

THE EARMARKING OF GOVERNMENT REVENUE: A Review of Some World Bank Experience

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William McCleary

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Abstract

Economic theory provides some justification for earmarking. Some economists argue that by assigning revenue from specific sources to specific purposes, a government can facilitate agreement about increasing both revenue and expenditure in cases in which there would be no consensus about raising either separately. Earmarking may also protect high-priority programs from shifting majorities, inefficiency, and corruption.

Most economists, however, have been skeptical about earmarking. In practice, it is difficult to achieve pricing and taxation arrangements that will allocate resources appropriately for the service in question and yet require few administrative decisions. Often, efficient pricing and taxing lead to unbalanced budgets for the earmarked fund and hence to interdependence with the general budget. The independence of earmarked funds is further compromised because they so often depend on the government for additional, non-earmarked sources of funding, or for reiterated endorsement of decisions about prices or taxes for the earmarked sources. Governments also frequently withhold the allotted funds, fail to make necessary changes in prices or taxes, or simply suspend the earmarking arrangements.

This article looks at the arguments for and against earmarking and goes on to illustrate the discussion with case studies from World Bank experience. The lessons from the real world appear to bear out the skepticism of the majority about earmarking: in general, it has not worked very well. The article, therefore, concludes by cautioning against the practice except under certain defined and restrictive conditions.

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