How to Finance Public Investment in High Quality Early Childhood Education and Care When Government Budgets are Tight

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Introduction

Let me begin by noting that I am somewhat embarrassed to be here talking to you. This is not because of who you are, but because of who I am. I am a professional economist and, sadly, it is a profession that has never attracted a great deal of either respect or admiration. As someone once put it, "Economists are just people who work with numbers and never had the personality to become accountants". And, of course, the continuing economic crisis has hardly enhanced their reputation. Indeed the models used by most economists completely failed to see the crisis coming; not least because most of these models ruled out such events by assumption. As Kenneth Boulding said many years ago "Even an economist, when he sees something happen, has to admit it is possible". So there is currently a lot of eggs on a lot of faces, and a lot of fundamental rethinking going on.

But an even greater source of embarrassment is that I am here to talk to a group of experts on ECEC, a subject about which I know very little. The saving grace is that I want to talk about a specific aspect of ECEC that does have something to do with my professional training. What arguments would you make to get more money out of the Minister of Finance when he feels he has no money to give? Broadly speaking, I want to suggest that you speak to him in language he is sure to understand; namely that ECEC is good for economic growth, and what is good for growth is good for taxes.

Before beginning, let me assure you that I understand there is more to ECEC than just its economic utility. In fact, I profoundly agree with John Maynard Keynes, who was both a great economist and a cultivated gentleman, when he said in 1943:

> "The day is not far off when the economic problem will take the back seat where it belongs and the arena of the heart and the head will be occupied or reoccupied, by our real problems- the problems of life and of human relations, of creation and behavior and religion"

Well, that is all very well, but we still have a difficulty. First, we have to get the money. My speech then reflects the philosophy of Willy Sutton who, aged 80, was being sentenced to jail (yet again) for robbing banks. When the judge asked him why he kept robbing banks, Willy responded simply but effectively: “Because that’s where the money is.” Tonight then, let us pretend we are robbing a few banks.

What is the Economic Problem?

It has two main facets, and they are both serious. Ministers of Finance are truly between a rock and a hard place.

First, government debts have risen to levels that markets increasingly fear cannot be serviced out of available tax revenues. This sets the stage for a rise in interest rates that makes the servicing problem worse, a ”self-fulfilling run”. This is the fundamental reason for the need for fiscal consolidation. But to make matters worse, the potential growth rate of most OECD economies has fallen in the wake of the crisis, threatening tax revenues near term. And a sharp drop in fertility rates and the labor supply will worsen things even more in the further future.

As to how we got into the current fiscal mess, I believe it was many decades of asymmetrical policies with deficits rising sharply in bad years and never being adequately reined in during good years. This tendency was exacerbated in the period leading up to 2007 since the “boom” was deemed permanent - a New Era. Evidently, when the “bust” overturned this fiction, and the automatic stabilizers kicked in during the recession, the debt literally exploded.

The second facet of our economic problems is that income inequality, as measured by Gini coefficients and other indicators, has been widening sharply in OECD countries and even more sharply elsewhere. Given that social mobility has also been falling in many countries, the implication is that, for significant chunks of the population, a “culture of poverty” is becoming increasingly entrenched. If that culture eschews work in favour of welfare, again the Minister of Finance has a problem.

As to how this increasing inequality came about, there are many components. Reflecting broader aspects of social change, a growing proportion of the poor are single parents with children. Even if the parent is working, children in such circumstances have a much greater likelihood of being poor. Technological change has also made a lot of unskilled and uneducated workers redundant, while globalization and outsourcing has also played a role. None of this will be easy to roll back, even if we wanted to.

So, the Minister of Finance does have to face up to some serious problems. He or she is not saying “no” just because of being a bad person.

What Might be the Solutions

Let me begin with a few general observations before going on to some more specific measures concerning ECEC.

Evidently we need a bigger work force and a more efficient use of our economic resources if we are to “grow” our way out of the debt problem. Similarly, we need more “equity” and “fairness” in the economic system if we are to deal with the problems associated with inequality. Ministers of Finance, and economists generally, have tended to think of these objectives as conflicting. Moreover, they commonly consider that the arguments for the former dominate the arguments for the latter. I want to suggest that this way of thinking is outmoded. Equitable, or inclusive growth may well be faster growth. This opens the way for win-win solutions.

An extremely useful introduction to new economic thinking in this regard is given by Eric Beinhocker’s wonderful book “The Origin of Wealth”[1]. He starts with the observation that “cooperative behavior” is really at the root of economic growth. Moreover, he notes that a willingness to cooperate rests on trust, and that trust derives basically from the notion of fairness in our cooperative dealings. In fact he goes on to note that, after four million years of evolution, and the continued pursuit of optimal survival strategies, a sense of fairness is now hard wired into

[1] E D Beinhocker (2006) “The Origin of Wealth” Harvard Business School Press, Boston

our brains. Margaret Atwood agrees with this, noting in another remarkable book[2] that even a two year old will tell you “it isn’t fair”. From this perspective, when we allow the sense of fairness to be eroded, we may be setting ourselves up for some very bad economic outcomes.

Just by way of example, think of the various structural, and growth enhancing changes, that are now required in countries like Greece and Italy. If the short term hardships associated with these changes are not seen to be allocated “fairly”, they are simply not going to happen. Thus, on average, everyone will be shortchanged as a result.

Further reasons for seeing a positive link between income distribution and income levels is found in the recent book “The Spirit Level”[3]. To my mind, the authors make a very convincing case that countries with highly skewed income distributions suffer from a whole variety of ills. They have lower life expectancy and more health and social problems- not least more early school leavers, more mental illness, heightened criminality, more homicides and more people in prison. None of these things could remotely be thought of as growth enhancing.

ECEC is a good example of this duality. It is a policy that can foster both growth and equity, with the latter itself contributing to growth in turn. Let me focus on these growth enhancing elements, in a way that a Minister of Finance might find persuasive.

Perhaps the first point to make is that high quality ECEC can allow working women to return to the work force more quickly. Not only that, but if they are not away too long, they can maintain their place on the ladder and avoid a costly loss of human capital. In sum, we have not only more labour but more efficient labour.

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[2] M Atwood (2008) “Payback: Debt and the Shadow Side of Wealth” House of Anansi Press, Toronto

[3] K Pickett and R Wilkinson (2011) “The Spirit Level: Why Greater Equality makes Societies Stronger” Bloomsbury Press, London

A second point is no less important against the backdrop of declining fertility rates. OECD work shows clearly that counties with higher female participation rates also have higher fertility rates. It seems that in many countries women want to both have a family and have a job, and they will do so if the conditions allow. However, if forced to choose between one and the other, the evidence indicates they will increasingly choose to work. Moreover, the more educated is the woman forced to make this choice, the greater the likelihood the woman will choose to remain childless. Against the highly desirable trend of rising education levels for women almost everywhere in the OECD, the economic effects of such personal choices could prove truly disastrous for their societies. Korea and Japan are two obvious countries that must give women more choice.

A third economic argument for more ECEC, thus allowing women to work, is that it reduces household poverty. This is growth enhancing in that better off parents can put more resources into the "human capital" of their children. More and better education contributes to the development of both "cognitive skills" and "character" (not least, understanding the merits of cooperative behavior), but so does the better "parenting" made possible by less stressful economic circumstances.

Fourth, in a world where the culture of poverty is spreading, high quality ECEC provides an offset to that culture and helps put disadvantaged children on to a better educational path. The Jesuits were not entirely wrong when they said, "Give me the child for seven years, and he is mine forever". If the hard cases can have their whole life transformed by ECEC then the economy will benefit in all the ways alluded to above.

Finally, abstracting from the role of working women and the problems of the disadvantaged, there is significant evidence that high quality ECEC improves the educational and income prospects of those who participated in it. In a globalized world, in which we are increasingly forced to live off our wits (or at least our brains), this is no small advantage. Education is "where it's at", and ECEC is increasingly seen as an important part of improving overall educational outcomes.

Making the Case for More Funding for ECEC

So we have two big problems, low growth and high inequality, and we see high quality ECEC as part of the solution to both. Clearly, the arguments I have just put forward are convincing in themselves, but how might we go beyond this to actively "sell the product"

My first piece of advice would be "do not despair". I am told the Chinese character for "crisis" is a combination of the characters for challenge and opportunity. Or, as Barack Obama's Chief of Staff put it, "Never waste a good crisis". There are in fact a number of reasons for believing that the door to the Treasury might be less strongly locked than you would think.

First, standard macroeconomic theory (based on short run problems and short term solutions) has taken a big hit. I suspect there is now more open mindedness generally, and a much greater willingness to think about policies that make sense over a longer term horizon.

Second, it now seems generally agreed that standard demand side policies (expansionary monetary and fiscal policies) have been used to the limits of their capacities. The emphasis is now shifting to structural reforms to encourage growth over the longer run. I suggest that ECEC is an important part of those structural reforms.

Third, rising levels of unemployment almost everywhere attest to the fact that peoples' circumstances are not due solely to their own efforts, or lack thereof. Bad things happen, not least being born into a disadvantaged family. Thus, there should now be a greater recognition that it is appropriate for society to help such people and that this can be done without moral hazard.

Fourth, the crisis has pushed issues having to do with equity and fairness way up on the political agenda. Consider the Arab Spring, the "Occupy Wall Street Movement", and increasing street demonstrations in Russia and China. Inequity builds up in the "boom", but concerns about it manifest themselves in the "bust".

And finally, there is ample evidence that fiscal consolidation generally hits the poor the hardest, and their children. In a sense, Ministers of Finance have a moral obligation to help alleviate this tendency.

So, current circumstances provide an opportunity for change as well as a challenge.

However, I do not want to sound naive. The door to the Treasury might be unlocked, but it is still likely to be firmly closed. Confronted with "today's" fiscal difficulties, a Minister of Finance is likely to have an even higher rate of time discount than normal. And the truth is that a politician's time horizon is pretty short even in more normal times. When you note that the maintenance of bridges and water systems can be put off for decades at a time, you get a sense of how difficult the task of persuasion will be.

One thing that could help your case for more funding would be more specific suggestions as to where the increased money for ECEC might be found, within budget limits. Note, however, whenever we talk "reallocation" you must be fully prepared to take on the other Ministers who have a vested interest in the status quo. Moreover, you must also take a real interest in budgetary procedures. There is no point in urging cuts elsewhere if the money freed up does not flow into your ECEC budget. And, as an aside, make sure that you know your own budget backwards because that is the least the Minister of Finance will expect from you.

Let me go from suggestions for more general budget reallocations to more specific ones.

First, there might be a broad rethink of spending priorities for government as a whole. We all know that in good times governments can spend large amounts without serious thought. The time for a rethink is now.

Second, within the overall education budget, spending on tertiary education might be cut back. The OECD typically recommends that this funding be replaced by higher tuition fees. Money for this could come in the form of loans to students with repayments related to subsequent earnings. This obligation might also provide the incentive for more productive work later.

Third, within the ECEC and schools budget, state clearly your willingness to take a much harder look at the current distribution of resources. No program should be considered off limits.

Fourth, money (or tax credits) currently paid to new mothers should be replaced with more ECEC, and the length of maternity leave should be constrained. This provides an element of self financing for the ECEC and, in addition, allows mothers to work and pay taxes. Thus, the fiscal benefits are short term as well as long term.

I recognize that some of these suggestions will seem misguided, even abhorrent, to many. But in a budget constrained world, the choice is between half a loaf or no loaf. If pride or principle leads you to demand a whole loaf, you will be gravely disappointed.

I also recognize that the last suggestion, encouraging women back into the work force, will also seem contentious to many. In many cultures, it is felt strongly that the woman's place is at home bringing up the children. If, however, the end point for such cultures is no more children to bring up, then (at the least) these traditions need a rethink. I am almost certain that Ministers of Finance everywhere would agree.

So, to conclude, robbing banks is not an easy job, nor without its dangers. However, I hope my presentation has given you some useful insights as to how you might get more money to support what all of us believe to be an important purpose - more high quality ECEC.

Thank you for your attention. I look forward to the discussion.