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The path to universal coverage

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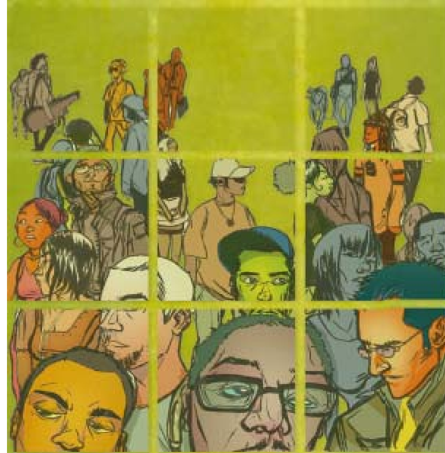

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Hypothecation of tax revenue for health

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Introduction

Hypothecated taxes, sometimes called *earmarked* taxes, are those whose revenue is designated to be spent on a particular programme or use. There are many examples of hypothecated taxes, including TV licence fees, road tolls or certain national insurance contributions. In each case, the individual paying the tax knows exactly what the state will spend his money on. The word originates from Greek *hypotithenai*: 'to give as pledge', via Latin *hypotheca*: which referred to the act of pledging property as a security.[i] Indeed, in ancient Athens as well as Rome all taxes were hypothecated.[ii]

Hypothecating tax revenue is not inherently right or wrong. It depends crucially on whether citizens trust its government to spend tax revenues wisely or not. This is evident from the fact that the same argument is made in favour as well as against hypothecated taxes. While proponents argue that they limit a governments' propensity to spend according to their own agenda, critics retort that they curtail a governments' flexibility to spend when and where it is needed most.

Arguments for hypothecated taxes

Accountability and trust: Rather than paying taxes into a perceived *black hole*, hypothecated taxes provide taxpayers with in-built accountability for public spending. At times when a government is suspected of following its own agenda, this can help to restore trust between it and its citizens.[iii, iv]

Transparency: Hypothecated taxes can educate people about the cost of particular services, such as healthcare. Taxpayers can then make better informed decisions about the balance between tax burden and level of services provided. Health spending in particular has grown faster than GDP in many countries and the decision whether to go on spending ever more on health or whether to cut back on these services can be a tricky one for politicians. Paying for health through hypothecation allows governments to explicitly hand back that choice to the electorate and escape a potential political fallout.[v]

Public support: In some cases, hypothecation can even generate public support for tax increases. This, however, is highly dependant on whether the service set to benefit from the earmarked tax is perceived to merit it. Only education and health have consistently and across countries shown this potential.[vi, vii, viii]

Protecting resources: Because of the relative public support for such spending, ministries of health are often in favour of hypothecated taxes for health. They see it as a way to ring-fence their resources from competing political interests and a way to by-pass budgetary constraints mandated by ministries of finance.

Arguments against hypothecated taxes

Exemption from review: Unsurprisingly, ministries of finance rarely endorse hypothecation as it undermines their mandate to allocate budgets as they see appropriate. It exempts the tax revenues in question from scrutiny and potential cuts that others are subjected to.[ix] There is also no obvious answer as to who should set rules on the level of hypothecation.[x] Furthermore, when the hypothecation affects a large amount of public expenditure, as is typical for health, it can severely impact on other public spending should cuts be necessary.

Undermining solidarity: Financing from tax revenue is one of the major mechanisms allowing governments to achieve a fair distribution of the cost of healthcare. Some fear that specifying each individual's share of the cost vis-à-vis services received could undermine this solidarity.[xi]

Inappropriate funding levels: Hypothecated taxes are accused of linking spending not to the requirements of the services but to unrelated macroeconomic circumstances. Rather than determining health spending by how much a tax raises, it should be based on the health needs of the population. Severing this link between need and provision risks wasteful spending when the tax base is buoyant and insufficient budgets when it is depressed.[xii]

Tying the hands of government: By taking decisions on spending levels out of government discretion, hypothecating tax revenues constrains its ability to deal with economic cycles.

Hypothecated 'sin-taxes' for health

Hypothecated taxes for health often come in the form of so-called *sin-taxes.* These are levies on the consumption of products that are harmful to health, such as tobacco and alcohol. They both raise funds for health spending and discourage health damaging behaviour. Unfortunately, they also tend to be regressive, i.e. taking proportionately more money from the poor than from the rich.[xiii]

The Australian state of Victoria implemented the world's first such sin-tax that was hypothecated for health in 1987. It came in the form of tobacco control legislation that added a 5% levy on tobacco products and whose revenue was then used to fund a newly formed independent health promotion foundation called VicHealth. Apart from increasing cigarette prices, the legislation banned most tobacco advertising and formed the basis for later rules to create smoke-free workplaces and public venues.[xiv] Meanwhile, VicHealth bought-out all tobacco industry sponsorships of the arts and sports. This proved less costly and easier than anticipated, as most preferred non-tobacco sponsors. Among the foundations other activities are more than AUS$ 20 million annually in funding for health research and in support of anti-smoking and other public health campaigns.[xv] Until 1997, all of these activities were funded exclusively from the hypothecated tax on cigarettes. Since then, the hypothecation aspect has been weakened as states are no longer allowed such tobacco levies. However, tax funding from the national level from sin-taxes and others is transferred to states to compensate.

Scholars argue that the combined effect of mass media campaigns, restrictions on tobacco advertising and increases in cigarette prices account for most of the continued decline in tobacco consumption in Australia.[xvi, xvii] By one estimate the government saves twice as much in healthcare costs as it is spending on these programmes.[xviii] The Victorian hypothecated tax of 1987 included all of these measures.

Other countries to now fund health promotion from hypothecated taxes include Finland, the Republic of Korea, Portugal and Thailand.[xix, xx] Furthermore Belgium, Egypt, the United Kingdom as well as the US states of Alaska, Arizona, California, Maryland, Massachusetts, Michigan, Oregon and Utah have all instituted some level of hypothecation for health of their tobacco taxes.[xxi, xxii] Egypt, for example, earmarks a part of the revenues from tobacco taxes for subsidizing health insurance for students, covering preventive, curative and rehabilitative health services. The insurance is funded from students' contributions as well as from tax revenues, including a fixed amount of 10 piastres for each pack of 20 cigarettes sold.[xxiii]

Conclusion

Prior to the Victorian tobacco legislation, a survey found 47% of respondents in favour of an increase in tobacco taxes (including 20% of smokers). If hypothecated for health or other community benefits, this support surged to 84%.[xxiv] To retain such support and realise the benefits in terms of accountability and public trust the hypothecation must be strict, i.e. no topping-up from general taxation and no siphoning off to other purposes. Over time, many hypothecated taxes do however become less strict. As government revenues are essentially fungible, an increase in income flows from hypothecated taxes may be offset by a reduction in the rest of the health budget. In the Australian example, hypothecation was replaced by general taxation. Hypothecated payroll taxes in the form of social health insurance in Germany have been capped and supplemented from general tax revenues. This process is not surprising, as the lack of fiscal flexibility and the fact that these taxes often do not raise the exact amount needed will be exacerbated over time.

Hypothecation is most intensely debated at election time and when public spending is under threat, as it has been in many countries since 2008. During campaigns, candidates can be seen portraying themselves as protectors of health resources or as modernisers seeking efficiency gains. The former would then inevitably be accused of wasteful spending and increasing taxes, while the latter would be cast as threatening to dismantle public services. The 2010 general election in the United Kingdom provided only one of the latest such examples.

In practice, whether or not tax hypothecation for health results in increased funding availability for health depends on the context and on how other government spending is adjusted as a consequence. Perhaps hypothecation is most aptly summarized as a sacrifice of fiscal flexibility on behalf of government in order to achieve greater accountability and citizen support; however both effects will most likely be of temporary nature only.

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