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Index

Financing development goals in times of crisis (Antonio Savoia & Kunal Sen) 2

Income inequality in Italy: is there a role for the geographical divide? (Chiara Mussida) 5

Financing development goals in times of crisis

Antonio Savoia and Kunal Sen

Pursuing the global development agenda will require genuine commitment from political leaders and significant stepping-up of government efforts. But, above all, it will require increased financial resources. Where will these resources come from?

We are at the mid-point of the 2030 Agenda for Sustainable Development and governments are grappling with multiple crises, the most evident of these being the economic aftermath of the COVID-19 pandemic, climate change and the ongoing conflicts in Ukraine and Palestine.

Nobody can precisely quantify the crises' net effects or predict when they will end, but almost everyone agrees that they represent significant headwinds for the global development agenda. According to the 2022 Sustainable Development Goals Report by the UN, progress on many targets may be slowing or even reversing as a result of the crises.

The challenge of financing the Sustainable Development Goals

The 2023 OECD outlook on financing the SDGs estimates that the COVID-19 pandemic has caused a decrease in nearly all sources of finance for development, amounting to a 17% drop over 2019-2020. This leaves the poorest countries with an increasing shortfall.

Foreign aid is, and will likely remain, an important source of development finance. However, these are not normal times for development cooperation. Official Development Assistance (ODA) was at record levels in 2020 and 2021, but only due to COVID-19 related expenses. Apart from that, contributions have been stagnant over the last few years, and there is no increase in sight as rising military spending in Europe most probably diverts resources away from development aid.

Normally, loans provide an alternative to foreign aid for poorer countries. But rising interest rates, high debt loads, and uncertainty in capital markets make borrowing more costly. The 'polycrisis' means that resorting to debt may not be a good option now for many Global South countries. Indeed, the world may be facing a new debt crisis, with a high likelihood of painful fiscal adjustments and reduced fiscal space – in other words, policies that add up to austerity.

Taxation matters, but how do states learn to tax?

With foreign aid and borrowing becoming less prominent, what other finance options do less developed countries have to drive their development? Taxation is key. It is a fundamental part of how states provide crucial public goods and services that support development, such as universal education, public health systems, and an effective administration of justice.

Improving the ability of developing countries to generate resources for development spending is now part of SDG 17: Partnerships for the goals, where Target 17.1 requires 'strengthening domestic resource mobilization'. Progress on this target is measured by 'Total government revenue as a proportion of GDP' and the 'Proportion of domestic budget funded by taxes'.

This choice of target and indicators may turn out to be a particularly timely one, not only because the SDGs agenda is much more ambitious than that of the previous Millennium Development Goals (MDGs). In the current climate, where development financing faces new headwinds, governments may have to increasingly focus on domestic revenues and, in particular, tax revenues.

This is not without challenges. With stagnant or declining economic activity, tax revenues may decline too. To address this, tax policies may have to be adjusted. For example, the OECD finds that significant resources may come from "stopping the leaks" by recalibrating tax breaks on aid. Similarly, a significant amount of tax revenues may be recovered with a crackdown on tax havens. This would no doubt help.

One, however, should also reflect on the capabilities of states to tax. Improvements on this front, by building *fiscal capacity*, may have long-lasting effects that stretch well beyond the development goals cycle. But how do states learn to tax? The formation and organizational performance of public finance institutions, and national revenue administrations in particular, depends on a number of structural factors, including the economic and historical conditions that help to build and consolidate a tax systems that is capable of regularly raising revenues from across the population through a broad tax like income tax.

From fiscal contract to a virtuous cycle

One key aspect of building this effective tax system, however, concerns the political conditions for raising revenues through taxes. Political systems that place stronger constraints on government leaders tend to collect higher tax revenues. This is because constraints on the leaders will diminish public concern that the government caters to elite interests. Institutionalized checks and balances reduce leaders' discretion over public finance decisions and improve public accountability. This improves legitimacy and tends to make citizens and businesses more willing to pay tax.

For example, an effective parliament, that is independent from government, can keep checks on leaders by regularly overseeing and auditing the state's budget, including taxation. These processes build "tax morale" and significantly increase revenues through tax. This is because citizens are more willing to pay taxes when they know that the state is more accountable to them. In other words, citizens enter a *fiscal contract* with the state. They are happier to exchange money through taxes for goods and services as they have more control over the state's actions.

This creates a virtuous cycle. The quality of government improves because states that raise significant revenues from taxation may, in turn, face stronger public demands for accountability and representation. Recent research finds that tax revenues and constraints on leaders reinforce each other over time, bringing about a more sophisticated form of taxation levied from a broad tax base. Income taxation, in particular, can act as a powerful tool for redistributing wealth from the rich to the poor, and is a key feature of a modern fiscal state.

The challenges the world currently faces make a compelling case to build political support and commitment within countries to mobilize domestic revenues for development – that is, to increasingly finance development spending through taxes. This is not only a technocratic exercise. politics matters. While technical solutions, such as improved IT systems for tax collection and administration, are significant to achieving this end, understanding the politics behind fiscal contracts is of even greater importance.

This contribution previously appeared on globaldev.blog

https://globaldev.blog/financing-development-goals-in-times-of-crisis/

Income inequality in Italy: is there a role for the geographical divide?

Chiara Mussida

The geographical differentials in the average standard of living are often mentioned among the main causes of the high income inequality in Italy. In this topic, we will explore the role of such disparities by calculating, based on micro-data collected for Italy in the EU-SILC (European Union Statistics on Income and Living Conditions) survey, data from the Labour Force Survey gathered by the Italian National Institute of Statistics (ISTAT), and from EUROSTAT, how much of the recorded inequality is actually attributable to territorial disparities, i.e. gaps across the Italian macro regions. Additionally, we will investigate whether, during the more recent crises, i.e. the Great Recession and the COVID-19 shock, the role played by these disparities in determining the dispersion of the standard of living of Italian residents has increased. We will use different indicators of income inequality, and we will consider years/period before and after the mentioned economic recessions.

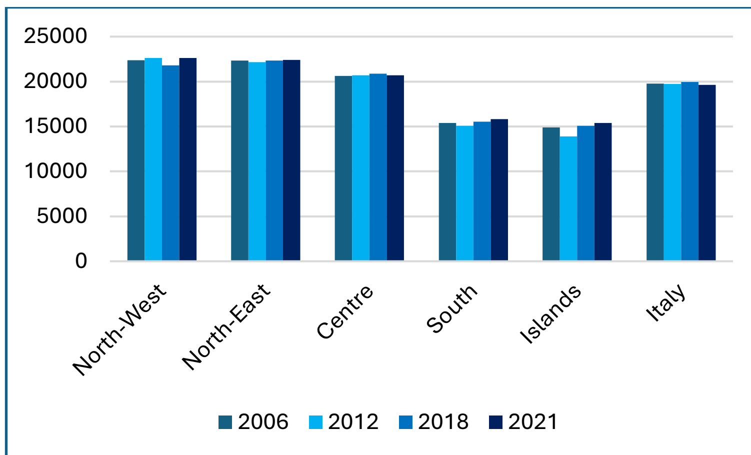
The first indicator is the mean equivalized disposable household income. It is the sum of all market incomes, regardless of their source (wage employment, self-employment, capital, income), received by the household members net of taxes and gross of transfers, made equivalent to account, through appropriate equivalence scales, i.e. the modified OECD scale, for the different size of households.[1]

Based on this indicator (mean equivalized disposable household income), according to Eurostat data, Italy was among the most unequal countries in the European Union, exceeded only by three Southern European countries, that are Spain, Portugal, and Greece. Notably, this ranking remained unchanged after the most recent crises, i.e. the Great Recession and the COVID-19 shock. Moreover, as suggested by other studies, the level of inequality in Italy increases if we consider the market equivalent incomes, without taking into account the progressive effect related to taxation and welfare transfers.

Figure 1 reports the mean equivalised disposable household income for Italy and its macro areas in four selected years: pre-Great Recession (2006), post-Great Recession (2012), pre-COVID-19 (2018), and post-Covid-19 (2021). We note that the level of income in Italy was not influenced significantly by the crisis.

[1] This is a standard equivalence scale to calculate the number of "equivalent adults" in a household. The scale assigns a weight of 1.0 to the first adult, 0.5 to the second and each subsequent person aged 14 and over, and 0.3 to each child under 14.

Figure 1. Mean equivalised disposable household income, macro area and Italy (selected years)



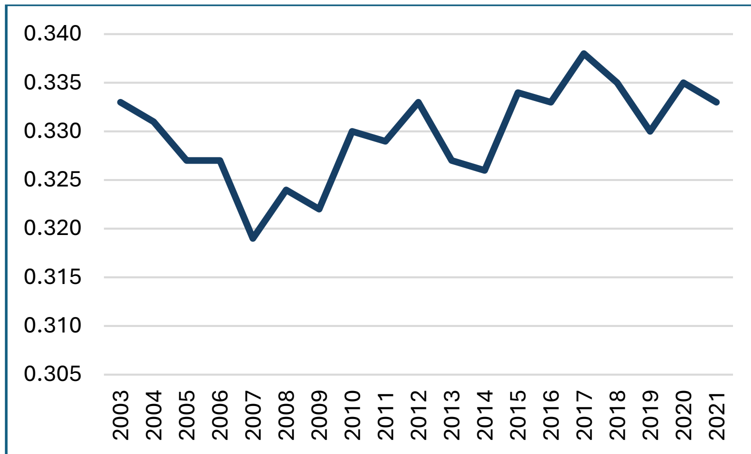
Source: Author's calculations from EU-SILC data

We explored the geographical differences in the average standard of living by calculating the same indicator for the same selected years for the main Italian macro areas. From Figure 1, we see that there are important differences across the geographical areas. While between the North-West and North-East the differences in the level of income were negligible, we see relatively lower levels in the South and Islands. In the former areas, the indicator exceeds € 20.000 in all the years analysed, while in the South-Islands it was around € 15000.

However, the overall inequality also depends on the distance (deviation) that separate the distribution of income among individuals (or households) within the same macro-area, meaning the inequality within this area. The Gini indicator was calculated to capture such character of income inequality. The index ranges from 0, that is perfect equality/equidistribution of income, to 1 which is maximum income concentration.

Figure 2 reports the evolution of the Gini index for Italy from 2003 to 2021 (ISTAT data). Here we notice that there were some changes in the inequality, like increasing inequality after the Great Recession and during the austerity era. Nonetheless, the magnitude of these changes were negligible and, on average, we see that the overall level of inequality remained basically the same from the beginning (2003) to the end of the period (2021) explored, at around 0.335.

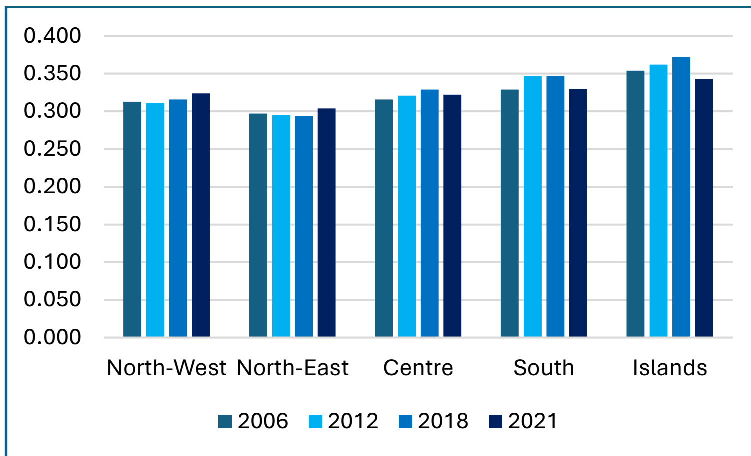
Figure 2. The evolution of the Gini index in Italy, 2003/2021



Source: Author's calculations from i.stat data

If we look at the Gini index in the macro-area (Figure 3), we see that inequality increases as we move from the North-West (0.320 on average) to the South and Island (0.360). More detailed data on the index, i.e. regional level data, as also discussed in other reports, confirm that inequality is relatively higher among the regions of the South of Italy.

Figure 3. Gini index by macro area (selected years)

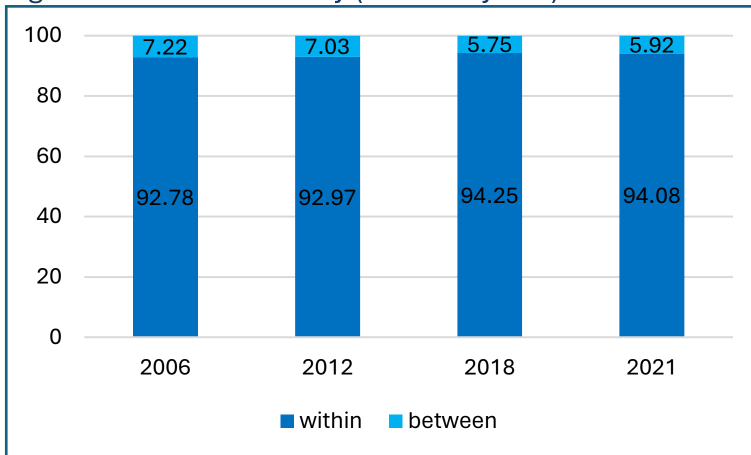


Source: Author's calculations from EU-SILC data

The last indicator calculated is the Theil index, as it allow considering both the 'between' and 'within' component of inequality. The former reflect the distances "between" groups of individuals residing in different geographical areas, while the latter those distances that depend, instead, on the dispersion within each area, namely the distances "within" groups of individuals residing in the same geographical area.

In Figure 4, we see that the between component only explain, on average, 6.5 percentage points of the overall income inequality in all the years considered. The relevance of this component did not change with the recessions.

Figure 4. Theil index in Italy (selected years)



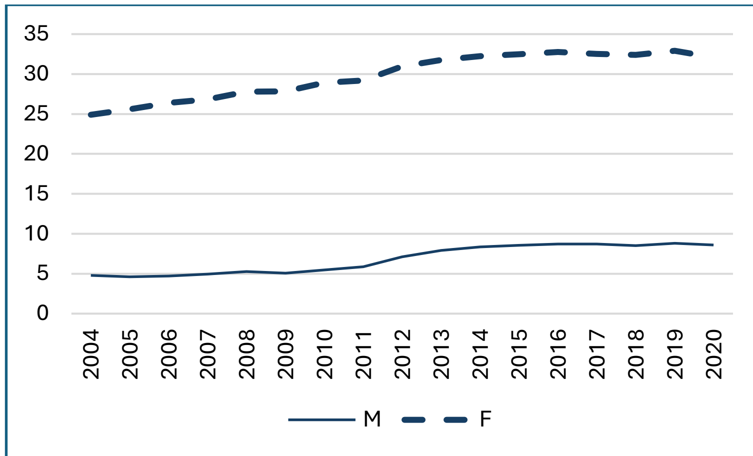
Source: Author's calculations from EU-SILC data

In other words, if the disparities between areas were completely eliminated while keeping the differences within each area unchanged (for example, by multiplying or dividing all incomes of residents in different areas - regardless of the starting income level - by the differential between the average income of the area and the Italian average), inequality in Italy would decrease (on average) by only 6.5 percentage points. In the ranking of the European Union countries with the highest inequality, Italy wouldn't improve its position, remaining at the fourth place (as explained above).

The role of geographical differentials on Italian income inequality was not significant. Income inequality, indeed, is a multifaceted and complex phenomenon. As such it is determined by different factors, which are often interrelated thereby generating a significant cumulated effect of exacerbation of disparities. Looking only at one factor, i.e. geographical disparities, is not enough to understand the phenomenon and, especially, to suggest correct policy implications.

What are the other causes? Among the other possible explanations there are the changes in the labour market. The Italian labour market underwent important reforms in the last three decades, namely the Treu package of 1997, the Biagi law of 2003, the Fornero's reform of 2012 and the Jobs Act of 2015. These institutional changes lead to the increase in the incidence of part-time work, particularly for women (Figure 5), and the growing reliance of firms on fixed-term contracts, which also serve as signals for future career progression (Figure 6).

Figure 5. Incidence of part-time work (on total employee) by gender, 2004/2023

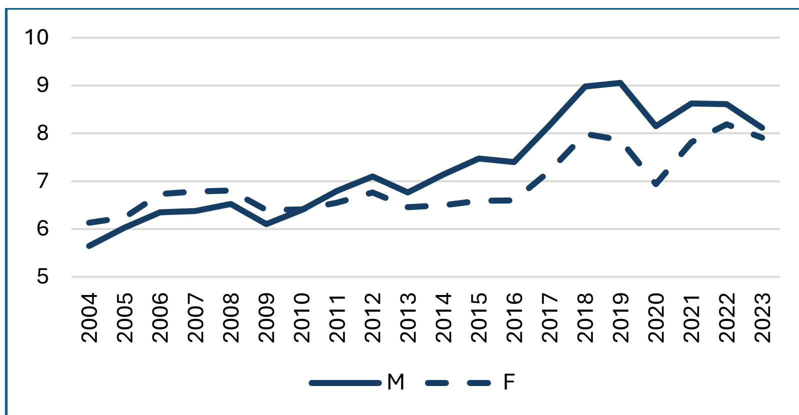


Source: Author’s calculations from i.stat data

From Figure 6, we see that there is an important and increasing gender gap in the incidence of part-time job on the overall employment. For women, the relevance of part-time jobs increased from 25% in 2004 to around 32% in 2020. For men the values ranged from around 5% to around 8.5%. These figures suggest a role of part-time job as instrument for the conciliation of paid and unpaid job for the female component of the labour force.

The incidence of temporary job (on total employment) increased for both genders with a relatively lower gender gap (compared to the one for part-time job) which reversed its sign during the period explored. In Figure 7, we note that the incidence for women increased from approximately 6% in 2004 to around 8% in 2020. For men, the use of temporary job increased from around 5.5% to around 8.5%. As a result, the use of temporary jobs was relatively higher for men at the beginning of the period, then reversed its sign after the Great Recession.

Figure 6. Incidence of temporary job (on total employee) by gender, 2004/2023



Source: Author’s calculations from i.stat data

Both these aspects, i.e. the use of part-time job and temporary contracts, are negatively associated with wage levels – reduced number of hours and carrer interruptions and consequently with income inequality (due to the relevance of labour income on total income).

All in all, the calculations suggest that income inequality in Italy is a complex and multifaceted phenomenon. The geographical differentials play a negligible role in the overall inequality. Policy makers should pay attention to disadvantaged labour market categories such as women (penalized in terms of woking hours due to the mentioned important use of part-time jobs) and working poor (defined as employed - either employee or self-employed - for over half of the year living in households at risk of poverty). Policy interventions might help increasing the quantity and quality of conciliation measures that should ease the access of women to full-time jobs, i.e. childcare, elderly care. Further, the use of temporary jobs should be limited, as they might be used as stepping stone to permanent employment positions.

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