

What economics predicts about pre-school fees after subsidies

Contrary to popular belief, a subsidy given to parents will benefit childcare centres too because of how the market works

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Last month, the Early Childhood Development Agency (ECDA) announced that 330 childcare centres – or about one-fifth of childcare centres in Singapore – would be raising their fees for full-day childcare for Singapore citizens come 2020.

This comes on the back of government announcements made earlier in August that subsidies for pre-school would be enhanced to ensure affordability – with higher subsidies given out per child, and more households qualifying.

In its announcement, ECDA clarified that a large majority of the centres had informed the agency of their planned hike for next year, even before the enhanced

subsidies were announced at the National Day Rally on Aug 18. It noted that the median increase is “within 5 per cent of fees” and “broadly comparable” with those of previous years.

Nevertheless, this news made some parents upset, with a number taking to social media to question why subsidies were given, only to have childcare centres raise their full-day fees. Some observers opined that we should guard against fee increases because these would simply run counter to the intentions of the subsidies.

What were the reasons for the fee hike? Many childcare centres interviewed by The Straits Times cited rising costs such as increasing rents and staff salaries.

The question then is whether it would be realistic to expect fees to remain the same had these costs not increased. Contrary to popular belief, the answer may actually be “no”. Economics tells us that, with increased subsidies, for-profit

childcare centres would generally raise fees even if costs remained the same. Here’s why.

SUBSIDIES TO CONSUMERS INCREASE MARKET DEMAND

Imagine you are a parent who is willing to pay up to \$400 per month for full-day childcare service. Suppose the Government now gives you a subsidy of \$380 per month which can be used to pay for childcare service. How much would you be willing to pay for childcare now?

You would now be willing to pay up to \$780, since paying \$780 with the subsidy is the same as paying \$400 with no subsidy. This logic applies to all other parents receiving a subsidy as well. The result is that a subsidy provided to parents increases the market demand for childcare services, and hence the demand faced by each childcare centre. Accordingly, each centre would be able to realise a larger profit by increasing fees. For-profit childcare centres are therefore predicted to increase their fees.

Who enjoys the subsidy? Let’s think: The subsidy is given to parents – the consumers in this

market. But who really enjoys – that is, who benefits from – the subsidy is an entirely different question.

In effect, the subsidy benefits both sides of the market – consumers as well as childcare providers. Relative to the case without subsidy, childcare centres receive more in fees per child. And parents are charged these higher fees.

However, because the Government pays part of the fees through the subsidy, the cost that parents face for each child is actually lower than that without the subsidy. The subsidy effectively drives a wedge (or creates a difference) between the price which childcare providers receive and the price which parents pay. Therefore, the result is that although the subsidy may initially be given to parents, only part of it will end up as a direct benefit to the parent; the rest goes to the childcare centre.

To give an example, in the case of the parent described above who receives a subsidy of \$380 per month, the childcare centre might raise fees by \$80 per month after the subsidy. So after this change,

the parent effectively enjoys a \$300 decrease in the cost of childcare per child, while the centre receives an additional \$80 per child, splitting the benefit of the subsidy between them.

This example highlights a more general lesson about the effects of subsidies: Although a subsidy may be provided to one side of the market, the distribution of the benefits will eventually fall on both sides of the market. In the language of economists, the legal incidence of a subsidy might fall on the consumer, but the economic incidence generally falls on both consumer and firm, not just the consumer.

Strictly speaking, the price adjustments described above will occur after the subsidy has been given and after parents and childcare providers have had the time to adjust their behaviours.

However, in the case of childcare in Singapore, childcare providers are required to inform ECDA of fee revisions and give parents at least four months’ notice before they kick in. It is therefore possible that forward-looking childcare centres might anticipate the higher demand for their services and

adjust fees ahead of time.

These market dynamics imply that it is not realistic to expect profit-driven childcare centres to keep their fees unchanged after a subsidy, even if there was no change in costs.

The fact that costs have risen for many childcare centres provides further impetus for them to increase their fees. While the question of whether childcare centres should increase their fees is certainly a debatable one, economic theory predicts that profit-driven centres will raise their fees. Given this, the concern should be less about whether fees would rise at all but more on whether the increase in fees would be large enough so that it more than offsets the subsidy initially given to parents. Because if that were the case, this would counter the original intention to make childcare more affordable.

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