

Title: Two Year Olds' Entitlement to Early Education: Options for Extended Eligibility in the Second Phase of the Entitlement. IA No: Lead department or agency: Department for Education Other departments or agencies:	Impact Assessment (IA)			
	Date: 05/06/2012			
	Stage: Consultation			
	Source of intervention: Domestic			
	Type of measure: Secondary legislation			
Contact for enquiries: Simon.hampson@education.gsi.gov.uk				
Summary: Intervention and Options			RPC Opinion: AMBER	

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?
£-2,251m	£m	£m	No
			NA

What is the problem under consideration? Why is government intervention necessary?

Currently, disadvantaged two year olds are less likely to access early education than their better off peers. This is partly due to the costs of early education. The Government seeks to enable disadvantaged two year olds to access free early education, to drive social mobility and improve life chances. The Government has already consulted (and completed an IA) on extending a free early education entitlement to the poorest 20% (around 130,000) two year olds from September 2013. In the second phase of the policy, the Government plans to extend free early education to around 260,000 two year olds by 2014 (the first and second poorest quintiles together).

What are the policy objectives and the intended effects?

The second phase of the policy aims to enable around 260,000 two year olds to access free early education by 2014 (extending from 130,000 in 2013). This will extend the free places to low income working families and children with special educational needs or disabilities, as well as the workless households targeted in the first phase. It is intended to improve the cognitive, social and behavioural development of disadvantaged two year olds, and thereby narrow attainment gaps. Evidence suggests that this will contribute to subsequent increases in their achievement at school, and on lifetime earnings.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option1) - The status quo: maintain provision at the level of the first phase of the entitlement; eligibility criteria and funding maintained to provide free places for around 130,000 disadvantaged two year olds.
Option 2) Additional funding is provided to LAs to extend free places to around 260,000 disadvantaged two year olds, allowing total discretion over whether -and how- the free places are extended to more children, beyond the groups reached in the first phase.
Option 3) Extend a legal entitlement to around 260,000 two year olds, with additional funding.
Option 3 is preferred. Option 1 would not address concerns over low-income working families' access to early education for their children. Option 2 risks diluting the focus on disadvantaged families (see evidence from Two Year Old Pilot Evaluation), lower take-up and a consequent reduction in economic benefits.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 08/2016

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro No	< 20 No	Small No	Medium No	Large No
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: n/a	Non-traded:	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: _____ Date: _____

Summary: Analysis & Evidence

Policy Option 2

Description: Additional funding to allow local authorities to extension of free places to around 260,000 two year olds, but with local authority discretion over which children receive the free places.

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: £-1,754	High: £-2,295	Best Estimate: £-2,025

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£58m	£ 269m	£ 2,686m
High	£59m	£271m	£2,710m
Best Estimate	£59m	£270m	£ 2,698m

Description and scale of key monetised costs by 'main affected groups'

The majority of costs will be to government for paying for early education places for two year olds. There will also be indirect costs to government of increased take up of free early education for three and four year olds, and providing additional funding for children with additional needs. There will also be some administration costs to local authorities who will be responsible for delivery of the entitlement.

Other key non-monetised costs by 'main affected groups'

The increase in the number of two year olds in settings is likely to lead to earlier identification of additional needs, which will raise the short-term total costs of interventions to address these needs. However, there is also potential for long-term savings, by preventing problems from escalating.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	£19	£93	£932
High	£8	£41	£415
Best Estimate	£14	£67	£673

Description and scale of key monetised benefits by 'main affected groups'

Due to methodological considerations, the benefits of the option have not been monetised. Nevertheless, the overall benefits to the policy are expected to outweigh the costs (see below for non-monetised benefits).

Other key non-monetised benefits by 'main affected groups'

The main benefits are to the two year olds receiving early education as a result of this entitlement, through the expected improvements in cognitive development and school readiness, leading to improved future educational attainment and lifetime earnings. The policy is also expected to increase take up of the three and four year olds' entitlement by disadvantaged children, further enhancing the benefits.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

1. Take up - an assumption has been made that take up will be 70% (range of 60% to 80%), lower than the take-up assumption for Option 3 - higher take up will increase the gross benefits and NPV of the policy.
2. Quality - the assumption made is that 78% of provision is high quality with regulation.
3. Focus upon the most disadvantaged - the policy would not meet its stated objectives if provision is not focused primarily on the second most deprived quintile of two year olds.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net:	No	NA

Summary: Analysis & Evidence

Policy Option 3

Description: Extend legal entitlement to around 260,000 two year olds, with additional funding.

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: £-1,980	High: £-2,521m	Best Estimate: £-2,251m

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£55m	£269m	£2,694m
High	£55m	£272m	£2,718m
Best Estimate	£55m	£271m	£2,706m

Description and scale of key monetised costs by 'main affected groups'

The majority of costs will be to government for paying for early education places for eligible two year olds. There will also be indirect costs to government of increased take up of free early education for three and four year olds, and providing additional funding for children with additional needs. There will also be some administration costs to local authorities who will be responsible for delivery of the entitlement.

Other key non-monetised costs by 'main affected groups'

The increase in the number of two year olds in settings is likely to lead to earlier identification of additional needs, which will raise the short-term total costs of interventions to address these needs. However, there is also potential for long-term savings, by preventing problems from escalating.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	£14m	£71m	£714m
High	£4m	£20m	£197m
Best Estimate	£9m	£46m	£456m

Description and scale of key monetised benefits by 'main affected groups'

Due to methodological considerations, the benefits of the option have not been monetised. Nevertheless, the overall benefits to the policy are expected to outweigh the costs (see below for non-monetised benefits).

Other key non-monetised benefits by 'main affected groups'

The main benefits are to the two year olds receiving early education as a result of this entitlement, through the expected improvements in cognitive development and school readiness, leading to improved future educational attainment and lifetime earnings. The policy is also expected to increase take up of the three and four year olds' entitlement by disadvantaged children, further enhancing the benefits.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

1. Take up - an assumption has been made that take up will be 80% (range of 70% to 90%), higher than the take-up assumption for Option 2 - higher take up will increase the gross benefits and NPV of the policy.
2. Quality - the assumption made is that 78% of provision is high quality with regulation.
3. Focus upon the most disadvantaged - the policy will meet its stated objectives as provision will be focused primarily on the second most deprived quintile of two year olds.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net:	No	NA

Evidence Base (for summary sheets)

Problem under consideration

The Government seeks to enable more two year olds to access high quality early education a year younger than the existing free entitlement for all three and four year olds. To achieve this, the Government plans to fund 570 hours of free early education for specified two year olds (if taken over 38 term-time weeks, this equates to 15 hours a week). Evidence suggests that early education has significant advantages for children and families, and is particularly beneficial for disadvantaged children. However, take up is lowest amongst disadvantaged families.

The Government plans to take a phased approach to the implementation of this policy:

- From September 2013, around 130,000 (20%) of two year olds will be eligible for free early education places: eligible children will be those who meet the Free School Meals eligibility criteria, or who are looked after by the local authority (i.e. the poorest quintile)
- From September 2014, the free places will extend to around 260,000 two year olds.

This impact assessment (IA) concerns the Government's plans for the second phase only, the changes made for the first phase are treated as the baseline. An impact assessment has been already completed for the consultation on the first phase of the entitlement.

This IA considers how free places for the second group of 130,000 children should be targeted: whether national eligibility criteria (accompanied by statutory duties) should be set, or whether this should be left to local discretion. The IA accompanies a consultation document on the second phase of the policy.

The Government announced additional funding in the Autumn Statement 2011, in recognition of the costs of extending the free places to around 260,000 children. The total funding allocations are as follows:

	Funding announced in the Spending Review (2010)	Additional funding announced in the Autumn Statement (2011)	Total funding
2011-12	£64m	-	£64m
2012-13	£223m	£73m	£296m
2013-14	£331m	£203m	£534m
2014-15	£380m	£380m	£760m

In 2011-12 and 2012-13, this funding is within the early intervention grant to local authorities, which is not ringfenced. It gives scope for local authorities to fund free places, as well as to support capacity or quality improvements before the entitlement starts. From 2013-14 onwards the funding will be allocated to local authorities through the ringfenced Dedicated Schools Grant.

Rationale for intervention

The benefits of early education are well established, but without government intervention not all children will be able to benefit. Not all parents are aware of the benefits of early education, and many from disadvantaged backgrounds cannot afford it without financial assistance. Government intervention is therefore necessary to ensure that disadvantaged children can access early education.

Recent research demonstrates a strong case for investing in the early years. Graham Allen's *Early Intervention Next Steps*ⁱ points to the way that children's neurological pathways develop

before the age of three and the benefits of early support and intervention to ensure all children develop the social and emotional foundations they need. In his report of the *Independent Review of Poverty and Life Chances*, the Rt. Hon. Frank Field MP also stressed the critical importance of the foundation years upon a child's life chancesⁱⁱ.

The rationale for intervention has three parts:

- **The benefits of early education** to children's development, and life chances;
- **The rationale for a targeted approach:** extending early education to the children who will most benefit; and,
- **The rationale for free places:** why access to early education should not be left entirely to the market.

The benefits of early education

Most children who are developing well at the end of their early years go on to exceed expectations in reading and maths at the end of Key Stage 1 (KS1).ⁱⁱⁱ Children in the lowest achieving fifth in terms of their learning and development at the end of the Early Years Foundation Stage are six times more likely to be in the lowest fifth at KS1.^{iv} Research indicates that early education supports children's development in these critical first years. The benefits include both cognitive gains – for example, speech and language development – and non-cognitive developments, such as behaviour.

The evidence for the benefits of early education is set out more fully in the 'benefits' subsection of the Economic Appraisal below.

The rationale for a targeted approach

The Government intends to take a targeted approach to the extension of the free places for two year olds. This will focus on those groups for whom the positive impact will be particularly great. The proposed target groups, discussed in turn below, are:

- Children in low income working families;
- Children with special educational needs or disabilities (SEND);
- Children who have left care under an adoption, special guardianship or residence order.

The first phase of the entitlement will extend free places to the most disadvantaged 20% (130,000) two year olds, the poorest quintile. For the additional places in the second phase, the primary focus will remain on economic disadvantage. The proposals on which Government is consulting would mean that around 130,000 low income working families, the second poorest quintile, would be entitled to places. This will reach more children in poverty; around 20% of two year olds in poverty are in this group.^v

Research on access to early education supports a primary focus on the second poorest quintile for the additional places. Only 37% of this group currently benefit from any form of early education, compared to 43% of the most disadvantaged, and 72% of the most advantaged^{vi}. This data is indicative only: it does not suggest, for example, that all of the free places for this 37% of families will be 'deadweight', as they are not likely to be currently accessing the full 570 hours of early education that the free entitlement will offer. They are likely also to be being funded for these places through other public sector funding streams, for example Sure Start.

Targeting free places at children in this quintile will also support the Government's objective of closing attainment gaps between poorer school children and their better off peers. Currently, gaps in attainment appear in children's first few years and disadvantaged children are less likely

to be ready to achieve when they start school. 54% of children in the second lowest IDACI quintile achieve a good level of development at age 5 compared to 59% of children nationally and 70% for the most advantaged quintile^{vii}. A 2008 review of research has established that early years interventions can narrow the gap between disadvantaged and other children in terms of their cognitive, social and behavioural development.^{viii}

The Government also proposes that two year olds with identified SEND should be able access free early education in the second phase. Children with SEND may be accessing some provision, but feedback from the sector is that this is generally health-based for children as young as two. Research evidence suggests that early education could have significant benefits for children with SEND and their families. The Effective Pre-School and Primary Education (EPPE) study found that the social and behavioural benefits of pre-school education were higher for children with SEN.^{ix} High quality early education also has wider benefits for children with SEND; it is one means of facilitating social inclusion and improving their well-being.^x

Finally, the Government proposes that children who have left care under an adoption, special guardianship or residence order should also receive free places. In the first phase of the entitlement, children who are looked after will be included, and this will continue for the second phase. This proposal will mean that children who have previously been looked after would also benefit. Children's needs do not change overnight with adoption, it is right that they continue to be supported. The Government is also concerned to ensure that there are no disincentives to adoption.

Free places

The Government expects that extending free places will widen access and increase take-up of early education. One of the reasons for lower take-up of early education among economically disadvantaged children is the cost of early education. An independent survey by the Daycare Trust carried out in 2012 found that the average cost of a nursery place for children aged two and over in England was £98.75 for 25 hours a week (although it should be noted that the costs of childcare vary between providers, and areas; we have used the Daycare Trust figures as a guide)^{xi}. This equates to an average of £59.25 for 15 hours of childcare a week. 24% of parents say they find it difficult or very difficult to cover the costs of early education or childcare^{xii}. The proportion of families finding it difficult to pay for early education or childcare is significantly higher in lower income families.^{xiii}

The evaluation of the Disabled Children's Access to Childcare (DCATCH) initiative found that parents of disabled children often face higher costs of early education and childcare^{xiv}. The evaluation cites the lack of affordable care for children with disabilities and special educational needs as being a prevalent barrier to work, social activities and educational opportunities for parents. It also highlights the additional costs of early education for children with disabilities, partly due to more intensive support and practitioner-child ratios.

Policy objective

The Government's objective for the second phase of the roll-out is to extend access to free early education to low income working families, and children with SEND. This is part of the Government's social mobility and child poverty strategies, aiming to improve life chances for disadvantaged children. The Government aims to:

- **Support child development** - the Government expects that supporting children to access educational provision at a younger age will have a positive impact on children's cognitive, social and behavioural development.

- **Increase take-up of the three and four year old entitlement.** Currently, take-up of this entitlement is lower among disadvantaged families – widening access to free places at two years old is intended to make it more likely that these children will continue to access provision at age three and four. This will strengthen the impact on child development.

There are additional benefits to widening access to free early education places for two year olds:

- **Parental employment** – the majority of the additional families in the second phase will be low income working families. Widening access to free early education should reduce childcare costs for parents and support parents to balance working and family life.
- **Job creation** – Additional early education provision will need to be created in order to deliver the additional places. This will lead to new employment opportunities. While the impact is difficult to quantify with precision, it is reasonable to assume that this will have a positive impact on reducing unemployment.

Options

Three options have been considered in order to meet the policy objectives.

Option 1 – Maintain the status quo: funding and places at the level of the first phase of the entitlement.

This option would not introduce any additional support for two year olds, beyond the level of the first phase of the entitlement. This would mean that around 130,000 two year olds would be able to access free early education from September 2013 onwards. Funding would remain at the level before the Autumn Statement 2011 allocations; that is, £380m in 2014-15.

Option 2 – Allocate funding for second phase of the two year old entitlement, and local authorities have discretion over which –if any – additional children will receive free places.

Additional funding would allow for around 260,000 free places nationally (i.e. 130,000 more than in the first phase). Local authorities would only have a statutory duty to secure free places for children who meet the eligibility criteria set out in the first phase of the entitlement, but funding would rise to £760m by 2014-15. Local authorities would have full discretion over any additional places.

Option 3 – Introduce a new legal entitlement for around 260,000 two year olds, with funding for the expansion in free places.

New eligibility criteria, in regulations, would create a legal entitlement to free early education for a total of around 260,000 two year olds from September 2014. The extended entitlement would be accompanied by additional funding, bringing the total allocation to £760m from 2014-15.

The new eligibility criteria would replace the criteria used in the first phase. The design principles for the new eligibility criteria are:

- Families who would have been eligible under the first phase of the entitlement should continue to be eligible under the second phase;
- They should focus on economic disadvantage; and,
- They should be simple to administer, and to communicate to parents, providers and local authorities.

Working from these design principles, the Government proposes that in the second phase, two year olds should be eligible to free early education if:

- Their household's gross earnings are below £16,190 per annum.
- **Or**, the child has been issued with a statement of SEN, or attracts Disability Living Allowance (DLA).
- **Or** the child is looked after by the local authority (continuing the policy from the first phase)
- **Or** the child has left care under an adoption, special guardianship or residence order.

In total, the Government's modelling estimates that these eligibility criteria would extend the legal entitlement to around 268,000 two year olds in 2014. This equates to around a **130,000** increase in the numbers of children expected to be eligible in the first phase.

The vast majority of additional places would be for children in low income working families. A much smaller number would have SEN statements or attract DLA. Around 8,000 two year olds attract DLA, and there were 250 two year olds with statements in 2011^{xv}. From the Government's internal analysis, 2,000 two year olds are estimated to be in the first income quintile covered by the first phase; therefore, the net increase of eligible two year olds with SEND in the second phase is estimated to be 6,000. Less than 1,000 two year olds have left care under an adoption, special guardianship or residence order.

Economic Appraisal

Benefits of the two year old offer

This impact assessment does not monetise benefits. The previous impact assessment, for the first phase of the entitlement, did monetise benefits. However, the Government has revised this approach and the RPC has now advised officials against structuring evidence to estimate the Net Present Value of policies if there is a lack of robust evidence on which to base the assumptions for monetisation.

The Government believes that there is a strong benefits case for extending the free early education places to low-income working families and children with SEND. However, there are methodological problems in quantifying and then monetising these benefits. In particular, there is an inherent difficulty in tracking the impact of early education at such a young age onto monetised benefits such as lifetime earnings. The Government considers that focussing on non-monetised benefits is a more realistic and transparent appraisal of the expected impact. Nevertheless, the combination of benefits described in detail below are expected to more than outweigh the cost of the policy over its lifetime.

The main expected benefits of the second phase of the two year old offer are set out below, along with a brief outline of the methodological problems with monetising them:

- **Improvements in cognitive development from starting early education at two, rather than three years old.** The Effective Pre-School Education Study (EPPE) (2004) found a strong body of evidence that good quality early education, especially from age two upwards, has positive benefits on children's all round development and that these benefits last through primary school to age 10/11.^{xvi} The evaluation of the Early Education Pilot for Two Year Olds^{xvii} also found some evidence of the benefits of early education for disadvantaged children – it found some positive impact on language ability and on parent-child relationships, compared to a control group who were not offered free early education. The evaluation of the pilot evidences the benefit of free early education for low income working families: 40% of the 13,500 families in the pilot had household

earnings of between £10,000 and £19,999.

The difficulty with monetising this benefit is that the data from the pilot shows only the immediate cognitive benefits of early education at two years old, rather than the sustained additional benefit of starting early education at two, rather than three years old.

- **Improvements in non-cognitive development, from starting early education at two, rather than three years old.** The EPPE study also suggests that there are additional benefits to starting early education at two years old, rather than three. EPPE research found that - particularly for children in low and middle income families - starting early education at two years old had a positive impact on behaviour and 'self regulation', and the effects are still present at Year 6 in primary school.^{xviii} Evidence suggests that the benefits of early education have a sustained impact, beyond school age. A study published by the US National Bureau of Economic Research (NBER) found that early education has a positive impact on lifetime earnings, and the impact is particularly great in higher quality settings. The researchers suggest that the positive impact may be the result of the non-cognitive gains of early education, such as social skills and behaviour.^{xix}

However, the NBER research focused on kindergarten cohorts, rather than children aged two, and the Government has concerns over using this evidence to monetise the benefits of the two year old offer. The NBER's evidence on the impact of early education on lifetime earnings are suggestive, rather than conclusive.

- **Improved take-up of the three and four year old entitlement.** 88% per cent of families who took part in the two year old pilot went on to access the three year old entitlement, relative to an estimated 81% in the matched comparison group^{xx}. The EPPE research, which focussed on children aged three years and older, suggests that increased take up of early education at three years old would have a positive impact on child development.

However, the increase in take-up is only statistically significant at 12%, and so while the evidence is indicative, the Government considers that an assumption of monetised benefits would not be appropriate.

As well these three main benefits, which link to the primary policy objective of supporting child development, the following additional benefits are also expected:

- **The equity impact of transfer payments to parents.** As referenced above, up to 37% of two year olds in the second poorest quintile may currently be paying for some early education. Extending free places to these families has an equity impact, because of the primary focus on disadvantaged families.

However, the Government has taken a cautious approach against monetising this benefit (with a 'distributional weighting') because the underlying data does not show the duration and type of early education that these families are currently accessing. Therefore, one cannot assume that the 570 free hours will be a direct replacement for the provision for which the families would otherwise pay. It is also likely that some of the provision captured through the survey is provision being funded through other public sector funding streams, such as Sure Start.

- **Supporting parental employment.** While the impact of this was low in the original pilot (1% of parents said that the free place had enabled them enter to work^{xxi}) changes to Universal Credit, and to the flexibility of when the free places can be taken up, may make employment possible for more parents. Given the lack of robust evidence, the Government does not consider that monetising these benefits is appropriate.
- **Job creation.** The early education and childcare sector is a significant source of employment for women and young people; 98% of the workforce is female, and 30% of staff in full day care settings are aged 16 to 24^{xxii}. The Government estimates that, while there is some spare capacity in the sector, the new free places for two year olds will mean that some new capacity will be required. This is expected to have a positive impact on reducing unemployment. However, the impact is difficult to quantify at this stage, because of uncertainties over how many new early education staff will be needed.

The Government is commissioning a wide range of research which will further develop the evidence base on the impact of the free places for two year olds, including a follow-up to the EPPE study to assess the longitudinal impact of the roll out of early years education to two year olds, but there is unavoidable time-lag before such research can be concluded.

Assumptions used for costs and benefits

This IA monetises the costs, but not the benefits, of the policy proposal. Two central assumptions we have used to calculate these costs are set out below. In order to make the IA more readable, other, more technical, assumptions have been included in **Annex A**. The Government welcomes any comments on the assumptions that have been made, through the accompanying consultation, and will revise them if necessary post consultation.

Programme costs

In addition to the funding available for the first phase of the entitlement, programme funding for the extension of the two year old offer has been announced as £73m in 2012-13, £203m in 2013-14 and £380m in 2014-15.

The gradual increase is designed to allow LAs time to support quality improvements, build capacity, and increase the number of places before the second phase of the entitlement comes into effect in September 2014.

Once the entitlement is in place, funding is intended to be sufficient to cover the costs of the places made available and administration by local authorities, including the cost of identifying eligible two year olds. Funds that are not spent on two year old places, and the associated administrative costs, are available to the LA for discretionary spending. This is treated as a transfer payment to LAs.

Take up rates

A range of likely take-up rates has been used. These are 10 percentage points higher for Option 3 than for Option 2 to reflect the increased clarity that a national entitlement is likely to bring. For Option 2 a range of 60%, 70% and 80% is used. For Option 3 a range of 70%, 80% and 90% is used.

This is based on:

- A DfE survey of parents found that 76% of families earning between £0-£20,799 per annum (both the poorest and the second poorest quintile) would be 'very likely' or 'fairly likely' to take up a free early education place for their parents. This survey group is not an exact match for the additional families we will be targeting in the second phase. The

Government believe that a sensible, and conservative, inference is to set central take-up estimates between 70% -80%.

- It is a reasonable assumption that take-up among families in the second phase will be slightly higher than for families in the first phase (assumed to be 70% in the first IA). This is because the first phase targets the most disadvantaged families, which includes a higher proportion of families with multiple problems, who tend to be ‘hard to reach’.
- The 2009 Early Years Parents’ Survey^{xxiii} estimated that current take-up by disadvantaged three year olds is 87%^{xxiv} for a universal benefit, and the Government believes that this is slightly higher than would be achieved initially for a non universal benefit. Evidence from the three year old entitlement supports this: when the three year old offer was scaled up from the most disadvantaged children to being a universal offer - take up amongst three year olds increased from 44% to 93%^{xxv} over a four year period. The same increase in take-up over time might be expected for the new two year old entitlement.
- In the consultation on the two year old entitlement, a number of local authorities responded that engaging parents and encouraging take-up will be a key challenge of the new entitlement. Therefore, assuming high take-up rates (90-100%) would not be appropriate.
- The Government considers that take-up will be lower under Option 2 than Option 3. This is because:
 - Option 2 risks causing some confusion for parents, as it will incorporate a legal entitlement for some two year olds (first phase) but not others. Local authorities would be likely to develop different criteria locally. A nationally consistent entitlement, as under Option 3, will allow the Government to communicate directly with parents to inform them of their eligibility, and will give greater clarity in national media and to organisations advising parents.
 - Local decisions to fund additional places will also differ between areas and local authorities would have flexibility to fund other policies instead, if they chose. This could mean that fewer parents will be offered places and therefore that overall take-up amongst the target group would be likely to be lower.

Option 1 – Maintain funding and places at the level of the first phase of the entitlement.

Benefits

The benefits of the two year old entitlement will remain at the level of the first phase (estimated in the first phase impact assessment). There will be no change in take up of early education by two year olds in low-income working families.

Costs

This option will have no additional costs.

Option 2 – Allocate additional funding for second phase of the two year old entitlement, and local authorities have discretion over which –if any – additional children will receive free places.

Non-Monetised Benefits

As set out above, the extension of free places to additional two year olds in the second phase is expected to have a range of non-monetised benefits:

- Improvements in cognitive and non-cognitive development;
- Improved take-up of the three and four year old entitlement;
- The equity impact of transfer payments to parents;
- Supporting parental employment; and,
- Job creation.

Monetised Benefits

Programme funding not spent on provision or administration of the two year old places is treated as a transfer payment to local authorities. The best estimate of the annually recurring transfer payment, based on 70% take up, is **£98m** (calculated from the £380m programme funding, minus the £263m for provision, and £18.5m annually recurring administration costs¹). The range is between £136m for 60% take up, and £60m for 80% take up.

The transfer to local authorities is assumed to be costs neutral, and is treated equally in the costs and benefits of the policy.

Monetised Costs

Total costs

Total annually recurring costs are estimated to be **£392.2m**.

This includes programme funding, and non-programme funding (for the additional needs of two year olds with SEND). The breakdown of costs is given below.

Programme costs

Costs of provision: The costs of funding two year old places will depend on the take up rates.

	Option 2		
Take up scenario	60%	70%	80%
Number of two year old places funded	78,000	91,000	104,000
Costs of providing two year old places (£m)	226	263	301

Other costs: The Government has assumed that doubling the numbers of free places will require a doubling of resources for day to day administration of the offer (e.g. provider payments). Accordingly, the same administrative cost estimates used for the first phase impact assessment have been used, to give a 100% increase over the first phase. In actual fact, there are likely to be economies of scale as the offer is expanded, but we have no firm basis for estimating the extent of such economies.

¹ Figures do not sum exactly due to rounding.

However, in this option local authorities will also have discretion over which – if any – additional two year olds can access free places. Local authorities would therefore be likely to develop and consult upon their own criteria, and would be responsible for putting systems in place to verify eligibility. This will add to the one-off costs to set-up the offer.

Estimated one off costs - £4.1m across 152 LAs

- 6 months (22 working weeks) of senior staff time (at £25.83per/hour, uplifted by 27% to reflect non-wage costs) which equates to £4.1 million across 152 LAs.

Estimated annual recurring costs: £18.5m across 152 LAs

- 2 x senior full-time equivalent (FTE) in each LA to work on increasing capacity and quality in the sector as well as negotiating with providers (at a rate of £25.83 per hour, uplifted by 27% to reflect non-wage costs; based on 44 working weeks each year this roughly equates to £16.2 million across 152 LAs)
- About 0.6 FTE for an administrative member of staff to process applications for places, verify eligibility, and payments to providers and answer enquires (at £11.97 per hour, uplifted by 27% to reflect non-wage costs; based on 44 working weeks each year this roughly equates to £2.3 million across 152 LAs)

These cost estimates are based on the two year old pilot, and feedback from the sector. They will be reviewed and possibly revised as a result of feedback received through the consultation

Transfer payments to local authorities

Programme funding that is not spent on provision or administration of the free places for two year olds is treated as a transfer payment to local authorities. The Government anticipates that this funding will be spent on improving quality or capacity in the early years sector, or additional free places (by local discretion).

The best estimate of the annually recurring transfer payment is **£98.5m** (calculated from the £380m programme funding, minus the £263m for provision, and £18.5m annually recurring administration costs).

Non-programme costs of provision for two year olds with SEND and those adopted from care

It is assumed that local authorities would fund discretionary free places for the two year olds with identified SEND at a higher rate due to their additional needs (discussed in Annex A). There are expected to be an additional 6,000 two year olds with SEND in the second phase, on top of the 2,000 children with SEND who are estimated to be captured by the earnings threshold in the first phase.

	Option 2		
Take up scenario	60%	70%	80%
Number of SEND two year old places funded	3,600	4,200	4,800
Additional costs of SEND two year old places (£m)	10.4	12.2	13.9

Option 3 - Introduce a new legal entitlement for around 260,000 two year olds, and provide additional funding.

Benefits

The benefits of Option 3 are expected to be similar to Option 2. However the Government considers that take-up of the free places is likely to be higher in Option 3, and so the benefits are expected to be greater.

The national eligibility criteria in Option 3 would also ensure that, in the second phase, the free places are targeted on those children who will benefit most. Without a national entitlement there is a greater possibility that some two year olds that benefit from the free education will be from better off families – who are more likely to already be accessing early education. For example, in the Two Year Early Education Pilot a notable minority (10%) of two year olds that took up places were from relatively affluent families with an income of £30,000 or more.^{xxvi} This was a result of allowing local authorities to develop their own eligibility criteria – for example, some targeted places at children living within a certain postcode and thereby reached a small number of more affluent families. The proposed national eligibility criteria (principally a household income threshold of £16,190) will ensure that free places are focused on low income working families.

Monetised Benefits

Programme funding not spent on provision or administration of the two year old places is treated as a transfer payment to local authorities. The best estimate of the annually recurring transfer payment, based on 80% take up, is **£66.3m** (calculated from the £380m programme funding, minus the £301m for provision, and £12.6m annually recurring administration costs). The range is between £104m for 70% take up, and £29m for 90% take up.

The transfer to local authorities is assumed to be costs neutral, and is treated equally in the costs and benefits of the policy.

Monetised Costs

Total annually recurring costs are estimated to be **£393.9m**.

This includes programme funding, and non-programme funding (for the additional needs of two year olds with SEND).

Programme costs

Costs of provision: The costs of funding two year old places will depend on the take up rates:

	Option 3		
Take up scenario	70%	80%	90%
Number of two year old places funded	91,000	104,000	117,000
Costs of providing two year old places (£m)	263	301	339

Other costs:

Estimated one off costs - £0.2m across 152 LAs

In contrast to Option 2, it is unlikely that there would be significant one off costs for Local Authorities in the first year because consultation/decisions upon eligibility criteria and design of new processes

would not be required. One week for familiarisation with national guidance equates to a one off cost of £0.2m across 152 LAs

Annual recurring costs: £12.6m across 152 LAs

Recurring administrative costs are assumed to be slightly lower for Option 3 than for Option 2. This is because the national eligibility criteria in Option 3 will mean that local authorities will be able to use the automated Eligibility Checking Service. This computerised system is currently used to check for FSM eligibility, and could be adapted to the new criteria for the two year old places. National eligibility criteria will also give greater clarity to providers who work across LA boundaries, and this is assumed to slightly reduce administrative costs of working with providers:

- 1.5 x senior FTE member of staff in each LA to work on increasing capacity and quality in the sector as well as negotiating with providers. (at a rate of £25.83 per/hour, uplifted by 27% to reflect non-wage costs, costing roughly £12.2 million across 152 LAs)
- About 0.1 x FTE finance officer to process payments (at £11.97 per hour, uplifted by 27% to reflect non-wage costs, costing roughly £0.4m across 152 LAs)

Transfer payments to local authorities

As for Option 2, any remainder of the programme funding for the second phase not spent on provision or administration of the two year old places is treated as a transfer payment to local authorities. Accompanying statutory guidance will put in place minimum quality requirements for the two year old entitlement. The Government therefore anticipates that this funding will be spent on improving quality or capacity in the early years sector, or additional free places (by local discretion).

The best estimate of the annually recurring transfer payment is **£66.4m** (calculated from the £380m programme funding, minus the £301m for provision, and £12.6m annually recurring administration costs).

Non-programme costs of two year olds with SEND.

This option includes a legal entitlement to free places for two year olds with SEND. Provision for these children will, on average, involve additional costs. As set out in the Assumptions section, the additional costs of provision for these children are included (that is, on top of the funding level for children without SEN or disabilities) in the non-programme costs.

	Option 3		
Take up scenario	70%	80%	90%
Number of SEND two year old places funded	4,200	4,800	5,400
Additional costs of SEND two year old places (£m)	12.2	13.9	15.6

Wider Impacts

Equalities Assessment

An Equalities Impact Assessment has been completed and shows a positive impact upon children from underachieving ethnic groups who are often over-represented within the most deprived groups of two year olds; amongst children with SEND; and amongst women in terms of improving their ability to work and creating employment in a sector which is dominated by female employees.

Small and medium sized enterprises (SMEs)

Extending the entitlement to more two year olds will increase demand for the early education sector. Many providers are small businesses: around 80% of the day nursery market is made up of providers running just one or two nurseries. The private and voluntary sector accounts for 43% of the three and four year old free entitlement market, and we anticipate the proportion may well be higher for the two year old entitlement.

The Government does not consider that the free places will present additional costs for providers. It is likely that the administration of processing payments to a local authority will be equal, if not less than, processing payments from parents. Participation in the two year old entitlement will not be statutory for providers. There is no new regulation, inspection or reporting required of any business that does not choose to take up the opportunity of delivering the two year old free early education places.

Preferred Option

The costs and benefits of Option 3, relative to Option 2, are expected to be similar. Option 2 would also be likely to broadly achieve the policy objectives. However, the Government prefers Option 3 as it considers that it is likely to secure greater benefits:

- The legal entitlement for around 130,000 additional two year olds would best ensure that the second phase targets the children who will most benefit rather than places being given instead to relatively affluent families.
- A consistent national entitlement would make it easier for parents and those advising them to know whether they are likely to be eligible for a free place, compared to Option 2 where eligibility might vary from area to area. The Government considers that this should lead to higher take-up compared to Option 2.
- Having national eligibility criteria would reduce administrative burdens for local authorities, compared to Option 2. In Option 3, Providers would only have one set of eligibility criteria to work with, and local authorities would be able to use the automated Eligibility Checking Service to assess who is eligible.
- Extending the legal entitlement would provide greater reassurance to providers about the sustainability of the increased funding levels, and encourage providers to expand to meet the increase in demand.

Implementation plan

Many aspects of the implementation plan apply to both the first phase and the second phase of the new entitlement. The first phase of the entitlement will begin in September 2013, when around 130,000 (20%) of two year olds will be eligible. The second phase, expanding to around 260,000 two year olds will begin from September 2014. In 2011-12 and 2012-13 funding has been allocated which LAs can use to build capacity, support quality improvements, and begin expanding the number of free places that they fund, in advance of the entitlement coming into force. The Government will be carrying out voluntary surveys of local authorities in April and September in each of 2012 and 2013, to collect data on how many free two year olds places local authorities are funding. This will allow us to track how local authorities are building towards the new entitlement, and to identify any local authorities which appear to be facing difficulties in expanding provision.

18 local authority trials ran in 2011-12, to develop effective ways of delivering the free places from two year olds; some trials looked at flexibility in how the offer is delivered, while others focussed on how quality improvements in the early education sector can be supported. The lessons learnt from these trials will be disseminated to local authorities in May 2012. Further trials are taking place in ten local authorities in 2012-13. These include trialling delivery of free places for all eligible children (following the first phase eligibility criteria) in localities within the local authority area. Again, the lessons learnt will be disseminated to other local authorities, which we envisage will be a useful resource for local authorities as they develop approaches to stimulate the early education market and to engage more parents in the two year old offer.

In addition, the Department for Education intends to let a National Support Contract, to support local authorities as they prepare for the new entitlement. The support will include:

- support to focus specifically on the relationship between local authorities and local providers and methods for stimulating the local market;
- support to enhance the quality of settings and the workforce, including links to the implementation of the new progress check at age two;
- a specific work strand to help local authorities' engagement with parents, to stimulate take-up of the free places.

The Government recognises that giving early clarity to local authorities and providers will help them to prepare for the new entitlement. Accordingly, the Government plans to publish statutory guidance a year before the entitlement begins. The content of the statutory guidance is not expected to change between the first and the second phase (aside from including the new eligibility criteria), and so the early publication of the guidance will also help local authorities and providers prepare for the second phase of the entitlement.

Risks

The first and second phase of the entitlement share many of the same risks.

Capacity of the early years sector – The second phase of the entitlement will increase the delivery challenge for local authorities and providers, to expand provision to meet the demand for places. While there is some suitable vacant capacity in the sector, additional places will need to be created. There is a risk that, if suitable and high quality places are not created quickly enough, this will limit the availability of the free places, and reduce the benefits of the policy. The trials in 2011-12 and 2012-13, and the dissemination of lessons learnt, will help to mitigate this risk by sharing good practice on how existing provision can most efficiently be utilised, and on stimulating the early education market to expand. The National Support Contract (see above) is supporting local authorities in meeting this delivery challenge. Funding has also been made available for 2011-12, 2012-13, and 2013-14, before the entitlement starts, which local authorities can use to support the sufficiency and quality of provision locally.

Quality – A risk is that LAs cannot secure enough provision of a high enough quality to secure the maximum benefits outlined above. Provision for children with SEN or disabilities also raises additional challenges around quality, given the additional needs of these children. Increasing investment in the years before 2014-15 will allow local authorities and providers to prepare for the entitlement, including supporting quality improvements.

Take Up – Take-up could be lower than we anticipate. The local authority trials in 2012-13 will indicate the level of parental demand, and ways to engage parents with the two year old offer, and lessons learned will disseminated to other local authorities.

Demographic and economic shifts – The affordability of giving 570 hours a year of free early education has been modelled using the latest data on the two year old population. An increase in the birth rate and/or economic downturn which brought more families into eligibility would increase the pressure. This risk is being mitigated by ensuring that there is sufficient funding available to manage reasonable shifts in these factors; both Option 2 and Option 3 are estimated to have a margin of funding available (treated as a transfer payment to local authorities in this IA), after estimated costs of provision and administration of the two year old places.

Annex A: Assumptions used in estimating costs

Baseline

In the first phase of the entitlement, we modelled that around 136,000^{xxvii} two year olds will be eligible for the free places. In the IA on the first phase of the entitlement, we estimated that take-up would be 70%, based on take-up rates in the pilot, and the take-up of the three year old entitlement among disadvantaged families. Therefore, our baseline for the second phase of the entitlement is that the 95,000 places delivered under the first phase of the entitlement continue (70% of 136,000).

Two year olds with SEN or disabilities

In the consultation on the first phase of the two year old entitlement, 119 out of 128 local authorities agreed that children with special educational needs or disabilities should be prioritised for free places. Therefore, the Government has assumed that in Option 2 local authorities would fund discretionary free early education places for two year olds with identified SEND. Given the small numbers of these two year olds, there is a lack of robust figures on the take-up of early education for these groups specifically. Accordingly, the IA assumes the same take-up rates for these children as those for disadvantaged children.

Additional costs for children with SEND

The cost of provision for two year olds with SEND is generally higher. There is a wide variety in the type and severity of needs among children with SEND, and robust information on the likely average additional costs of early education provision for these children is not available. The IA assumes that the average cost of provision would be double that for children without SEND. This is based on practitioner feedback that higher practitioner-child ratios are generally needed for children with SEND. Assuming that costs are doubled would allow for 1:2 practitioner/child ratios on average, as opposed to the statutory 1:4 minimum ratio.

The Department for Education's High Needs Funding Block is planned to come into effect from April 2013 (that is, before the start of the two year old entitlement). This will be allocated to local authorities, to fund all provision for pupils in specialist settings, and the additional costs of education for high needs children in mainstream settings. For a two year old with high needs (SEND) who is accessing the free entitlement in a mainstream setting, the funding will then comprise two elements; funding for the core costs of 570 hours of early education, and then High Needs Block funding for the additional costs. Because these additional costs of children with SEND are to be met from the High Needs Block, rather than the programme funding for the two year old entitlement, they are included in the non-programme costs.

ⁱ Allen, G, 'Early Intervention: The Next Steps', (DWP, Jan 2011), p14 -15

ⁱⁱ Rt. Hon Frank Field MP, 'Independent Review of Poverty and Life Chances', December 2010.

ⁱⁱⁱ Department for Education (DfE) (2010), *Achievement of children in the EYFSP*, RR-034 London: DfE. To note that 94 percent of children who achieved a good level of development at the end of the EYFS in 2007 – as shown by their EYFS Profile results – went on to exceed expectations in reading and in maths at the end of Key Stage 1.

^{iv} DCSF (2008) *How strong is the relationship between Foundation Stage Profile (2005) and Key Stage 1 (2007)*, DEP2008-1634, Deposited in House of Commons Library

^v Internal analysis.

^{vi} Speight, S. Smith, R. La Valle, I. Schneider, V and Perry, J. with Coshall, C. and Tipping, S (2009), 'Childcare and early years survey of parents 2009', DCSF Research Report 136

^{vii} <http://www.education.gov.uk/rsgateway/DB/SFR/s000979/index.shtml>, p5

^{viii} Springate, I., Atkinson, M., Straw, S., Lamont, E. and Grayson, H. (2008) *Narrowing the gap in outcomes: early years (0–5 years)*, Slough: NFER

^{ix} K Sylva et al. The Effective Pre-school and Primary Education 3-11 Project (EPPE 3-11). 'Report from the Primary Phase: Pre-school, School and Family Influences on Children's Development during Key Stage 2 (Age 7-11)'. DCSF Research Report 061.

^x 'Aiming High for Disabled Children', HM Treasury/ DfES, 2007

^{xi} Daycare Trust Childcare Costs Survey, 2012

^{xii} Speight, S. Smith, R. La Valle, I. Schneider, V and Perry, J. with Coshall, C. and Tipping, S (2009), '*Childcare and early years survey of parents 2009*', DCSF Research Report 136

^{xiii} Speight, S. Smith, R. La Valle, I. Schneider, V and Perry, J. with Coshall, C. and Tipping, S (2009), '*Childcare and early years survey of parents 2009*', DCSF Research Report 136

^{xiv} D. Abbott, 'Disabled Children's Access to Childcare (DCATCH): a qualitative evaluation', Department for Education Research Report, 2010.

^{xv} Internal analysis, DfE and DWP

^{xvi} Sylva, K et al. The Effective Provision of Pre-school Education (EPPE) Project: Findings from the Early Primary Year. November 2004(b)

^{xvii} Smith, R., Purdon, S., Schneider, V., La Valle, I., Wollny, I., Owen, R. and Bryson, C. (2009), 'Early Education Pilot for Two Year Old Children Evaluation', DCFS Research Report RR134

^{xviii} EPPE, Sylva K et al, The effect of starting pre-school at age 2 on long term academic and social-behavioural outcomes in Year 6 for more deprived children (*internal analysis*).

^{xix} Raj Chetty, John N. Friedman, Nathaniel Hilger, Emmanuel Saez, Diane Whitmore Schanzenbach, and Danny Yagan, 'How Does Your Kindergarten Classroom Affect Your Earnings? Evidence From Project STAR', National Bureau of Economic Research Working Paper (2011)

^{xx} Evaluation of the Early Education Pilot for Two Year Olds, DCSF Nov 2010

^{xxi} Smith, R., Purdon, S., Schneider, V., La Valle, I., Wollny, I., Owen, R. and Bryson, C. (2009), '*Early Education Pilot for Two Year Old Children Evaluation*', DCFS Research Report RR134

^{xxii} Brind, R., Norden, O., McGinigal, S., Garnett, E., Oseman, D., LaValle, I., Jelacic, H., *Childcare and Early Years Providers Survey*, DfE, 2010, p.95-97.

^{xxiii} The Parents survey collects the amount spent on childcare at a household level. It does not collect data on how much is spent on each individual child.

^{xxiv} Internal DfE analysis of the Childcare and Early Years Survey of Parents 2009

^{xxv} DfE Statistical First Release: Provision for Children Under Five Years of Age in England

^{xxvi} Evaluation of the Early Education Pilot for Two Year Olds, DCSF Nov 2010, p41

^{xxvii} Internal analysis, HMRC