

DISCUSSION PAPER SERIES

IZA DP No. 17305

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Countries: Role and Uses of Revenue
Earmarking**

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ABSTRACT

Financing Social Protection in OECD Countries: Role and Uses of Revenue Earmarking*

In many OECD countries, the majority of social spending is financed from earmarked revenues, and a large share of revenues earmarked for any type of government spending is used for social purposes. Tying revenue sources to specific expenditure categories has a number of potential advantages and weaknesses. These trade-offs depend on the design and implementation of earmarking, and they can become more binding when fiscal space is tight. In practice, provisions for linking revenues to programme spending differ widely, and they vary also by social protection branch within countries. This paper compares financing patterns and trends and provides examples of earmarking for social insurance and assistance programmes. It concludes with a discussion of carbon pricing as a potential source of financing social support programmes.

JEL Classification: H20, H50, I00, P52

Keywords: social protection, financing, earmarking, fiscal space

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Summary and main findings

Already before the COVID pandemic and recent cost-of-living crises, social spending in the OECD area accounted for nearly half of all government spending. Budget pressures have grown since then, and demands for social support, and the fiscal space for providing it, are set to diverge further in the medium term. Earmarking, the practice of tying revenue streams to specific expenditure programmes, is one approach of allocating public funds to social protection and other priority programmes. Most OECD governments use earmarking. Some countries finance the majority of social expenditures from earmarked revenues, and large shares of revenues earmarked for any type of government spending are used for social purposes.

Tying revenue sources to specific expenditure categories has potential advantages and weaknesses. These trade-offs depend on the design and implementation of earmarking, and they can become more apparent when fiscal space is tight. This paper compares financing patterns and trends and discusses advantages and drawbacks of earmarking for the budgeting process. In practice, provisions for linking revenues to programme spending differ widely, and they vary also by social protection branch within countries. The paper provides examples of revenues earmarked for social protection, ranging from social contributions, to income, payroll and property taxes, excise duties and value added tax, and to environmental taxes.

Social contributions are a specific type of earmarked revenue, accounting for large shares of social protection resources in European countries in particular. There has been a long-standing debate over the sustainability of social insurance as a central pillar of social protection financing, notably in the context of population ageing and new forms of employment. Yet, over the past two decades, social contributions have changed little as a share of total social spending, and they have in fact increased as a share of GDP, from an OECD average of 8.4% in 2000, to just under 9% before the pandemic.

Outside of social insurance, the designation of tax revenues for social purposes is less common, though some countries finance significant shares of social spending through earmarked direct or indirect taxes. Many countries also operate tax breaks with a specific social purpose (such as tax concessions for families with children) and these “tax expenditures” constitute another, less visible, form of earmarking. There are several examples of earmarked taxes featuring progressive elements, indicating that equity objectives are sometimes pursued in tandem, on both the financing and the expenditure sides of government budgets.

Tightening fiscal space, with increasing and competing demands on public funds, may make it more challenging to ring-fence revenue sources for specific purposes. Yet, carbon pricing is one growing revenue source that is frequently associated with financing specific social protection measures, such as income transfers that alleviate the impact of rising prices on households. Carbon pricing aims to reduce carbon emissions and is therefore not a stable financing source in the long run. Prospective revenues are sizeable, however, and rates are expected to increase significantly in the medium term. Using some of the revenues for social protection can alleviate adverse distributional impacts of a green transition and may strengthen voter support for necessary climate-change mitigation. While climate change adaptation and mitigation will create competing demands on government budgets, and on new revenue sources such as carbon pricing, earmarking some of these public funds can arguably clarify spending priorities, and may even help to avoid over-committing available and prospective resources.

Introduction

Tying government revenues to specific expenditure categories narrows budgetary flexibility and can crowd out public resources for other functions and areas of spending (Buchanan, 1963^[2]). In practice, earmarking also places constraints on the role and powers of the legislature in the recurring budget process (Moretti and Kraan, 2018^[3]). These concerns are reflected in the OECD Principles of Budgetary Governance, which recommend that “ear-marking of revenues for particular purposes [be] kept to a minimum” (OECD, 2015^[4]).

Nevertheless, attaching a clear use or purpose to tax revenues can resonate with the public and with political stakeholders, and the practice of protecting revenue sources for designated social programmes indeed remains widespread. Possible arguments for earmarking are that it may help with reducing the volatility of resource envelopes for key policy priorities, or that it can signal a clear purpose of new taxes or tax increases, and may thus strengthen public support for fiscal policy initiatives (Guillaud and Zemmour, 2023^[5]; OECD, 2020^[6]; Moretti and Kraan, 2018^[3]).

This paper provides an overview of different forms of earmarking in the OECD area, including social contributions and designated revenues from direct and indirect taxes. It compares financing models, illustrates trends, and discusses specific examples of earmarking for insurance and assistance programmes. It also discusses emerging revenue sources linked to climate-change mitigation, which can be expected to create additional scope for earmarking.

Earmarking: advantages, challenges, trade-offs

The advantages and challenges of earmarking vary between countries, and they depend on the specific features and objectives of both the social protection programme and the revenue source in question.

Revenue stability / counter-cyclical support

A stable revenue source is attractive for ensuring that social programmes remain viable over time. Yet revenues from individual funding sources are typically not stable, and they are often pro-cyclical, unless discretionary tax-policy measures compensate for cyclical movements in the tax base. Even revenue sources that provide broadly stable funding constrain the ability of social programmes to serve as stabilisers during economic shocks and downturns, when some social spending needs to be stepped up.

In general, earmarked financing for rights-based social programmes therefore needs to be backed up by financing from other specific sources or, implicitly, by general government revenue. From a political economy point of view, earmarking might act as a backstop in periodic budget negotiations, effectively providing a certain funding floor. But, in some cases, obtaining ad-hoc additional budget allocations, e.g., during an economic crisis, could also become more difficult when significant funds are already tied to social programmes. Indeed, one motivation for earmarking may be to discourage overspending on certain programmes.

Transparency

Earmarking can help with clarifying the purpose of a specific tax, the cost of a government programme and the resulting burdens for taxpayers. For instance, governments may wish to draw greater attention to the rationale for specific tax revenues, e.g. by associating newly introduced taxes with specific expenditure programmes. If earmarking mechanisms are clearly understood, and an earmarked revenue finances all or most of a government

programme, then this can aid budgeting transparency for policymakers, taxpayers, programme beneficiaries and voters. In practice, however, and as illustrated below, the link between revenue source and programme spending can easily become blurred, e.g., when a revenue source is earmarked to finance not one programme but several. Relatedly, a given social programme may be financed from a range of different sources, some of which may be earmarked and others not.

Earmarking provisions themselves can also remain opaque, for instance when the underlying legal rules are vague, or when earmarking takes the form of a political commitment ('soft' earmarking), without explicit legal stipulations. Tax expenditures with a social purpose are a specific form of earmarking that does operate based on specific legal rules and that is common in OECD countries. They reduce revenues from particular taxes (e.g., the income tax in the case of child tax credits), which therefore directly finance the resulting expenditure. But the earmarked nature may not be immediately evident to voters or decisionmakers. Moreover, although tax expenditures can be large (see below), their size and evolution may be less well understood than other forms of government spending, as they are typically not subject to the same scrutiny and reporting standards (OECD, 2023^[7]; Redonda and Neubig, 2018^[8]; OECD, 2018^[9]).

Regular evaluation

As any use of public funds, the practice and extent of earmarking should be subject to systematic and periodic spending reviews and outcome evaluation, possibly accompanied by sunset clauses, to ensure accountability and spending efficiency (OECD, 2020^[10]). In practice, earmarking can have notable implications for monitoring and evaluation efforts, and for interpreting results:

- Links between revenue sources and specific social programmes can require careful consideration when assessing programme performance, and when deciding whether a programme should be maintained, expanded or rolled back. For instance, the distribution of tax burdens varies greatly by revenue source, e.g., with income tax burdens more "progressive" than social contributions or consumption taxes. Social transfers may therefore be more progressive, or less so, after accounting for the taxes that finance them (Immervoll and Richardson, 2011^[11]).
- For some social-expenditure categories (e.g., healthcare) intended programme outcomes may be reinforced through earmarked taxes (Vammalle, Penn and James, 2023^[12]). For instance, using fiscal measures for health-promotion purposes has become more common, including in the form of excise duties on alcohol, tobacco or on foods with a high fat, salt or sugar content (Sassi, Belloni and Capobianco, 2013^[13]). If the poor spend large shares of their budgets on goods subject to those taxes, then such excise duties may have adverse distributional consequences. The net distributional impact is not straightforward, however, as there is evidence that health-related benefits from lower consumption of these goods are also greater for low-income groups (Paraje et al., 2023^[14]).

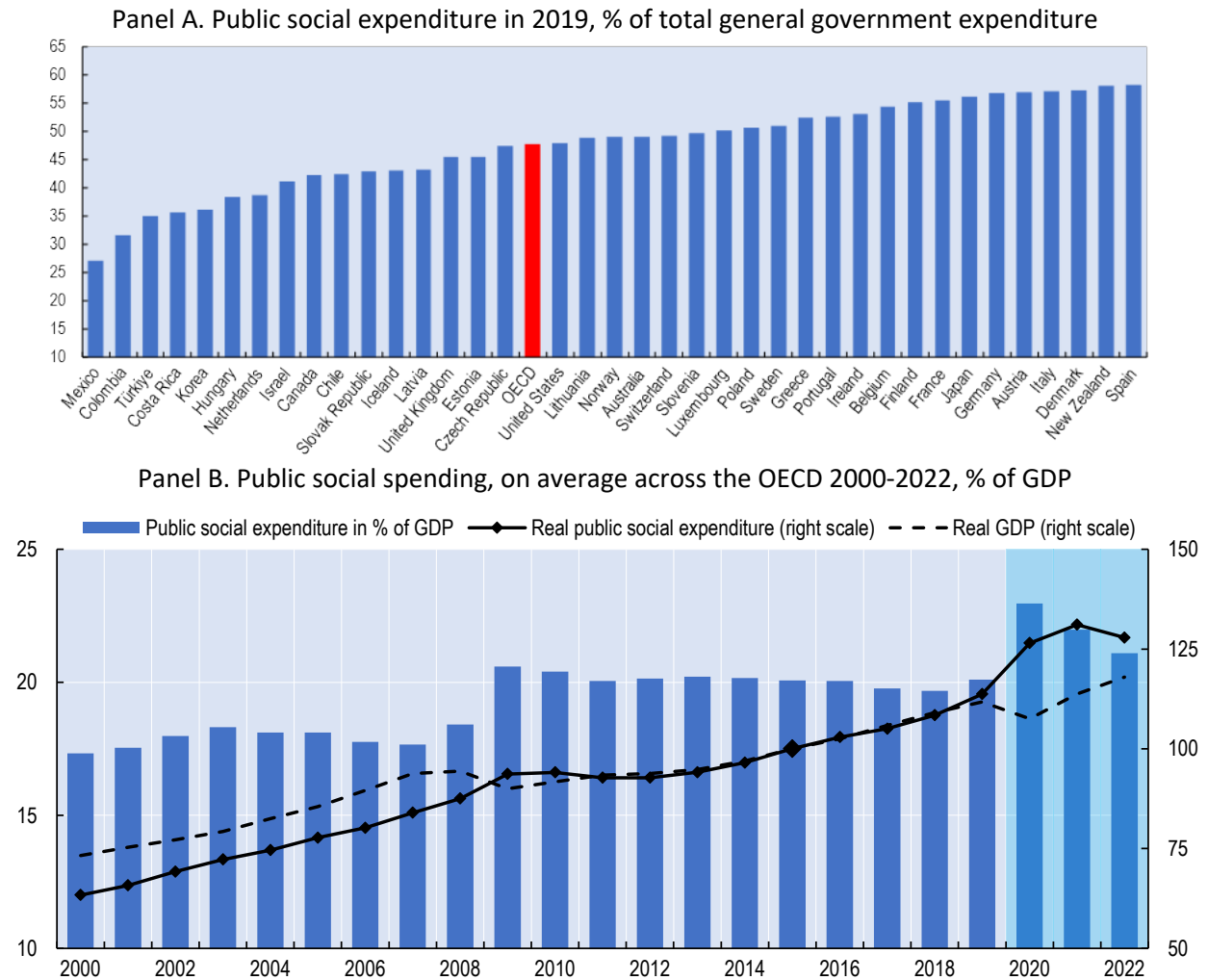
Fiscal space

In the OECD area, social spending already accounted for nearly half of all government spending before the COVID pandemic (Figure 1, Panel A). Budget pressures have been growing since then, following unprecedented support measures during the COVID pandemic and cost-of-living crisis (Panel B). In the medium term, the demands for social support, and the fiscal space for providing it, are set to diverge further. Reasons include expectations of lower economic growth, high interest rates, spending linked to an ageing population, the costs of climate-change mitigation and adaptation, as well as new national security risks and the disappearance of the so-called "peace dividend" (OECD, 2023^[15]; OECD, 2023^[16]) (Guillemette and Château, 2023^[17]).

When fiscal space is tight, reserving public funds for specific programmes may become more difficult, and the associated trade-offs can be more apparent. Indeed, from an overall budgeting point of view, an expectation of

escalating budget pressures may call for redoubling efforts to analyse existing expenditures and raise overall spending efficiency, rather than ring-fencing specific revenue sources. Yet, when fiscal adjustments trigger comprehensive reviews of spending priorities and envelopes, maintaining or expanding earmarking can also appear more attractive, notably for line ministries seeking to maintain adequate resources for vital government programmes, e.g., those supporting the poorest.

Figure 1. Social protection in the OECD accounted for much of government spending before the pandemic, and increased strongly during it



Note: Panel A: OECD refers to the unweighted average of the countries shown. Panel B: real public social expenditure and real GDP is shown relative to 2015 (2015=100). For EU countries data for 2020-2022 were estimated on basis of OECD Economic Outlook 112 (November 2022) and DG ECFIN (2022), the European Union's Annual Macro-economic database (AMECO) as in November 2022. For the United Kingdom, data for 2021 were estimated on basis of OECD Economic Outlook 112 (November 2022) and National Accounts Blue Book 2022. For Korea and the United States, data for 2021-22 were estimated based on national budget data. Spending totals for 2020 and 2021 are subject to revision, but these are likely to be small; estimates for 2022 are subject to data revisions to spending and GDP. The public social expenditure to GDP ratio for 2020 is estimated based on trend in OECD-35; for 2021 and 2022 it is estimated based on trend in OECD-26. Data for real trends in public social expenditure and GDP refer to OECD-31 countries with available data, i.e., OECD countries except Australia, Canada, Colombia, Costa Rica, Japan, Mexico, and Türkiye. Real trend in public social expenditure for 2022 is estimated based on trend in OECD-26. Public social expenditure is deflated using CPI and GDP is deflated using GDP deflator.

Source: OECD (2023) OECD Social Expenditure database, www.oecd.org/social/expenditure.htm.

Prevalence of earmarking in the OECD area

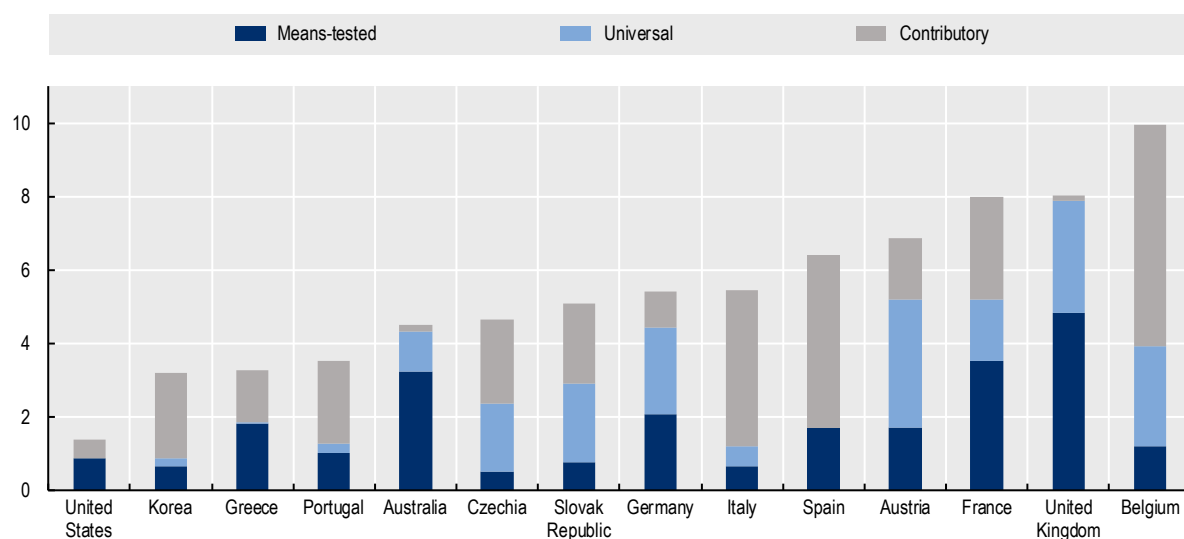
Earmarked financing is more common in some types of social protection system than in others, and the extent to which countries rely on social insurance plays an important role in this respect. Social security contributions normally finance some or most of the cost of specific social programmes, and they confer entitlement by definition. The actual links between social contributions and associated entitlements, however, differ strongly across countries and programmes. While all social contributions open entitlement in one way or another, entitlement *levels* can vary weakly or strongly with contributions paid. In some cases, there may be no link at all, as often in the case of health services for example, which people may receive regardless of the actual contributions paid. Other taxes can be earmarked for social purposes, but without securing individual rights. This is the case for payroll taxes, for example. The terms ‘social contribution’ and ‘payroll tax’ are sometimes used interchangeably, and they can be levied on a similar or identical income base. Yet, the presence (in the case of contributions) or absence (for payroll taxes) of a link between payments and entitlements is the distinguishing feature between these revenue categories.¹

Social insurance is a dominant type of social provision in a number of OECD countries, and country differences in the use of earmarking partly reflect the reliance on insurance and assistance provisions. As an illustration, Figure 2 shows that the relative size of contributory, targeted and universal (“categorical”) transfers for working-age support varies enormously across countries – and differences are also large for public pensions (OECD, 2021_[18]). There is therefore no representative social-protection financing model in the OECD area, and also no straightforward association between spending levels and the main entitlement criterion. For instance, Figure 2 indicates that Australia and the United Kingdom both rely almost entirely on means-tested or universal social assistance transfers. But as a share of household income, total working-age benefits in the United Kingdom are nearly twice as high as in Australia. Total benefit pay-outs in Belgium, Italy and Spain also differ but social insurance programmes in all three countries account for more than 60% of support payments to working-age individuals and their families.

Figure 2. Social assistance and contribution-based support: big country differences

Government transfers as a share of total household incomes, by main entitlement criterion, pre-retirement age

¹ For instance, the OECD Revenue Statistics defines social contributions as “compulsory payments to general government that confer an entitlement to receive a (contingent) future social benefit. Such payments are usually earmarked to finance social benefits”.



Note: Cash benefits to working-age individuals and their children, excluding old-age pensions. Countries are ranked by share of working-age benefits in total gross household incomes. Benefits that are both contributory and means-tested (e.g. the *Notstandshilfe* unemployment assistance in Austria), are counted as contributory. For the United States, disability benefits (Supplemental Social Security) and veteran benefits (both regular veterans' disability pension and service-related disability pension) are classified as contributory. Information on some cash benefits may be imputed in the original data and is included in the calculations as provided (e.g. Family Tax Benefit in Australia).

Source: (Immervoll et al., 2024, forthcoming^[19]), using EU-SILC (EU Statistics on Income and Living Conditions, 2016 wave for Belgium and the United Kingdom, 2019 wave for Austria, Czechia, France, Greece, Italy, Portugal, Slovak Republic, Spain), GSOEP (German Socio-Economic Panel, 2018 wave) for Germany, KLIPS (Korean Labour and Income Panel Study, 2019 wave) for Korea, HILDA (Household, Income and Labour Dynamics in Australia Survey, 2018 wave) for Australia and SIPP (Survey of Income and Program Participation, 2020 wave) for the United States.

Using available OECD and Eurostat data, Figure 3 shows breakdowns of social spending by financing source across 37 OECD countries. Australia, Denmark and New Zealand finance social spending exclusively through general revenue. Several European countries (notably Czechia, Estonia, Hungary, the Netherlands, the Slovak Republic and Slovenia) rely predominantly on contributions. A majority of countries use a mix, however, with general government revenue typically the main funding source.

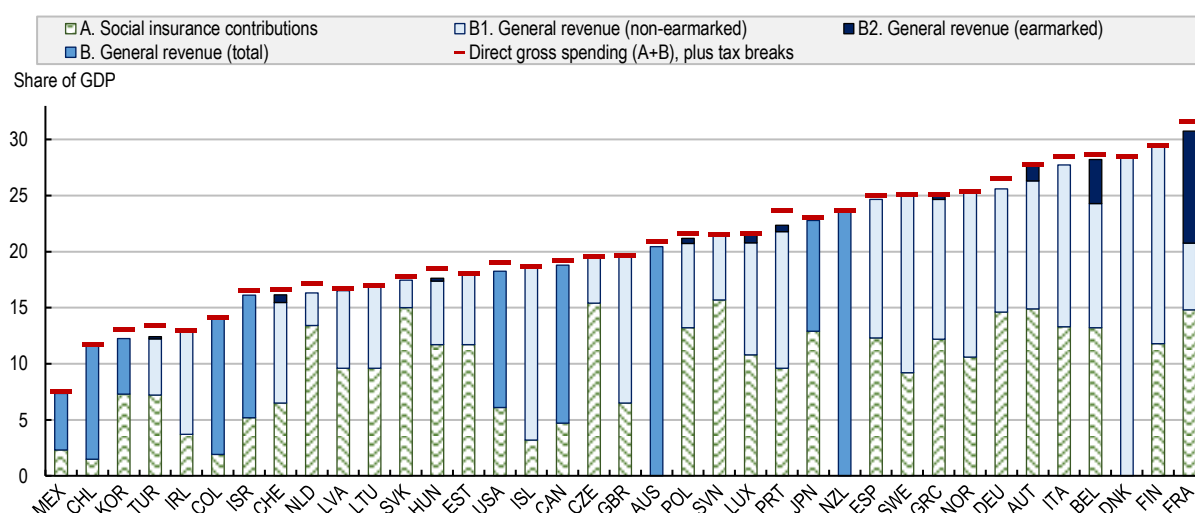
The breakdowns in the figure are approximate (see notes for limitations) but show that earmarking in OECD countries is mostly synonymous with levying of social contributions. For most countries with information on earmarked general revenue, estimates were either zero, or small, representing less than 5% of public social expenditures (Greece, Hungary, Lithuania, Luxembourg, Poland, Portugal, Türkiye). Only Austria (5%), Belgium (14%) and France (32%) relied on earmarked general revenue for sizeable shares of social protection financing, accounting for more than 5% of public spending.

In addition, most countries provide tax concessions with a social purpose, e.g., in the form of tax allowances or tax credits for children that are similar to cash benefits.² As mentioned, such tax expenditures are effectively earmarked for social support and they can be sizeable, as shown by the horizontal markers. They amount to 1.3% of GDP in Portugal, and close to 1% of GDP in France, Germany, Hungary, Korea, the Netherlands and Türkiye.

² Other tax breaks may encourage employers and/or individuals to organise or purchase private insurance. Such tax breaks are not shown in Figure 3, although they could also be considered as tax expenditures earmarked for social purposes. They can be large in countries where private insurance is common, e.g., just under 2% of GDP in the United States (OECD, 2023^[48]).

Figure 3. Earmarking is very common, but its extent is modest outside of social insurance

Gross social expenditure by financing source, 2019



Note: Countries are ranked by direct gross spending (i.e., without counting tax breaks). Tax breaks refer to tax expenditures with a social purpose, similar to cash benefits (such as tax credits). Approximate breakdown of revenue used for financing public social spending (including public old age and survivor pensions, income support to the working-age population and children, health, and all other social services except health). Shown shares of social contribution financing represent upper bounds, as social expenditure totals exclude administration costs (i.e., the costs incurred with the provision of cash or in-kind benefits), whereas social contributions may finance costs related to the administration of insurance institutions (administration costs of social protection systems in European countries range from 1% to 6% of total spending, while evidence from the US suggests that the costs of administering a non-means tested benefit represents 1–2% of total spending (Browne and Immervoll, 2017^[20])). The share of general government contributions is calculated as the *residual* by subtracting social contribution revenues from public social spending totals. It therefore includes *all* sources of social protection financing other than social contributions, including also debt financing and withdrawals or property income from public pension reserve funds or sovereign wealth funds. Breakdowns of the “general government contributions” category into “earmarked taxes” and “non-earmarked general revenue” are available for European countries only, and the earmarked category refers to proceeds from taxes and levies which, by law, can be used only to finance social protection (European Commission, 2022^[21]). In principle, the earmarked category includes revenues that finance programmes at central-government or state/local-level. For the United Kingdom, the share of earmarked general revenue refers to 2018, the last year available in the European Union ESSPROS data.

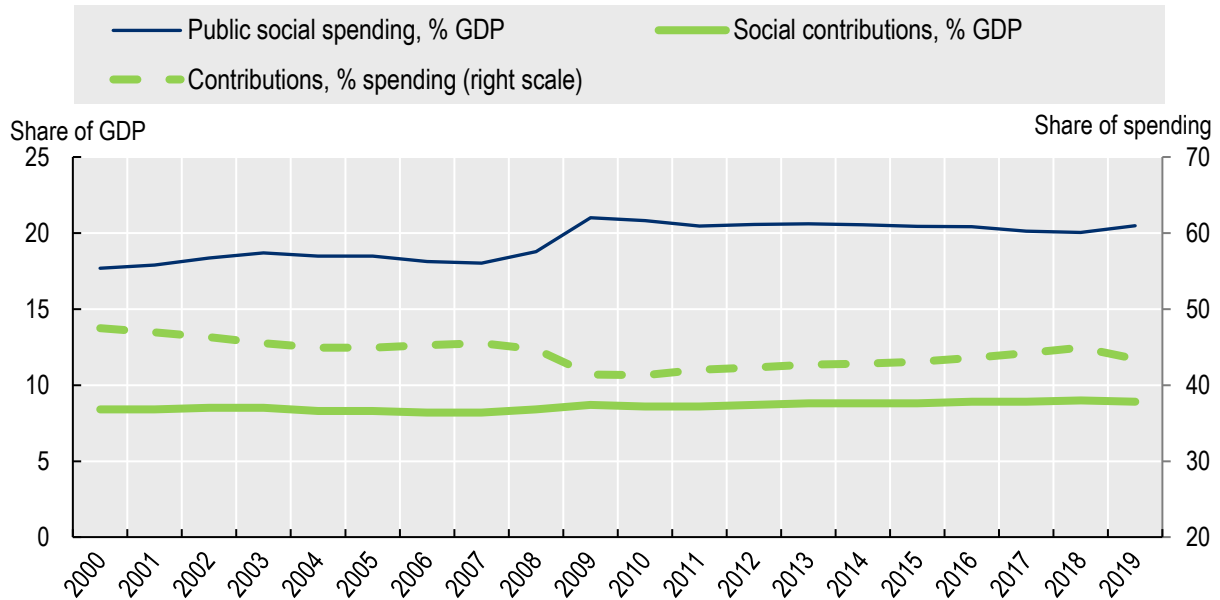
Source: OECD Social Expenditure Database (<http://oe.cd/socx>), OECD Revenue Statistics (for social contributions), ESSPROS (for breakdowns of the “general revenue” category in European countries).

There has been a long-standing debate whether financing social protection mainly through social insurance contributions is sustainable, considering population ageing and elevated levels of non-wage labour costs in a number of OECD countries. Without reforms, the emergence of new forms of work also presents challenges for social insurance, if leaves a growing number of workers partly outside the scope of social contribution payments, reducing revenues and coverage. The debate over the viability of social insurance has intensified recently, sometimes with contrasting conclusions for different regions (OECD, 2019^[22]; World Bank, 2018^[23]).

There are early examples of OECD countries reducing their reliance on social insurance contributions, e.g., reforms in Denmark during the 1980s and 1990s (Obinger et al., 2010^[24]). But over the past two decades, social contributions have in fact increased as a share of GDP in the OECD area as a whole, from 8.4% in 2000, to 8.9% in 2019 (Figure 4). As a share of total financing, social contributions did fall, from 47.5% of spending in 2000, to 43.5% in 2019. The decline was notable after 2000, as labour-income shares declined markedly, and especially following the global financial crisis, when employment rates fell strongly. But the trend reversed as labour markets recovered, and the social-contribution share actually increased every year between 2010 and 2018 (the observed decline in between

2018 and 2019 was not due to lower contributions but to increased social spending totals). Just before the pandemic, the share of contributions in total financing was very close to that in the mid-2000s.

Figure 4. Social contribution revenues in the OECD have remained relatively flat



Note: OECD-36, excluding Colombia and Costa Rica (spending data pre-2010 not available).

Source: OECD Social Expenditure Database (<http://oe.cd/socx>), OECD Revenue Statistics (for social contributions).

Earmarking outside of social insurance: country examples

In practice, earmarking of tax revenues takes different forms. ‘Soft’ earmarking (not shown in Figure 3 and Figure 4 above) might take the form of a political commitment, rather than a legally binding budget rule. When legal provisions to spend revenues on social protection are in place, as in the examples below, these requirements can be either broad (e.g., to spend on a certain branch, such as family support or health) or specific (e.g., to spend on one or several particular programmes). Revenues may pass through an autonomous fund or employ other forms of dedicated financing vehicle from which funds cannot be easily repurposed or redirected. Earmarked funds may comprise all receipts from a specific revenue source, a certain part of it, or a certain prescribed amount or fraction of programme expenditures. The different models of earmarking, and their combination with other financing strategies, mean that, even with earmarking in place, programme spending may not move in tandem with the earmarked revenues.

The earmarking examples below include several revenue sources with progressive elements, where higher-income earners typically pay more. This contrasts with social contributions, which are typically not progressive (and often feature regressive elements, in the form of moderate contribution ceilings). In addition to the illustrations of tax-revenue earmarking below, some countries commit non-tax revenues to specific social programmes. Examples are income from the US State of Alaska Permanent Fund (to pay out a variable annual “basic income” to residents), and

lottery and other betting/gambling revenues in Portugal (with just under one third of revenues allocated to the Ministry of Labour, Solidarity and Social Security).^{3,4}

Family benefits in Austria

The *Familienlastenausgleichfonds* (FLAF), established in 1967, is an earmarked autonomous fund in Austria that pays for various child and family benefits. The FLAF is financed mainly by employers, through a payroll tax equivalent to 3.9% of the gross wage bill. It also receives smaller contributions through earmarked transfers from income and corporation tax revenues. Its total budget stood at EUR 7bn (2019), with 5.5bn coming from earmarked payroll taxes, equivalent to about 1.4% of GDP. The biggest expenditure of the FLAF is Austria's universal child benefit (*Familienbeihilfe*). It also pays for some smaller family-related benefits such as public transport subsidies for students, subsidies for school textbooks, and it provides partial financing for parental-leave benefits.

Disability benefits in Poland

Since 2019, Poland operates an earmarked payroll tax paid by employers. It amounts to 0.15% of the wage bill for most employees but increases to 4% for wages above PLN 1 million per year (the so-called 'solidarity income'). Receipts are earmarked to a variety of social assistance benefits for people with disabilities, including cash benefits, in-kind assistance, and paying for carers (Chłoń-Domińczak and Szarfenberg, 2019_[25]).

Pension Trust Fund in Portugal

The aim of the Portuguese Social Security Financial Stabilisation Fund (FEFSS) is to cover future deficits from the earnings-related benefits/pensions Social Security system, by holding and managing assets equivalent to pension expenditure of at least 2 years (Law 4/2007). A number of revenue sources are earmarked for the FEFSS:

- A special supplement to the property tax, introduced 2017. It has been levied annually on properties worth more than EUR 600 000, at a progressive rate that has ranged from 0.6% to 1.5% (Perista, 2019_[26]).
- Part of corporate income tax revenue, since 2018, increasing from an initial 0.5% of corporate income to 2% from 2021. Pay-outs from the FEFSS guarantee a minimum social pension paid to each elderly person irrespective of their contribution history. As such, it is considered a special-purpose vehicle that finances the gap between pension pay-outs and current contributions that are a result of the social pension.
- An additional solidarity contribution on the banking sector, introduced in 2020 and aiming to compensate a VAT exemption on most financial services (Law 27-A/2020).
- Revenue from personal income tax on capital gains from securities/financial assets held for less than 365 days was earmarked for FEFSS in 2022 (Law 12/2022).

³ The Alaska Permanent Fund pays out about half of fund earnings to state residents in the form of an annual income (the Permanent Fund Dividend). Although the dividend formula is based on average earnings over a number of years, pay-outs vary strongly between years as they are financed by investment income (rather than the state oil revenues that make up the fund).

⁴ Portugal Decree-Law No. 56/2006. The value of this allocation was approximately EUR 240 million in 2019 (Departamento de Jogos de Santa Casa de Misericórdia de Lisboa, 2020_[49]).

State social assistance and federal Medicare Tax in the United States

A number of US states levy taxes that are earmarked for social assistance purposes (National Conference of State Legislatures, 2008^[27]). For example, Colorado earmarks a small share of its tax on the revenue of hydrocarbon extraction to provide means-tested energy subsidies for low-income households. Florida earmarks a share of the revenue from fees related to real-estate transactions for the provision of social housing. Similarly, Iowa earmarks a share of real-estate tax revenues for social housing purposes.

At the federal level, part of Medicare resources come from earmarked taxes, though non-earmarked general revenue is the main source of Medicare financing (Steuerle and Garrett, 2022^[28]). Since 1965, the Medicare programme has been providing free health insurance to elderly individuals (65 and older) and to individuals receiving disability benefits. Financing sources include an earmarked payroll tax levied on both employers and employees, at a rate of 1.45% for each and paid into a trust fund. Since 2010, there is an additional progressive charge for high-wage earners (0.9% for earnings in excess of USD 200 000 in 2023). A small additional part of earmarked Medicare funding comes from income taxes that are levied on social security income (old-age, survivor and disability benefits).

Rebalancing social-protection financing in France

France has the highest level of public social spending in the OECD (Figure 1), with old-age support and health care accounting for about 80% of the spending increase in the past 10-15 years. Until the 1990s, social protection was financed mainly through social contributions. The financing mix has become much more diverse since then and contributions now represent some 60% of spending (Huteau, 2019^[29]). One driver behind this trend were multiple rounds of reductions in contributions paid for by employers, as part of efforts to dampen the cost of employing low-wage workers in particular. The overall rate of social contributions now stands at around 36% for an average-wage worker. Employers pay a large majority (28%) of that total, but this heavily reduced for low-paid workers and falls to almost zero for those earning the minimum wage.

To partly compensate for the resulting financing gap, revenues from health-related taxes (excise duties on alcohol and tobacco) were allocated to social protection. More importantly, the so-called Generalised Social Contribution (*contribution sociale généralisée*, CSG), first introduced in 1991, was scaled up massively, and now accounts for two thirds of all general revenue that is allocated to social spending. Social contributions typically finance replacement benefits (such as public pensions and unemployment insurance), while CSG revenue is earmarked for health and solidarity benefits, including also the solidarity elements of old-age pensions and related benefits. Since 2018-19, a fraction of CSG revenue has been allocated to finance unemployment insurance. Social contributions for unemployment were reduced to zero at the same time for employees, but were left unchanged for employers.

Despite its name, CSG is in fact an income tax (on individual incomes), though distinct from the personal income tax (levied on family incomes). It is paid at rates between 6% to 10% on most income sources. Lower rates are levied on pensions and unemployment benefits, and higher rates apply to income from capital and also from gambling. Despite a tax base that is much broader than that for social contributions, in practice 75% of CSG revenue come from labour income, which is currently taxed at a (CSG) rate of 9.2%. CSG rates are mostly flat, i.e., independent of income levels, though they are progressive for pensions, with a zero rate for low-income pensions, increasing in steps to 8.3%.

There is a continuing debate on how to ensure sufficient revenues for financing social protection in France, while also simplifying the system, making it more progressive, and possibly broadening the base further. Proposals in the debate include also merging the (individual) CSG with the (joint / family-based) personal income tax.

Earmarking revenues from the value added tax (“social VAT”)

An option also discussed in France, and implemented in a number of OECD countries, consists of earmarking a portion of revenues from the value added tax for social spending (“social VAT”):

- Between 1987 and 1989, Denmark abolished employers' social security contributions for unemployment and invalidity insurance, financing the measures by raising the VAT rate by 3 percentage points to 25%.
- In Germany, the Merkel government raised standard VAT rates from 16% to 19% in 2007. This increase can be likened to a social VAT, as social security contributions were subsequently lowered, resulting in a reduction of contribution revenues equivalent to approximately 1 percentage point of VAT. A 2017 report published by the Ministry of Labour and Social Affairs considered VAT as a possible source of future social protection financing, though follow-up political debates around this topic have remained relatively muted since then.
- Japan increased the standard VAT rate from 5% to 8% in 2014, and then to 10% in 2019, while introducing a reduced rate (8%) for most food items. The entire additional revenue was allocated to social security, including for measures aimed at supporting younger generations, such as free childcare and pre-school.

In principle, there is considerable scope for raising additional revenue from VAT in OECD countries: the VAT revenue ratio (actual VAT revenue divided by theoretical revenue from collecting taxes on all goods at a uniform rate) stands at around 56% across OECD countries on average, essentially the same level as more than two decades ago in 2000 (OECD, 2022_[30]). Any additional VAT revenue can be broadly earmarked for social purposes, e.g., by re-allocating tax expenditure, such as the cost of poorly targeted preferential VAT rates, towards social transfers.⁵ In recent years, however, VAT rates were in fact sometimes reduced (OECD, 2023_[31]). Rate reductions were relatively common in Europe, typically on a temporary basis, as part of cost-of-living support aiming to counter steep price increases for energy and/or food. There was also a notable trend of leveraging VAT provisions for supporting the green transition, e.g., by lowering VAT rates on low-carbon goods and infrastructure (e.g., electric vehicles or heat pumps), or by exempting them from VAT altogether. Yet, a tightening of such preferential rates or exemptions in countries with more mature low-emission car markets indicates that these preferential VAT provisions are often temporary as well.

Earmarking in the context of a green transition

Carbon pricing can take various forms, such as emissions trading systems, excise duties or explicit carbon taxes (OECD, 2022_[32]).⁶ The OECD's (2022_[33]) Tax Policy Reforms report notes that “promoting environmental sustainability has become increasingly central to the policy goals of taxing energy and vehicle use”. As part of its Fit for 55 package, the European Union plans to extend carbon pricing to transportation and residential sectors. In addition, countries variously committed to phasing out of fossil fuel subsidies, which effectively lower carbon prices

⁵ The earmarking is ‘broad’ as a strict longer-term correspondence between social spending and higher VAT revenue can raise technical difficulties (one would need to know what VAT revenue would have been each year, had preferential rates remained in place).

⁶ Explicit carbon taxes were first introduced in Finland in 1990 and in Norway in 1991, with several countries introducing or announcing them since then. In Europe, carbon tax rates in 2021 ranged from 7 cent/tonne of CO₂ in Poland to 116 Euro/tonne in Sweden. Other OECD countries operating an explicit carbon tax at a national level include Austria, Canada, Chile, Denmark, Estonia, Finland, France, Iceland, Ireland, Japan, Latvia, Luxembourg, Mexico, Netherlands, Norway, Portugal, Slovenia, Spain, Switzerland and United Kingdom (OECD, 2019_[47]; OECD, 2022_[32]).

and encourage wasteful consumption (G20 Leaders Statement, 2009^[34]; OECD/IEA, 2021^[35]). Reducing subsidies for fossil fuel has equivalent consequences to pricing carbon emissions and can also generate significant budgetary space (OECD, 2021^[36]; Black et al., 2023^[37]; OECD, 2023^[38]).

Marten and van Dender (2019^[39]) take stock of the use of revenues from different carbon pricing measures across 40 OECD and G20 economies, see also (World Bank, 2019^[40]). As in the case of health taxes mentioned above, revenues from carbon pricing are not a stable source of financing and will eventually subside once they achieve their objective of significantly reducing carbon emissions. Similar to other government revenues, those from carbon pricing are also subject to competing demands, and this may limit the scope for earmarking them for social protection (Immervoll et al., forthcoming, 2024^[41]). Yet, there are reasons why carbon revenues could play a significant role in financing social protection:

1. At commonly discussed carbon price trajectories, prospective revenues are sizeable. For instance, carbon revenues in 2018 averaged to around 1.3% of GDP across OECD and G20 countries. Using disaggregated data by sector and fuel type, and accounting for emission reductions in response to higher prices, (D'Arcangelo et al., 2022^[42]) find that a moderate carbon-price floor of EUR 60/tCO₂ would roughly double revenues to 2.5% of GDP, with much larger increases in countries with high emission intensities but low current carbon prices. A recent evaluation of a moderate proposed carbon tax of EUR 60/tonne of CO₂ in Lithuania estimates total revenues to exceed 1% of GDP (Immervoll et al., 2023^[43]);
2. Although rising carbon prices will, and are designed to, narrow the tax base eventually, this is a gradual process and the negative impact on revenues can and should be compensated by increasing rates further. Escalating prices are, implicitly or explicitly, indeed part of existing national and international decarbonisation commitments. Carbon price revenues are therefore set to decline at some point, but this is a matter of decades, not years;
3. Social protection has a key enabling role by cushioning adjustment costs for affected households, ensuring that adjustment costs are shared equitably, and thus promoting majority support for mitigation measures during a green transition (Dechezleprêtre et al., 2022^[44]). The resource needs associated with transitional support are temporary rather than permanent. It may thus not be a fundamental problem that revenues diminish once the transition is, in fact, successfully completed. Figure 5 provides an illustration of how government transfers financed by a carbon tax may cushion households' adjustment burdens in a specific country context. (Immervoll et al., forthcoming, 2024^[41]) present and discuss comparative results for several additional countries.

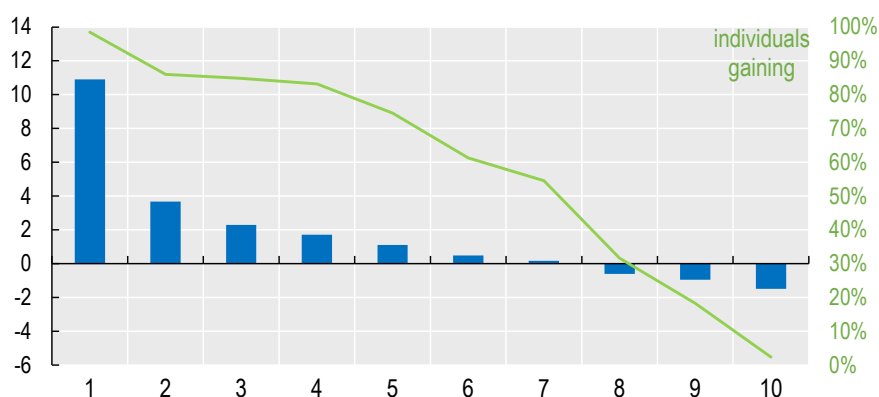
While climate change adaptation and mitigation will create competing demands on government budgets and on new revenue sources such as carbon pricing, earmarking some of these public funds can arguably clarify spending priorities, and may help to avoid over-committing available and prospective resources. There are several existing examples of earmarking carbon-pricing revenues for social protection:

- **New Zealand:** The 2022 budget established a Climate Emergency Response Fund based on proceeds from its emissions trading system. Initiatives that are eligible for financing from the Fund include those that reduce vulnerability or exposure to climate change, or that address distributional consequences of climate change and mitigation policies.
- **Austria:** A 32.50 EUR/t carbon tax measure enacted in 2022 recycles all revenue in the form of cash payments to households. The system uses location-based targeting, whereby residents in regions with greater dependence on carbon-heavy activities (e.g., private transport if public transport is comparatively difficult to access) receive more support (OECD, 2022^[45]).
- **Switzerland:** A carbon tax of 12 CHF/t was introduced in 2008 and has since increased in steps to 120 CHF/t in 2022, with a current annual revenue of about CHF 1.2bn. Two thirds this revenue are distributed as a lump-sum transfer, in the form of reduced health insurance rates (FOEN (Swiss Federal Office for the Environment), 2023^[46]).

- **Ireland:** A 48.50 EUR/t carbon tax was put in place in 2010. It employed a ‘soft’ type of earmarking, with a political commitment to use a share of revenues for raising social assistance benefits for households with children, and to provide retraining for workers in carbon-intensive sectors. More recently, the 2020 budget raised carbon taxes by 6 EUR/t and ring-fenced the proceeds, including for protecting vulnerable households and workers.

Figure 5. Country example: Cash transfers financed by a carbon tax can make a majority better off

Average gains and losses in Lithuania (% of household income) and share of gainers, by income group (deciles)



Note: Incidence of a comprehensive EUR 60/t carbon tax in Lithuania with revenues paid to households in the form of a uniform lump-sum transfer, and accounting for households' consumption changes in response to higher prices. Share of gainers refers to individuals in each income group.

Source: (Immervoll et al., 2023^[43]).

Concluding remarks

This paper compares social protection financing patterns and trends, including estimates of the extent of revenue earmarking for social purposes. It presents country examples of earmarking, indicating that it is a common practice in OECD countries, for both social insurance and assistance programmes. Tax expenditures with a social purpose (such as tax credits for families with children) also present a type of revenue earmarking.

The examples and discussion highlight that the term “earmarking” can comprise different linkages between revenue sources and spending programmes, varying by type (e.g., the balance between earmarked and non-earmarked resources for a specific programme) and institutional setup (e.g., legal provisions versus broader political commitments to devote revenues to specific uses). There can be different rationales for earmarking, and its consequences for the budget process are also likely to vary depending on design and policy context.

Future work could complement the qualitative analysis and sharpen its insights through quantitative empirical work drawing on cross-country data. Such work could focus on factors influencing the use of earmarking, its impacts on budgeting outcomes in general, and on social protection budgets in particular. Possible topics include political determinants of earmarking initiatives, and the consequences of earmarking for budget envelopes and fiscal balances at different points in the economic cycle. Existing time-series data on spending and revenues are in principle well-suited for such analysis. Yet, key requirements for further work in this area include a richer representation of earmarking provisions in available fiscal data, including internationally agreed concepts and definitions of earmarking.

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