



DEDICATING TAX REVENUE Constraining Government or Masking Its Growth?

Dedicating a portion of tax revenue to a specific expenditure, commonly referred to as earmarking, is a popular fiscal tool that every state government uses. Revenues are often earmarked for politically popular expenditures, such as education, to justify new revenue sources such as lotteries. In theory, earmarking state revenue should have no effect on the size of government if the targeted programs were previously funded from general fund revenue.

In a new study for the Mercatus Center at George Mason University, economists [George R. Crowley](#) and [Adam J. Hoffer](#) examine earmarking as a tool for government expansion. The study finds that earmarking revenue is an ineffective means of increasing total spending for the targeted category. However, earmarking in general is very effective at increasing general government expenditures outside the intended recipient category. This means that dedicating tax revenue tends to increase the overall size of government.

To read the study in its entirety, see [“Dedicating Tax Revenue: Constraining Government or Masking Its Growth?”](#)

STUDY DESIGN

The study tests the hypothesis that earmarking tax revenue allows policymakers to advocate for increases in the earmarked tax on the basis of benefitting the targeted recipient category. Should the tax increase be approved, the dedicated revenues may be used in place of previously used general-fund revenues. The result may or may not affect the targeted expenditure but will increase total government size.

The hypothesis is tested using data from 49 states over a period of three years. The analysis focuses on the most commonly employed revenue sources and the primary targets of dedicated tax revenues: education, roads, and local governments.

For more information, contact
Kyle Precourt, 703-993-8196, kprecourt@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Boulevard, 4th Floor, Arlington, VA 22201

KEY FINDINGS

The majority of dedicated tax revenues do not lead to increased spending on their targeted expenditure category. Of the 15 earmarks explored, only 4 showed the intended effect of increasing spending for the earmarked cause. Only tobacco tax revenue and personal-income tax revenue earmarked to education, along with sales tax revenue and vehicle registration revenue earmarked to local governments, unambiguously led to increases in expenditures on the targeted category.

Earmarks tend to lead to an increase in the overall size of government. In nearly every case where an earmark failed to increase targeted expenditures (either partially or at all), nontargeted spending increased. Thus, the majority of the earmarks that failed to stick instead increased spending on other expenditure categories unrelated to their intended target—thereby increasing the overall size of government.

- For each dollar of general sales tax revenue earmarked to education spending, no significant increase in education spending was observed, but an increase of \$0.55 in total government expenditure was found.
- Tobacco tax revenue dedicated to spending on local governments was only effective at increasing overall government size, with no effect on spending in the targeted category.
- For each dollar of personal income tax revenue dedicated to local governments, expenditures in other areas increased by roughly \$0.84 and total spending by \$0.94.

Earmarks can decrease total expenditures in the recipient category. For each dollar of general sales tax revenue earmarked to education spending, no significant increase in education spending was observed, but an increase of \$0.55 in total government expenditure was found. A similar effect was observed in corporate income tax revenue dedicated to education. Each dollar of corporate tax revenue dedicated to education was associated with a decrease of roughly \$2.72 in spending on education and a similarly sized increase in spending on other programs.

CONCLUSION

Policymakers use the practice of earmarking tax revenue to increase the total size of government without resorting to the implementation of unpopular general tax rate increases. But the revenue raised from earmarks does not primarily go to its intended use. Instead, it is used as fungible revenue to be spent at the government's discretion. Earmarking is ineffective at increasing targeted spending and more often than not results in the growth of overall government spending.