To Earmark or Not to Earmark?
Allocating Revenue from Health Taxes

Joint Learning Network Webinar
Pro-Poor Earmarking of Health Taxes for Domestic Resource Mobilization

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Health tax revenue

Health taxes are “corrective taxes”—they encourage behavior change and generate revenue, often a lot of revenue.

Source: Chaloupka et al. 2019 Annu. Rev. Public Health
Allocating health tax revenue

How can governments allocate health tax revenue?

- Offset new burdens created by the tax (e.g. if the tax is regressive compensate the poor with transfer programs)
- Further the goal of the tax (e.g. allocate the tax to health promotion efforts)
- Compensate people who bear the cost from the taxed activity (e.g. allocate to the health sector in general)
- Fund unrelated public priorities
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Dedicated expenditure purpose ➔ Earmarking
Earmarking is very common globally

64 countries earmark payroll taxes for social

3 countries earmark a portion of VAT

General revenue
Earmarked shares of general revenue (2 countries), intergovernmental transfers (3 countries)

24 countries earmark tobacco taxes

20 countries earmark other health taxes

Other instruments
Lotteries, mobile phone companies, and foreign personal money transfers

Earmarking for health: from theory to practice.
WHO/R4D Health Financing Working Paper No.5
Countries have different objectives for earmarking

- Increase revenue overall for the country
  - Increase political acceptability of a tax increase
- Increase revenue for the expenditure purpose
  - Health sector
  - A specific program in the health sector
- Show political commitment to a popular program or initiative
- Improve transparency in funding allocation
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Pros and Cons (theoretical)

<table>
<thead>
<tr>
<th>Increase revenue</th>
<th>Budget rigidity</th>
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<tbody>
<tr>
<td>Efficiency</td>
<td>Economic distortion</td>
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<tr>
<td>Public support</td>
<td>Pro-cyclicality</td>
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<td>Accountability</td>
<td>Fragmentation</td>
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<td>Cost awareness</td>
<td>Decreased solidarity</td>
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<tr>
<td>Flexibility</td>
<td>Susceptibility to special interests</td>
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Potential Pitfalls (in practice)

- Off-setting in the budget
- Misperceptions of adequate funding
- Earmarked revenue becomes a “ceiling” for the expenditure purpose
- Defunding of other priorities
What does earmarking look like in practice?

- Earmarking typology to tease out features of design, implementation, and results
- Review of literature, published examples, and 6 country case studies of different types of earmarking for health (Estonia, Ghana, Indonesia, Philippines, South Africa, Vietnam)
- Understand whether and how earmarking is effective for meeting political and revenue objectives

Does earmarking work to increase (net) revenue for the expenditure purpose?

It depends

- How the earmark is designed and implemented
- Underlying PFM system
- Political priorities
- Time horizon
Increase in revenue from the earmark in absolute terms

Ghana

Philippines

Vietnam

2014 revenue = 299 billion Vietnamese dong (0.5% of national health budget)

Source: Philippines Bureau of Internal Revenue and Philippine Statistics Authority (2017)
Less dramatic impact on share of the general budget allocated to health

Ghana: 2.5 percentage points of VAT in 2004
Philippines: Earmarked portion of alcohol and tobacco tax increase
Vietnam: 1% of factory price of cigarettes earmarked for health promotion

Earmarking does not bypass priority-setting
Earmarking Typology

**Revenue Characteristics**
- Revenue source
- Tax or contribution
- Instrument
- Tax/contribution rate
- Revenue base
- Portion earmarked
- Where earmarked funds are collected
- Administrative level at which revenue is generated

**Expenditure Characteristics**
- Expenditure purpose
- Revenue and expenditure linkage
- Identifiable benefits rationale
- Expenditure level
- Expenditure flexibility

**Adoption and Implementation**
- Policy adoption process
- Length of time earmark has been in place
- Collection of earmarked funds and funds flow
- Allocation and use of earmarked funds
- Accountability

**Results**
- Impact on health sector budget
- Impact on general budget process
- Broader economic impacts
- Broader health and social impacts

**Political economy and contextual factors**
If the budget process is effective and health is prioritized, allocating the revenue from health taxes to the general revenue fund should lead to a proportional increase in the health budget—**no earmark needed**

But—if the budget process fails to generate allocations to health that match priorities or if earmarking will make the tax more politically acceptable, **earmarking may be useful** (at least in the short term)

It is important to avoid rigidity, fragmentation and lack of transparency

And remember, the more successful a health tax is, the less revenue it will generate
What design features make earmarking more effective?

- **Expenditure purpose** narrow enough to be enforceable, reduce fungibility, and link funding clearly to activities but broad enough not to exacerbate rigidity

- **Strong but flexible revenue-expenditure link**
  - Avoid extremes of revenue entirely determining expenditure (earmark is a revenue ceiling) or expenditure driving revenue (expenditure drives increase in tax rates)

- “**Release valves**” allow some of the earmarked funds to be reallocated to other priorities

- “**Sunset clauses**” or at least periodic review

- Earmark funds **part of consolidated government budget** for accounting purposes

**Hard earmark** ➔ all earmarked revenues must be allocated to the expenditure purpose, no more no less

**Soft earmark** ➔ earmarked revenue can be diverted to other purposes or additional funds can be allocated to the expenditure purpose beyond the earmarked revenue
So you want to earmark? Here’s a checklist

Support for the expenditure purpose
- Does the policy or programme to be funded with the earmark support the country’s broader development objectives?
- Does the policy or programme to be funded with the earmark have broad-based support and commitment from politicians, policy-makers and the public?
- Were finance authorities part of the discussions from an early stage?

Definition of the expenditure purpose
- Is the policy or programme to be funded with the earmark defined narrowly enough for the earmark to be enforced and broadly enough to be flexible?
- Does the expenditure purpose help advance certain health sector priorities without detracting from others?

Alternative revenue sources
- Can revenue needs for the policy or programme be met through the existing budget process?
- Have alternative sources been explored for their revenue-raising potential?

Impact on health sector efficiency and equity
- Will the earmark improve or inhibit the government’s ability to manage health expenditure, including implementing strategic purchasing approaches?
- Will the earmark facilitate pooling of health funds or introduce fragmentation and limit the ability to pool health funds across sources, leading to equity concerns?

Spending flexibility
- Are mechanisms in place to ensure efficient spending of earmarked revenues?
- Can earmarked revenues be spent flexibly within the expenditure purpose, or are restrictions in place related to line-item budgets or other PFM rules?
- Can unspent earmarked revenues be carried forward into the next fiscal year?

Time horizon
- Will the earmark be temporary or permanent?
- If the earmark is intended to be temporary, will it come with a “sunset clause,” mandatory periodic reviews or a transition plan?
- Will the revenue source be sustainable relative to the intended expenditure purpose?

Revenue-expenditure link
- Does the policy or programme to be funded with the earmark have sufficiently diversified revenue sources so it will not completely depend on the earmarked revenue?
- Will a release valve or contingency option be put in place to reallocate earmarked funds if other urgent needs or priorities arise?
- Are expenditure management mechanisms in place to prevent overspending?

Fiscal and public financial management (PPFM) impact
- Will the earmark improve or impede the efficiency of budget allocations?
- Will the earmark mitigate or exacerbate distortions or inefficiencies in the underlying revenue source?
- Will the earmark improve or exacerbate the equity impacts of the underlying revenue source?
- Have simulations and scenario testing been done to analyze:
  - impact on the health sector budget
  - impact on the total government budget
  - broader fiscal, economic and social impact
- Will the above analysis be updated periodically?

Managing earmarked funds
- Will the funds flow through the treasury or a consolidated fund into an extrabudgetary fund, or will they go directly to an implementing agency?
- Will the institution that spends the earmarked revenues be prepared for the inflow of funds?
- Will reserve fund or contingency fund be created to manage revenues in excess of expenditure needs?

Accountability
- Have assessments been conducted at all levels of the system to ensure sufficient capacity to manage and monitor the flow of earmarked funds?
- Can earmarked revenues be accounted for at every step, from collection to expenditure?
- How will the institution that spends the earmarked revenues be accountable for results or outcomes?
Thank you