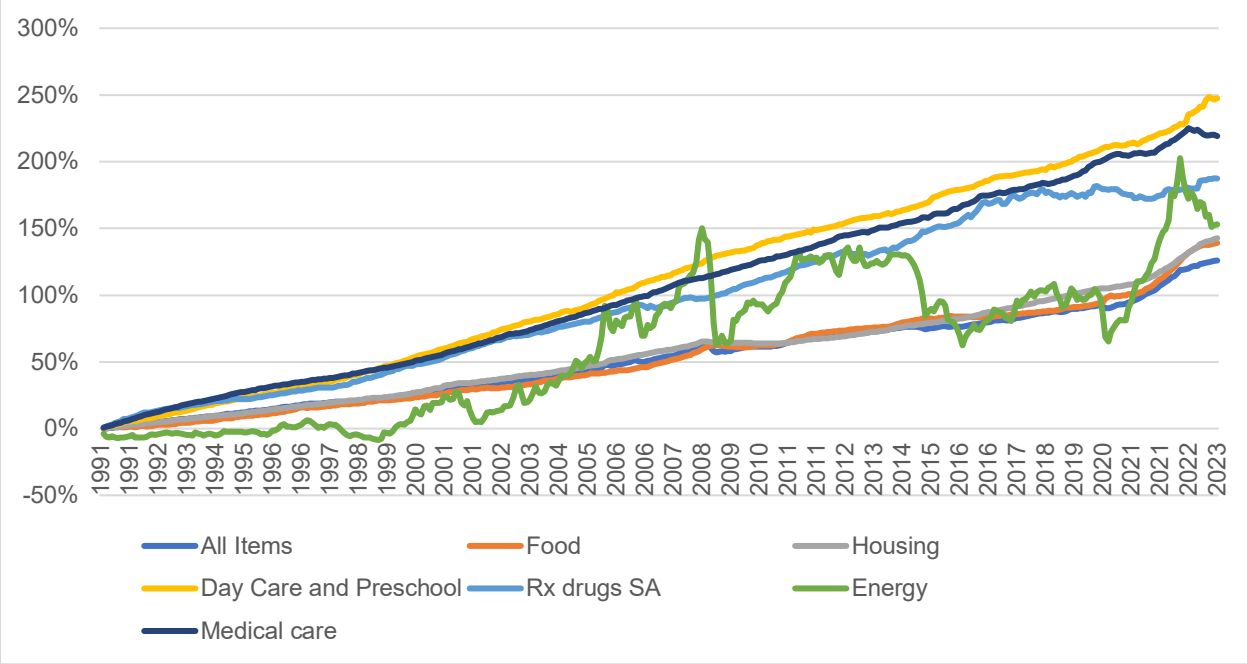
First, it is expensive and has seen unsustainable price increases. According to Child Care Aware of America, the average price of care was $10,853 in 2022. Relative to other household expenses, childcare for two children is higher than:

- Average mortgage payments in 41 states and DC (1-53% higher),
- Average rent payments in all 50 states and DC (24-100% higher),
- In-state university tuition in 32 states and DC (0-100% higher).

Care.com, in their annual Cost of Care report in which they survey parents about care spending and pricing, report that families spend on average 27% of their income on childcare expenses. 59% of families report that they spend at least $18,000 a year on care per child. Further, they report childcare costs have increased 80% in the ten years they've been tracking the data.

Indeed, childcare is notable not only for its high cost but also its variable cost based on the age of the children and the city in which care is sought. The Department of Labor's National Database for Childcare Prices notes that the median cost for infant care is $5,800 for a home-based provider in a small city of fewer than 100,000 people, but $15,500 for center-based provider in a city of more than 1,000,000.

Figure 11. Percent change in price index of Day Care and Preschool and select goods and service since 1991



Source: Bureau of Labor Statistics, Consumer Price Index, series CUSR0000SA0 CUSR0000SAF1 CUSR0000SAH CUSR0000SEEB03 CUSR0000SEMF01 CUSR0000SA0E CUSR0000SAM.

The Bureau of Labor Statistics, which tracks prices in the economy through its Consumer Price Index, has produced an index for "day care and preschool" since 1991. By their measure, the price of day care and preschool has increased faster than food, housing, energy, medical care, and prescription drugs in that time. On average, the price of day care and preschool increased 3.9% a year and in total increased 248%, compared to 2.5% a year for prices overall and a 126% total increase.

The second feature of market failure exhibited by childcare is that it is inadequately supplied.

The supply of care relative to demand is very difficult to estimate. Care comes in many forms, from center-based case and licensed home-based care (often grouped together as paid care), to informal friend and family care that is unpaid. Families that cannot afford or find one can switch to another. Families that cannot find either paid or unpaid may have a worker leave the labor force. Hence, there is no constant or measurable pool of unmet demand.

Before the pandemic, the Center for American Progress estimated that half the country lives in a 'childcare desert' where there are too few licensed providers relative to the number of children in a geographic area: more than three children for every available licensed spot. A separate research group at the University of Minnesota employed a different methodology, where they used driving distance to a childcare provider rather than geographic distance, and found families have even fewer care options than the 'desert' estimate suggests, though their work was limited to Minnesota.

The pandemic saw the closure of many paid providers. The number of center-based providers has recovered, but the number of home-based providers has not, declining 11% since 2019. However, for neither type of paid provider are there consistent estimates of the totally number of spots they offer.

An effective measure for estimating unmet demand would be an analysis of waiting lists—providers who are full and no longer accepting new enrollment add waiting children to a ranked list that are offered spots as they open. However, there is no centralized record keeping of the size of lists. A survey from the National Association of Educators of Young Children (NAEYC) reported that 38% of waiting lists have gotten longer in the pandemic. A company that makes waiting list software told a news outlet that the lists they manage have grown from 185 kids on average before the pandemic to 236 in early 2023.

Yet, there is little prospect for the industry to generate sufficient supply. Over the long term, the childcare services industry (NAICS code 6244) has evinced troubling signs. Its establishment entry rate, which measures the number of new firms as a share of existing firms, used to be higher than its parent industry, health care and social assistance (NAICS code 62). They are now on par. At the same time, the exit rate, which is exiting establishments as a share of existing firms, in child care services is and has consistently been higher than its parent industry. This suggests that was once an industry of churn is now tending towards decline. These trends are based on the latest data available, which has not been updated in the pandemic.

Figure 12a. Entry rate of establishments into Health Care and Social Assistance industry (NAICS 62) and Child Care services subindustry (NAICS 6244), 1978-2020

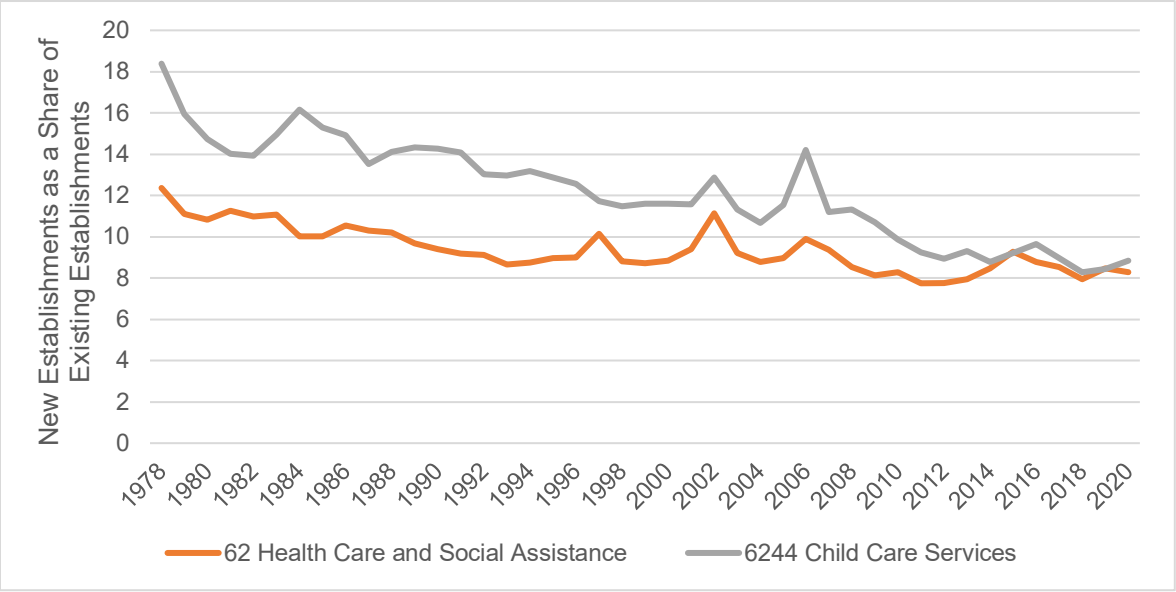
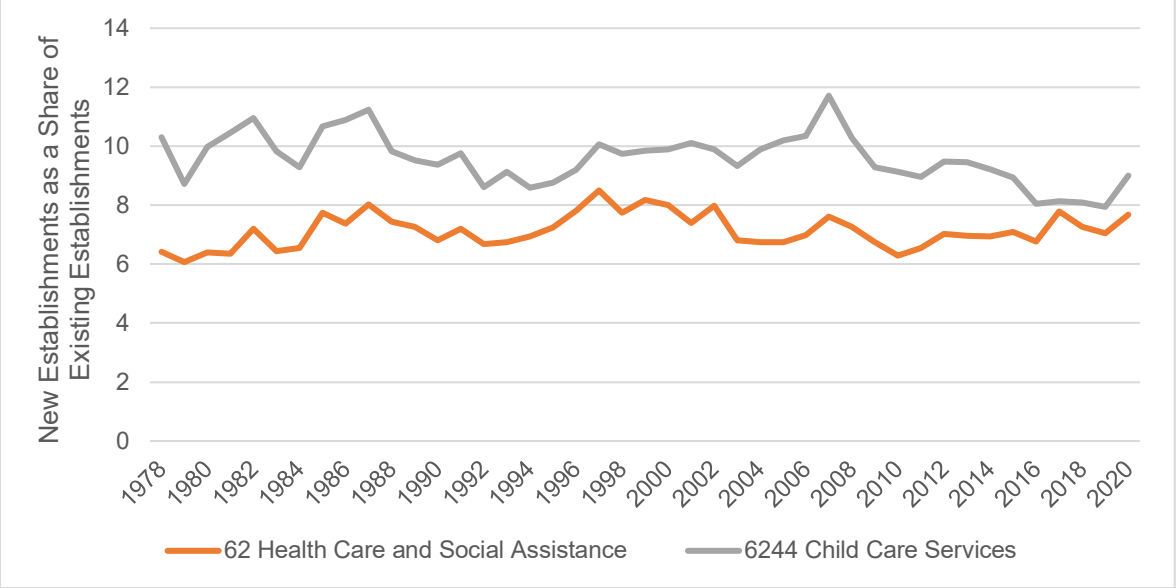


Figure 12b. Exit rate of establishments into Health Care and Social Assistance industry (NAICS 62) and Child Care services subindustry (NAICS 6244), 1978-2020



Source: U.S. Census Bureau, Business Dynamics Statistics.

Childcare is not a lucrative business; profit margins are small and the largest and majority expense is staff salary. Most establishments in the industry are small. Of the for-profit chains, the largest ten serve just 6% of the total childcare market.

The third feature of market failure exhibited by childcare is that it has almost no capacity for market-based improvement.

The delivery of goods and services mostly evolves over time through market innovations. These can come in the form of technology, in production efficiency, in a return to scaling, or a combination of the three. Classic examples are the invention of the steam engine, the assembly line, or the rapid expansion of fast-food chains.

Those solutions are not applicable to childcare, which has seen little market evolution. Very young children require the eyes, hands, and attention of a capable adult. They can share that adult attention, but only up to a point. There is no technological substitute, no process malleable to efficiency gains, and no room to scale without dramatic reductions in quality or safety.

There is no innovation coming that will suddenly increase supply or decrease cost. The implication of which is that the childcare market can only deteriorate further.

The fourth feature of market failure exhibited by childcare is that its provision does not reflect its immediate economic value: it enables the labor supply of parents. Nor does it reflect its long-term value: high-quality early childhood education is enormously beneficial to children in both childhood and well into adulthood.

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FAQ 2 Does childcare actually increase labor supply?

Throughout the narrative, I state as fact that childcare reductions would reduce labor supply. This is a logical conclusion—a person cannot work and care at the same time. Therefore, care enables work.

However, it is also a consistent finding from studies of childcare policy and markets. In general, the introduction of any program or school that provides children a safe and affordable environment between 8:30am-5:30pm has been shown to increase maternal labor force participation and long-run earnings. Logically, care enables a parent to work. In practice, care enables mothers to work.

Since the US does not have substantive childcare investments, evidence on maternal labor supply often comes from other countries, where the provision of care has expanded while the cost to families has fallen. However, within the US there are instances of expanded care, such as the introduction of kindergarten and current childcare subsidies for very low-income families.

Results are consistent, care increases maternal labor supply while the lack of care reduces it. Additionally, research confirms that mothers leaving the labor force experience long-term consequences. Any absence from the labor force reduces the probably of participation in the future. Even if mothers return to work, they likely have lower earnings than they would have if they never left and are unlikely to recover them. The longer the gap, the less likely future participation and the bigger the earnings effect.

The topic of debate is less *if* maternal labor supply would increase if childcare was affordable and accessible in the US, but more *how much* it would increase by. Looking at the suite of childcare and labor policies in other countries and mapping them on to the US context, one prediction is for women's overall labor force participation to be 6-7 percentage points higher. Predictively modeling of a fully subsidized childcare system found maternal labor supply to increase by a similar degree.

Studies that rely less on theory or prediction are those that relate the observed decline of maternal labor supply to the observed increase in childcare prices in an elasticity. They suggest at 10% decrease in childcare prices would result in a 2.5% increase in maternal employment.

Together, this puts the range of mothers who would be working if care were affordable or accessible at several million.

There are select cases in which care or schooling has expanded and maternal labor supply did not expand, and cases where care or schooling expanded and maternal labor supply did not expand by the degree predicted. However, there has never been a decline in care coupled with an increase in supply. Circumstances—such as the timing, quality, reach, or generosity of the childcare expansion—may make the labor supply increase smaller or negligible. But a reduction in care would reduce labor supply.

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FAQ 3 Is childcare good for children?

High quality early childhood education (ECE) is enormously beneficial for children and has shown to improve a variety of short- and long-term outcomes, including:

- Cognitive development,
- Test scores through high school,
- Need for remedial education,
- Need for grade retention,
- High school graduation rates,
- Earnings and employment in adulthood.

The results tend to be largest for those from middle- and low-income families. Investments in ECE that are universal or near universal have been shown to increase earnings at the bottom and middle of the income distribution when those children become wage earning adults, so critical is the early childhood period and so large the gaps between high- and low- income families.

Hence, the key questions are:

1 Is childcare high quality ECE?

It can be, but is not necessarily. With few subsidies and institutional investments in the US currently, the range of childcare type and quality is large.

Researchers assessing the current distribution in the US have found that the five types of care have varying average quality:

- Highest – in home care provided by a nanny,
- Next – public center care operated by Head Start,
- Next – private center care
- Next – in provider's home care (home-based care),
- Lowest – relative care.

Center-based care, whether Head Start or private, are both assessed as average quality, and home-based care as just below average. The outliers are in-home nanny care, which is much higher quality on average, and relative care, which is must lower quality on average (this low-quality is sometime attributed to extensive television watching).

In practice, however, quality is dictated more by the mothers' education (a proxy for income and socioeconomic status) rather that the type of care itself. Children of highly educated mothers have better quality care whatever the type, whether they are in a center or home with a relative. No "type" of care consistently predicts quality as strongly as the "buyer" does. High income children will receive high quality care.

Related back to the question, much of the care currently provided in the US would probably not be regarded as ECE.

2 Do public interventions work to improve childcare and make it ECE?

To the extent that they can create affordable and high-quality care, yes. Mothers offered subsidies mostly take them and use them to find higher quality care than they would have otherwise.

Mixed evidence is mostly the result of mixed success in creating the quality.

3 But I've heard that childcare causes behavioral issues in children?

Childcare itself—that children below the age of kindergarten spend most of their day outside the care of their parents—does not harm children. There is no default state in which some "bad" emerges from nonparental care.

Indeed, there is no evidence of high-quality ECE childcare harming or stunting children. Sadly, the US has many other examples of low-quality situations in which evidence of poor outcomes can be found.

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FAQ 4 Is childcare good for families?

In 1971, President Richard Nixon vetoed Comprehensive Child Development which would have created a system of federally provided and supported childcare. In his veto message, he wrote:

> "Though Title V's stated purpose, "to provide every child with a full and fair opportunity to reach his full potential" is certainly laudable, the intent of Title V is overshadowed by the fiscal irresponsibility, administrative unworkability, and family-weakening implications of the system it envisions. We owe our children something more than good intentions.
>
> We cannot and will not ignore the challenge to do more for America's children in their all-important early years. But our response to this challenge must be a measured, evolutionary, painstakingly considered one, consciously designed to cement the family in its rightful position as the keystone of our civilization."

Nixon's assertion is that care of young children by a nonparent weakens the family as an institution. It presupposes that there are two states possible: children at home with a parent or children in care supported and funded by the government. It does not consider what became the most common case in the years following his veto: children in care paid for by the family at significant expense.

Were the federal government to start supporting and broadly subsidizing childcare, the effect on families would not be what comes from switching kids from parental care to childcare, but rather, what comes from switching the payer from parents to the government.

Reducing the childcare costs to families decreases the amount of income they must direct to care. This would likely have enormously beneficial effects on families; the "freed up" income would be like getting an extra amount of cash each month.

Prior research on introduced childcare subsidies have found this to be the case, noting that children are helped both from the early childhood education but also the increases spending power and economic security of their parents.

In the US, we've have no such broad subsidy to care. But, in 2021, families did get an extra amount of cash each month through the temporary expansion to the Child Tax Credit. Researchers assiduously studied households receiving the CTC monthly payments to understand how they used the money.

Families mostly spent the money on food, though spending was also directed to housing, necessities, and child-related goods and services. Food insecurity decreased. Financial stress and hardship decreased. Research continues to emerge about the beneficial effect the 2021 CTC in particular, however there is a large body of evidence of the deleterious effects of financial hardship and uncertainty in childhood that the CTC-specific findings join.

The benefit of reduced hardship for families, it important to note who has agency in this decision. The question of whether childcare is good for families forgets that most families have decided that childcare is good for them. In 2022,

- 77% of women with children 6-17 worked,
- 68% of women with children under 6 worked, and
- 66% of women with children under 3 worked.

Further, according to the Brookings Institute, between 1979 and 2018, 91% of the increase to "middle-class income" over that time period came from women's earnings.

If you simply take families as acting in their own best interest and trusting their decision making, childcare is good for families.

Section References – Summary Articles

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