Financing Early Care and Education:

Options for South Carolina

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INSTITUTE *for* CHILD SUCCESS

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(executive summary)

Despite recent funding increases, less than one third of South Carolina's low income young children receive publicly subsidized early care and education (ECE). Meeting the unmet demand for ECE services would cost the state several hundred million additional dollars.

State general revenues and a handful of federal block grant programs provide the lion's share of funding for ECE in South Carolina and the US overall. Block grants are capped and state revenues are tight. Thus, proposals to expand and/or improve ECE must be accompanied by new financing strategies.

(by)

Kelly O'Donnell

O'Donnell Economics and Strategy

Numerous studies have demonstrated that public investments in ECE yield high returns for children, families and society; but these investments require large, upfront expenditures while the returns can take years to accrue.

This report describes a number of possible ways South Carolina could generate new revenue to invest in ECE. It does not endorse any particular approach, rather it lays out a menu of options for stakeholders to consider. Some of these options entail viewing ECE from new or non-traditional perspectives: as critical infrastructure, economic development, preventative health care, and the underpinning of a successful K-12 education system.

A SOUTH CAROLINA REVENUE SNAPSHOT

State personal income tax and sales tax are the two largest components of South Carolina's general fund revenue. Sales tax also funds Education Improvement Act (EIA) expenditures. Growth rates for both revenue streams have diminished due to tax cuts and changes in the state and national economies.

South Carolina's sales tax base is contracting, reducing growth in general fund and Educational Improvement Act (EIA) revenue. The volume of sales exempted from South Carolina's sales tax is now almost twice as large as the activity that is actually subject to taxation

Preferential tax treatment of business income and a 44% capital gains deduction has resulted in higher taxes on wage income relative to non-wage income. Because non-wage income is growing faster than wage income, the share of personal income subject to state income tax is diminishing.

South Carolina also projects significant (37.8%) declines in Tobacco Master Settlement and cigarette tax revenue.

NEW REVENUE OPTIONS

Retail Sales and Use Tax

South Carolina's retail sales tax generates $2.7 billion in state general fund revenue and $677 million in EIA funding annually. The revenue generating capacity of the state sales tax has been progressively undermined by hundreds of targeted exemptions, deductions, and credits and by the exclusion of most services from the sales tax base. There are three significant opportunities to dramatically increase revenue from South Carolina's retail sales and use tax:

1. **Tax More Services**
   Broadening the sales tax base by adding more services would enable tax revenue to increase markedly without a change in rates. One hundred sixty eight different types of services – from cosmetology to research and development – have been identified as potentially taxable by states. Most states don't come close to taxing them all, and the "typical" state taxes 57. South Carolina taxes 35.

   Broadening South Carolina's sales tax base to include 100 services, still only 60% of those potentially taxable, would generate an additional $700 million without a rate increase.

2. **Close Existing "Loopholes"**
   South Carolina provides over 100 targeted sales and use tax exemptions, exclusions, and discounts, at an annual cost to the state of over $3 billion. The largest sales tax exemptions are for motor fuels, prescription drugs and groceries.

3. **Repurpose Existing Tax Expenditures Intended to Benefit Families**
   South Carolina's annual "Back to School" sales tax holiday costs the state $2.25 million, but it is extremely hard to say how much of this expenditure actually benefits the families for which it is intended, or if the same money, invested in child care quality or the creation of several hundred new home visiting slots, might not make a larger and more lasting contribution to child well-being.

"Sin Taxes"

Sin taxes are selective excise taxes levied upon commodities, such as tobacco products, alcoholic beverages, and junk food that serve the dual purpose of discouraging over-consumption of the taxed goods and generating revenue with which to offset costs they impose on society.

Sin taxes are an especially effective deterrent for young people who are more price sensitive than adults and have had less time to develop deeply entrenched habits or dependencies.

South Carolina's 57 cent per pack cigarette tax is one of the nation's lowest. Each cent of South Carolina's current cigarette tax generates $460,474 in state revenue, for a total of $26 million annually.

Approximately 39,800 South Carolina high school students smoke and 5,000 South Carolina youth become daily smokers each year.

If South Carolina were to increase its tax by just three cents, to that of Kentucky, the state would generate $1.1 million in additional tax revenue and reduce youth smoking by 1%. If South Carolina were to increase its tax to the US average rate ($1.54) it would generate over $35.5 million in new revenue and decrease youth smoking by 17%, resulting in almost 7,000 fewer youth smokers.

However, sin taxes are also regressive and unsustainable. They place a disproportionate financial burden on low income households, and, if they are effective deterrents to consumption, the revenue they generate will decline over time.

Sin taxes can be a source of consistent and sustainable revenue for ECE if they are invested in a trust fund. Once the trust fund has attained a sufficient balance, earnings can be withdrawn to fund ECE programs on an annual basis.

Due to their environmental impact, many state and local governments have broadened the definition of "sin" to include disposable plastic grocery bags and have enacted policies to discourage their use. If imposed for ten years, a 5 cent plastic bag tax could capitalize a trust fund capable of generating several million dollars annually for ECE in perpetuity.

Tax Credits

They do not increase overall state revenue, but tax credits can increase funding for ECE.

Tax credits are state expenditures implemented through the tax code rather than the appropriations process. Tax credits embed spending in the tax code, where it is not subject to the annual scrutiny of the budget and appropriations process and is less likely to be cut during periods of budget stress.

South Carolina has two ECE tax credits, one for families and one for businesses, but the family credit is non-refundable and thus doesn't reach the households that need it most, and the business credit is under-utilized. Improving access to these credits and adding a third ECE contribution credit would greatly enhance the ability of the state tax system to support ECE.

South Carolina's child and dependent care credit (CDCTC) returned $20.1 million to 115,315 filers in FY 2012. An estimated 69% of credits ($13.9 million) were for children under five.

South Carolina's CDCTC is non-refundable, meaning that it confers no benefit to families that don't have state income tax liability. Full refundability for care provided to children under five would increase the credit's cost by about $6.8 million, benefitting about 32,458 additional low income working families.[i]

The South Carolina Child Care Program credit is available to employers who provide child care for employees' children. This generous credit returned only $56,596 to 30 South Carolina businesses in 2012, suggesting that businesses may be unaware of the credit or may encounter barriers to accessing it.

Several states have contribution credits for taxpayers who make contributions to ECE businesses, non-profits, or grant funds. The South Carolina Children's Trust and First Steps to School Readiness would both benefit from a state ECE contribution credit.

Temporary Assistance for Needy Families (TANF)

TANF is a federal block grant program to assist extremely low income families. States have a great deal of discretion in how they spend their TANF funds and most spend a substantial share on child care. South Carolina ranks 48th among states in the percentage of TANF funds spent on child care.

i Estimate based on 2009-13 US Census Public Use Microsample: 150,300 households with income below 140% FPL (no income tax liability) and children under 6 in which all parents work. Assumes 32% of working families utilize paid child care (Source: US Census Bureau Who's Minding the Kids?), 7,531 receive SC Voucher, 80% credit take-up rate and annual credit of $209

TANF funds can also be used to provide home visiting services and pre-K to income-eligible families. At least 24 states, including Washington, Minnesota, New York and Louisiana, use TANF for non-medical home visiting programs. Ohio and Louisiana allocate unspent TANF funds to pre-K. At the end of FFY 2013 South Carolina had $12.4 million in unobligated and unspent TANF funds.

Maximally Leverage Medicaid for Home Visiting

As the payer for 55% of births statewide and the primary insurer of over 654,813[1] children, South Carolina's Medicaid program has a deeply vested interest in improving birth outcomes, promoting well-spaced pregnancies, and preventing childhood injuries, illnesses and developmental delays.

The federal government matches South Carolina's Medicaid spending at a rate of 2.38 federal dollars to every 1 state dollar, yet South Carolina is among the more than 25 states that do not leverage Medicaid for Early Childhood Home Visiting (ECHV).

Using Medicaid for ECHV can be administratively complex because not all services provided in the context of a typical home visit qualify for Medicaid reimbursement.

Interpreting the comprehensive set of services provided by ECHV programs as a single preventive healthcare service or Early Periodic Screening and Diagnostic Testing (EPSDT) service could greatly simplify Medicaid financing by enabling the individual services provided in a home visit to be bundled and billed as a single service.

Base State Appropriations on Directly Measurable Cost Savings

If South Carolina were to increase its baseline pre-K funding by the annual savings from reduced special education placements and grade retention in grades K-3, pre-K funding would increase by $8.6 million in the first year, enabling the creation of 1,793 new full day pre-K slots.

Annual savings per pre-K cohort would increase with the increase in slots, and, ultimately, South Carolina would maximize the benefits of pre-K by providing full day pre-K to all of the state's at-risk four year-olds.

Approximately 19,269 four-year-olds—about half of those considered at risk of poor educational outcomes due to poverty—receive state pre-K services. Thirty-six percent of South Carolina's kindergarten class of 2017-18 will have received state pre-K services.

Each avoided special education placement saves South Carolina $8,169 annually. Assuming that pre-K reduces special education placements by 32%, as was recently documented in North Carolina, South Carolina's current pre-K investment will save the state about $6.9 million per grade per year, or about $28 million for grades K-3.

Pre-k also generates measurable cost savings by reducing the likelihood that a child will be required to repeat a grade. A vast literature describes the many negative short and long-term consequences associated with grade retention, all of which have financial consequences for the individual and society. However, the most readily quantifiable public sector cost of retention is the price of an additional year of public education ($9,077) for each child retained.

If, as the data suggest, high-quality pre-K reduces a child's likelihood of being held back in grades K-3 by at least 22% and potentially over 50%, a high quality pre-K program that serves 36% of 4-year-olds should prevent about 189 children from being retained each year, generating about $1.7 million in annual savings.

Include ECE in the Definition of Economic Development

The return on South Carolina's investment in ECE businesses and support infrastructure is as large, if not larger, than the return on public investments in car manufacturers, food processors, film production companies, or any of the other more traditional economic development targets. Yet, despite their large and multi-faceted contributions to state economies, ECE providers often struggle to remain in business, and, as such, have extremely limited access to the commercial capital necessary to expand or enhance their operations.

Making ECE an economic development priority and enabling ECE providers to access South Carolina's many state economic development incentives would bolster a crucial but under-resourced sector of the economy and enable providers to invest in capacity and quality.

Examples of South Carolina incentives that could be made applicable and/or more accessible to ECE businesses include: tax-exempt private activity (conduit) bonds, revolving loan funds, loan guarantees, tax increment financing, New Markets Tax Credits, and job training incentives including Workforce Investment Act training grants and the state's Job Development Tax Credit.

Many communities require real estate developers to pay fees that offset the public sector costs of providing infrastructure and public services to new developments. Because residential developments and projects that increase area employment both require additional child care capacity, a number of US communities impose dedicated development fees or earmark a portion of existing development fees for early childhood.

SUMMARY CONCLUSION

ECE is as essential to state economic vitality as well-maintained roadways, broadband access, and streamlined regulation, but rarely are ECE services regarded through an economic development lens.

ECE draws hundreds of millions in federal grant funds into South Carolina each year. In addition to attracting outside revenue, pre-K and child care serve as critical workforce supports.

Thousands of parents would be unable to work were it not for affordable, reliable child care. Access to child care has also been shown to greatly reduce both employee turnover and absenteeism, increasing worker and industry productivity.

Throughout the US, ECE systems have expanded in an ad hoc fashion as available funding has ebbed and flowed, resulting in an often inefficient patchwork of policies and funding mechanisms. Stable and sufficient funding is key to the thoughtful and cohesive system-building that will maximally leverage all funding sources and provide the highest quality early childhood services for the largest number of families.

Ideally, the amount a state invests in ECE would be proportional to the expected return on that investment. If that were the case, states would invest far more than they currently do, and, over time, those investments would help to resolve some of our most pressing societal problems and inequities, vastly improving social and economic well-being and, in so doing, save taxpayers money. Until that day comes, state investments in ECE will likely remain suboptimal.

(introduction)

Over the past several years, federal and state funding for early care an education (ECE) has increased significantly. Since 2010, the number of South Carolina families receiving early childhood home visitation has nearly doubled and state funding for full-day pre-K has increased by more than threefold. Much has been accomplished in a relatively short period of time, but far more remains to be done before the potential benefits of ECE are fully realized. Numerous studies have demonstrated that public investments in ECE yield high returns for children, families and society; but these investments require large, upfront expenditures while the returns can take years to accrue.

Consistency is a hallmark of quality ECE. So, in addition to generating hundreds of millions dollars, funding sources must be stable, ensuring that families have uninterrupted access to the services their children need to thrive.

Just as there is no "one size fits all" approach to ECE, the right combination of financing strategies will differ from one community to another, based on the characteristics of families, providers, and the local economy. This report therefore offers a number of possible ways South Carolina could increase funding for ECE. These options are not mutually exclusive, but none are without cost. In today's environment of scarce public sector resources, every increase in funding for one purpose is an implicit decrease in funding for another. This report does not endorse any particular approach, rather it lays out a menu of options for stakeholders to consider. It is hoped that the wide variety of alternatives presented here will inform and invigorate the conversation about how best to fund state services for young children.

REVENUE GENERATION PRINCIPLES

Decisions about how best to fund expanded access to high quality ECE should be guided by several basic principles:

1. Adequacy—The financing strategy or combination of strategies must provide enough revenue to support the desired level of ECE services and investment. This means that funding goals are based on state and local priorities for ECE, rather than the more typical approach of basing ECE priorities on available funding.

2. Stability—High-quality care received on a consistent basis over a sufficient span of time is key to high-quality ECE; therefore access and quality must not vary from year to year based on the availability of funds. The revenue strategy or mix of strategies used to finance ECE must produce an income stream that is stable and reliable over time.

3. Sustainability—Recurring expenditures must be paid for with recurring funds. Non-recurring (one time) funds should pay for non-recurring expenditures, such as capital improvements, or be invested so as to generate a sustained funding stream over time.

4. Fairness—As noted earlier, all public expenditures have an opportunity cost. Often that cost is higher taxes. Equitable tax systems impose the greatest burden on those with the greatest ability to pay.[ii] Because so many of the problems ECE seeks to ameliorate arise from, or are correlated with child poverty, it is especially important that ECE revenue strategies be as progressive as possible.

5. Maximum Leverage—State spending choices should fully leverage all potential sources of funding so as to maximize the return on investment, stabilize funding by diversifying the revenue portfolio, and broaden the base of support for ECE. ECE has broad societal benefits. Everyone who benefits, directly or indirectly, from ECE has an incentive to participate in its funding.

6. Minimal Displacement—New revenue sources should supplement, not supplant, existing funding. There is no sure-fire way to guarantee a state's ongoing commitment to a specific level of ECE spending[iii]. Because a sitting legislature cannot enact a statute that prevents a future legislature from exercising its law-making power, a legislature that creates a new funding source for ECE cannot dictate how future legislatures budget the funds. However, the probability that an appropriation will augment rather than supplant future spending can be increased by: (1) earmarking a specific revenue stream for ECE; (2) embedding current ECE spending in the state's *base* budget;[iv] and/or (3) embedding current ECE spending in the state tax code where it is not subject to the scrutiny of the annual appropriations process.

ii A progressive tax is one that takes a larger percentage of income from higher income households. An income tax with a zero bottom bracket, refundable credits for low income families, and rates that increase with income is the classic example of a progressive tax. A regressive tax is one that places a disproportionate burden on lower income households. Sales taxes on necessities such as groceries or residential utilities tend to be highly regressive.

(south carolina's tax system)

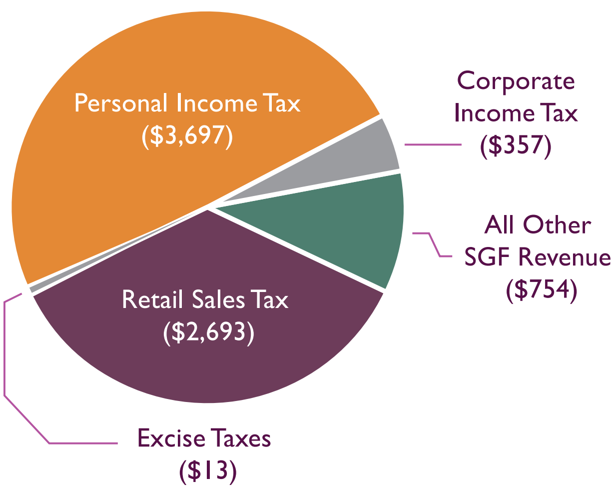
South Carolina's general fund revenue is expected to total $7.5 billion for fiscal year 2015-16. State personal income tax and sales tax are the two largest components of state general fund revenue. Growth rates for both revenue streams have diminished due to tax cuts and changes in the state and national economies. State general fund revenue as a percentage of personal income has declined by almost one third since 1995.[2]

Projections for fiscal year 2015-16 include $287 million in new recurring general fund revenue, $30 million in new recurring EIA revenue and $166.6 in non-recurring (one time) revenue.

iii Maintenance of effort (MOE) is a state's commitment to use newly available program funds to augment rather than replace current program funding. MOE is a requirement of many federal block grant programs. States comply with federal MOE requirements because failure to do so would cost them many millions of dollars. In contrast, MOE requirements imposed by a sitting state legislature on future state legislatures are difficult to enforce because each year's legislature has the plenary power to enact laws, except as limited by the state or federal constitutions.

iv The base budget is the basis for the next year's budget and items in the base are generally harder to cut than appropriations made with one-time funds.

Figure 2. South Carolina General Fund Revenue ($ Millions) FY 15-16 Projection



Significant sources of non-general fund state revenue include the 1% Education Improvement Act sales tax levy ($676.6 million), the state lottery ($296 million) and the Tobacco Master Settlement Agreement ($70 million).

South Carolina's sales tax base is contracting, reducing growth in general fund and Educational Improvement Act (EIA) revenue. The volume of sales exempted from South Carolina's sales tax is now almost twice as large as the activity that is actually subject to tax (Table 1). The largest sales tax exemptions are for motor fuels, prescription drugs and groceries.[v]

South Carolina, like most states, exempts the majority of services from sales tax. South Carolina taxes only 35 of 168 services identified as potentially taxable by the Federation of Tax Administrators.[3] In South Carolina, as in the nation overall, the relative size of the goods-producing sector has declined as services have come to dominate the economy. Substantial increases in interstate and internet sales also undermine the adequacy of the retail sales tax because the taxes levied on internet and other remote sales can be extremely difficult for states to collect. The aging of the population will also negatively impact future state sales tax collections because older individuals devote a larger percentage of income to purchases of tax exempt goods and services such as prescription drugs and medical care.

Table 1. South Carolina: Gross Sales and Taxable Sales FY 2000 and FY 2014 (in $ millions)

	FY 2000	FY 2014
Gross Sales	$94.4	$171.8
Net Taxable Sales	$45.2	$59.2
Percent	48%	35%

Source: Presentation to South Carolina School Boards Association Legislative Advocacy Conference, Mike Shealy, South Carolina Senate Finance Committee, December 2014

South Carolina has a progressive income tax with six rate brackets ranging from zero for taxable income below $2,850 to 7% for taxable income over $14,251. Revenue from South Carolina's personal income tax (PIT) is expected to grow more slowly than state personal income due to declining rates and a shrinking base. In 2008 the state's bottom PIT bracket was eliminated, enhancing progressivity but diminishing revenue. Rates for pass-through trade and business income have been more than halved since 2007, at a cost to the state of $937.6 million. Preferential tax treatment of business income including the aforementioned rate reduction and a 44% capital gains deduction resulted in higher taxes on wage income relative to non-wage income. Because non-wage income is growing faster than wage income, the share of personal income subject to tax is diminishing.

Like many other states, South Carolina South Carolina also projects significant (37.8%) declines in Tobacco Master Settlement and cigarette tax revenue due to faster than expected declines in smoking.

(state spending on ECE and currently unmet need)

Economic disadvantage contributes to a host of negative outcomes for children. Roughly 200,565 South Carolina children ages birth through four live in low income households.[vi] Publicly funded home visiting, child care and/or pre-K programs serve approximately 56,568 young children. Serving the remaining 144,068

v The state sales tax on food was repealed in 2007

vi Household income below 200% of the federal poverty level low income children at an average annual cost of $4,200 per child would cost the state an additional $605.1 million annually.

(revenue options)

I. RETAIL SALES TAX

The amount of revenue a tax can generate is a function of what is taxed (the base) and the rate. Generally speaking, the broader the base, the lower the rate needed to generate a given amount of revenue. Broad-based taxes with low rates are beneficial for both businesses and households. High tax rates can damage the economy by suppressing commerce and motivating costly tax avoidance behavior. Broadening the base also makes the tax system fairer by distributing the tax burden more widely. By broadening the base, South Carolina could increase sales and use tax revenue by 35% without increasing the rate.

South Carolina's retail sales tax generates $2.7 billion in state general fund revenue and $677 million in EIA funding annually. The revenue generating capacity of the state sales tax has been progressively undermined by hundreds of targeted exemptions, deductions, and credits as well as the exclusion of most services from the sales tax base. There are three significant opportunities to dramatically increase revenue from South Carolina's retail sales and use tax: (1) add more services to the tax base, (2) eliminate some of the over 100 targeted tax breaks, and (3) redeploy state funds currently spent on less effective tax breaks for families to programs that improve access to high quality ECE.

Tax More Services

The Federation of Tax Administrators has identified 168 services potentially taxable by states. The "typical" state taxes 57 of these services. South Carolina taxes 35.[4] In 1951, when South Carolina's sales tax was first implemented, goods made up the bulk of consumer expenditures. Over time, however, services have come to dominate the national and South Carolina economies, dramatically diminishing the share of economic activity subject to South Carolina's sales tax.

The only way to prevent tax revenue from declining as the tax base shrinks is to increase rates. South Carolina's 6% sales tax rate is already higher than that of most other states. Over the last several decades, as services have grown from less than 50% of South Carolina's Gross State Product (GSP) to over 75% of GSP, the state sales tax rate has doubled. Conversely, broadening the sales tax base by adding more services would enable tax revenue to keep pace with economic growth and the demand for public services without increasing rates.

In fact, broadening the base could generate enough revenue to substantially *reduce* the sales tax rate, as was recommended in 2010 by the South Carolina Tax Realignment Commission (TRAC). The TRAC recommended adding 70 services to the state's sales tax base and using the $700 million in additional revenue to fund a 20 to 33% rate reduction.

Close Existing "Loopholes"

In addition to excluding most services from the sales tax base, South Carolina provides over 100 targeted sales and use tax exemptions, exclusions, and discounts at an annual cost to the state of over $3 billion. Many policymakers find the idea of "eliminating loopholes" more palatable than "raising taxes," but even this remains a hard sell, because, no matter how obscure a tax break may seem, if it costs the state money, someone is benefitting from it, and that someone is likely to vociferously oppose any effort at its repeal.

Repurpose Existing Tax Expenditures Intended to Benefit Families

South Carolina could also consider ways to more efficiently utilize the current tax expenditures intended to benefit families. Like many other states, South Carolina offers an annual "Back to School" sales tax holiday in August. During this three-day period, items including clothing, footwear, school supplies, bed linens and computer equipment are exempt from state sales tax. The holiday costs the state $2.25 million, but it is extremely hard to say how much of this expenditure actually benefits the families for which it is intended or if the same money, invested in improvements to child care quality or several hundred new home visiting slots, might not make a more meaningful contribution to child well-being.

Table 2. South Carolina Cigarette Tax Increases: Impact on State Revenue and Youth Smoking

	Kentucky ($.60)	Oklahoma ($1.03)	US Average ($1.54)
Additional State Revenue	$1.1 million	$16.9 million	$35.5 million
Percent Reduction in Youth Smoking	1%	8%	17%
Teens Who Quit or Never Start	214	3,281	6,919

Source: Author Calculations, using data from the Federation of Tax Administrators and the US Congressional Budget Office

2. "SIN TAXES"

"Sin Taxes" are selective excise taxes levied upon commodities, such as tobacco products, alcoholic beverages, and junk food, which impose high costs on society. Alcohol and tobacco taxes constitute 3% of South Carolina state revenue.[5]

Sin taxes serve the dual purpose of discouraging over-consumption of the taxed commodities and generating revenue with which to offset their societal costs. Sin taxes are an especially effective deterrent for young people who are typically more price sensitive than adults and have had less time to develop deeply entrenched habits or dependencies. However, sin taxes lack both equity and sustainability, two of the key attributes of an effective revenue source discussed in the Introduction. Taxes on commodities like alcohol, cigarettes, and junk food are regressive because they take a larger percentage of income from lower income households. They are inherently unsustainable because, if they are effective deterrents to consumption, the revenue they generate will decline over time.

Despite their inherent instability, sin taxes *can* provide a consistent and sustainable revenue source for ECE if they are deposited in a state trust fund and invested. Once the trust fund has attained a sufficient balance, earnings can be withdrawn to fund ECE programs. Arkansas, for example, created an ECE fund with the revenue from a limited time beer tax.[6]

Plastic Bag Tax

Disposable plastic grocery bags are an example of a widely used commodity that imposes high external costs. Due to the environmental impact of the petroleum products used in their manufacture and the pollution caused by their disposal, many state and local governments have enacted policies to discourage the use of disposable plastic grocery bags. One such policy, a plastic bag tax, could, if imposed for ten years, supply enough revenue to capitalize a trust fund capable of generating several million dollars for ECE each year in perpetuity.

Approximately 535 million disposable plastic grocery bags are used in South Carolina each year. At five cents per bag, a plastic bag tax would generate about $24.1 million in the first year. If bag use were to decline by 10% annually, the tax would generate $13.4 million in year five. If revenue from the tax were deposited in a permanent fund and invested at an annual return of 5%, there would be a total of $93.6 million in the fund at the end of the first five years. If, at the end of year five, the state began withdrawing fund earnings, revenue for ECE would total $4.8 million initially and climb to about $6.8 million per year by year ten.[vii] At the end of year ten, the fund balance would be $136 million.

Cigarette Tax

Cigarettes are taxed at the federal, state, and sometimes local levels. In South Carolina, the state cigarette surtax generates over $26 million annually.[7] In addition to generating revenue, tobacco taxes discourage smoking initiation and encourage people who already smoke to quit.

Approximately 39,800 South Carolina high school students smoke and 5,000 South Carolina youth become

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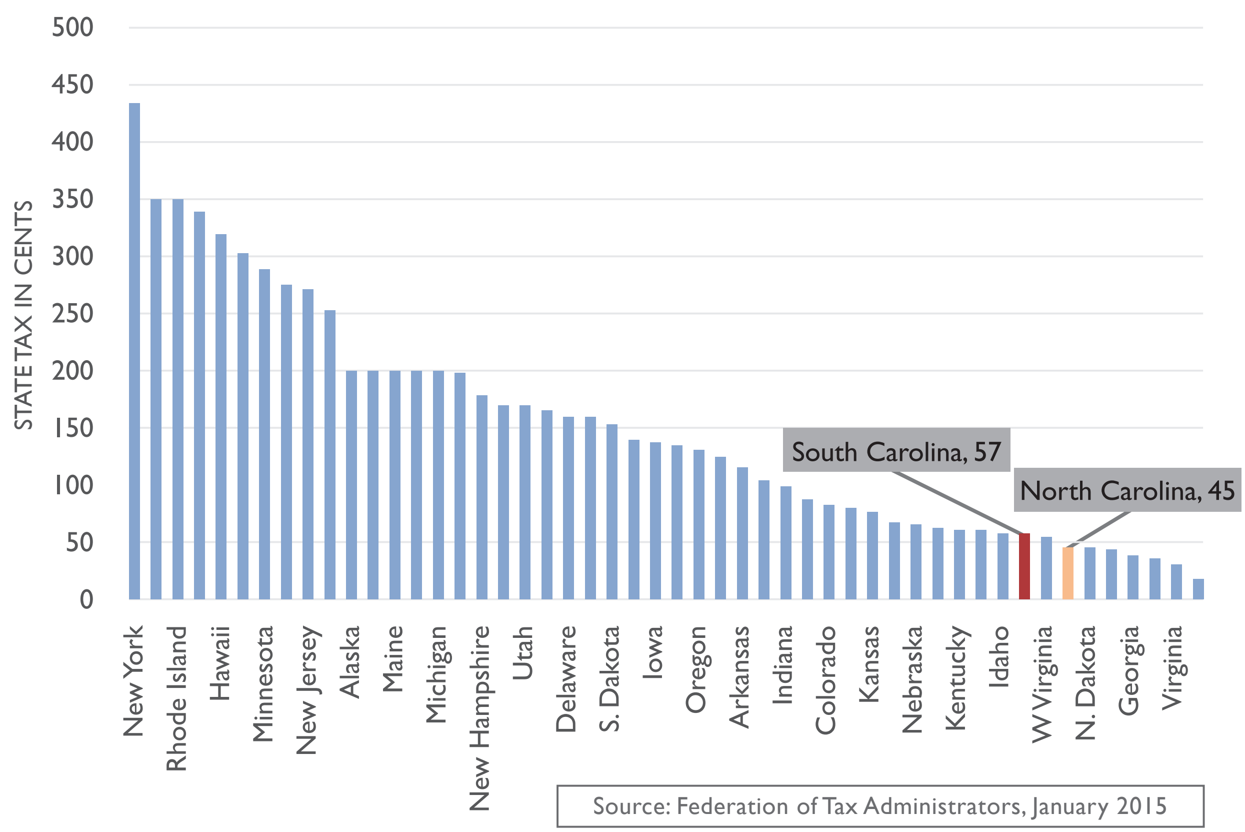
vii Assumes consumption of bags decreases by 5% per year in years 6-10

Figure 2. State Cigarette Tax Rates, 2015



daily smokers each year.[8] Eighty percent of adult smokers began smoking in their teens. Young people tend to be more price sensitive than adults,[9] making cigarette taxes an especially effective deterrent for youth. The US Congressional Budget Office (CBO) estimates that a 10% increase in cigarette prices would reduce youth smoking in the US by between 5 and 15% and adult smoking by between 3 and 7%.[10]

South Carolina's 57 cent per pack cigarette tax is well below the national average ($1.54) and one of the nation's lowest. Each cent of South Carolina's current cigarette tax generates $460,474 in state revenue. Table 2 depicts the additional revenue South Carolina would generate if it increased its tax rate to that of Kentucky, Oklahoma, and the US overall.[viii] It also shows the percent reduction in youth smoking that would result from the higher tax and the number of South Carolina youth who would quit smoking or never start in the first place.[ix]

If, for example, South Carolina were to increase its tax by just three cents, to that of Kentucky, the state would generate $1.1 million in additional tax revenue and reduce youth smoking by 1%. If South Carolina were to increase its tax to the average state rate it would generate over $35.5 million in new revenue and decrease youth smoking by 17%, resulting in almost 7,000 fewer youth smokers.

viii Estimates assume an average price of $5.58/pack and are adjusted to reflect a .75% decrease in overall consumption (youth and adult) and a 1.25% reduction in taxable sales for every 1% increase in price.

ix The estimate of the percent reduction in youth smoking is based on the CBO estimates and utilizes the method described in Marr, C and Huang, C. 2014. Higher Tobacco Taxes Can Improve Health and Raise Revenue. Center on Budget and Policy Priorities.

3. TAX CREDITS

Tax credits do not increase overall state revenue, but they can increase funding for ECE. Tax credits are state expenditures implemented through the tax code rather than the appropriations process. South Carolina already has two ECE tax credits, one for families and one for businesses, but the family credit is non-refundable and thus does not reach the households that need it most, and the business credit is under-utilized for reasons that are not entirely clear. Improving access to these credits and adding a third ECE contributions credit would greatly enhance the ability of the state tax system to support ECE.

Tax credits are usually administered through the personal and/or corporate income tax systems. Unlike tax deductions, which reduce the amount of income subject to tax, tax credits are subtracted, dollar-for-dollar, from net tax liability. Refundable tax credits return credit amounts in excess of tax liability to the filer in the form of a refund, making it possible for businesses and individuals with limited or no tax liability to receive the credit's full benefits. Tax credits embed spending in the tax code, where it is not subject to the annual scrutiny of the budget and appropriations process and is less likely to be cut during periods of budget stress.

The most well-known and widely used early childhood tax credit is the federal Child and Dependent Care Tax Credit (CDCTC). The CDCTC offsets the cost of work-related child care for children under 13 and/or other family members who are physically or mentally incapable of self-care. The credit is non-refundable, so it cannot be utilized by the majority of low income working families that do not have net federal income tax liability.

Seventeen states, including South Carolina, provide a state income tax credit based on the CDCTC. South Carolina's credit is equal to 7% of expenses that qualify for the federal credit. It returned $20.1 million to 115,315 filers in FY 2012.[11] An estimated 69% of credits ($13.9 million) were for children under the age of 5. Like the federal credit, the South Carolina CDCTC is non-refundable. Full refundability for care provided to children under five would likely increase the credit's cost by about $6.8 million, benefitting about 32,458 additional low income working families.[x]

Many states also offer tax credits for businesses that operate child care programs for their employees or subsidize employee child care costs. South Carolina's Child Care Program credit is available to employers who provide or subsidize child care for their employees. Qualifying employers may take a credit of up to 50% of expenses, not to exceed $100,000 in capital expenses per facility, $3,000 per employee served, or 50% of total tax liability. This generous credit returned only $56,596 to 30 South Carolina businesses in 2012,[12] suggesting that businesses may be unaware of it or may encounter barriers to accessing it.

Other ECE tax incentives employed by states include:

1. ***Wage credits*** award bonuses to ECE workers who obtain additional ECE education and training. Louisiana's credit is available to the directors and staff of programs participating in the state's Quality Rating Improvement System (QRIS). Credit amounts increase with educator qualifications and program quality rating.

2. ***ECE business credits*** offset the costs of operating an ECE business, and, if linked to the state's QRIS, encourage ECE providers to invest in quality by awarding larger credits to higher quality programs. Louisiana's credit is only available to owners of child care centers with at least a two-star rating under the state's QRIS.

3. ***ECE contribution*** credits reward taxpayers who make contributions to ECE businesses, charities, or grant funds by refunding up to 100% of the taxpayer's contribution:[xi] Iowa, Colorado, Pennsylvania and Oregon have ECE contribution credits.

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x Estimate uses data from 2009-13 US Census Public Use Microsample: 150,300 households with income below 140% FPL (no income tax liability) and children under 6 in which all parents work. Assumes 32% of working families utilize paid child care (Source: US Census Bureau Who's Minding the Kids?), 7,531 receive SC Voucher, 80% credit take-up rate and annual credit of $209

xi Charitable contributions are also deductible for purposes of federal, and sometimes state, income tax, meaning that the combined state and federal tax benefits arising from an ECE donation that qualifies for a contribution credit may actually exceed the contribution amount.

Table 3. State Child Care Tax Credits in Select Southern States

State	Description	Refundable	Maximum Credit 1 child	Maximum Credit 2 children
South Carolina	7% of federal CDCTC	No	$210	$420
North Carolina *Repealed effective tax year 2014*	7%-13% of federal CDCTC, depending on income and child age	No	$390	$780
Oklahoma	20% of federal CDCTC	No	$210	$420
Virginia	Deduction of expenses used to calculate federal CDCTC	No	$173	$345
Tennessee	*No Income Tax*			
Louisiana Child Care	10% to 50% of federal CDCTC depending on income	Yes lower income filers only	$525	$1,050
Louisiana School Readiness	50%-200% of federal CDCTC depending on the provider quality rating	No	$1,050	$2,100

Adapted from National Women's Law Center *Making Care Less Taxing 2011*

Pennsylvania's Education Improvement Tax Credit program awards credits to businesses that contribute to approved educational improvement, scholarship, and/or preschool organizations. Companies may claim tax credits worth 75% of a contribution made for one year and 90% of contributions made for two or more consecutive years.

The amount of revenue a contribution credit generates will be a function of the credit's specific characteristics and the size of a state's ECE donor base. A state with relatively little ECE related corporate philanthropy might net a few hundred thousand dollars annually with a contribution credit while a state with large donors committed to ECE could generate several million in contributions. The South Carolina Children's Trust and First Steps to School Readiness could both benefit from a state ECE contribution credit.

4. TEMPORARY ASSISTANCE TO NEEDY FAMILIES

Temporary Assistance for Needy Families (TANF) is a federal block grant program to assist extremely low income families. TANF is most closely associated with cash assistance, but in fact most state TANF funds are used for other purposes including job training, refundable tax credits, Individual Development Accounts (IDAs) and pregnancy prevention. States can spend an unlimited amount of their TANF allocation on child care provided directly to TANF eligible families and may transfer up to 30% of TANF funds to the Child Care and Development Block Grant (CCDBG) where it is used to fund child care subsidies and quality initiatives.

South Carolina ranks 48th among states in the percentage of TANF funds spent on child care. In 2013,[xii] states

xii Unlike the majority of states, South Carolina spends most of its TANF funds (63.4%) on a catch-all expenditure category called "Other Non-Assistance", which includes spending on child welfare, family preservation, parenting education, substance abuse treatment, and domestic violence services. See: Derr, M. *et al*., "Understanding Two Categories of TANF Spending:

devoted an average of 15.8% of TANF funds ($5 billion) to child care, one quarter ($1.4 billion) of which was transferred to CCDBG. South Carolina spent 2% ($4 million) of its TANF allocation on child care and did not transfer any TANF funds to CCDBG.[13]

TANF funds can also be used to provide home visitation and pre-K to income-eligible families. At least 24 states, including Washington, Minnesota, New York and Louisiana,[14] use TANF for non-medical home visiting programs. Home visitation programs funded by TANF must promote at least one of TANF's four primary objectives: reducing dependency by promoting work and marriage, assisting needy families so children may be cared for at home, reducing out of wedlock pregnancies, and encouraging the formation and maintenance of two-parent families.

Ohio and Louisiana allocate unobligated TANF funds to pre-K. At the end of FFY 2013 South Carolina had $12.4 in unobligated and unspent TANF funds.[15]

5. MAXIMALLY LEVERAGE MEDICAID FOR HOME VISITING

As the payer for 55% of births statewide and the primary insurer of over 654,813[16] children, South Carolina's Medicaid program has a deeply vested interest in improving birth outcomes, promoting well-spaced pregnancies, and preventing childhood injuries, illnesses and developmental delays. Compelled by the mounting evidence of home visiting's short and long-term cost effectiveness, states, including South Carolina, have increased their investment in early childhood home visiting, but the unmet need remains great. Medicaid can be a significant source of funds for home visiting, especially in poorer states where the federal government matches state Medicaid spending at rates of almost 3:1,[xiii] yet South Carolina is among the many states that don't utilize Medicaid funding.

Because the term "home visiting" is used to refer to a number of markedly different services provided to a wide variety of clients, it is important to define early childhood home visiting (ECHV) for purposes of this analysis. The definition used here is drawn from the New Mexico Home Visiting Accountability Act:[17]

> *ECHV is a program strategy that delivers a variety of informational, educational, developmental, referral and other support services for eligible families who are expecting or who have children who have not yet entered kindergarten, and that is designed to promote child well-being and prevent adverse childhood experiences. Home visiting provides a comprehensive array of services that promote parental competence and successful early childhood health and development by building long-term relationships with families and optimizing the relationships between parents and children in their home environments.*[xiv]

This definition is useful because it clearly articulates the key features of high-quality early childhood home visiting but does not exclude promising, standards-based programs that have not yet been conclusively evaluated.

At least 20 states currently use Medicaid funds to support at least one early childhood home visiting program.[18] Medicaid can be used to finance many of home visiting's core components including health and behavioral health services, service coordination, referrals, and parent education, but it does not cover the full array of health, education and psychosocial services provided by a high quality ECHV program. States that use Medicaid for ECHV may fund specific components of comprehensive programs or reimburse for individual services provided in the context of a home visit, but they cannot pay for home visiting, as defined here, entirely with Medicaid and must therefore braid Medicaid with other state, federal and private funds to cover all the services provided in an evidence-based or standards-based home visit. Given that most other funding streams have their own limitations and reporting requirements, combining funds in this way can greatly increase the cost and complexity of administering a home visiting program. Taking time to document and differentiate the provision of Medicaid eligible and ineligible services may also detract from home visitors'

'Other' and 'Authorized Under Prior Law,'" Mathematica Policy Research, September 2009, http://mathematica-mpr.com/publications/PDFs/family_support/TANF_spending.pdf.

xiii Currently, the Federal Medical Assistance Percentage (FMAP) ranges from 50% to 73.6%. South Carolina's current FMAP is 70.6 percent, a ratio of 2.38 federal dollars to every one state dollar.

xiv The New Mexico Act defines "home visiting program" as *a program that uses home visiting as a primary service delivery strategy and offers services on a voluntary basis to pregnant women, expectant fathers and parents and primary caregivers of children from birth to kindergarten entry.*

time with families. The alterations in practice necessitated by Medicaid reimbursement rules can also complicate implementation fidelity.[xv] Further complicating the use of Medicaid for home visiting is the fact that not all home visiting clients are enrolled in, or eligible for, Medicaid and that some Medicaid benefits, such as pregnancy coverage, are time limited and terminate before home visiting can be truly beneficial.

Despite the challenges, some states find that the substantial and sustainable funding available through Medicaid justifies the additional administrative burden. States utilize a variety of mechanisms to access Medicaid funds for home visiting.[19] These include Targeted Case Management (TCM), Administrative Case Management (ACM), managed care carve-outs, Enhanced Pregnancy Benefits (EPB) and Section 1115 waivers. In addition, Medicaid mechanisms utilized to fund other forms of community based prevention, such as the CMS rule adopted January 1, 2014 allowing states to recognize unlicensed practitioners in the delivery of preventive services,[20] may also be applicable to home visiting.

Some Medicaid funding mechanisms require that states submit state plan amendments that specify key features such as allowable reimbursements and provider approval processes. In 2012, CMS approved an amendment to the Ohio state Medicaid plan to fund targeted case management through home visiting for Medicaid-eligible children and families participating in the state's Help Me Grow home visiting program.[21]

Several states in addition to Ohio fund home visiting as targeted case management (TCM). TCM includes assessment, development of a care plan, referrals and scheduling, monitoring and follow-up, but it does not include any medical services. Because TCM is not subject to the requirement applicable to most other Medicaid services that it be offered statewide or not at all, TCM home visiting services can target specific high risk populations or communities identified in the state plan amendment.

Illinois funds home visiting as Medicaid Administrative Case Management (ACM). ACM funds can be used for outreach and coordination but, like TCM, cannot be used to pay for direct medical services. ACM services are subject to a 1:1 match in all states.

"Home visiting" is a recognized service category of the Medicaid Enhanced Prenatal Benefit (EPB) and 32 states include some form of "home visiting" as a service available to at least some Medicaid eligible pregnant and postpartum women. However, EPB home visiting services run the gamut from a single pre-natal consultation, to comprehensive, evidence-based home visiting programs. All are limited in their effectiveness by the termination of benefits for most mothers at 60 days post-partum. By way of contrast, the average duration of evidence based home visiting programs is 44 weeks, and many models, including Nurse Family Partnership and Parents as Teachers, are designed to be multi-year.[22] For states that have opted in, the Affordable Care Act expansion of Medicaid eligibility has the potential to help counteract this problem, but only for the subset of postpartum women with income below 138% FPL.[xvi] Another possibility is to follow the lead of states that have successfully justified reimbursing for some services provided to Medicaid-ineligible parents on the grounds that the primary beneficiaries of the service are the parents' Medicaid eligible children. Illinois, for instance, provides mental health screening to Medicaid ineligible parents of children enrolled in Medicaid[23] because of the profound impact parental mental health can have on a child health and development.

Medicaid Funding of Community Health Workers

The services provided by paraprofessional home visitors and promatoras (community health workers) often overlap. As such, the provisions of the Affordable Care Act that encourage utilization of community health workers (CHWs) by Medicaid programs and the corresponding CMS rule allowing states to recognize unlicensed practitioners, including CHWs, in the delivery of preventive services may provide another Medicaid funding avenue for paraprofessional home visiting programs. In New York state Community Health workers

xv A program's adherence to the underlying home visiting model upon which it is based

xvi In South Carolina, Medicaid pregnancy benefits are available to women with income below 199% FPL.

employed by the state health department provide home visiting services using a combination of MCHBG and Medicaid funds.[xvii]

Defining Home Visiting as Preventative Care

Evidence-based ECHV programs have been shown to prevent certain negative health outcomes for infants and their caregivers and may therefore be considered a form of preventative healthcare. States are permitted to include optional preventive services in their state Medicaid programs.[24] If the comprehensive set of services provided by ECHV programs were interpreted as a preventive service for purposes of this provision, a home visit could become reimbursable as a single service rather than a collection of individual services, only some of which are reimbursable. This could greatly reduce the administrative complexity of Medicaid funding for home visiting.[25]

Home Visiting within Early Periodic Screening and Diagnostic Testing (EPSDT)

EPSDT is a mandatory set of services and benefits for Medicaid enrollees under age 21 that helps to ensure that they have access to required health care and enables them to effectively utilize it. EPSDT requires states to provide Medicaid-eligible children with a broad set of periodic health screenings and to address any issues the screenings identify. Home visiting and EPSDT share many core functions including developmental screenings, health education and some aspects of care coordination and case management. Medicaid administrators could simplify reimbursement for home visiting by compiling a group of EPSDT services, that, when provided in the context of a home visit is paid for as a single, bundled service.

xvii Further acknowledgement of the overlap between community health workers and home visitors is provided in Section 5313 of the Affordable Care Act which authorizes grants to promote positive health behaviors and outcomes through the use of community health workers." The grants may be used to fund CHWs in the performance of many of the activities typical of EC home visitors including: promoting positive health behaviors and discouraging risky ones; encouraging Medicaid and SCHIP enrollment, making referrals to healthcare agencies and community based programs and "to educate, guide, and provide home visitation services regarding maternal health and prenatal care." The grant program has not yet been funded.

Managed Care

Funding early childhood home visiting through Medicaid managed care would not require a state plan amendment. Medicaid administrators could write home visiting into Managed Care Organizations (MCO) contracts or, absent a state mandate, MCOs might simply choose to offer home visits as a cost-effective way reduce ER visits, increase use of preventative care, reduce pre-term births, lengthen the interval between births and catch developmental issues as early as possible. Home visiting may also be provided on a fee-for-service basis as a "carve out" from managed care.

Other Federal Grant Programs

As noted earlier, Medicaid usually must be combined with other funding streams to cover delivery of ECHV as it is defined here. States utilize a broad array of public and private funding streams to fund their home visiting programs. In addition to Medicaid, commonly used federal funding sources include Maternal Infant and Early Childhood Home Visiting (MIECHV) grants, Early Head Start, Temporary Assistance to Needy Families (TANF), the Title V Maternal and Child Health Block Grant (MCH), and Community-Based Child Abuse Prevention (CBCAP) grants.

Title V Maternal and Child Health Services Block Grants

The Title V Maternal and Child Health Services Block Grant Program provides funding for a broad array of direct, enabling, and population-based services for women and children. As noted earlier, New York braids Medicaid and Title V MCH fund for home visiting and North Carolina braided Title V funds and state funds to expand Nurse Family Partnership (NFP). Title V also funds NFP in Louisiana and is braided with TANF to fund Best Beginnings for Wyoming Babies, a home visiting program staffed by state public health nurses.

Child Abuse Prevention Grants

Oklahoma and Pennsylvania are among the states that utilize federal child abuse prevention and family preservation grant funds to support home visiting.[26] Federal Community-Based Child Abuse Prevention (CBCAP) grants support community programs that seek to prevent child abuse and neglect by strengthening and supporting families.[27] CBCAP can be used to fund a variety of family support programs, including voluntary home visiting. The Children's Trust administers

CBCAP grants in South Carolina. The Trust's current CBCAP grant-making efforts emphasize the use of home visiting and/or parenting education and support as a primary service delivery mechanism.[28]

The federal Promoting Safe and Stable Families Program (PSSF/Title IV-B) can also be used to support home visiting. PSSF/Title IV-B seeks to prevent child abuse and neglect, preserve families, and promote permanency for children in foster care by funding a variety of supportive services.[29] Pennsylvania and Tennessee use PSSF funding for evidence based home visiting.

6. BASE STATE APPROPRIATIONS ON DIRECTLY MEASURABLE COST SAVINGS

Numerous analyses have demonstrated the high return on state investments in early care and education. The promise of long-term cost savings has motivated many of the recent increases in public funding for ECE programs. Some of the more innovative approaches to ECE funding, such as the "pay for success" expansion of pre-K in Salt Lake City, leverage the expected return on investment to attract private financing for ECE.

If South Carolina were to increase its baseline pre-K funding by an amount equal to the annual savings from reduced special education placements and grade retention in grades K-3, pre-K funding would increase by $8.6 million in the first year, enabling the creation of 1,793 new full day pre-K slots. Annual savings per pre-K cohort would increase with the increase in slots, and, ultimately, South Carolina would maximize the benefits of pre-K by funding full day pre-K for all of the state's at-risk four-year-olds.

Each component of the early childhood continuum has the potential to improve child outcomes and, in so doing, generate public sector cost savings. However, because state pre-K programs have been the subject of particularly intense evaluation efforts in recent years, their impacts on specific, measurable outcomes are especially well-documented.

Numerous evaluations of state pre-K programs have demonstrated significant improvements in measures of cognition, social aptitude, and school readiness. High quality pre-K has also been shown to reduce grade repetition and special education placements,[30] both of which are extremely costly to states. Unlike some of the other cognitive and socio-emotional benefits of pre-K, which impact costs indirectly or over long periods of time, the costs of early grade repetition and special education placements are incurred fairly quickly and are readily quantified.

Longitudinal analyses of pre-K programs in Louisiana, New Jersey, and Texas have found reduced rates of both grade retention and special education referrals. The evaluation of Texas' targeted pre-K program found that pre-K participants were 13% less likely than non-participants to be assigned to special education at third grade and 24% less likely than non-participants to have repeated a grade.[31] New Jersey's Abbott Pre-K program reduced grade retention rates by 40%[xviii] and special education placements by 31%.[32]

Students who participated in the Pennsylvania's Pre-K Counts had fewer special education referrals in kindergarten than their non-pre-K peers. Almost 20% of students identified as having or be at-risk for developmental delays upon entry to Pre-K Counts were in the typical range of functioning at the program's end. A Maryland study of kindergarteners found that children who had attended full-day pre-K required less than half of the special education services required by their peers who had not attended pre-K.[33] A 2015 study of North Carolina's More at Four found that pre-K reduced the likelihood of a child's needing special education in third grade by 32%.

Michigan's Great Start Readiness Program (GSRP) diminished the likelihood of a third grade child's having been retained by 36% (14% for GSRP participants versus 22% for control).[34] Participation in the state-funded Virginia Preschool Initiative reduced the chance of a child's being retained in kindergarten by over 50%.[35] Participation in Georgia's state pre-K program decreased a child's chance of repeating kindergarten by 50% and first grade by 25%.[36] A study by South Carolina First Steps to School Readiness correlated

xviii Rates were 10.7% for children who did not attend pre-K, 7.2% for those who attended for one year, and 5.3% for those who attended two years

South Carolina's early childhood education programs with a 52% reduction in first grade retention rates over ten years.[xix] [37]

Approximately 19,269 four-year-olds – about half of those considered at-risk of poor educational outcomes due to poverty—receive state pre-K services. K-3 enrollment averages 53,500 children per grade.[38] Thus, 36% of South Carolina's kindergarten class of 2017-18 will have received state pre-K services.

Special Education

Approximately 13.7% of South Carolina students receive special education services.[39] Per-child annual operating expenditures for special education students ($18,154) are approximately twice that of typical students ($9,077).[40] State and local government pay 90% of the additional cost of special education placement.[41] Thus, each avoided special education placement saves South Carolina $8,169 annually.

Assuming that pre-K reduces special education placements by 32%, as was recently documented in North Carolina, South Carolina's current pre-K investment will save the state about $6.9 million per grade per year, or about $28 million for grades K-3.[xx]

Grade Retention

Pre-K also generates measurable cost savings by reducing the likelihood that a child will be required to repeat a grade. A vast literature describes the many negative short and long-term consequence associated with grade retention,[42] all of which have financial consequences for the individual and society. However, the most readily quantifiable public sector cost of retention is the price of an additional year of public education for every child retained.

Approximately 2.6% of South Carolina's primary school students have repeated at least one grade.[43] Most children who repeat a grade are held back in kindergarten or first grade. [44] If, as the data suggests, high-quality pre-K reduces a child's likelihood of being held back in grades K-3 by at least 22% and potentially over 50%, a high quality pre-K program that serves 36% of 4-year-olds should prevent about 189 children from being retained each year.[xxi] If the cost of grade repetition is simply the cost of an additional year of school ($9,077 per child), the savings from reduced retention attributable to pre-K will total $1.7 million per pre-K cohort.

If the $8.6 million in savings attributable to one pre-K cohort were reinvested in pre-K, an additional 1,800 children could be served. The addition of these slots would increase the second year savings to $9.4 million per pre-K cohort, enabling the addition of even more slots. If just one year of savings per pre-K cohort were reinvested in pre-K each year, the entire unmet need for pre-K could be met in under 10 years.

7. DEFINE ECCE AS ECONOMIC DEVELOPMENT

Despite their many contributions to state economic vitality, early childhood businesses rarely qualify for state economic development incentives. Making ECE an economic development priority and enabling ECE providers to access South Carolina's many state economic development incentives would bolster a crucial but under-capitalized sector of the economy and enable providers to invest in capacity and quality.

Economic development is a high priority for South Carolina. Since 2007, state and local governments in South Carolina have issued over 825 economic development subsidies to private businesses with a total worth of over $1.8 billion.[45] With the nation's lowest overall cost of doing business, a plethora of generous economic development incentives, a large supply of shovel-ready commercial/industrial land, a business-friendly state government, and the nation's lowest private sector unionization rate, South Carolina ranks high among states for economic competitiveness.[46]

Financial incentives and low-cost labor, although important to the bottom line, are not the only factors firms consider when deciding where to locate. Especially in today's knowledge-based, service economy, the same features that make a state a good place to live make it a good place to do business. South Carolina

xix The First Steps analysis lacks the experimental design and rigorous methodology of the other studies cited and does not link nor attribute the entire decline in grade retention to pre-K programs; but the First Steps results are not dissimilar from those of programs that were evaluated more scientifically.

xx 53,500 third graders, 19,629 of whom attended high quality pre-K*13.7% special education placement rate*32% reduction in special education placement*$8,169 annual additional state and local cost of special education.

xxi Assumes a 37.5% reduction

ranks 45th among states for quality of life, based on an index compiled by the Organization for Economic Cooperation and Development (OECD).[xxii]

ECE is every bit as important to a healthy state economy as traversable roads, broadband access, and streamlined regulatory processes, but rarely are ECE services regarded through an economic development lens. Rather, ECE is seen as a social service, a support for the K-12 educational system, or a service for working parents. These are all valuable functions, but they represent only a fraction of ECE's true contribution to a state's economic vitality.

Each year, states devote billions of dollars to economic development incentives designed to attract, retain or support the growth of businesses deemed especially beneficial to the state economy. Although each state has its own list of "target industries," there is a great deal of overlap and states compete feverishly to attract and retain a relatively small subset of businesses. Economic development incentives include tax breaks, many refundable; subsidized capital improvements, loan guarantees, operating grants, and customized worker training programs offered free of charge through public colleges and universities. Most states limit eligibility for these generous incentives to "economic base" industries. Economic base industries draw money into the local economy, usually through the export of goods or services. Manufacturing and tourism are economic base industries, as are businesses and institutions, like federal contractors and military installations, which draw most of their revenue from the federal government.[xxiii] "Non-base" businesses are, for example, grocery stores, hair salons, dentists, and gas stations, produce goods and services for consumption by local residents. These businesses recirculate funds within the local community but do not draw new funds into the community from outside and therefore do not directly grow the local economy.

ECE services are considered non-base because more than 50% of industry revenue typically originates within the local economy in the form of parent payments to private providers. However, this is not always the case. In South Carolina the federal government pays about one third of ECE costs in the form of grants for Head Start, early childhood home visiting, early intervention services, and child care subsidies. Most federal grants target primarily at-risk children and families. Thus, in low income communities, the percentage of ECE revenue derived from federal sources may greatly exceed 50%. Despite this reality, ECE providers are categorically excluded from most economic development incentives.

In addition to attracting outside revenue, pre-K and child care serve as critical workforce supports. Roughly one-in-three working mothers relies on paid child care and the supply of labor would be considerably less if affordable child care were not available. The impact of child care on maternal labor force participation has been shown to persist well after children have entered school.[47] Reliable child care has also been shown to greatly reduce both employee turnover and absenteeism, increasing worker and industry productivity.

For all of these reasons, the return on state investment in ECE businesses and support infrastructure is likely as large, if not larger, than the return on public investments in car manufacturers, food processors, film production companies, or any of the other more traditional economic development targets. Yet, despite their large and multi-faceted contributions to state economies, ECE providers often struggle to remain in business, and, as such, have extremely limited access to the commercial capital necessary to expand or enhance their operations.

Examples of state and local incentives that could be made applicable or more accessible to ECE businesses through statutory and/or policy changes include:

1. Private Activity (Conduit) Bonds—State and local governments frequently use their tax exempt status and/or bonding capacity to support economic

xxii The OECD index uses nine different measures of well-being: health, safety, housing, access to broadband, civic engagement, education (43rd), job opportunities (47th), environment, and income. See: OECD How's Life in Your Region?: Measuring Regional and Local Well-Being for Policy Making. http://www.oecd.org/regional/how-is-life-in-your-region.htm

xxiii Manufacturing is the classic example of an economic base industry because rarely are all the widgets produced by a factory consumed by the residents of the community in which the factory is located. Instead, most of the widgets are exported for purchase elsewhere. The revenue from those purchases flows back to the manufacturer and the community in which the widgets were produced, increasing the overall volume of commerce in the local economy.

development. State and local governments may issue tax-exempt private activity bonds on behalf of private companies to help them obtain lower-cost capital financing. These bonds differ from the revenue and general obligation bonds issued for public projects because the private company, not the government entity issuing the bonds, is responsible for their repayment. 501(c) (3) bonds are conduit bonds issued by governments on behalf of private non-profits. Either form of financing could be valuable for ECE businesses that need access to lower cost capital in order to expand.

2. Revolving Loan Funds—Many state and local governments maintain revolving loan funds for use by local small businesses. Oftentimes, early childhood businesses qualify to access these funds and a lack of awareness is the only barrier to their use. Some communities maintain loan funds specifically for early childhood businesses and/or earmark a specific revenue source for ECE business support. Santa Cruz County uses revenue from developer's fees to provide loans to child care providers.[48] The New Mexico Finance Authority maintains a Child Care Facilities Revolving Loan Fund.[49]

3. Loan Guarantees—The extremely narrow profit margins of many ECE businesses make it difficult for them to meet commercial loan underwriting standards and thus obtain the financing necessary to grow. By guaranteeing all or part of a loan, government can absorb some of the lender's risk, enabling them to relax their underwriting standards and provide financing to ECE businesses. North Carolina uses Child Care and Development Fund (CCDF) revenue to guarantee loans to child care businesses that serve children receiving state-subsidized care.[50]

4. Tax Increment Financing (TIF)—Tax increment financing enables developers to borrow against the increased tax revenue expected to result from development and redevelopment projects to finance infrastructure. The "increment" is the anticipated difference between the local tax base before the development and the tax base after. Bonds are issued to finance the improvements and repaid with the increased tax revenue resulting from higher property values and/or increased economic activity. Authorized improvements are typically critical infrastructure including roadways, open space, health care facilities and K-12 public schools. Some statutes authorizing tax increment financing or any of its many permutations[xxiv] include ECE as critical infrastructure and allow bond proceeds to be used to construct, equip or maintain child care facilities, but many do not. Amending state statute to allow TIDD financing of ECE facilities and encouraging state and local governing bodies to require adequate, accessible child care in development agreements would help to ensure that child care slots increase in proportion to new jobs and/or housing.

5. New Markets Tax Credit (NMTC)—The NMTC is a federal tax credit enacted in 2000 to increase investment in businesses and development projects in low-income communities. NMTC provides income tax credits to individual and corporate investors who make equity investments in specialized financial institutions called Community Development Entities (CDEs). The CDEs, in turn, invest in qualifying projects located in low income communities. The NMTC enables the CDE to provide qualifying projects with attractive gap financing that may include below-market interest rates, lower origination fees, longer periods for interest-only loan payments, higher loan-to-value ratios, longer amortization periods, more flexible borrower credit standards, low debt service coverage ratios, and subordination to other available financing. A wide variety of projects, including economic base, service sector, and 501(c) (3) businesses and institutions qualify for NMTC financing. Many NMTC-funded real estate developments include dedicated space for ECE programs. CDEs also invest NMTC recipient funds directly in ECE programs. Examples of NMTC funded ECE projects include a Portland Oregon Head Start center that will house comprehensive family support and child development resources, a $10 million investment in operating reserves for an Educare program in Lincoln Nebraska;[51] and, in Los Angeles, a $28.1 million investment in a 48,000 square-foot early childhood campus that serves 5,000 children and trains 2,200 ECE professionals annually.[52]

xxiv This include Tax Increment Districts (TIDs) and Public Improvement Districts (PIDs).

6. Job Training Incentives—South Carolina's Workforce Investment Act provides discretionary job training grants of up to $9,500 to companies that create new jobs through expansion or relocation. The state's Job Development Tax Credit authorizes the state to refund the personal income tax a company withholds on behalf of its employees to the company.[xxv] [53] The refund can be up to 5% of employee gross wages. Companies must create new employment and make capital investments to qualify.

Many communities require real estate developers to pay impact fees that offset the public sector costs of providing infrastructure and public services to new developments. Because residential developments and projects that increase area employment both require additional child care capacity, a number of communities including Sacramento, San Francisco,[xxvi] and Concord, California, impose dedicated development fees or earmark a portion of existing development fees for early childhood.

Meeting the challenges of the modern economy calls for a more nuanced, comprehensive approach to economic development, one that recognizes a broader spectrum of economic benefits and supports those industries upon which the success of other industries depend – education being one of the most important. Most states have a handful of key industries to which they target a large portion of their economic development resources. A state's selection of priority industries is usually based on the number of high quality jobs the industries directly create, the extent to which the industries purchase goods and services from in-state suppliers, and their potential to attract other, related businesses and industries to the state. These are strong criteria, but they do not capture all of the factors that make up an industry's impact on the state economy or its contribution to the quality of life enjoyed by state residents.

xxv The employees are still credited with the tax withheld, so the tax credit is essentially a cash grant to the company

xxvi In San Francisco, any new development or commercial renovation larger than 100,000 square feet must contain a child care center. A developer who chooses not to construct a center must pay a fee per square foot of new space. Fees are deposited in the city's Affordable Child Care Fund. See: Creating Dedicated Local Revenue Sources for Early Care and Education BY Barbara Hanson Langford, The Finance Project http://www.financeproject.org/Publications/Local_revenue_early_care.pdf

(conclusion)

Throughout the US, state ECE systems have expanded in an ad hoc fashion as available funding has ebbed and flowed, resulting in an often inefficient patchwork of policies and funding mechanisms. Stable and sufficient funding is key to the thoughtful and cohesive system-building that will maximally leverage all funding sources and provide the highest quality early childhood services for the largest number of families.

Ideally, the amount a state invests in ECE would be proportional to the expected return on that investment. If that were the case, states would invest far more than they currently do and, over time, those investments would help to resolve some of our most pressing societal problems and inequities, vastly improve social and economic well-being and, in so doing, save taxpayers money. However, many of ECE's benefits accrue over many years and not enough is yet known about the precise timing, magnitude, and drivers of the cost savings attributable to ECE to say with any certainty that an investment of $X today will produce savings of $X+Y dollars at some specific date in the future. Until that day comes, state investments in ECE will likely remain suboptimal.

Despite recent funding increases, less than one third of South Carolina's low income young children receive publicly subsidized ECE services. Meeting the unmet demand for ECE services would likely cost the state several hundred million additional dollars. State general revenues and a handful of federal block grant programs provide the lion's share of funding for ECE in South Carolina and the US overall. Block grants are capped and state revenues are tight. Thus, proposals to expand and/or improve ECE must be accompanied by new financing strategies. This report has presented a range of different options that states seeking to expand and diversify their ECE funding bases might want to consider. Some of these options entail viewing ECE from new or non-traditional perspectives: as critical infrastructure, economic development, preventative health care, and the underpinning of a successful K-12 education system.

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