New Proposals to Invest in Young Children

By James Sly

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Introduction

From a policy perspective, the benefits from investing more in young children are already well established. Programs to provide paid maternity leave, expanded child care subsidies, universal high quality pre-K education, and a new system of college grants awarded to young children will likely improve the lives of both children and their parents, while also helping the economy over the long term. Some programs, like universal, high quality pre-K education have been shown to provide benefits worth many times the initial cost so that the overall return on investment is quite high.(1) The problem is essentially a political one, where these investments in young children can end up getting quite expensive and provide a lot of funds to a relatively narrow subset of the population. For example, reducing income inequality provides large tax benefits to the bottom 80% of the population by transferring money from the top 1%.(2) Reducing poverty generally helps only the bottom 20% of the population, but can be paid for by eliminating tax deductions for the top 10% of the population.(3) Investing more in young children only directly benefits the less than 15% of the population with a child under the age of 5, but is so expensive it requires broad based tax increases that would impact the entire population.(4)

The only way to overcome the formidable political obstacles is to garner widespread bipartisan political support that ensures no one will want to raise a public alarm when a large amount of new revenue needs to be raised. This is essentially how Democrats and Republicans teamed up to get rid of the 2% cut in payroll taxes in 2013, which really ended up being a broad based tax increase on all workers currently employed in the country, but because it had strong bipartisan support and no one had the incentive raise a big fuss in the media, there was little public backlash.(5) Without bipartisan support, any attempt to increase investments in young children can always be demagogued, making passage impossible in our system of government that provides many opportunities for the minority to raise barriers to enactment.

To overcome this intractable political problem, this policy memo proposes an overarching deal on tax policy that would eliminate taxes used to fund health care (including some that primarily impact the rich) in exchange for enacting a well funded Value Added Tax (VAT). A VAT is simply a broad based consumption tax that is collected at every stage in the supply chain, sometimes described as a national sales tax, though it is not collected at the point of sale like our state sales taxes but from businesses along each step in the production process. The vast majority of countries around the world use a VAT in some form or another, and a VAT is generally considered by policy experts to be a highly effective and highly efficient way to raise a lot of money for governments to spend.(6)

The core of the idea is that by eliminating certain taxes used to fund health care, this will provide a significant tax cut for the top 1% and businesses in general, and then the new VAT will replace the revenue lost from those tax cuts plus another $100 billion that can be used to pay for new investments in young children.(7) Politically, the tax cuts for the top 1% and employers would earn the support from Republicans, and the overall gain in revenue that could be spent on new programs would earn the support from Democrats, and neither side would have an incentive to demagogue the policy change to the public and the overarching tax deal could pass with little fanfare. This grand compromise could even represent a dramatic shift in policy strategy over the long term, where if Democrats might want to start with their most politically popular proposals that reduce income inequality, once this deal is struck, perhaps the Democrats could step back from additional plans to tax the rich and redistribute the revenue in exchange for getting Republicans to drop opposition to spending more on programs as long as long it was funded with broad based tax increases on the middle class instead of tax increases targeted on the top 1%. The rest of this policy memo then goes on to provide more details on this overarching political deal by describing what a new VAT might look like in the first part of this policy memo, and then describing how that new money might get spent in the second part of the policy memo.

Creating a VAT in the US

Creating a VAT in the US has long been on the agenda of tax policy experts. About 150 countries in the world use a VAT to raise revenue, and the US is the only country in the OECD not to use one.(8) The tax is generally considered efficient, fair, and easy to administer, yet has never garnered the political support necessary to get passed in the US. The running joke among tax policy experts is that Democrats oppose a VAT because it is regressive, and Republicans oppose it because it raises a lot of revenue, and that a VAT is only ever going to get passed in the US once Democrats realize it raises a lot of money and Republicans realize the tax is regressive.(9) This is exactly the sort of transformation that this overarching deal on tax policy is trying to achieve.

In order to get both sides to agree to the deal, there will have to be tradeoffs, and in order to get Republican support there would have to be tax cuts for the rich. The proposal presented here would eliminate certain taxes used to raise money for health care. Currently, Medicare charges a 2.9% payroll tax on all workers with half imposed on individuals and half on businesses, and then adds on a 0.9% surcharge on married couples making more than $250,000 a year and single people making $200,000 a year. This means that high income individuals pay a 3.8% tax on income over those levels, and when Obamacare was passed, that legislation included a 3.8% tax on investment earnings for high income individuals in order to help pay for it.(10) Repealing the payroll taxes used to fund Medicare would cost about $285 billion a year, of which about $15 billion would come from the 0.9% surcharge on the highest income individuals, and $135 billion from the payroll taxes on businesses. Repealing the extra tax on investment earnings would reduce revenue by an additional $25 billion so the combined cost would reach about $310 billion and the tax cut for the rich would reach about $40 billion a year for high income individuals and $135 billion for businesses.(11) Economists generally agree that over the long run the payroll tax on businesses is paid by individuals through lower wages, but once completely removed, this would represent a short run windfall for business that would go away over the long run as wages adjust to the new tax system.

If this overarching tax deal is going to replace all the lost revenue for health care and raise an extra $100 billion for investments in young children, then the total amount of revenue raised by the VAT would have to reach $410 billion or about 1.9% of GDP. In a 2012 Brookings proposal for the Hamilton Project, William Gale and Benjamin Harris (2012) estimate that instituting a broad based VAT that excluded only a few areas would raise about 0.45% of GDP (or about $95 billion in 2019) for each percentage point of VAT imposed, but that this would reduce revenue from other taxes as well, which would reduce the net revenue raised by about one quarter. This means each percentage point of VAT imposed would raise about $70 billion a year overall, so if the US needed to raise about $410 billion, then the US would need to impose a VAT of about 6%.(12) Among OECD countries only Canada currently has a lower rate for their VAT at 5%, and a 6% rate in the US would still put us slightly below other low tax countries like Japan and Switzerland which impose a rate around 8%, and well below the OECD average around 19%.(13) There are some downsides, for example this tax is somewhat regressive, but other policy memos describe proposals to reduce income inequality (Sly 2020a) and poverty (Sly 2020b) that would directly address those concerns. The tax also might want to be increased gradually since a VAT builds the tax into the overall price of the good when sold, so consumer prices would jump as a result of a new VAT, and a slower increase might be preferred to a dramatic jump in prices.

Investing $100 billion in Young Children

If this overarching tax deal were ultimately reached, then the government would have an extra $100 billion to spend on investments in young children. This policy memo offers four ways to spend that $100 billion dollars, spending approximately $30 billion each on paid family leave, expanding access to child care subsidies, and providing universal high quality pre-K education. An additional $10 billion could be spent creating a program where children earn money for college throughout their entire childhood based on the income of their parents.

The first proposal to invest in young children emphasizes the importance of paid maternity leave, which has been shown to provide valuable improvements in the lives of children and parents, while also possibly aiding in long term economic performance. Once new mothers gain access to maternity leave, young children generally experience higher rates of breast feeding and lower infant mortality rates early in life and are less likely to be overweight or experience attention deficit hyperactivity disorder (ADHD) as they get older.(14) In another policy memo on the Finnish education system (Sly 2020c), I suggest that extremely generous policies on maternity leave may have helped the country achieve incredible success in reading scores on international standardized tests.(15) Research on the introduction of paid maternity leave in Norway indicates that children might experience lower high school drop out rates and higher wages by age 30. As a result of paid maternity leave, parents are likely to experience significantly lower levels of pre-natal and post-natal stress, in part due to the smaller financial cost of taking time off to give birth and take care of a young infant.(16) Over the long term, the economy could benefit from paid maternity leave as well by reducing turnover, increasing the wages of caregivers, increasing the labor force participation of women, and improving productivity for the next generation by investing in their human capital.(17)

The United States is an outlier when it comes to paid maternity leave, since it is the only country in the OECD not to offer any at the national level. Even though only the benefits of paid maternity leave have been highlighted so far, the policy proposals designed to improve the generosity of maternity leave generally get wrapped into the debate over broader paid family and medical leave in general. In 1993, the US passed a law providing 12 weeks of unpaid family and medical leave, but also created restrictions on its availability that limited it to about 60% of workers. In response, six states (including California) and the District of Columbia have passed their own paid family leave policies.(18) More recently, Democrats in the House and Senate have introduced the Family and Medical Insurance Leave Act (FAMILY Act) that would provide 12 weeks of paid leave either for the birth of a child or to help care for yourself or a family member experiencing health problems. It would reimburse those taking leave under these circumstances for about two-thirds of their income up to $4,000 a month. The Institute for Women's Policy Research estimates this would cost the government about $28 billion a year.(19)

The second place where the US could invest more in young children is to provide more funding for child care subsidies. Currently, child care is extremely expensive in the US, and many low income families have trouble affording it. In 2017, the yearly cost of center based child care for an infant ranged from $5,300 in Mississippi to $23,700 in Washington DC. This means that families below the poverty line who pay for child care had to use 30% of their income on those costs, compared to 18% for families between 100% and 200% of poverty, and only 7% for families above 200% of poverty. The federal government does provide subsidies for child care through a variety of programs, however the primary program dedicated to helping low income families, the Child Care and Development Block Grant, currently receives limited funding. In 2017, the federal government spent about $6 billion dollars in total on the Child Care and Development Fund, which did cover 1.3 million children on average each month, but because of a lack of funding, less than 1 in 6 eligible children actually received child care subsidies under this program.(20) If the federal government increased funding through this program by $30 billion, this could possibly get us close to providing child care for all the low income families who need it. Since 2017, the federal government increased funding on this program by $2.4 billion, and allocated some additional aid through the pandemic stimulus bill, but there is still a large gap between the need for the program and the funds available to pay for it.(21) States are the ones who decide how the funds will be used, and new funds could be used to pay for better health and safety monitoring, more training for current child care workers, expanded eligibility so more families can keep their subsidies, higher pay for new workers to attract more qualified care givers, as well expanding subsidies to more eligible families. An extra $30 billion in funding could do a lot to improve both the generosity, availability, and quality of the program, but ultimately states will decide which priorities are most important to them.

The third way the US could invest more in young children is to provide voluntary, universal, high quality pre-K across the entire country. There have been multiple long term studies of high quality preschool programs that have shown them to be incredibly valuable in creating a wide variety of benefits for the people attending those programs and for society in general. Early on, students who participated in a high quality preschool program did better on test scores and were less likely to be held back a grade, while as they got older there were less likely to get involved in criminal activity and more likely to graduate from high school and go on to attend college. As adults, students who went to a high quality preschool program earned more money and also had fewer health problems.(22) In one well known study by researchers at the Minneapolis Federal Reserve, they reported that one of the early experiments in high quality pre-K had a 16% internal rate of return, much higher than just about any other type of potential government investment.(23) A report by the Washington Center for Equitable Growth calculated the relative costs and benefits of a voluntary, universal, high quality, publicly funded pre-K program for 3 and 4 year olds based on the impact of a similar program set up in Chicago decades ago, and replicated elsewhere in other Midwestern cities just recently. They found that initially the program would cost about $5,800 per kid and cover about 7 million children in 2017, requiring about $41 billion in government funding, but once you take into account the money the government already spends on pre-K, then then only $26 billion of new funding would be required in 2017. Once implemented, the benefits would gradually accrue over time as the newly participating students got older, and by 2050 the yearly benefits would outweigh the costs by a ratio of 8.9 to 1.(24)

The fourth way the US could effectively invest in young children is to create a new need based system of college aid awards that start accumulating as soon as a child is born. I describe this proposal in more detail in another policy memo (Sly 2020d), but the basic idea is to build on a system of college subsidies developed by Canada by granting a $1,000 college aid award as soon as a child is born, and then increase the award by $200 a year for about half of the children with the lowest income families. Technically, the aid would not go to young children in their own college savings account but instead be structured more like Social Security where benefits are awarded early on but the funding gets spent on those students currently attending college. This would be an improvement on our current financial aid system since it would require no applications, be completely transparent, and impact the educational expectations of children very early in life. This would also be an improvement on Canada's system of individual accounts since full benefits could start going out to the public as soon as the policy is enacted, rather than waiting decades for balances to accumulate in individual accounts, while also avoiding the incredible complexity, low take up rates, high administrative costs, and excess benefits for the rich that a system of individual college savings accounts would create. The plan described here would cost about $11 billion dollars a year.

Conclusion

Currently, the US has a very acute problem with income inequality in the country, and that needs to be addressed to some extent by raising taxes on the top 1% and distributing the income to the bottom 80% as I described in another policy memo (Sly 2020a). At some point, however, this process is going to tap itself out as further tax increases on the top 1% become impractical or infeasible. Policymakers and politicians should prepare for this predictable development by eventually making an overarching deal on tax policy that more closely follows the approach adopted by Europe, where government benefits are made significantly more generous by increasing broad based taxes that largely impact the middle class.

Adopting this approach in the US would be made significantly easier if the US had access to a fair, efficient, and easily scalable source of revenue like a VAT. In order to get to that point, however, incredible political obstacles would need to be surmounted which would require broad based bipartisan support, so that neither side has the incentive to demagogue what would likely be a socially beneficial but politically unpopular policy since it would raise taxes on just about everyone while providing generous benefits for only a few. The solution offered here would get Republican buy in by removing certain taxes used to fund health care programs in the US, like the Medicare payroll tax and the 3.8% tax on investment earnings for high income individuals. This proposal would get Democratic support by creating a new VAT that not only replaced the revenue lost from the tax cuts but also raised an additional $100 billion dollars that could be spent on important investments in young children. This policy memo described three proposals for paid family leave, child care subsidies, and universal pre-K that would cost about $30 billion each, while the remaining $10 billion dollars could be spent on offering college awards to young kids that accumulate over their entire childhood. Enacting each of these changes would not only improve our overall tax system, but also provide for a better future for our country by making critical investments in our children early on that yields tremendous benefits as time goes on.

End Notes

#1 – Research on the benefits of paid maternity leave is described by Maya Rossin-Slater and Lindsay Uniat (2019). The financial importance of child care subsidies for low income families is described in a report by the Center on Budget and Policy Priorities (Rice et al 2019). The benefits arising from high quality pre-Kindergarten programs are described in a report by the Washington Center for Equitable Growth (Lynch and Vaghul 2015). The estimates of the internal rate of return for the iconic Perry Preschool program comes from an analysis by researchers at the Minneapolis Federal Reserve Bank (Rolnick and Grunewald 2003).

#2 – In another policy memo (Sly 2020c), I describe how the US can address its own problems with income inequality by raising taxes on the top 1% and using it to fund a refundable tax credit that benefits the bottom 80%.

#3 – In another policy memo (Sly 2020d), I describe a variety of ways the US could work to reduce poverty here, and one way to pay for some of those programs would be to eliminate some deductions in the tax code. Currently only about 12% of all taxpayers itemize their deductions so eliminating those deductions would only impact slightly more than 10% of the population.

#4 – In 2019, there were about 17.5 million households with a child between the ages of 0 to 5 years old. Since there were about 129 million households in the US, that means the percent of families with a child 5 years old or under fell just under 14%. Creating a new VAT would increase taxes on anyone who spent money on goods or services covered by the tax, which is basically everyone.

#5 – In February of 2009, Obama passed the middle class Making Work Pay tax credit that reduced taxes by $400 for single individuals and $800 for married couples in 2009 and 2010. The tax credit was not extended into 2011, but in December of 2010, a 2% cut in payroll taxes was enacted that lasted until the end of 2012 at which point it was allowed to expire for 2013.

#6 – In policy brief published by the Brookings Institution, William Gale and Benjamin Harris (2013) provide a basic description of how a VAT works and offer the statistic that about 150 countries currently use a VAT, even if the exact count depends on the source you use.

#7 – Our current tax system imposes an extra 0.9% payroll tax on high income individuals on top of the 2.9% payroll tax it already collects from everyone else that goes into the Medicare Health Insurance Trust Fund, and also imposes a 3.8% tax on investment income for high income individuals that was originally designed to help fund Obamacare.

#8 – The statistic on how many countries around the world use a VAT comes from Gale and Harris (2013), as well as the observation that the US is the only OECD country not to use one.

#9 – This original joke was originally offered by Lawrence Summers back in 1988 was cited in Gale and Harris (2013).

#10 – A description of the taxes used to fund Medicare came from a policy brief written by the Center on Budget and Policy Priorities (CBPP 2020). The 0.9% payroll tax surcharge on high income individuals was passed at the same time as Obamacare but goes into the Medicare Hospital Insurance Trust Fund.

#11 – The latest report by the Social Security Trustees reports that the Medicare Hospital Insurance Trust Fund raised $285 billion in payroll taxes in 2019, which includes both the 2.9% payroll tax on everyone and the 0.9% surcharge on high income individuals. When Obamacare was passed, the Joint Committee on Taxation estimated that in 2019 the 0.9% payroll tax surcharge by itself would raise $15 billion in revenue and the payroll tax surcharge along with the 3.8% tax on investment income would raise about $40 billion in 2019, indicating the 3.8% tax on investment income by itself would raise about $25 billion. That means the 2.9% payroll tax on everyone collects about $270 billion in revenue of which half (or $135 billion) is collected from individuals and half (or another $135 billion) is collected from businesses. If you add on the $25 billion collected from the 3.8% tax on investment income and add it to the $285 billion collected from payroll taxes, then you get about a total of $310 billion of revenue lost from repealing these taxes.

#12 – In their policy brief, William Gale and Benjamin Harris (2013) calculate that a broad based VAT that only excludes spending on education, Medicare and Medicaid, charitable organizations, and state and local government would raise about 0.45% of GDP for every percentage point in taxes imposed. They also calculate that imposing this tax would reduce the total amount revenue raised by about 27% because other types of taxes would collect less money as a result of imposing a VAT. Since the US had a GDP worth $21.4 billion in 2019, that means a VAT would collect about $95 billion for each percentage point imposed, but reduce the revenue raised by other taxes by about $25 billion, so the net amount of taxes raised would be about $70 billion for each percentage point of tax. Since the US would need to replace $310 billion in tax revenue from repealing certain taxes used to fund health care (see end note #11) and also pay for $100 billion in new investments the total tax needed to be raised would reach $410 billion. To raise that much revenue overall, that would require a tax rate for the VAT of 5.9% which gets rounded up to 6% in the policy memo.

#13 – The OECD reports that in 2018 Canada imposed a 5% tax rate for their VAT, the lowest in the OECD. The next lowest countries were Switzerland which imposed a 7.7% tax rate and Japan which collected an 8% tax rate for their VAT. The OECD average for 2018 was 19.3%.

#14 – A description of the positive benefits arising from paid maternity leave can be found in Rossin-Slater and Uniat (2019).

#15 – In 2018, Finland had one of the most generous policies for maternity leave in the entire world, offering about 3 years of leave and this amount was only matched by 3 other countries in the OECD. When the results from the international standardized tests given to 15 year olds called the PISA exams came out in 2000, Finland had the top reading scores in the entire world, and has remained at or near the top in reading scores on this exam since then. In 2018, Finland tied for 2nd place in reading scores among countries in the OECD and the only country that beat them, Estonia, was one of the 3 other countries that offered around 3 years of maternity leave.

#16 – The results from the Norwegian study on paid maternity leave, as well as the other benefits to parents from this policy, were described in Rossin-Slater and Uniat (2019).

#17 – The economic benefits from providing paid leave is described in testimony given before the Washington DC city council by Heather Boushey of the Washington Center for Equitable Growth (2016).

#18 – A description of the current state of unpaid and paid family leave policies can be found in Rossin-Slater and Uniat (2019).

#19 – A summary of the FAMILY Act as introduced in Congress in 2017, along with an estimate of its overall cost can be found in analysis done by the Institute for Women's Policy Research (Hayes and Hartmann 2018). The analysis finds that the bill would cost about $28 billion a year.

#20 – The statistics provided in this policy memo on the current state of child care subsidies came from a report by the Center on Budget Policy Priorities (Rice et al 2019).

#21 – In 2018 Congress passed a substantial increase in funding for the Child Care and Development Block Grant (CCDBG) and were able to maintain that level in 2019, so that from 2017 to 2019 discretionary spending on program went up by $2.4 billion. As part of the pandemic relief provided in the CARES Act that passed in March of 2020, the CCDBG got an additional $3.5 billion in funding that states could use to help child care providers stay in business or to provide child care to first responders and health care workers regardless of their income as well as for the usual expenses incurred by the program. Even with these funding expansions, the vast majority of eligible families do not receive any subsidies from this program.

#22 – The research demonstrating the benefits provided by high quality pre-Kindergarten education programs is described in a report by the Washington Center for Equitable Growth (Lynch and Vaghul 2015).

#23 – Researchers at the Minneapolis Federal Reserve Bank (Rolnick and Grunewald 2003) calculated estimates of the internal rate of return for the iconic Perry Preschool program to be around 16%, which is vastly higher than most other private and public investment opportunities.

#24 – The statistics and cost estimates for a voluntary, universal, high quality, publicly funded pre-Kindergarten program comes from a report written by Washington Center for Equitable Growth (Lynch and Vaghul 2015).

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