Policy brief: Demand-side financing is no silver bullet for improving access to early childhood education in South Africa[1]

Gabrielle Wills

In South Africa, public financing of early childhood care and education (ECCE) has followed a supply-subsidisation approach. Under this approach, public finance flows directly to the provider of services in the form of subsidies for children who pass a means-test and subject to their daily attendance. These providers are almost entirely not-for-profits, sole proprietors, micro-enterprises, and NGOs, further supported by parent fees and backed by social and financial capital in the communities they serve. But in many developed and a few developing countries, a demand-side approach is used where funding for ECCE attendance flows directly to those benefitting from these services, namely parents or caregivers. This brief summarises findings[1] from a review of the advantages and disadvantages of two demand-side financing approaches – namely vouchers or conditional cash transfers – with application to financing non-grade R ECCE in South Africa. **A key conclusion is that demand-side financing presents no silver bullet to resolving the current challenges in ECCE financing in South Africa.**

Main findings

- **The existing, subsidy financing model for ECCE has limited reach and depth,** producing an over-reliance on parent/caregiver fees. The indirect impact of COVID-19-related household shocks on the ECCE sector suggests that demand-side funding (to parents/caregivers) might better support access to quality ECCE.

However:

- **Demand-side ECCE financing does not guarantee supply,** since providers often have too little information about the decision-making of parents/caregivers to determine demand for their services.
- **Leveraging South Africa's cash transfer system for ECCE would require reshaping the unconditional grant system to have "conditionalities,"** which presents significant administrative, ethical and practical hurdles.
- The **success of cash transfers or vouchers for ECCE depends on ensuring a sufficient supply of programmes and effective administration and oversight.**
- **Demand-side financing could augment, rather than replace, existing early early childhood care and education (ECCE) financing models.** But more research is needed to better understand government expenditure, provider costs and incentives, and parent/caregiver preferences.

1 This Policy Brief is based on a working paper written for the Ilifa Labantwana and Resep ECD Working Paper Series.

Shortcomings of the current ECCE financing model

The expansion of the means-tested per-child, per-day operational subsidy for ECCE has driven increased access to ECCE in post-apartheid South Africa. Any further gains, however, are being hampered by shortcomings in the existing ECCE service delivery and financing model.

Table 1: Shortcomings in the existing ECCE service delivery and financing model

Reach	Subsidy funding to ECCE programmes is limited and uneven in reach, partly due to constraints imposed by the regulatory framework of ECCE.
Depth	The depth of ECCE financing is very limited. At R17 per-child per-day, the subsidy is much lower than the estimated costs of quality ECCE programmes in another middle-income country context.[2]
Vulnerability	Pre-pandemic, over 80% of children aged 0-5 enrolled in non-grade R ECCE programmes paid fees. A system this dependent on parent fee payments leaves ECCE access highly vulnerable to demand-side shocks. This also limits equal access to quality ECCE as fee payments are unlikely to make up the gap between the costs of providing quality ECCE and low subsidy amounts.
Capacity	The lack of data management systems[3] and human resources[4] to effectively administrate and provide oversight of existing operational subsidies does not support the current financing model.

Benefits and pitfalls of demand-side ECCE financing

South Africa's ECCE services have been severely impacted by the socio-economic impacts of COVID-19 on households,[5] which hampered parents' ability to pay fees. Demand-side financing could support increased access to quality ECCE. Views that efficient institutional structures, such as the South African grant or cash transfer payment system, could be used to support ECCE[6,7] have also created interest in demand-side financing.

There are three main types of demand-side subsidisation mechanisms.

Table 2: Three demand-side financing mechanisms

Tax breaks or rebates	Parents or caregivers receive a tax break or rebate if their children attend ECCE facilities. This is uncommon in developing countries due to low earnings or the informal nature of work limiting the tax base.
Voucher schemes	Vouchers are provided to households or to poor mothers to stimulate ECCE access, and thereby support female employment.
Conditional cash transfers	Cash transfers are be linked to ECCE enrolment. There are limited examples of this although cash transfers have been linked to schooling in many developing countries.

International experiences illustrate the benefits and pitfalls of demand-side financing as summarised in Figure 1. Demand-side financing has been viewed as a more efficient way of promoting equity and efficiency in educational systems.[8] It is also known to stimulate choice, parent/caregiver voice, and increased competition. In South Africa, demand-side financing could support ECCE attendance at unregistered programmes, which have historically been ineligible for subsidies. But various failures and distortions in childcare markets can limit the effectiveness of vouchers or cash transfers for improving equitable access to ECCE.[9,10]

Figure 1: Benefits and pitfalls of demand-side vouchers for ECCE from international experiences

Benefits	Pitfalls
· Promotes increased efficiency · Promotes increased competition across ECCE providers · Stimulates choice and voice on the demand-side · Vouchers and cash transfers can be directed at the poorest households	· Distortions or failures exist in childcare markets including information asymmetries resulting in limited supply, especially in rural and low-income areas. · Uneven supply occurs if the level of the voucher or transfer is not sufficient to guarantee a return to providers.

Box 1: The problem of information asymmetries in childcare markets

One of the main reasons why demand-side financing may not result in wider access to ECCE is the presence of **information asymmetries** in childcare markets.

- This occurs when ECCE providers cannot observe households' decision-making process in choosing between ECCE centres/programmes and familial childcare arrangements (such as relatives or playgroups). Households can switch very quickly between ECCE providers and their own familial arrangements.[9]
- Without this information, ECCE providers struggle to determine demand for their services or the profitability of establishing new programmes. This in turn limits new providers from entering the childcare market.
- COVID-19 impacts on employment prospects, together with parent fears about COVID-19 infections, are likely to widen the gap between household decisions and ECCE providers knowledge, making it difficult for providers to assess the viability of their operations.[5]

A major problem of demand-side financing is that if low-value cash subsidies or vouchers for ECCE attendance are placed in the hands of users, rather than flowing directly to ECCE providers, supply-side responses are not guaranteed.[10,11] When the value of vouchers or cash transfers is low, ECCE providers are not encouraged to remain open or enter the market, as financial returns are not guaranteed. International literature indicates that this is a particular problem in places with limited existing supply, including in poorer and more rural areas– the very areas where children are underrepresented in South African ECCE programmes. Information asymmetries (as discussed in Box 1) contribute to limited supply responses.

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Aran, Munoz-Boudet and Aktakke[12] have simulated how subsidies and investment grants to ECCE private providers, versus cash transfer/vouchers to households, impact ECCE access in a middle-income context. They argue that "targeting the unaffordability problem through a demand-side transfer to households turns out to be an ineffective policy for expanding access to services" until supply-side capacity issues are resolved.

Challenges of linking cash transfers to ECCE programme attendance in South Africa

Leveraging the existing cash transfer system in South Africa to improve access to ECCE would require reshaping an unconditional system of grants to have "conditionalities" or "co-responsibilities". Moving towards a system of cash transfers conditional on ECCE attendance would require overcoming insurmountable ethical, feasibility, cost and efficacy concerns, signalled in Figure 2 below.[13–16]

Figure 2: Four questions to ask in implementing cash transfers linked to ECCE enrolment in South Africa

1. What does this mean for human dignity and rights?

- Imposing conditionalities on cash transfers assumes that poor households are unable to choose the most appropriate use of a cash transfer. Yet the positive effects of the unconditional system of grants on various child outcomes indicates that appropriate investments have typically been made by poor households in South Africa.
- Enforcing ECCE attendance conditions on grant receipt is problematic in a low-quality ECCE context. This may undermine children's right to development if alternative childcare arrangements are of better quality than ECCE programmes.

2. Are there unintended consequences of attaching conditionalities to an unconditional system of grants?

- Sector-specific conditionalities could undermine the broader 'multi-sectoral' benefits of cash transfers to children and households.
- If conditional cash transfers are linked to ECCE attendance, but direct household expenditure away from nutrition and health, this could undermine wider early childhood development goals.

3. Would this be a feasible system to implement?

- South Africa's grant system has been shown to be a reliable and agile "institutional lever" to support households, especially over the COVID-19 pandemic. But the administrative challenges and financial costs of incorporating conditionalities into transfers – such as ECCE programme attendance – can be very substantial, potentially raising costs well above potential benefits.
- Conditional cash transfers are generally only more effective than unconditional ones under stringent monitoring. But there are currently limited resources in place to monitor existing ECCE programmes. The already cumbersome systems of tracking ECCE attendance for subsidy payments would apply on a much larger scale.

4. Is this likely to be effective in raising ECCE attendance?

- A sufficient supply of ECCE programmes in poorer contexts would be required if conditional cash transfers are linked to pre-schooling. Supply constraints are likely to be particularly binding in the ECCE sector, and even more so during the COVID-19 pandemic. Demand-side financing would therefore require concurrent supply-side subsidisation.

Conditions for a successful ECCE demand-side financing approach

The underlying factors required for a successful demand-side financing approach are the same factors that need to be addressed under the current ECCE financing system.

The success of a voucher scheme or system of cash transfers attached to ECCE attendance would depend on ensuring a sufficient supply of programmes and effective administration and oversight. This includes new and improved ICT and data management systems, implementing quality assurance systems, and more human resources to support the higher administrative load of monitoring demand-side financing. More children are also likely to be eligible for subsidies under a demand-side approach, as this potentially circumvents registered providers. More finance would be required.

Even where new innovative private financing sources are used to augment mainstream government finance for ECCE, monitoring systems become critical when innovative financing is linked to delivery mechanisms such as results-based aid, results-based financing or impact investing. [17,18]

Policy Recommendations

- **Accelerate ECCE programme registration, increase subsidies, and allocate larger budgets for ECCE**. System improvement requires remedying the ECCE registration bottlenecks, implementing administrative systems for improved oversight, new quality assurance processes, and raising financing allocations for ECCE, regardless of the form of subsidisation.
- **Conduct simulations and experiments to ascertain whether demand-side financing could *augment* rather than replace the current supply-side financing model.** While demand-side vouchers should never replace a supply-side subsidisation approach, an ECCE voucher linked to the grant system might augment the current approach. Modelled simulation studies, in addition to randomised control trial studies, could help answer this question. Experimentation and testing is vital because similar financing strategies can yield vastly different results in different contexts.[7]
- **Collect provider cost data and public expenditure data on ECCE to enable simulation and improved design of financial models.** A well-developed ECCE strategy must be aligned with the costs of provision, and acknowledge that various modalities result in varied cost structures.[19] Getting clearer on costs will require collecting more comprehensive and reliable data on provider costs as well as public ECCE expenditure.[20] Linking provider cost data to demand-side data can help simulate how variations in subsidies, and their form, impact on ECCE access, equity and quality.
- **Understand the incentives driving ECCE providers and parent preferences for services.** Where ECCE provision is largely dependent on private provision, it is necessary to better understand what incentives drive private ECCE provision and parent decisions to enrol children in ECCE. Without an understanding of provider decisions and parent incentives, the size of subsidies and vouchers provided can be incorrectly set.[21] Ultimately, increased access to ECCE services will require sustained and increased supply responses from ECCE providers. It's time that these critically important aspects of the ECCE market in South Africa are better understood.

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The Ilifa-Resep ECD Working Paper Series is a collaboration between Ilifa Labantwana and Research on Socio-Economic Policy (Resep) at Stellenbosch University.