ADB Social Protection Week
Session 2B: Limited Fiscal Space and Growing Demand: The Dilemma of Financing Social Protection and Solutions That Countries Are Exploring
Manila, Philippines, Sep 26-28

EARMARKING AND “COMMITTED” FINANCING

SOME EXAMPLES FROM OECD COUNTRIES

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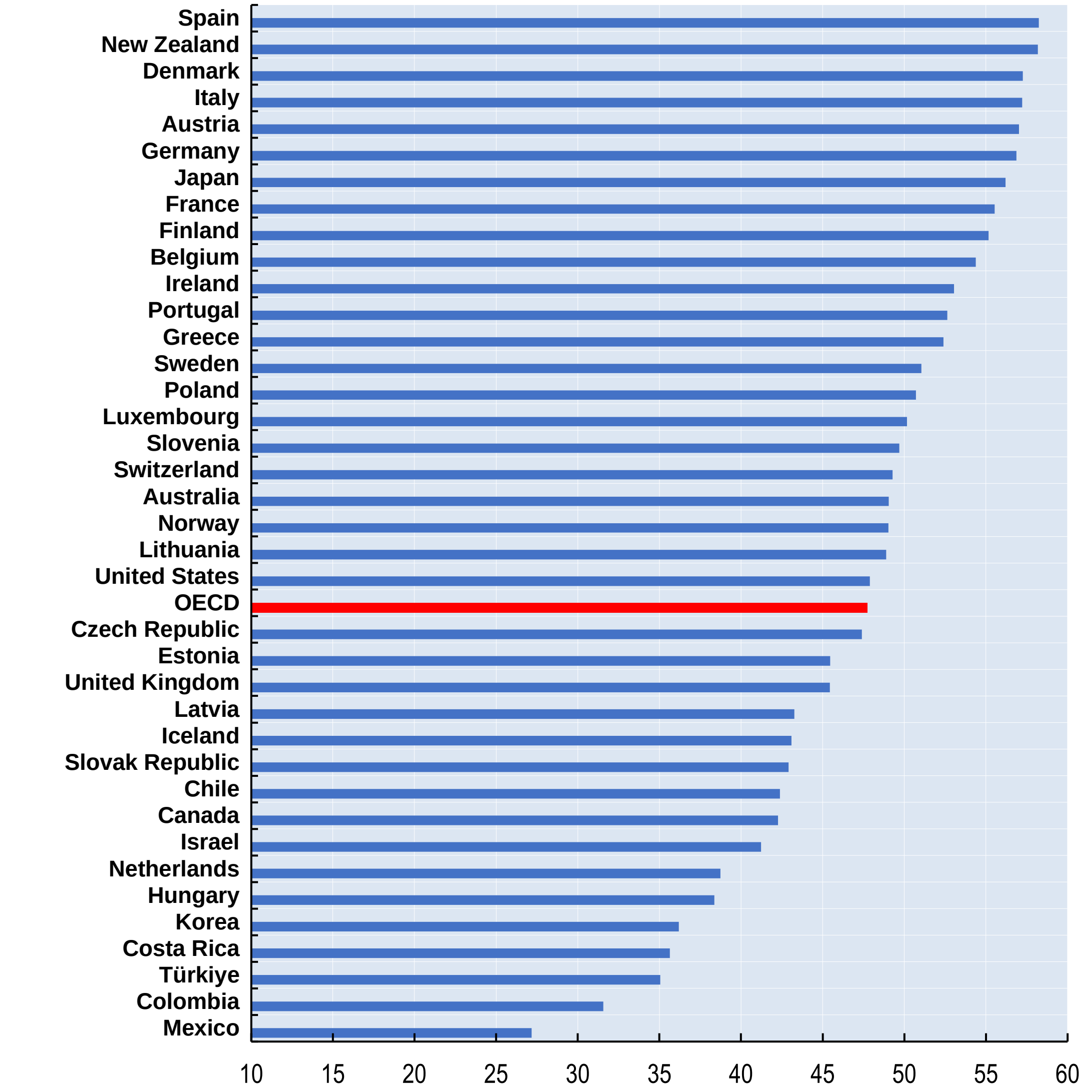
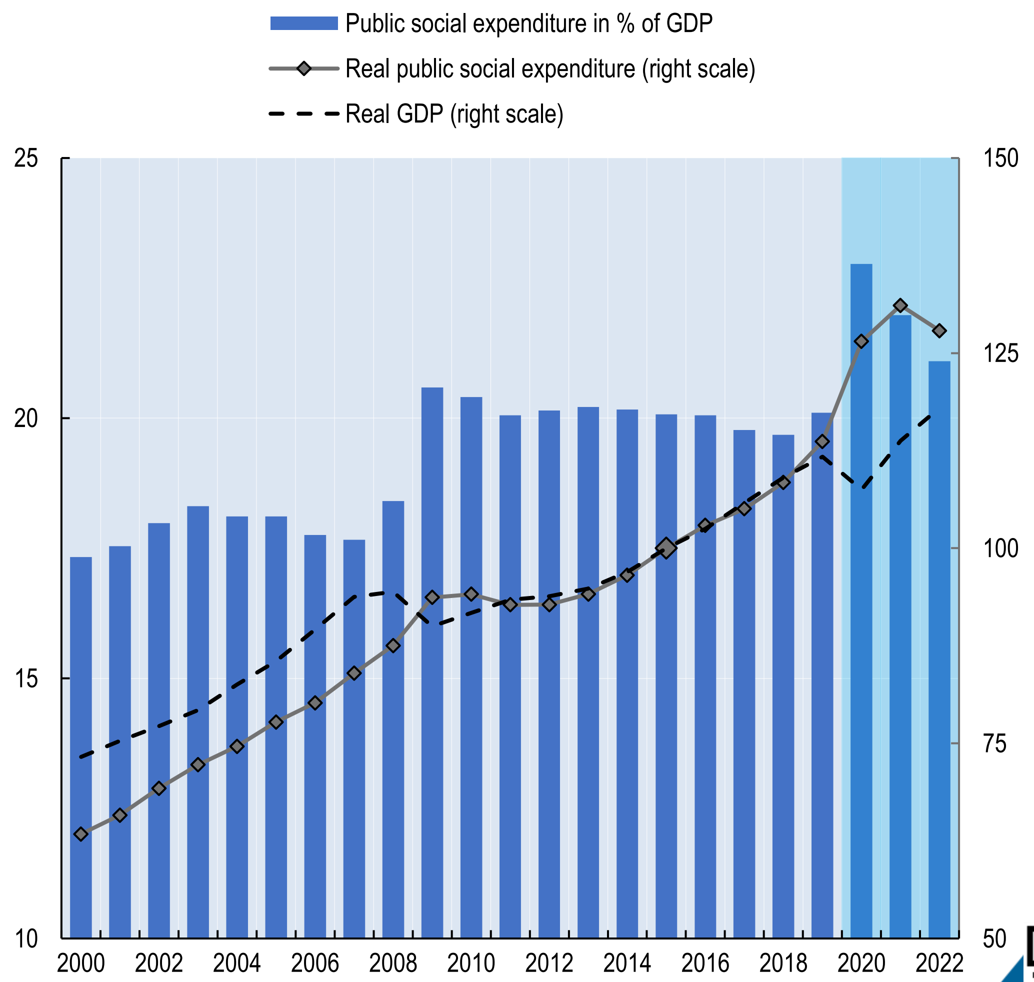
BETTER POLICIES FOR BETTER LIVES

Social protection accounted for half of government spending pre-pandemic & increased strongly during it

Public social spending in 2019, % of total government expenditure



Average across OECD, 2000-2022, % of GDP

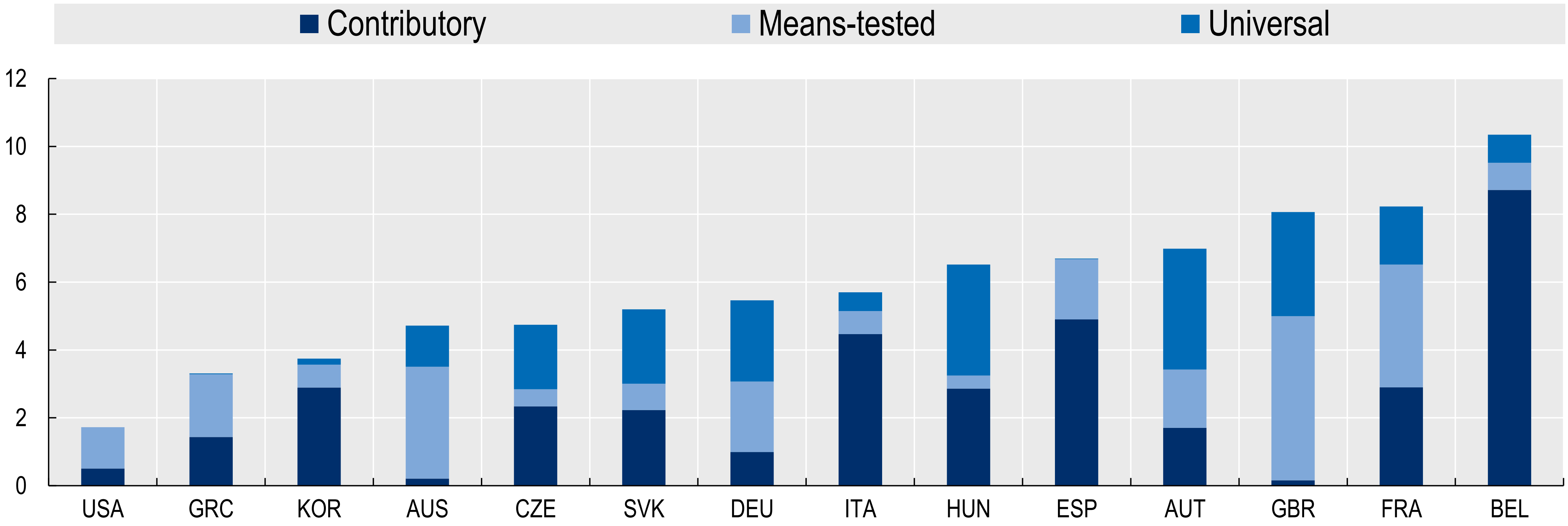


2020-2022 are estimates / projections.

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

Social assistance & contribution-based support:
Huge variation, no representative "high-income model"

Benefits as a share of total household incomes, by main entitlement criterion, working-age

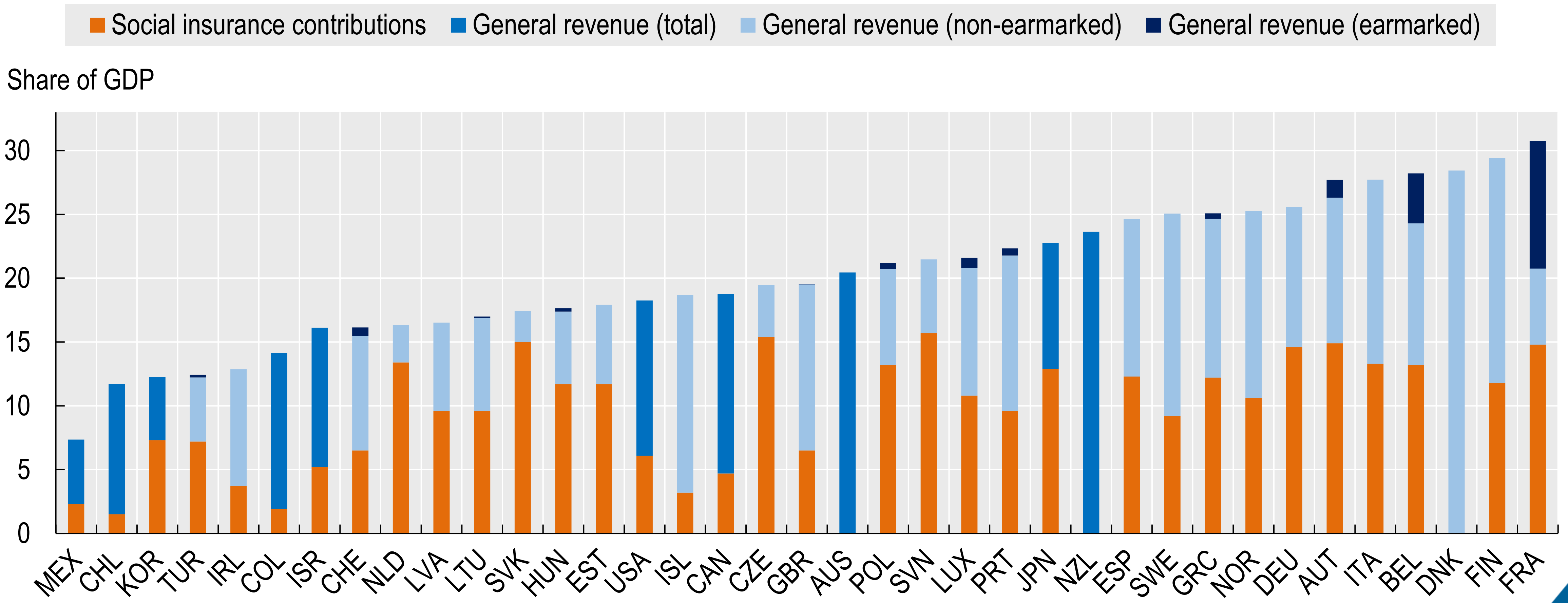


Excluding old-age pensions. Countries are ranked by the share of working-age benefits in total gross household incomes. Benefits that are both contributory and means-tested (e.g. unemployment assistance or "Notstandshilfe" in Austria) counted as contributory. For the United States, disability benefits (Supplemental Social Security) and veteran benefits (both regular veterans' disability pension and service related disability pension) are contributory.

Source: Hyee, Immervoll et al (2020), [How reliable are social safety nets?](), and OECD (2023), *Benefit reforms for inclusive societies in the United States*, using EU-SILC (EU statistics on income and living conditions, 2018), except for the United Kingdom (2016), GSOEP (German Socio-Economic Panel, 2018 wave), KLIPS (Korean Labour and Income Panel Study) (2019 wave), HILDA (The Household, Income and Labour Dynamics in Australia Survey) (2018 wave), Survey of Income and Program Participation (2014 wave, data refer to 2016).

Social protection spending & financing sources:
Models differ widely…

…but little earmarking outside of contributory measures

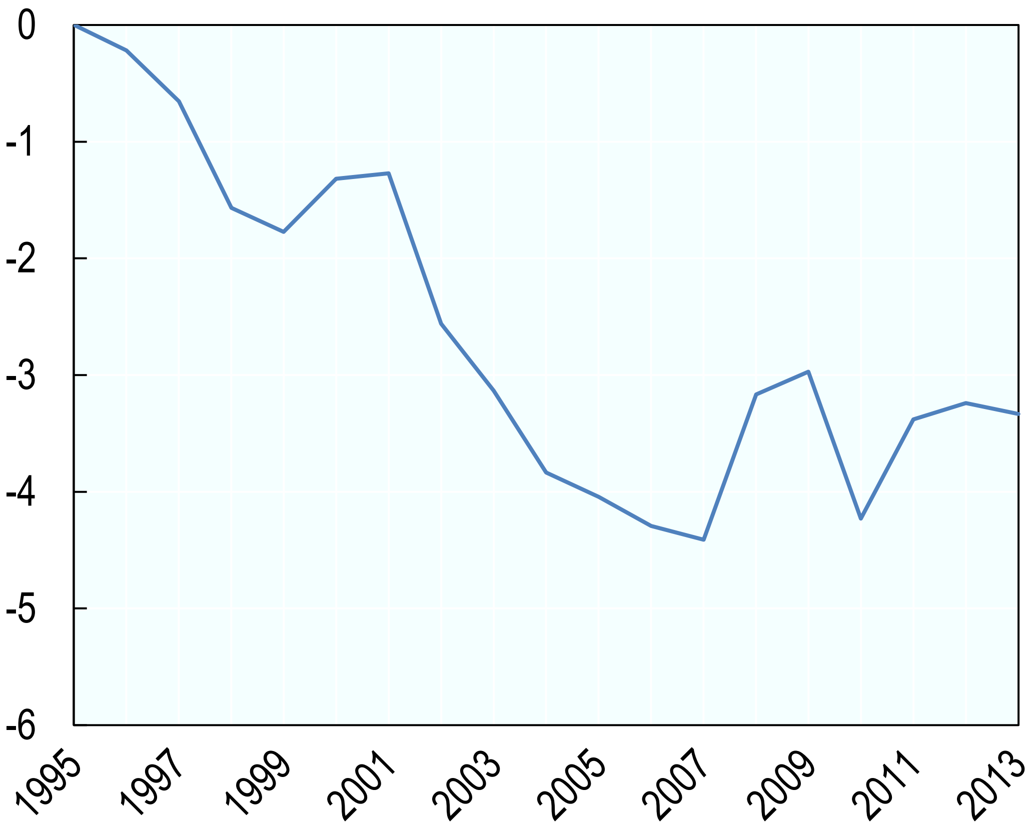


Source: OECD (forthcoming), *Social support when budgets are tight. The role of revenue earmarking.*
Calculations based on OECD Social Expenditure Database, OECD Revenue Statistics and ESPROS (earmarking for European countries)

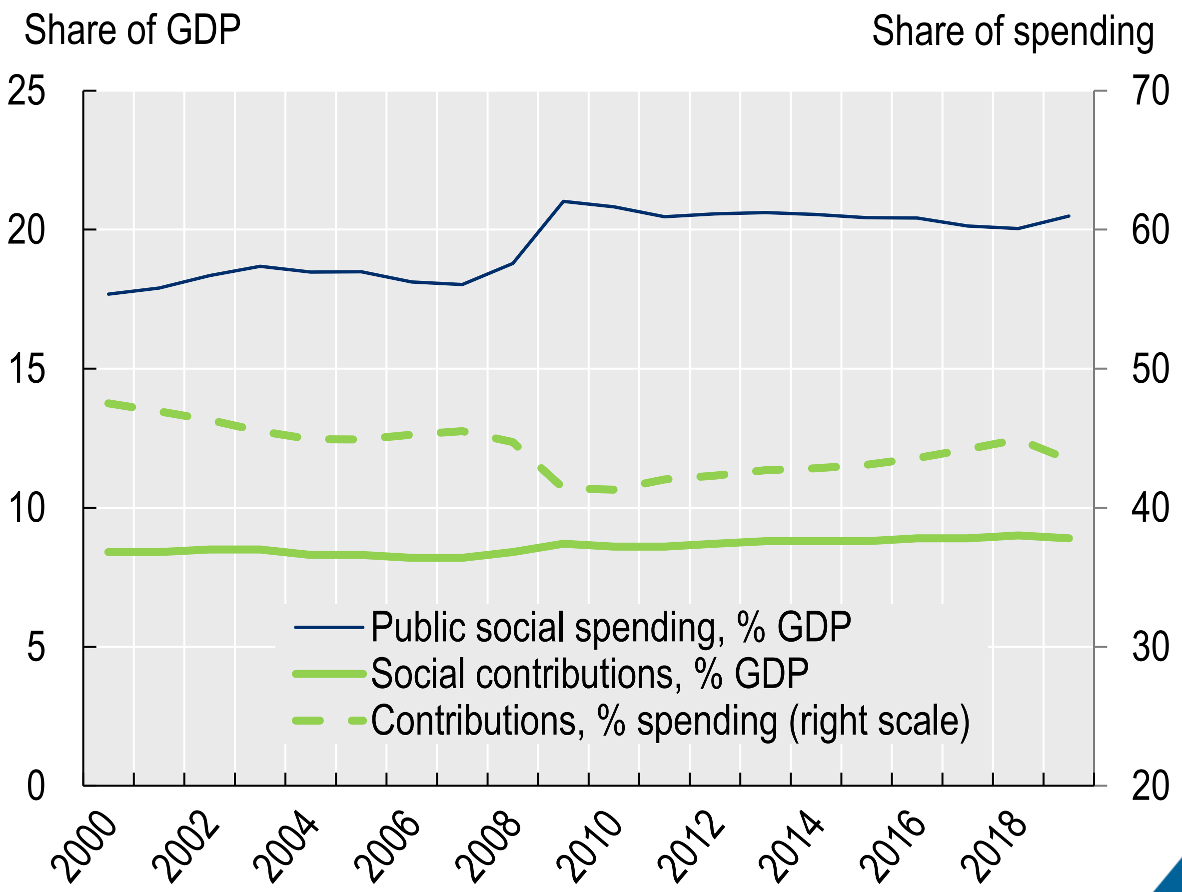
Contribution financing under pressure?

Revenues from contributions increased over past two decades

Labour income share, OECD average



Spending and contribution revenue, OECD average



Calculations based OECD National Accounts, OECD Social Expenditure Database, OECD Revenue Statistics and ESPROS (earmarking for EU countries). Labour income share: Percentage point changes, excluding the primary, coke and refined petroleum, housing and non-market industries, 1995=0

Source: OECD (forthcoming), *Social support when budgets are tight. The role of revenue earmarking*.

SOCIAL ASSISTANCE FINANCING: EXAMPLES OF EARMARKING

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Earmarking in social assistance financing
Some examples

- **Austria family benefits**, since 1967: Earmarked autonomous fund, ca. 1.4% GDP. Payroll tax (3.9%, employer) + small part of PIT & CIT
- **Poland disability benefits, and in-kind (care) assistance**, 2019: Payroll tax, 0.15% of wage bill (employer), but increasing to 4% for wages above PLN 1 million (so-called ‘solidarity income’)
- **Portugal minimum pension**, 2017: Social Security Financial Stabilisation Fund. Progressive supplement to property tax (0.6-1.5% above threshold). 2018: also 0.5% of CIT (2% from 2021)
- **USA medicare**, 1965: Payroll tax (ca. 1.5% each employer and employee). 2010: additional progressive charge (in 2023: 0.9% for earnings > USD 200 000). **Various state programmes**, e.g. shares of real-estate tax/fees for social housing in Florida and Iowa.

Earmarking in social assistance financing
France

- **Highest level of social spending** in OECD, old age support and health account for 4/5 of increase in past 10-15 years
- Financing **mostly through contributions up until 1990s**, but became much more diversified since then, down to ca. 60%
- Multiple rounds of **reductions in employer contributions**, to dampen cost of employing low-wage workers in particular
  - To compensate: some health taxes ("sin taxes" on tobacco, alcohol) allocated to SP
- Massive **scaling up of "*Generalised Social Contribution (CSG)*"**. Actually an income tax, substituted for contributions, now 2/3 of SP 'general' revenue
  - 6 to 10% of (almost) **all** incomes (including capital, gambling, but 3/4 is labour income)
  - CSG → Solidarity benefits, incl for old age; Contributions → insurance replacement bens
- **Reform debates** in recent years: merge CSG with income tax, "social VAT"
- Social VAT initiatives / debates also elsewhere, e.g. Germany, Portugal

REVENUES FROM CARBON PRICING: AN EMERGING FORM OF EARMARKING?

BETTER POLICIES FOR BETTER LIVES

Recycling substantial / growing carbon price revenues

for a Just Transition, and to shape distributional outcomes

- Revenue source to eventually diminish – but matter of decades, once green transition is complete
- Medium term: Revenue potential from carbon pricing is rising. And it is substantial: e.g. 1.3% of GDP for a comprehensive EUR 60/t carbon tax

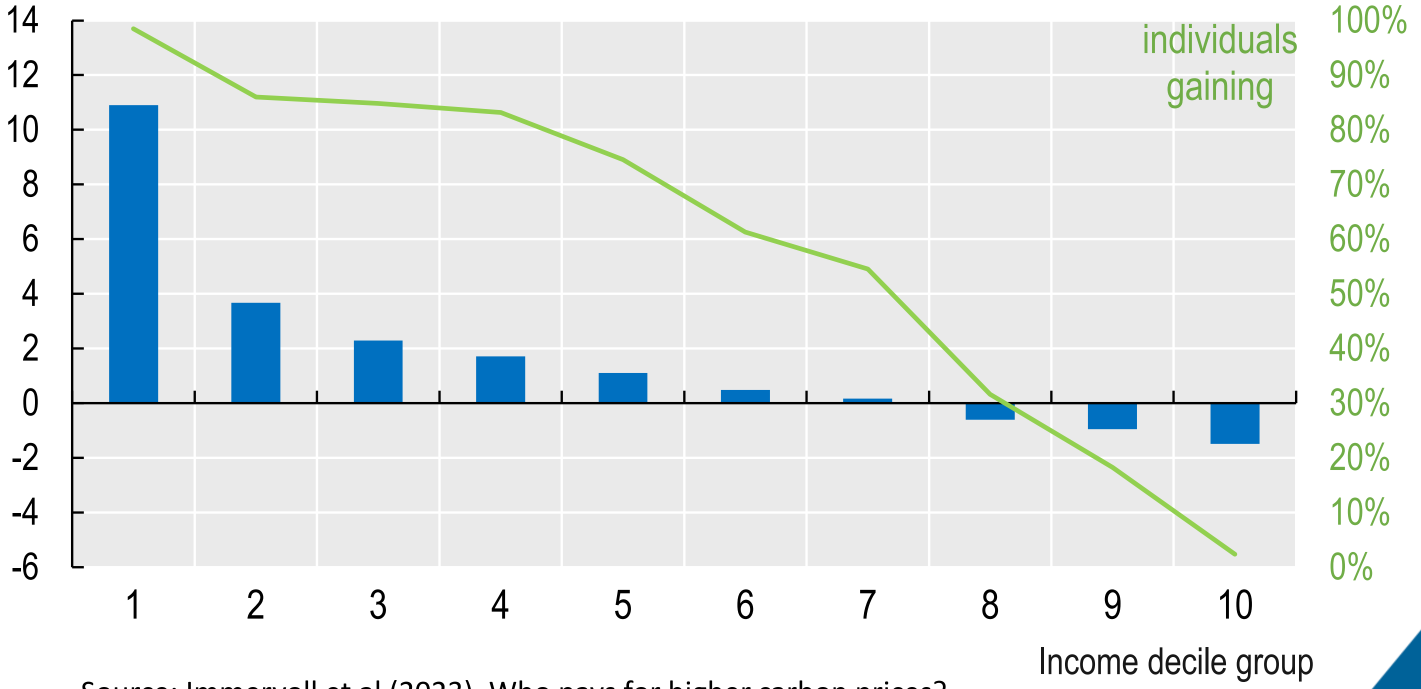
➔ Considerable scope for budget-neutral transfers and for pursuing distributional objectives

- Even a simple lump sum to everybody would reduce inequality, 60% better off
- Distributional outcome can be tailored in multiple ways
  - tax the transfer
  - differentiate between groups
- May still leave some budgetary room for furthering other key objectives
  - finance support for job losers
  - strengthen work incentives
  - support households as they lessen their carbon footprint (public transport, home insulation, “feebates”)

Illustration for one country: Lithuania

Redistributing carbon tax revenue, here a simple lump sum

Average gains and losses (% of household income) and individuals gaining



Source: Immervoll et al (2023), Who pays for higher carbon prices?
https://doi.org/10.1787/8f16f3d8-en

Carbon pricing
Examples of revenue recycling

- **Austria**, 2022, 32.5 EUR/t CO_2: Full revenue recycling for cash support. Lump-sum compensation, location-based targeting (eg access to public transport)
- **Switzerland**, 2011, 12 CHF/t, increased in steps to 120 CHF/t in 2022, with annual revenue of 1.2bn. Partial revenue recycling for cash support. 2/3 of revenue as lump sum (in practice reduced health insurance rates)
- **Ireland**, 2010, 48.5 EUR/t: Soft earmarking, gov’t commits to use a share of revenues for increasing social assistance benefits for households with children (and some to provide retraining for workers in an area affected by the loss of brown jobs)

Earmarking
Challenges, when useful, when counter-productive?

- Constrains budgetary flexibility, protects ‘essential’ spending?
- **Trade-offs greater if fiscal space is tight**, or when programme spending is large / growing
  - Efforts to raise spending efficiency *vs.* safeguarding vital programmes
  - Pair earmarking with systematic & periodic assessment of use of funds, sunset clauses
- **Objectives of social programme**: Does financing complement / support them?
  - Incentives / prevention (e.g. health taxes – tobacco, alcohol)
  - Equity: Who pays, who benefits?
- **Are earmarked revenues sufficient?** Are they ‘in sync’ with spending needs?
  - Rights-based programmes typically need backing up with other financing
Can be difficult to obtain when dedicated earmarked funds are already in place
- **‘Transitional’ earmarking *vs.* longer-term commitment** of specific revenue sources
- **Political economy.** New revenue source may need to be linked with compensation/benefits
  - E.g. surveys of people’s attitudes towards carbon pricing
  - Need link that is clear and understood by voters. In practice, earmarking can be opaque (e.g. implicit rather than explicit, in the case of tax expenditures with a social purpose)

THANK YOU

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