

# The Treasury

## Budget 2023 Information Release

### July 2023

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- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
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**From:** [23]  
**Sent:** Wednesday, 22 February 2023 5:06 pm  
**To:** [23]  
**Cc:** Laura King [TSY]; [23]  
**Subject:** Initial advice on ECE extension + scaling in draft package

Kia ora [23]

Please see below advice on:

- Extending 20 hours free ECE to two year olds

[34]

Many thanks

[23]

**Initial advice on proposal to extend 20 hours fees-free to two year olds (approx. cost \$800m total operating):**

[33]

*If there is interest in a more universal ECE subsidy there are targeted design options within the ECE funding mechanism to help achieve these policy objectives. Further detail and analysis is provided below.*

This extension of 20 Hours ECE to 2-year-olds would allow services to opt in to receive additional subsidies for up to 6 hours per day and 20 hours per week. Services may not charge fees for these hours, but there are no further fee restrictions, and services may require attendance beyond 6 hours and then charge a high 'daily fee'.

We understand that an extension to 2-year-olds is likely to have a total cost of approximately \$800 million operating over the forecast period, potentially covering approximately 43,000 children, and could be implemented from March 2024. We understand there may also be additional costs above that headline amount due to interactions with other policies and potential volume increases.

While a universal initiative of this type brings a range of potential cost of living, labour market and wellbeing benefits, there are some key limitations that need to be taken into account:

- Increased subsidies do not automatically mean reduced fees. A key limitation is that services may choose to not pass subsidy increases on to whānau through reduced fees. For any extensions of 20 Hours ECE to 2-year-olds, there is nothing to prevent services from charging daily fees to whānau of 2-year-olds. Services may use subsidy increases to raise profits or invest in service quality. Services already know that whānau are prepared to pay existing fees, and the ECE market is not particularly competitive in many places. It may be difficult to directly compel services to pass on any subsidy increase to whānau dollar for dollar.
- There are other potential risks from a universal approach, in particular deadweight costs. Extending 20 hours to ECE is universal rather than targeted, and because increases to ECE subsidies are unlikely to be fully passed on to parents, there is a risk of significant deadweight cost and relatively low value for money.
- We lack data to properly understand the potential benefits of an extension of subsidies. MoE does not collect information about ECE fees and centre costs, so a rigorous analysis of the potential benefits of an extension of subsidies is not possible. There is a case to direct MoE to collect fee data, though this is likely to

require new rules or regulations to compel services to report this information and a likely to bring a call from the sector for financial support for services to meet additional administrative burdens.

[33]

Such options are likely to target support to whānau where both affordability challenges and where the benefits to children of participating in ECE are likely to be greatest:

- [33]

The initiative aims to improve take-up, which is currently low, for low to middle income households. It will provide additional support for household costs and can support increased labour market participation. [33]

This complements the increases made to the income thresholds for MSD Childcare Assistance in November as a pre-commitment to Budget 2023 costing \$189 million over the forecast period. This initiative will provide more targeted support for families and whānau who would benefit from additional financial support for childcare.

If Ministers would like to invest in the 20 Hours ECE policy instead of in targeted support, then there are options that could offer better value for money and do more to reduce fees for parents than the proposed universal extension to 2-year-olds. These options include:

1. Increase 20 Hours ECE subsidy rates and require services to offer 20 genuinely free hours for 3–5-year-olds. Providers would no longer be able to require parents to enrol beyond the 20 free hours. This would create service viability risks that would need to be mitigated with an increase to the 20 Hours ECE subsidy rate. MoE has calculated that the total cost of a 2% increase would be \$90 million over the forecast period, [33]

[33]

We will provide further advice to inform discussions at the Budget Ministers 3 meeting.

[34]

[33]

