the budget lab

Evaluating the Impacts of Federal Subsidies for Early Childhood Education and Care

Author(s): Harris Eppsteiner, Maddie Lee and John Ricco

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Key Takeaways

1 We use The Budget Lab's new model of early childhood care and education for children ages 4 and under, which incorporates both demand- and supply-side dynamics, to analyze how five different policies would affect (i) families' care and work decisions, (ii) care worker wages, (iii) provider prices, (iv) the federal budget, and (v) children's long-run earnings.

2 Subsidies that limit out-of-pocket care costs to a fraction of income generate large shifts into formal care and boost maternal employment and wages for care workers. But these policies would also push up market prices, increasing costs for the federal government and for families who do not qualify.

3 Subsidizing providers' labor costs benefits families by bringing down market prices for care, but unlike with demand-side subsidies, these price reductions are not targeted by family income. This leads to larger benefits for higher-income families, who disproportionately use more expensive forms of care.

4 A $1,000 child allowance policy, which would increase families' disposable income without changing the relative cost of different forms of care, produces negligible changes in enrollment and associated outcomes.

5 Policies such as co-pay caps and tax credits for providers do the most to boost future earnings and future federal tax revenues, but these particular long-run benefits offset only a fraction of near-term costs.

Introduction

In recent years, there has been growing interest in policies that reduce out-of-pocket costs for early childhood education and care (ECEC) through subsidies or direct public provision. In addition to state- and local-level initiatives, federal proposals to subsidize care have been introduced as legislation or enacted temporarily in the last half-decade.

Assessing the impacts of these policies on both families and the federal budget is a challenge. Prices for paid formal care (like many forms of center-based care) are determined in part by supply and demand. Policies that increase demand for these forms of care by lowering families' costs may lead to price increases if the ECEC sector is limited in its ability to expand to meet the new demand. These increases would then translate to higher out-of-pocket costs for unsubsidized families and greater spending on subsidies for eligible families by the government. At the same time, shifts in prices may lead to families switching from one form of care to another—decisions that also affect whether and how much parents work, which in turn influences tax revenues. A realistic model of the ECEC sector needs to account for all of these dynamics.

To that end, The Budget Lab (TBL) has developed a new open-source equilibrium microsimulation model for analyzing ECEC policy. The model is designed to capture these dynamics in the nationwide market for ECEC for children from birth through age 4, allowing us to estimate how new federal policy initiatives would affect:

- **patterns of childcare usage and parental employment,** which are closely related decisions for families;
- **cost burdens for different types of families,** accounting for changes in subsidy eligibility and market prices;
- **the prices that childcare providers charge;**
- **the wages earned by care workers;**
- **the federal budget,** including feedback effects on tax revenues from changes in parental employment; and
- **children's future economic outcomes,** based on how a policy reform induces children to move between ECEC options with different estimated impacts on their future earnings.

TBL's model is a structural equilibrium microsimulation model of parents' decisions over employment and childcare (on the demand side) and of ECEC providers' ability to meet this demand (on the supply side). Family-level demand for different care alternatives aggregates to market demand for different forms of ECEC (for example, center-based care vs. home-based care), and provider prices and wages adjust to clear the market. Policy reforms can shift the equilibrium, and the model calculates how those changes flow through to fiscal and distributional effects. Importantly, the model accounts for the fact that parents have many reasons for their choice of care for their children—such as their assessment of the type of care, geographic proximity, cost, convenience, and cultural fit—and does not assume parents will necessarily prefer one dimension of care over another.

Our model allows for parents to make different decisions at different child ages and different decisions for multiple children in the same household, including both employment hours (full-time vs. part-time) and forms of childcare. In other words, we put no restrictions whatsoever on the combination of work and care decisions that different parents can make at different times. Full documentation for The Budget Lab's ECEC model can be found on TBL's website, with complete code available on GitHub.[1]

In this report, we use the model to analyze five illustrative policies for subsidizing ECEC, designed to highlight the tradeoffs policymakers face when crafting programs to increase access to affordable care:

1. **Universal Subsidy:** offer free childcare for low-income families and cap out-of-pocket childcare expenses for middle- and high-income families.

2. **Income-Limited Subsidy:** offer free childcare for low-income families and cap out-of-pocket childcare expenses for middle- and upper middle-income families, with high-income families ineligible for subsidies.
3. **Expanded Care Credit:** expand the Child and Dependent Care Tax Credit (CDCTC) to cover a greater share of childcare expenses and to allow low-income families to benefit fully from the credit.
4. **Provider Tax Credit:** partially subsidize labor costs for ECEC providers, making care provision at lower market prices financially viable.
5. **Child Allowance:** provide $1,000 per child for all families, regardless of childcare enrollment, parent employment status, or income.

Our choice of these five policies is meant to highlight different dynamics present in TBL's model for a broad set of ECEC subsidy and tax proposals, and is not meant to be exhaustive of potential new policies. Other policies that are similar in structure to those we analyze but with greater or lesser generosity, or policies at similar levels of generosity but different structure, would generate different results that may not necessarily scale dollar-for-dollar with our findings. Because we focus specifically on subsidies in this report, we also do not explicitly model policies intended solely to raise the relatively low wages of workers in the ECEC sector, which has been an important focus of policy discussions. Such a policy would have implications for both costs and the quality of childcare (and thus impacts on affected children), and is one area for future analysis.

It is also important to note that TBL's model cannot necessarily capture the complete range of effects that changes in ECEC policies can have on children, their families, and the federal budget. For example, and as discussed below, higher earnings for childcare providers can have positive effects on children's outcomes through lower turnover (Grunewald, Nunn, and Palmer, 2022), a channel not directly captured by our model. Additionally, the estimates in this report do not include savings to the federal government from potential decreases in utilization of public assistance programs (such as Medicaid and SNAP) or from decreases in criminal justice involvement, nor do they include effects on state and local spending and revenues. In future versions of TBL's ECEC model, we hope to expand its scope to include effects such as these.

Table 1 previews our findings.

Table 1. Summary of Results

Metric	Universal Subsidy	Income-Limited Subsidy	Expanded Care Credit	Provider Tax Credit	Child Allowance
Avg. Economic Value for Bottom-Quintile Families	$2,900	$2,900	$450	$150	$1,300
Avg. Economic Value for Top-Quintile Families	$1,500	$600	$350	$800	$1,300
Change in Home- and Center-Based Enrollment (pp)	+14.7	+13.8	+2.5	+2.9	0.0
Change in Maternal Employment (pp)	+5.8	+5.6	+2.2	+0.7	-0.1
Change in Care Worker Wages	+15% (No BA) / +34% (BA+)	+15% (No BA) / +32% (BA+)	+3% (No BA) / +4% (BA+)	+4% (No BA) / +6% (BA+)	0% (No BA) / 0% (BA+)
Change in Federal Deficit, FY26-FY35 (Nominal)	-$770B	-$728B	-$103B	-$90B	-$194B
Long-Run Annual Earnings Gain for Children of Bottom-Quintile Parents	$140	$140	$0	$10	$0
Federal Tax Revenue Recovery Ratio[a]	7.5%	6.7%	3.6%	23.9%	-0.2%

All values are for 2030 and are expressed in 2026 dollars unless otherwise indicated.

[a] *The federal tax revenue recovery ratio is the share of upfront federal costs (program costs net of changes in tax revenue from changes in maternal employment) that are recouped in the form of higher federal tax revenues as a result of changes in children's future earnings. It does not include other potential savings to the federal government, such as decreases in utilization of public assistance programs (such as Medicaid and SNAP) or decreases in criminal justice involvement, nor does it include potential labor productivity gains beyond the children directly affected by the policy. The ratio also does not include effects on state and local spending and revenues.*

Table: The Budget Lab • Source: The Budget Lab analysis • Created with Datawrapper

This report is the first in a series of planned reports from The Budget Lab analyzing policies intended to help families of young children, including paid family and medical leave (PFML) and pre-K expansion, and comparing the relative impacts of each set of policies on outcomes for children, families, and the federal budget on a dollar-for-dollar basis.

Policy Options

In this report, we model five federal policy reforms designed to illustrate a range of approaches available to federal policymakers. These options vary in delivery mechanisms, progressivity, and treatment of different kinds of ECEC arrangements.

We describe each policy briefly below, with full details on exact policy parameters in the Appendix.

Universal Subsidy

Under this policy, out-of-pocket costs for formal childcare (such as center-based care or paid home-based care) would be capped for all families with working parents. The subsidy would be structured as a sliding-scale copayment system under which families' out-of-pocket care expenses would be capped at a specified fraction of income. At low incomes, the maximum copayment would be $0—that is, childcare would be free for these families. The copayment rate would rise with income until reaching 7% for middle- and high-income families:

- 0% (free): families earning up to 85% of median income
- 2%: families earning between 85% and 100% of median income
- 4%: families earning between 100% and 125% of median income
- 7%: families earning more than 125% of median income

Income-Limited Subsidy

This policy is identical to the Universal Subsidy except that it would limit eligibility based on family income. Families with income above 250% of the median income would be ineligible for subsidies.

Expanded Care Credit

This policy would expand the Child and Dependent Care Tax Credit (CDCTC). The CDCTC is a credit that allows parents to claim an income-based percentage of eligible ECEC costs, up to an expense cap, as a credit on their tax returns. The credit is nonrefundable—it can only be used to offset tax liability—and is provided at tax filing time, rather than at the point at which childcare costs are actually paid by the family. In practice, these limitations mean that low-income families, who tend to have low tax liability (as well as less ability to pay out of pocket), are generally ineligible for the credit or will struggle to access it.

The proposal would make several changes to the credit to make it more generous and more progressive:

- The per-child eligible expense limit would be raised from $3,000 to $8,000.
- The credit rate—the fraction of eligible expenses covered by subsidy, depending on income—would be held at its maximum level for a much wider range of families. High-income families (those with incomes above a phase-out range starting at $400,000) would be made newly ineligible for the credit.
- The credit would be made fully refundable.

Provider Tax Credit

Unlike the demand-side subsidies above, this supply-side policy aims to reduce market prices in the ECEC sector by subsidizing providers' labor costs. Care providers would be able to claim a refundable payroll tax credit equal to 25% of

payroll costs, corresponding to approximately $8,700 per year per full-time worker without a bachelor's degree and $12,700 per year per worker with a bachelor's degree or higher.

Child Allowance

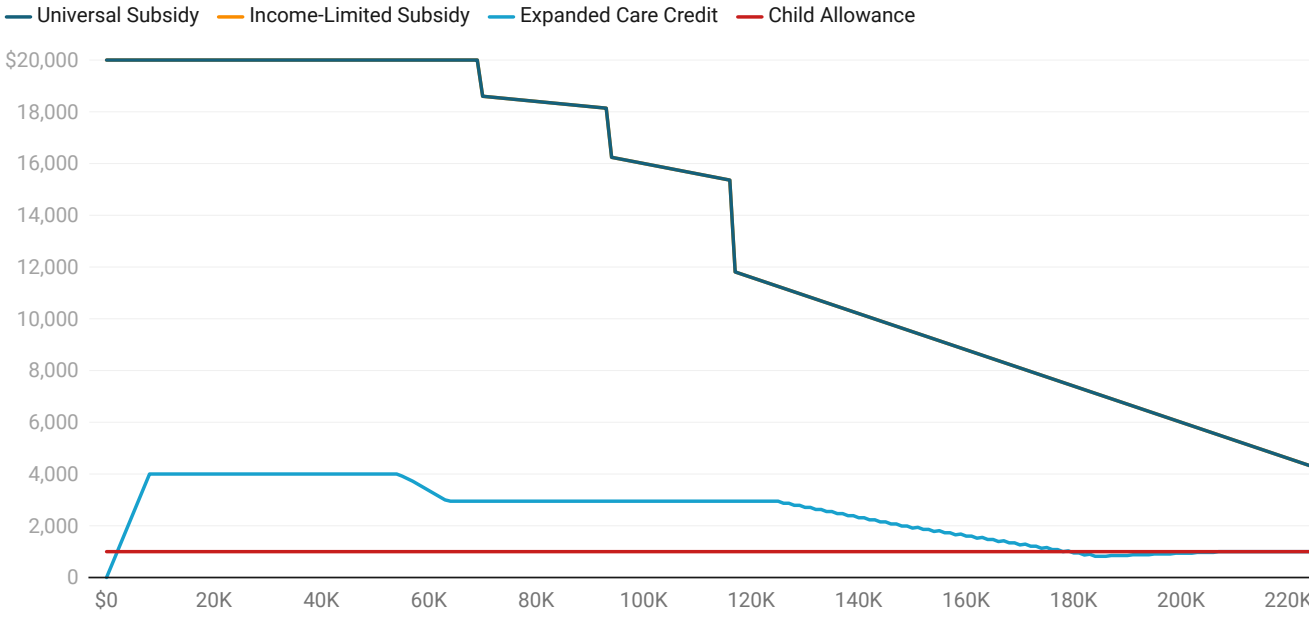
This policy would give families $1,000 a year for each child ages 0-4 via a fully refundable income tax credit, regardless of income, employment status, or choice of care. This policy differs from the others in that it does not affect the relative price of formal paid care versus other forms of care—payment is not conditioned on certain ECEC choices. While child allowance proposals are often intended as pure income support, rather than as direct interventions in childcare *per se*, we include this policy in this report to highlight how such proposals may affect the ECEC sector.

Comparing Policy Approaches

Figure 1 illustrates the comparative generosity of these policies at different levels of families' Adjusted Gross Income (AGI) relative to current law. It plots the difference from current law of the annual subsidy amount for a hypothetical family of three (two parents and one child) who enroll their child in care costing $20,000/year. (We do not include the Provider Tax Credit policy, which affects family budgets only indirectly through market equilibrium dynamics.)

Figure 1. Policy Subsidy by Household AGI

Hypothetical: married parents, 1 child, full-time center-based care ($20K/year)



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- Among these options, the Universal Subsidy and Income-Limited Subsidy policies would be the most generous for lower-income families.
    - For families of this size earning below roughly $70,000, each policy would cover 100% of ECEC costs, so the subsidy value is equal to the cost of care.
    - As income rises, discrete jumps in the subsidy rate would create benefit "cliffs"—ranges of income where small increases in income lead to large reductions in subsidies. (Within these subsidy rate ranges, there is an automatic income-based phase-out of the subsidy for a given price of care.)

    - The Income-Limited Subsidy option would create a larger cliff for families of this size when income nears about $230,000, at which point the family would lose subsidy eligibility entirely.

- The Expanded Care Credit line shows the incremental benefit of the expansion above and beyond the relief provided for under current law. Subsidies, which are largest at low incomes, phase down to lower levels at higher incomes.
- The Child Allowance, which is invariant to ECEC arrangement and does not scale with care costs, would provide $1,000 at all income levels for this single-child family.

Figure 1 above considers how subsidy generosity varies with family income for a given price of care. But some of these policies also differ in how much subsidy values change with the price of care, all else equal. For example, the Universal Subsidy covers all care costs above a fixed percentage of family income regardless of the size of those costs. In contrast, the Expanded Care Credit caps subsidy values at $4,000—regardless of whether care costs $5,000, $10,000 or $30,000. This means that, unlike the former policy, the latter policy does not automatically generate larger subsidies when care costs rise.[2]

Figure 2 highlights this dynamic by plotting the change in subsidy values by annual care cost. It shows these relationships at three different levels of income.

- The Universal Subsidy and Income-Limited Subsidy grow dollar-for-dollar with care costs above each family's copay. Because copays are set as a fixed percentage of income, higher-earning families face a larger threshold of care costs before subsidies begin. For example, a family earning $200,000 must spend over $14,000 on care before receiving any subsidy, while a family earning $50,000 faces no copay at all.
- The Expanded Care Credit grows with care costs only up to its $8,000 expense cap, beyond which the subsidy is flat.
- The Child Allowance, a fixed payment defined in dollars, does not respond to higher care costs.

Table 2 compares the policy options across design-choice dimensions: the degree to which benefits are tailored based on need ("income targeting"); the extent to which fiscal costs automatically grow with higher care costs ("fiscal cost control mechanisms"); the rules governing which kinds of care are eligible for subsidy ("ECEC type eligibility"); and how the policy is implemented ("delivery mechanism").

Table 2. Comparison of Policy Designs

Policy	Income Targeting	Fiscal Cost Control Mechanisms	ECEC Type Eligibility	Delivery Mechanism
Universal Subsidy	More generous at low incomes, but all families qualify for some relief	None: subsidies grow with cost of providing care	Formal paid arrangements	Family-specific copay caps
Income-Limited Subsidy	More generous at low incomes, with high-income families ineligible	None: subsidies grow with cost of providing care	Formal paid arrangements	Family-specific copay caps
Expanded Care Credit	More generous at low incomes	Eligible expenses capped at $8,000 per child	All paid arrangements	Income tax credit
Provider Tax Credit	None	None: subsidies grow with care worker wages	Formal paid arrangements	Tax credit for providers
Child Allowance	None (though $1,000 represents a larger fraction of income at low income than high incomes)	Not tied to ECEC spending	Not conditioned on ECEC use	Cash transfer

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Effects on ECEC Enrollment

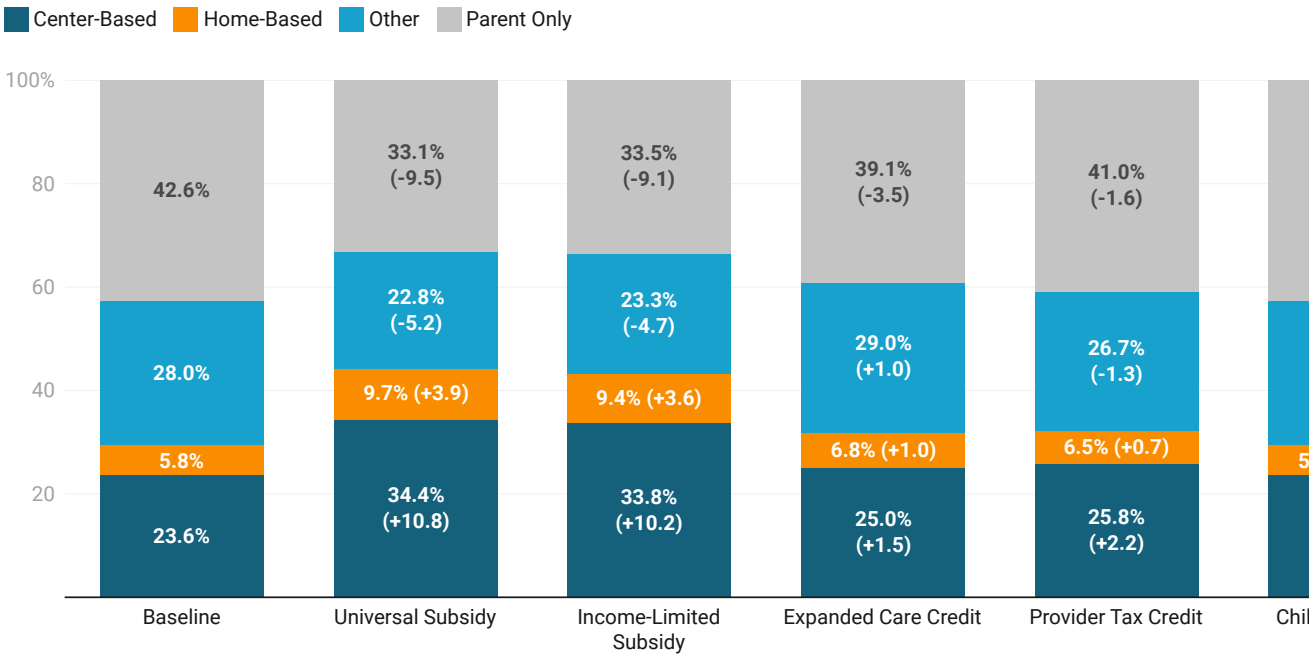
Each policy creates distinct incentives for families to place their children in different forms of ECEC, which in turn has implications for care worker wages, the prices families pay for childcare, and for long-run effects on children's earnings in adulthood. Below, we report estimated impacts on enrollment patterns, classifying children as being primarily enrolled in one of four types of ECEC arrangement:

- **Center-based care:** care provided at a center-based facility, including both paid programs (like private daycares) and free programs (like Head Start or public pre-K).
- **Home-based care:** care provided in home-based (often called "family-based') daycare programs.
- **Other care:** all remaining non-parental care arrangements, including regular care provided by nannies or relatives.
- **Parent-only care:** no regular attendance in any non-parental care arrangement.

Figure 3 shows ECEC enrollment patterns under baseline and under each reform scenario. We show results for 2030, since we assume—given the potentially large adjustments to ECEC enrollment, provider hiring, and other supply constraints—that the policy-induced changes to ECEC that we estimate will take multiple years to phase in.

Figure 3. Child Care Enrollment by Type (2030)

Share of children ages 0-4 (percentage points), with pp change from baseline



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- Our baseline estimates suggest that just over 40 percent of children ages 0-4 are not enrolled in any regular non-parental care arrangement. Just under one-quarter of children are enrolled in center-based care and just over one-quarter are in the "other" category. The remaining fraction of families utilizes home-based care.
- Direct subsidy policies (Universal Subsidy and Income-Limited Subsidy) would produce large shifts into formal care. We estimate that the fraction of children in center-based care would grow from less than one quarter to more than one third—an increase of almost 50 percent—driven by shifts out of both parent-only and other care arrangements.

    - This large shift is driven by policy design. Because each policy caps out-of-pocket expenses, families are largely insulated from higher sticker prices, making more-expensive arrangements like center-based care relatively more attractive.

- The Expanded Care Credit would also lead to families choosing less parent-only care and more center-based care. But unlike under the two direct subsidy policies, children would move *into* the "other" category, not out of it.

    - This difference is due to two factors. First, while the Universal Subsidy and Income-Limited Subsidy options restrict eligibility to formal care provided in centers or homes, care-type eligibility under the CDCTC is broader and includes options like nannies. Second, the expense cap under the CDCTC encourages families to choose cheaper options.

- The Provider Tax Credit policy works by subsidizing the labor costs of formal ECEC providers. Some of these cost savings would be passed on to consumers in the form of lower sticker prices for center- and home-based care (see the section below titled "Effects on ECEC Prices and Care Worker Wages" for more details). This translates to a modest enrollment shift into these forms of care, with outflows from parent-only and other forms of care.

- The main channel by which policy changes care arrangements is by altering relative prices across forms of care. Because the Child Allowance delivers identical payments regardless of which arrangement families choose, it leaves these relative prices unchanged. It is possible that extra disposable income would allow families to afford and thus "trade up" for higher-price care options, like moving from informal care to center-based care. But given economic evidence on the effects of income on parental decision-making, we find that these effects are negligible for a subsidy of the size we study: under the Child Allowance policy, ECEC enrollment patterns would look nearly identical to those at baseline.

Effects on Maternal Employment

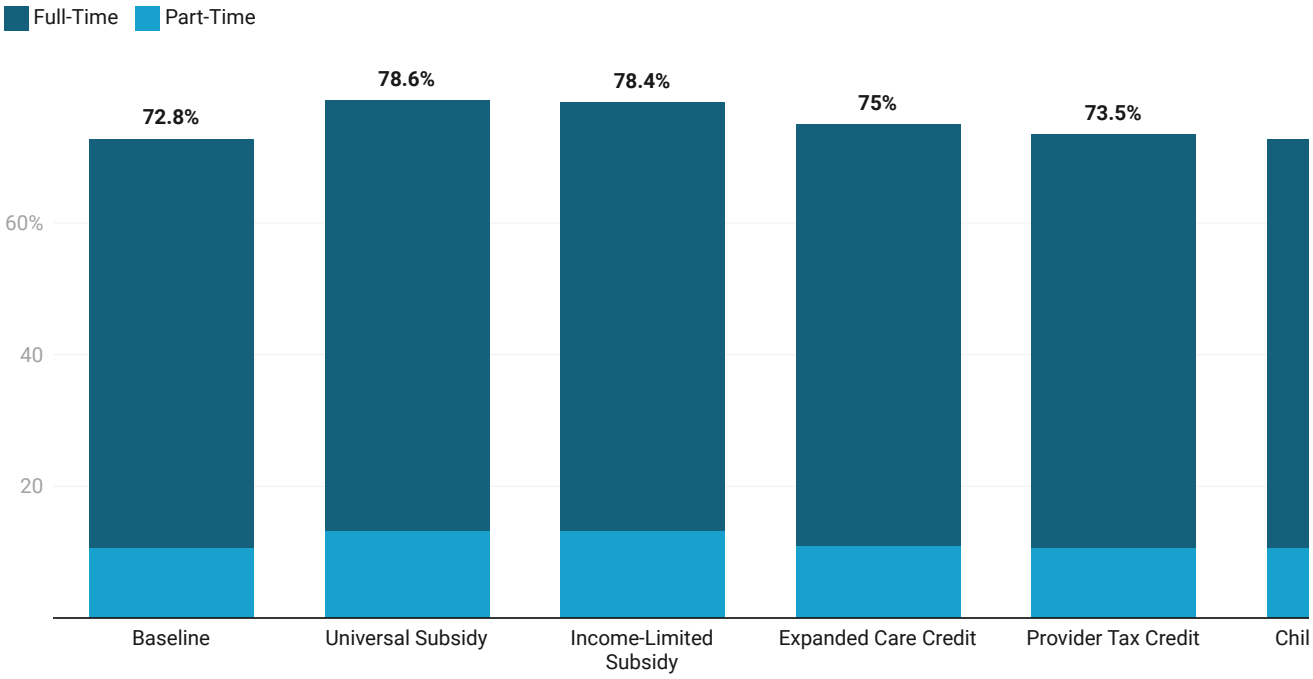
Parental decisions about childcare are tightly bound up with decisions about whether and how much to work. This is especially true for mothers of young children, who typically bear a disproportionate share of caregiving duties within families.

It is thus unsurprising that the estimated changes in ECEC enrollment under each policy, described above, are also accompanied by changes in maternal employment. When subsidies reduce out-of-pocket childcare costs, the net return to work rises. Policies that reduce the cost of formal care should, all else equal, cause some stay-at-home mothers to instead enter the labor force and send their child to daycare or preschool.

Figure 4 shows estimated employment rates for mothers of children ages 0-4 in 2030 under each policy.

Figure 4. Maternal Employment Rates (2030)

Employment rates for mothers of children ages 0-4



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- The two copay cap subsidy policies (Universal Subsidy and Income-Limited Subsidy) would increase employment rates among mothers of young children by around 6 percentage points. Among those who start working, a little over half enter full-time work, with the remainder entering part-time work. These shifts are consistent with our large estimated impacts on patterns of care usage, with more than 10 percent of children moving out of parent-only and informal care arrangements and into formal ECEC.
- The Expanded Care Credit and the Provider Tax Credit would generate comparatively smaller boosts to maternal employment—a difference due largely to smaller average subsidies.
- Unlike the other policies, which change the *relative* attractiveness of work and nonwork (what economists call the "substitution effect"), the Child Allowance policy merely increases the income of all families—regardless of which decisions they make about care and work (the "income effect"). Empirical evidence shows that substitution effects

are much larger than income effects.[3] The Child Allowance policy, accordingly, has a negligibly small negative impact on maternal employment.

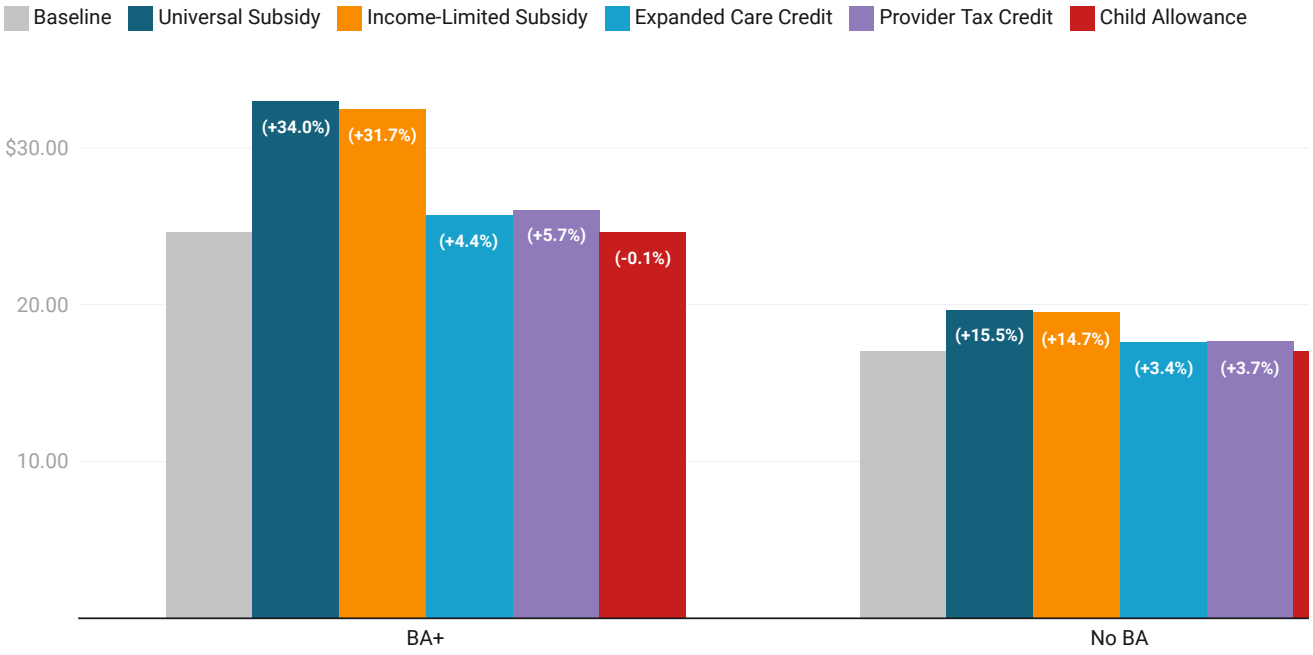
Effects on Care Worker Wages and Employment

When demand-side subsidies make formal care cheaper, more families try to enroll. Meeting this demand requires hiring more care workers, which in turn requires raising wages to attract workers to the ECEC sector.

Figures 5 and 6 present estimates of changes in care worker wages and employment, respectively.

Figure 5. Care Worker Hourly Wages (2030)

Equilibrium wages by worker education level, 2026 dollars



Percent change from baseline in parenthesis

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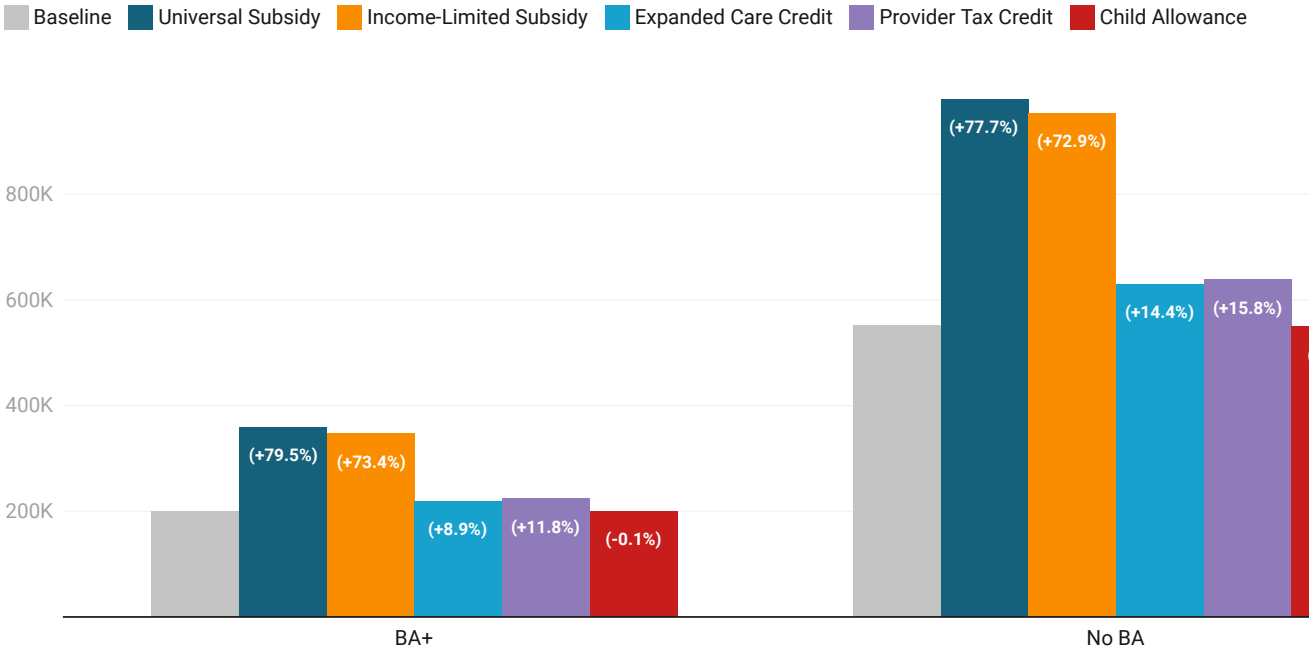
Figure 6. Care Worker Employment (2030)

Full-time equivalent workers by education level (2,000 hours/year)



Percent change from baseline in parenthesis

Chart: The Budget Lab • Source: The Budget Lab analysis • Created with Datawrapper

- The Universal Subsidy and Income-Limited Subsidy policies, which are the most generous policies considered in this report, would generate the largest demand responses.
    - To meet this demand, the ECEC workforce would have to expand dramatically: providers would need to hire more than half a million full-time-equivalent workers, an almost 80-percent increase from baseline.
    - Attracting this many workers would require raising average hourly wages from about $17 to $20 for care workers without a college degree and from about $25 to $33 for college-educated workers.
- The Expanded Care Credit would generate more modest wage effects.
    - Because the maximum subsidy amount is smaller than in either the Universal or Income-Limited Subsidy policies, and because the design allows for recipients to use the credit for informal care options, the demand increase for formal care is smaller, and fewer additional workers are needed.
- As discussed below, the Provider Tax Credit reduces ECEC sticker prices by subsidizing labor demand by providers. This price decline generates some additional enrollment (and thus hiring and wage increases), but less than under the copay cap policies.
- The Child Allowance, for reasons discussed in the "Enrollment Effects" and "Employment Effects" sections, produces negligible changes in demand for formal care. Wages and ECEC sector employment thus stay nearly unchanged from baseline levels.

Increases in wages for ECEC care workers may have important effects on children's outcomes beyond those our model captures (see below). Research has found that lower care worker wages are associated with higher turnover, which in turn can have meaningfully negative impacts on children's future outcomes, especially for children in lower-income households (Grunewald, Nunn, and Palmer, 2022). To the extent that the subsidy policies we analyze here decrease care

worker turnover through their effects on higher wages, they could, in turn, improve outcomes for these children in areas such as social development and language and literacy skills (Hamre et al., 2014).

Effects on ECEC Market Prices

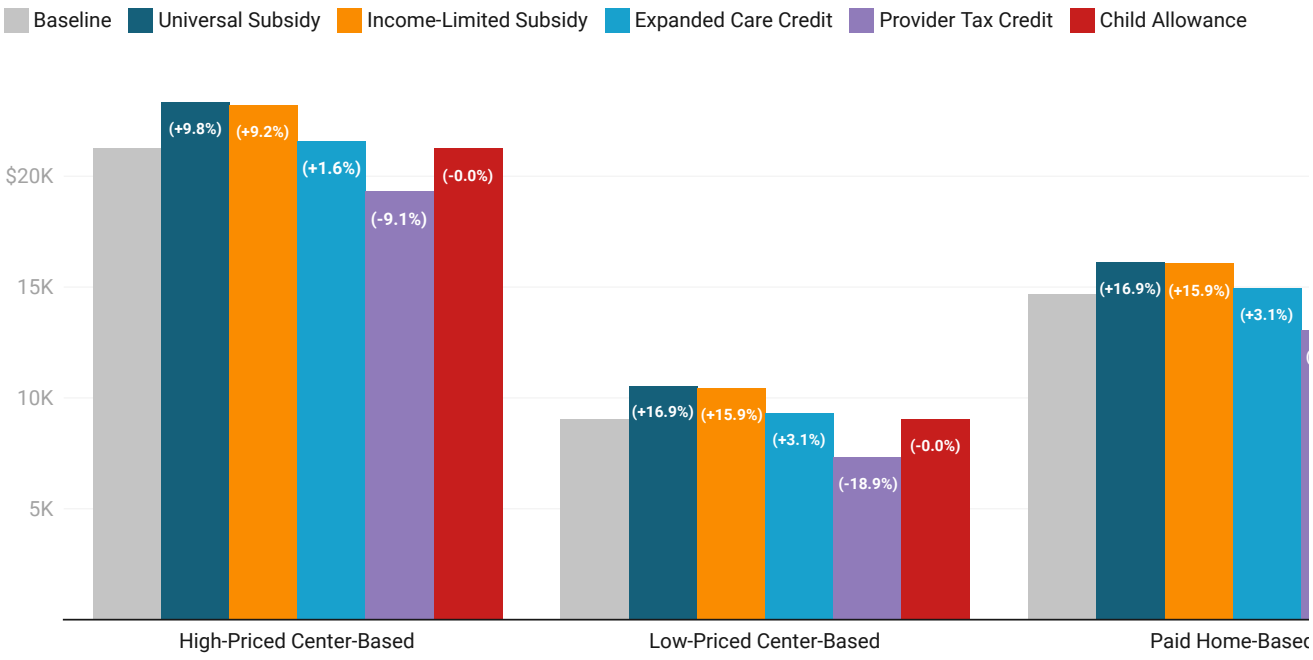
As discussed in the previous section, increased demand for care resulting from subsidies requires ECEC providers to raise wages to attract more workers. Labor is the largest cost faced by ECEC providers; the Department of Labor reports that care worker compensation represents 60 to 80% of provider operating costs. Higher wages, then, lead providers to raise prices to cover their increased costs. These higher prices, in turn, offset some of the initial increase in demand.

In this section, we present estimates of how these dynamics play out in equilibrium. Understanding these results helps contextualize other results in this report. For example, subsidy-driven price hikes increase fiscal costs and erode benefits for unsubsidized families.

Figure 7 shows estimated impacts on market (i.e. pre-subsidy) prices in the ECEC sector.

Figure 7. Annual Cost of Full-Time Care (2030)

Equilibrium market prices, 2026 dollars (2,000 hours/year)



Percent change from baseline in parenthesis

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- As discussed in the previous section, the Universal Subsidy and Income-Limited Subsidy policies would generate large increases in care worker employment and wages.
    - These wage hikes, about 15 percent and 30 percent respectively, would translate to increases in sticker prices of between 9 and 17 percent, depending on the type of care.
- The Expanded Care Credit would generate more modest wage effects, leading to smaller effects on market prices.
    - Moreover, the CDCTC's expense cap of $8,000 per child means that subsidies do not grow with price above that cap—so unlike under the copay cap policies, families are not fully insulated from price increases. This limits the feedback loop between subsidies and prices: as prices rise, families bear more of the increase, which dampens demand and further limits upward pressure on wages and prices.

- As noted above, the Provider Tax Credit reduces providers' input costs by covering part of the wage bill, allowing firms to offer the same amount of care slots at lower sticker prices. Even with increased demand offsetting some of these decreases, market prices are lower in equilibrium.
- Finally, the Child Allowance produces negligible changes in ECEC market prices.

Effects on Children's Future Earnings

Beyond their immediate impacts on family budgets, maternal employment decisions, and the federal budget, ECEC policies may also affect children's long-run economic outcomes. Empirical research finds evidence that enrollment in certain types of early childhood care and education improves performance on cognitive assessments. These gains are associated with higher earnings in adulthood. Therefore, policies that allow families to switch from ECEC arrangements that yield relatively low earnings in adulthood to those that yield relatively high earnings in adulthood may have effects that go beyond the immediate impacts on family budgets.

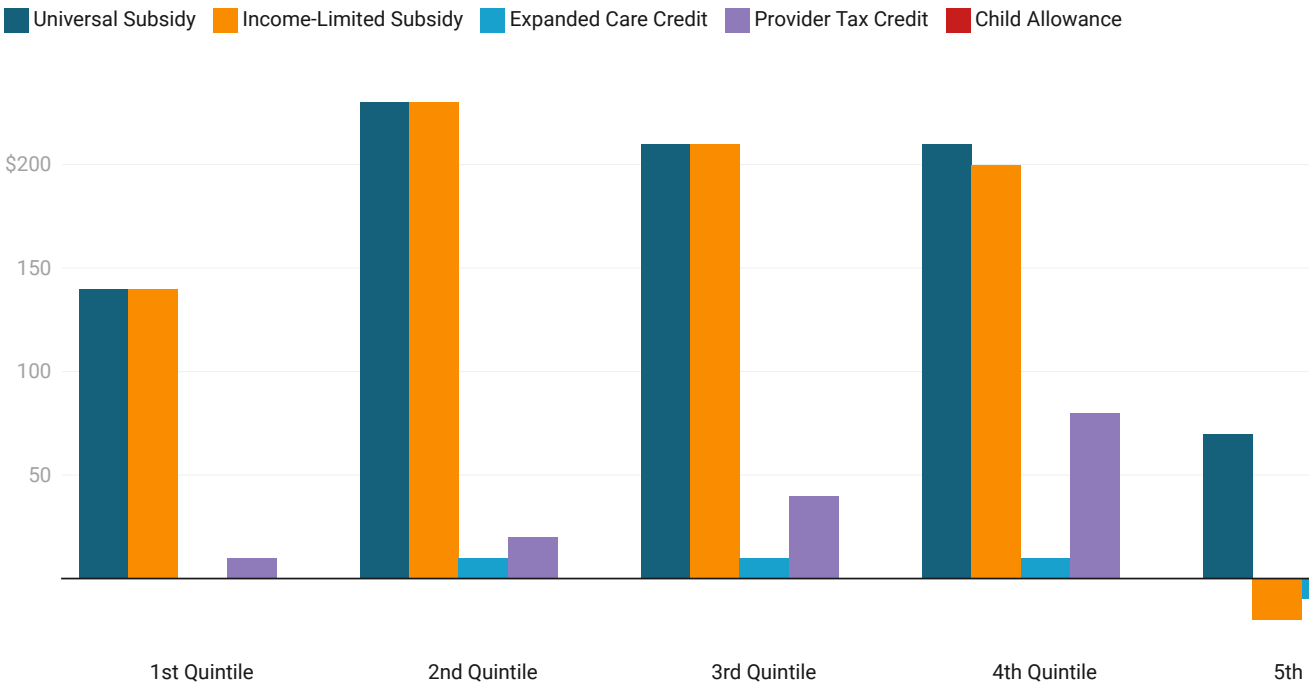
Because our model tracks how policy affects ECEC enrollment patterns, we can translate those changes into estimates of long-run earnings impacts for children. We do so by mapping policy-induced changes in care arrangements to changes in children's test scores (using different estimates for younger and older children), then converting those test score gains into projected adult earnings.[4] These estimates should not be taken as normative judgments about what constitutes "better" childcare. Instead, they are meant to incorporate the existing empirical literature on average effects on one aspect of children's long-run outcomes: later-in-life earnings.

(A full description of how we measure the impact of ECEC arrangements on cognitive assessments and how we translate these impacts into long-run effects on earnings can be found in the documentation for the ECEC model.)

Figure 8 shows the average estimated change in earnings at age 27, per child, by quintile of the *parent* income distribution. These are averages across all children in each quintile—including those whose care arrangements do not change under the policy—so they reflect both the size of the earnings gain for children who do switch and the share of children in each quintile who are induced to switch.

Figure 8. Change in Child Earnings at Age 27 by Parent Income Quintile

Average per child, real 2025 dollars (unconditional)



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- The Universal Subsidy and Income-Limited Subsidy policies, which produce the largest enrollment shifts toward center-based care, would generate the largest estimated earnings gains.
    - Benefits would be concentrated among children from lower- and middle-income families who, due to the progressive structure of the policies, are the most likely to move from parent-only or informal care into formal center-based programs.
    - Under the Income-Limited Subsidy policy, future earnings would actually fall slightly for children of top-quintile parents. This is because some higher-income parents, who do not qualify for the subsidies which insulate families from rising prices, would shift away from care options that yield relatively higher earnings in adulthood.
- The Expanded Care Credit would produce very small changes in children's future earnings.
    - As discussed in the "Enrollment Effects" section, the CDCTC's broad care-type eligibility and expense cap encourage families to choose cheaper informal arrangements, so fewer children transition into care types yielding higher future earnings.
- The Provider Tax Credit would also generate positive earnings effects by reducing sticker prices for formal care.
    - Because these price reductions are not targeted to lower-income families (as is the case for some of the other policies), enrollment shifts are more evenly spread across quintiles than under the copayment cap policies. This translates into average earnings impacts that rise with parent income, since children of higher-income parents earn more on average in adulthood.[5]
- The Child Allowance, which does not alter the relative prices of different forms of care, would produce negligible effects on children's future earnings through the channels we consider in this report.[6]

Fiscal Effects

Table 3 shows estimated direct federal budget effects of each policy over the next three decades. These estimates account for the direct cost of subsidy payments (or tax credits), net of changes in tax revenue driven by shifts in parental employment. They also reflect the effects of changes in enrollment and changes in sticker prices.

Importantly, these fiscal effect estimates do not include other potential indirect savings to the federal government, such as decreases in utilization of public assistance programs (such as Medicaid and SNAP) or decreases in criminal justice involvement, nor do they include potential labor productivity gains beyond the children directly affected by the policies. The estimates also do not include effects on state and local spending and revenues.

Table 3. Estimated Budget Costs by Decade

Nominal ($B) and share of GDP, with direct subsidy cost and tax revenue sub-components

	Budget Window		Second Decade		Third Decade	
Scenario	**Nominal**	**GDP%**	**Nominal**	**GDP%**	**Nominal**	**GDP%**
Universal Subsidy	**-$770B**	**-0.20%**	**-$1,118B**	**-0.20%**	**-$1,288B**	**-0.16%**
Direct Subsidy Costs	*-$784B*	*-0.20%*	*-$1,148B*	*-0.21%*	*-$1,328B*	*-0.17%*
Effects on Tax Revenue	*$14B*	*0.00%*	*$30B*	*0.01%*	*$40B*	*0.00%*
Income-Limited Subsidy	**-$728B**	**-0.19%**	**-$1,054B**	**-0.19%**	**-$1,217B**	**-0.15%**
Direct Subsidy Costs	*-$737B*	*-0.19%*	*-$1,080B*	*-0.19%*	*-$1,254B*	*-0.16%*
Effects on Tax Revenue	*$9B*	*0.00%*	*$27B*	*0.00%*	*$38B*	*0.00%*
Expanded Care Credit	**-$103B**	**-0.03%**	**-$127B**	**-0.02%**	**-$138B**	**-0.02%**
Direct Subsidy Costs	*-$0B*	*-0.00%*	*-$0B*	*-0.00%*	*-$0B*	*-0.00%*
Effects on Tax Revenue	*-$103B*	*-0.03%*	*-$127B*	*-0.02%*	*-$138B*	*-0.02%*
Provider Tax Credit	**-$90B**	**-0.02%**	**-$128B**	**-0.02%**	**-$165B**	**-0.02%**
Direct Subsidy Costs	*-$96B*	*-0.03%*	*-$135B*	*-0.02%*	*-$172B*	*-0.02%*
Effects on Tax Revenue	*$6B*	*0.00%*	*$7B*	*0.00%*	*$6B*	*0.00%*
Child Allowance	**-$194B**	**-0.05%**	**-$241B**	**-0.04%**	**-$280B**	**-0.04%**
Direct Subsidy Costs	*-$194B*	*-0.05%*	*-$241B*	*-0.04%*	*-$280B*	*-0.04%*
Effects on Tax Revenue	*$0B*	*0.00%*	*$0B*	*0.00%*	*$0B*	*0.00%*

Table: The Budget Lab • Source: The Budget Lab analysis • Created with Datawrapper

- The Universal Subsidy and Income-Limited Subsidy policies would have similar budget effects despite the latter imposing an income restriction. The reason for the small difference is that only a small minority of parents of young children earn above the income eligibility threshold (250% of median income), and among those who do

earn that much, the Universal Subsidy policy only covers the costs above 7 percent of income—and most care options generate costs of less than 7 percent of income for high-income families. (This similarity in effects is seen across all aggregate outcome metrics for these two policies.)

- The Expanded Care Credit and Provider Tax Credit, policies that are less generous in aggregate compared to the copay cap subsidies, generate correspondingly smaller fiscal impacts.
- As noted above, the Child Allowance policy does not meaningfully shift enrollment or employment behavior. Therefore, the policy's budget cost largely reflects a simple mechanical accounting exercise: $1,000 (adjusted for inflation) times the number of children aged 0-4.

Aside from these multi-decade budget estimates, another way to analyze fiscal impacts is to perform a net present value (NPV) calculation, where the direct costs of the policy are weighed against indirect fiscal benefits from the policy's longer-term economic impacts. In the case of ECEC policy, the direct fiscal costs are the subsidy outlays; the indirect fiscal benefits are higher tax payments from children who earn more in adulthood after being enrolled in forms of ECEC that are estimated to have a larger impact on children's future earnings. Because these tax revenues accrue decades from now, they need to be discounted when compared to the near-term costs.

We apply the child earnings estimates described in the previous section to The Budget Lab's projected population of tax filers in future years, accounting for intergenerational income mobility patterns so that children who benefit from ECEC policy are accurately matched to future earnings profiles and tax rates. Combining this information, we get projected annual changes in tax revenue due to policy-driven changes in human capital development starting two decades from now (when today's children enter the workforce).

Table 4 shows how these fiscal costs and benefits, appropriately discounted to 2026, stack up under each policy.[7] Calculations are done for a single cohort of children exposed to the policy reform environment from birth through age four. It reports the share of upfront net cost of the policy (including tax changes from parental employment changes) that are eventually recouped in the form of higher federal tax revenues decades from now—a kind of fiscal return-on-investment (ROI) metric we call the *federal tax revenue recovery ratio*. Policies that shift enrollment towards forms of care with a larger estimated impact on children's future earnings and that target benefits towards children of higher-income parents—who themselves tend to earn more and face higher tax rates in adulthood—will generally see higher federal tax revenue recovery ratios. (We stress that this is not a social ROI metric but rather a narrower financial calculation concerning the federal budget.)

Table 4. Fiscal Net Present Value at 3% Discount Rate

Upfront net cost, long-run returns, and fiscal recovery ratio at 3% discount rate

Scenario	Upfront Net Cost	Long-Run Returns	Fiscal Recovery Ratio
Universal Subsidy	$93B	$7B	7.5%
Income-Limited Subsidy	$88B	$6B	6.7%
Expanded Care Credit	$11B	$0B	3.6%
Provider Tax Credit	$8B	$2B	23.9%
Child Allowance	$19B	-$0B	-0.2%

Table: The Budget Lab • Source: The Budget Lab analysis • Created with Datawrapper

- None of the policies "pay for themselves" in fiscal terms—that is, all recovery ratios are less than one.
- The policy with the highest recovery ratio is the Provider Tax Credit policy. This finding is the result of two features of this policy:
  - First, because it focuses on formal, licensed types of care, the policy encourages shifting into forms of ECEC with a greater estimated impact on children's future earnings.
  - Second, relative to other policies which disproportionately impact low-income families, these enrollment shifts are concentrated among children of higher-income parents. These children, on average, have higher incomes and face higher tax rates, leading to relatively more tax revenue in the future.
- The Universal Subsidy and Income-Limited Subsidy policies, like the Provider Tax Credit policy, shift enrollment towards ECEC arrangements with higher impacts on children's future earnings. The typical beneficiary, however, has lower income as an adult than that of the Provider Tax Credit policy, leading to lower fiscal benefits.
- The Expanded Care Credit policy has a very low federal tax revenue recovery ratio because it does not necessarily target forms of care with larger impacts on children's future earnings in its subsidy design.
- Because it generates negligible behavioral responses, the Child Allowance policy generates essentially zero long-term fiscal benefits.

Distributional Effects

How does each policy affect families across the income distribution? In this section, we introduce The Budget Lab's preferred way of measuring policy-induced changes in a given family's well-being, which we call the *economic value* of the policy for that family. We then show how this measure varies across the income distribution for each of the five policies we consider.

Economists often quantify how a proposed policy would change an individual's (or family's) well-being by asking, "How much additional income would the individual (or family) need in order to be exactly as well-off today as they would be if the policy were enacted?"[8] For many policies, it is straightforward to answer this question: for example, if we were to impose a $1 tax on all individuals, every individual would be made worse off by exactly $1.

In other cases, like for the policies we study in this report, the answer is less straightforward. This is primarily because families can (and do) shift their utilization of different forms of childcare in response. This means that simply computing the change in out-of-pocket childcare spending due to the policy is not a good measure of the change in families' well-being. Suppose, for example, that a family shifts from unpaid childcare provided by a grandparent to center-based childcare once the latter is subsidized. In this case, their out-of-pocket childcare spending would go *up*—but they could very well be better off because a more-preferred but previously unaffordable childcare arrangement is now available to them.

For this reason, we prefer to use a metric we call *economic value*—which takes into account both changes in out-of-pocket prices faced by families *and* changes in use of different forms of childcare—when quantifying policies' impacts on families across the distribution.[9] In a companion blog post, we explain in detail how we calculate this metric and how it relates to other common distributional metrics, such as changes in after-tax-and-transfer income and changes in out-of-pocket spending.

Figure 9 shows the average economic value for each policy for families in each quintile of the income distribution, as well as for the top 10, 5, and 1 percent.[10]

- The Universal Subsidy, Income-Limited Subsidy, and Expanded Care Credit policies all show a similar pattern of progressivity: economic value is higher (in both dollar and percent-of-income terms) for families in the middle and at the bottom of the distribution, while those towards the top are made slightly worse off (largely due to increases in market prices for paid forms of childcare).
- Economic value is highest in dollar terms for the Provider Tax Credit policy for families at the top of the income distribution, who tend to use higher-priced forms of care and who thus benefit most from the policy's reductions in market prices. When expressed as a share of baseline income, however, the policy's benefits are higher towards the bottom of the distribution than at the top.
- The economic value of the Child Allowance policy is exactly equal to $1,000 per child for all families. Because this flat value does not vary with income, the policy has greater benefits as a share of baseline income for those at the bottom of the income distribution.

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Appendix: Additional Policy Details

Universal Subsidy

Under this policy, out-of-pocket childcare costs would be capped for all families with working parents. The subsidy is structured as a sliding-scale copayment system under which families would pay at most a specified fraction of income based on their family size and Adjusted Gross Income (AGI). Specifically:

- 0% (free): families earning up to 85% of the AGI threshold
- 2%: families earning between 85% and 100% of the AGI threshold
- 4%: families earning between 100% and 125% of the AGI threshold
- 7%: families earning more than 125% of the AGI threshold

The AGI threshold is calculated with reference to the median AGI for tax returns with four people filed in the previous year, and is then adjusted for family size.[11]

For this policy, a "family" is defined as the group of people who would file a tax return together if required.[12] Eligibility would be restricted to families where each parent is employed.

While this policy shares some similarities to the subsidy design under the proposed Child Care for Working Families Act, we stress that our numbers do not reflect a score of that exact policy, which is different in important ways.[13]

Income-Limited Subsidy

This policy would be identical to the Universal Subsidy policy except that families making above 250% of the median income would be ineligible. This income limitation makes the subsidy schedule similar to that of the childcare provision in the Build Back Better Act of 2021 (BBBA). (As with our disclaimer for the Universal Subsidy policy, it should be noted that our analysis is not a score of the exact BBBA policy.)

Expanded Care Credit

This policy would expand the Child and Dependent Care Tax Credit (CDCTC), permanently enacting provisions similar to those temporarily in effect under the American Rescue Plan Act (ARPA) of 2021. The CDCTC, under current law, is a tax credit that allows parents to claim an income-based percentage of eligible ECEC costs, up to an expense cap, as a credit on their tax returns. Eligible expenses cannot exceed earnings from work (in the case of joint returns, the lesser of both parents' earnings is used in the calculation); this design feature represents a work requirement. The credit is nonrefundable, meaning that its value is limited to positive income tax liability. In practice, this means that low-income families, who face low or no income taxes, are generally ineligible for the credit.

Under current law as amended by the One Big Beautiful Bill Act of 2025, the credit rate for tax year 2026 starts at 50% for families with AGI at or below $15,000 for single filers ($30,000 for joint filers). The rate declines by one percentage point for each $2,000 of AGI above those thresholds, reaching a floor of 35%. A second phase-out then reduces the rate from 35% to 20% for single filers with AGI between approximately $75,000 and $105,000 ($150,000 to $210,000 for joint filers). The credit applies to up to $3,000 of expenses per child for up to two or more qualifying children ($6,000 total).

The proposal would make the following changes:

- **Eligible expense limit.** The per-child eligible expense cap would be raised from $3,000 to $8,000, with a maximum of two qualifying children ($16,000 total). This more than doubles the maximum amount of care spending that can be subsidized through the credit.
- **Credit rate schedule.** The credit rate—the fraction of eligible expenses covered by the credit—would use a two-tier phase-out structure:
  - For families with AGI at or below $125,000, the credit rate would be 50%.
  - As AGI rises above $125,000, the credit rate declines by one percentage point for each $2,000 of AGI, reaching 20% at approximately $185,000.
  - The rate remains at 20% for AGI between $185,000 and $400,000.
  - Above $400,000, the rate again declines by one percentage point per $2,000, reaching zero at approximately $440,000. Families above this threshold would be ineligible for the credit entirely. (Under current law, the credit rate never falls below 20%, regardless of income. The expanded policy's complete phase-out above $440,000 thus represents a meaningful change at the top of the income distribution.)
- **Refundability.** The credit would be made fully refundable, meaning that families would receive the full credit value even if it exceeds their income tax liability.
- **Inflation indexing.** The eligible expense limit ($8,000), income phase-out thresholds ($125,000 and $400,000), and the discrete rounding step ($2,000) would all be indexed to inflation using the chained Consumer Price Index. Dollar amounts described above are expressed in 2026 dollars.
- **Work requirement.** As under current law, eligible expenses cannot exceed the lesser earner's income for married couples filing jointly. This implicit work requirement is unchanged by the expansion.

Appendix Table 1 summarizes the changes relative to current law.

Table A1. Expanded Care Credit Summary

Parameter	Current Law (post-OBBBA)	Expanded Care Credit
Maximum credit rate	50%	50%
50% rate applies up to AGI of...	$15,000 / $30,000 (single/joint)	$125,000
Expense cap per child	$3,000	$8,000
Refundability	Nonrefundable	Fully refundable
Credit rate floor	20% (never phases out fully)	0% (phases out starting at $400,000)
Inflation indexing	No	Yes

Table: The Budget Lab • Source: The Budget Lab analysis • Created with Datawrapper

For more information on how this policy would work, including visualizations of the subsidy schedule, see this Congressional Research Service report.

Provider Tax Credit

This supply-side policy would provide a direct per-worker-hour subsidy to ECEC providers, reducing their effective labor costs. The subsidy would be equal to 25 percent of payroll costs. For private providers operating in the paid formal care sector (center-based and home-based care), the subsidy would be provided in the form of a refundable payroll tax credit. Unpaid center-based programs (e.g., Head Start, public pre-K), on the other hand, would receive additional funding equal to 25% of payroll costs.

The subsidy reduces providers' effective wage bill without reducing workers' actual pay. In the model's equilibrium, this cost reduction flows through to families primarily via lower market prices for formal care, though some portion is absorbed by higher wages as additional demand draws more workers into the sector.

Child Allowance

This policy would provide a new $1,000 annual cash transfer for each child ages 0-4, with the credit amount indexed to inflation. The credit would be genuinely universal: there would be no income phase-out, no employment requirement or earnings phase-in, and no restriction based on the family's choice of care arrangement.

Footnotes

1 The Budget Lab's ECEC model draws on the work of Borowsky et al. (2022) and Brown et al. (2026) [Brown, Jessica H., Chloe R. Gibbs, Neale Mahoney, and T.V. Ninan. 2026. "The Stanford Childcare Model." Palo Alto, CA: Stanford Institute for Economic Policy Research.]. We are grateful to the authors of those papers for their advice and guidance in the development of TBL's model.

2 To be specific, for the Universal Subsidy and Income-Limited Subsidy policies, we assume that profit margins of for-profit providers are fixed at their baseline level through a cost-control mechanism in the policy—for example, setting provider reimbursement rates based on a cost structure formula rather than reported sticker prices for care, as has been the case in several legislative proposals for federal childcare subsidies. Put differently, our model allows for these subsidy policies to generate higher market prices due to higher costs of care provision (for example, due to higher labor costs) but not due to higher profit margins, as could be the case under a policy that naively reimbursed whatever sticker price that providers charge.

3 See, for example, McClelland and Mok (2012).

4 In our estimation procedure, we assume that effects on later-in-childhood test scores from switching from one form of childcare to another do not vary by parental income. We make this assumption because the existing literature does not provide sufficiently consistent estimates of the magnitude of heterogeneity in treatment effects for us to confidently adjust average treatment effects to account for such heterogeneity. Because there is evidence that the effects of switching may be smaller for children of higher-income parents (see, for example, Havnes and Mogstad 2015), our child earnings estimates—and the federal tax revenue recovery ratios discussed in the next section—may be too large to the extent that switching benefits are smaller for children of higher-income parents.

5 Our assumed functional form expresses earnings impacts in percentage terms, so the same percent increase in earnings applied to a higher-earning future worker generates a larger dollar-amount effect size than if applied to a lower-earning future worker. (As discussed in footnote 4 above, these figures should be seen as upper-bound estimates.)

6 These estimates focus on the impact of these policies on future earnings via their effects on children's enrollment in different ECEC environments. They do not account for effects on children's earnings of increases in after-tax parental income per se, which has been a topic of previous research from The Budget Lab.

7 We use a real discount rate of 3 percent following Hendren and Sprung-Keyser (2020).

8 Economists refer to this quantity as the equivalent variation for the policy or (equivalently) individuals' or families' willingness to pay for the policy.

9 For a given family, the economic value of a policy is equal to the average of two quantities: (1) The change, under the policy, in the family's after-tax income net of out-of-pocket ECEC spending if they had kept their baseline choice of care type(s) and work decisions unchanged; and (2) The change, under the policy, in the family's after-tax income net of out-of-pocket ECEC spending if they had chosen the same care type(s) and work decisions in the baseline as they ultimately do under the policy.

10 Note that this value does not directly incorporate longer-run benefits to children, such as the increased earnings estimated above.

11 The adjustment ratios for family size would be based on those of 45 CFR § 96.85, which is used to determine State Median Income adjustments for the Child Care and Development Block Grant. We estimate that for 2026 the AGI thresholds would be roughly: 1-person: $58,000; 2-person: $75,000; 3-person: $93,000; 4-person: $111,000; 5-person+: $129,000.

12 The one exception is unmarried but cohabitating parents, for whom family concepts are calculated by aggregating individual tax unit concepts.

13 Among other differences, the Universal Subsidy policy is based on tax information and not Census family information, has no reference to state-specific income thresholds, and does not impose provider wage requirements.