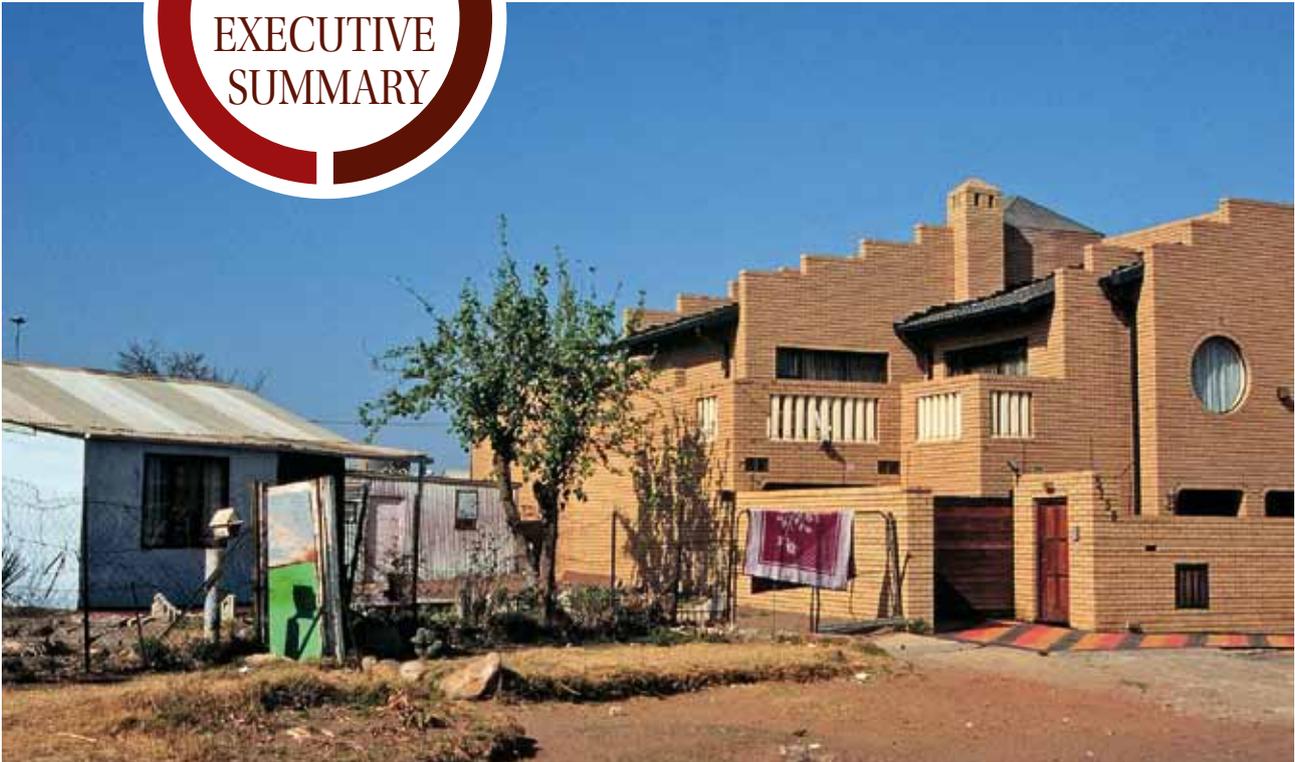




Number 15 · August 2010



## POVERTY AND INEQUALITY

### Facts, trends, and hard choices

This is an executive summary of **CDE Round Table no 15**, *Poverty and inequality: Facts, trends, and hard choices* (August 2010). The full-length publication is available from CDE, and can also be downloaded from [www.cde.org.za](http://www.cde.org.za).



**S**OUTH AFRICA is one of the most unequal societies in the world. In some ways, this is hardly surprising: for most of the past century, national policy discriminated vigorously against the majority of the country's population. In other ways, however, the level of present-day inequality is a surprise.

We have had 15 years of democracy, during which public spending has been radically reshaped. At its height, the apartheid state spent nine times more on each white person as it did on each black person; today, the state spends twice as much per capita on blacks as on whites. Add to that our aggressive programmes of affirmative action, the billions spent on black economic empowerment and the sheer weight of voter expectations, and it is remarkable that levels of inequality are no better than they were in the early 1990s, and may even have worsened.

What should we make of the stubborn persistence of inequality in our society, and what does it mean for public policy? How much of our anxiety about inequality is really a concern about the slow pace at which the economy has absorbed the unemployed? Should we be more concerned about the millions of people living in poverty, and the high levels of economic growth needed to deal with this, rather than trying to ensure that incomes are more equally distributed?

To explore these questions, CDE convened a Round Table in March 2010 at which some of South Africa's leading experts, together with Prof Paul Romer of Stanford University, wrestled with the politics and economics of inequality.

Thinking about policy options demands clarity about the underlying issues, which can be framed as a series of questions that informed the Round Table. These include:

- Is it fruitful to regard inequality as a priority, or should we focus instead on reducing poverty irrespective of its immediate impact on inequality?
- Are the roots of inequality in South Africa properly understood, and are they amenable to being changed more rapidly?
- Have existing policies helped or hindered the reduction of inequality and/or poverty on the required scale?

It is worth highlighting some of the major debates at the outset. Throughout, the discussion was marked by a tension between the need to focus on inequality as opposed to focusing on mass poverty and unemployment, as the best way of improving the quality of people's lives. Some participants argued that addressing South Africa's high levels of inequality might be a precondition for achieving higher levels of economic growth. Others argued that the country ought to focus on the many people living in poverty, and pay less attention to how income is distributed. Some asserted that inequality might lead to political instability and social conflict; others suggested that high levels of unemployment were so corrosive that job-intensive economic growth should be the overriding priority.



Apart from these substantive questions, some participants argued that the language of inequality, especially when reduced to the Gini coefficient, was inherently loaded, and tended to imply that policies that did not reduce income inequality had to be rejected, irrespective of their impact on other goals, including poverty alleviation. On the other hand, framing the debate on the basis of whether policies and institutions included or excluded people meant that more policy options might be available for consideration. Others pointed out that issues of affordability and longer-term sustainability were vital to the discussion.

## KEY INSIGHTS FROM THE ROUND TABLE

What should be done about South Africa's deep and persistent inequality? Perhaps we first need to ask: 'What can be done about it?'

The first thing to recognise is the scale of the challenge. In 2008, the average income of the richest 10 per cent of households was nearly 40 times greater than the average income of the poorest 50 per cent. More dramatically still, the average income of the richest 10 per cent of households was nearly 150 times greater than that of households in the poorest 10 per cent.<sup>1</sup>

Estimates of income are seldom exact, but the scale of these differences is incontestable. What is clear is that, while there has been some modest progress for the very poorest, much of this can be ascribed to the introduction of social grants provided by the state rather than increased employment. The number of people receiving these grants has increased dramatically – from 2,5 million in 1999 to 14 million in 2009.<sup>2</sup> To the extent that these policies have assisted poor individuals and families, they are a significant achievement. However, even as the welfare net continues to expand, many people in government and outside it now believe that this approach has reached or exceeded the limits of affordability.

For those who see the narrowing of levels of inequality as the key indicator of progress, these are disturbing conclusions, made more so by some of the insights gained from the Round Table.

### **The depth of poverty in South Africa is a major challenge.**

Poverty blights the lives of millions of South Africans. It represents a daunting challenge, but we have done too little to address it over the past 15 years.

### **Poverty cannot be reduced without high and sustained rates of economic growth.**

The empirical evidence – demonstrated in one developing country after another – is clear: high rates of economic growth are essential for raising large numbers of people out of poverty. Faster economic growth is the only sustainable means of generating large numbers of new jobs in a short period. It also generates the resources that smart states can use to improve key public services such as schooling, policing, public transport, as well as improved urban and rural infrastructure.

**Inequality in South Africa cannot be ignored.**

South Africa's high levels of inequality are a consequence of apartheid. They persist despite immense efforts by post-apartheid governments to widen the welfare net and redistribute benefits, rewards and opportunities. Over the past 15 years, public spending aimed at reducing poverty – including numerous subsidies to poorer communities and individuals – has increased dramatically, while new laws and regulations seek to shape outcomes normally left to market mechanisms. And yet, all these efforts have done little to reduce inequality, which may even have increased.

**Reducing poverty and dealing with inequality are not the same thing.**

A tension sometimes exists between steps needed to lift people out of poverty as rapidly as possible and those that might reduce inequality. International experience suggests that rapid economic growth can actually increase inequality in the short term, even when it creates jobs. However, it can also rapidly lift huge numbers of people out of poverty. By contrast, attempts to address income inequality through public spending often impact negatively on rates of growth in both the short and long term.

If redistributive spending diverts and reduces public and private expenditure on the physical, institutional and other infrastructure essential for higher growth, the rate of growth will be lower than it could be. As a result, mass poverty may be alleviated more slowly, if at all. It is not always possible, in other words, to reduce large-scale poverty while using public and private resources for redistribution aimed at inequality.

**The South African state is already highly redistributive, more so than most developing countries.**

More than a quarter of the country's residents receive social grants. Put this together with high levels of public spending on education, health care, housing, etc., and South Africa may well have built the most redistributive state in the developing world. Despite this, we remain one of the world's most unequal societies. How much further can redistributive policies be pushed?

**States are often not very good at redistributing income.**

One reason why South Africa's policies have not addressed inequality more effectively is that public spending is often profoundly inefficient. This usually impacts most on the poor, who are most dependent on effective public services, and for whom the inefficiencies of the state can have life-threatening implications.

Besides this, international experience has shown that state-driven redistribution programmes have an important unintended consequence: the creation of a culture of dependency. This is why many governments now introduce term limits to grants, or attach conditions for their continuation.

**Too many current policies have actually deepened inequality.**

South Africa's current growth path seeks to generate high-productivity, high-wage jobs, which raise the returns for those with education and skills while excluding those without them. The effect of this has been compounded by wage settlements, especially in the public sector, which have widened the gap between the employed and the unemployed, while also reducing the resources available to the state to deliver services to the poor. BEE, too, has helped to widen inequality among black South Africans. Many current policies help to ensure that the black share of income has risen more at the top end of the scale than lower down.

Unless there is a plausible route for individuals to move from poverty to higher levels of income based on their own efforts and achievements, it is difficult to see how poorer South Africans can feel that they have a chance at a better life.

**If we are to reduce poverty and inequality, we have to improve education and training systems.**

Most income inequality can be explained by the unequal distribution of human capital. Addressing this will require multiple interventions. Most importantly, we need to improve dramatically the performance of the vast majority of schools serving poorer South Africans, whose systemic failure is trapping poorer children in a life of poverty. Getting our schools right is a precondition for improving intergenerational mobility; only this can generate the skills, aptitudes and attitudes needed for advancement up the income scale.

We also need to improve our training systems, including effective vocational training for those in school and those who have left school. Further education and training needs to be dramatically improved, and private sector training expanded. These are vital rungs on the ladder of opportunity.

**Improving the education system will not reduce inequality in the short term.**

Important as it is, improving the education system will not significantly change the distribution of income in the short term. There are two reasons for this. First, educational outcomes are strongly influenced by factors outside the classroom, making it harder for children from poor or disorganised communities to acquire a good education. Second, even if successfully implemented, educational reform will take time to impact meaningfully on the structure of skills in the labour market, and even longer to impact on levels of inequality. The reason for this is obvious: new entrants into the labour market are only a tiny fraction of the labour force, so it takes time for the impact of better education to be felt throughout the working population. While their improved education will prepare younger workers for better-paying jobs, it will do nothing for the millions whose education has been compromised.

**Higher and more job-intensive growth is South Africa's best strategy for dealing with poverty.**

If the economy were to grow more rapidly, it would generate many more jobs. The benefits of a job – almost any formal job – are often not sufficiently appreciated.

One of the consequences of long-term unemployment is the declining employability of those who are without work for long periods. This is because the unemployed lose the skills and aptitudes needed for work. Given the weaknesses of our school system, this means that many of those whose education was compromised have seen their employability decay further because they have not found gainful employment in which to learn these skills.

It may seem paradoxical, but it is precisely because the education system is so weak that the only feasible way of increasing the employability of the unemployed is to maximise the number of people who actually get jobs. Pursuing policies that generate job-intensive growth can create powerful self-reinforcing processes as people in jobs acquire the skills and aptitudes that workplace experience can deliver, making them more productive and more employable. This is the only sustainable process that can lift large numbers of poor people out of poverty. Dramatically increased employment – and all that flows from this – is the essence of broad-based empowerment.

**CONCLUDING REMARKS**

South Africa faces a difficult choice. We could choose to renew and redouble existing redistributive policies, with the state seeking to provide more income support to the poor through increased welfare spending, enlarged public works programmes, and more spending on the 'social wage'. Properly implemented, this would make a marginal difference to poverty and income inequality. Poorly implemented, the additional spending will simply be captured by the non-poor – 'tenderpreneurs', civil servants, and others.

Whatever the quality of implementation, this approach will be problematic. The first and most obvious challenge is that of affordability: even before the recent recession, there was a widening consensus that public spending was becoming unsustainable. While there is scope to improve the mix and efficiency of state spending, we may have exhausted the inequality-reducing potential of our present trajectory.

Increased spending on redistributive policies will also have adverse effects on our growth potential. Every rand spent on transfers is a rand not spent on fixing schools, building roads and ports, and creating more efficient cities and towns. Moreover, some redistributive spending will deepen costly forms of dependency, and further restrict economic growth.

This approach will also place the state in an ever deepening trap. As growth fails, pressures will mount to expand redistribution even further – increasing the value of each individual grant; widening eligibility for such grants; increasing the number of no-fee schools; subsidising the rising costs of electricity, housing, water, and so on. The only way to pay for all this will be to raise already high taxes, which will hamper our growth prospects.



The current redistributive model is unsustainable. Instead, we should learn from the impressive performance of many countries in the developing world, and focus as single-mindedly as possible on adopting and implementing policies that will maximise sustained economic growth.

'Going for growth' will pay off in the form of far higher levels of national income, much higher employment rates, and the consequent lifting of millions of people out of poverty. Higher levels of economic growth will necessarily entail faster expansion of formal employment, with more and more people being drawn into the formal wage economy. Instead of seeing their human capital corrode through unemployment, millions will obtain real workplace experience, on-the-job training, and the psychological and cultural attributes needed to become more employable. Such a strategy would also create a sense of participation and inclusion in our society that no amount of redistributive spending could hope to achieve.

There is something to the argument that South Africa's high levels of inequality are potentially destabilising and create fertile ground for populist politics. Given the country's past, and the racialised character of inequality, these dangers are clear and present. However, we need to think carefully about *how* inequality is transformed into political discontent and possible instability. This can occur, in part, through political mobilisation and rhetoric. So, to the extent that inequality has the potential to destabilise South Africa, we need to recognise the importance of how politicians engage with, and help define, the issues of inequality and its persistence.

Politicians' rhetoric works more successfully if people are dissatisfied with the status quo, and many clearly are. However, the source of this discontent cannot be assumed to be high levels of income inequality. Many people are discontented because they feel excluded from the main currents of economic and social life, and locked out of the world of opportunity. This perception and the associated resentment is exacerbated by growing evidence of corruption – with well-connected people often getting the high-paying jobs and most lucrative opportunities, with employment, services and benefits often being allocated on the basis of who you know rather than how you perform.

It may be, in other words, that it is not the Gini coefficient or the underlying distribution of income that leads to discontent. It is rather the pervasive sense that the unemployed have become 'outsiders', that they are locked out of the economy. It may be wrong, then, to equate high levels of inequality with high levels of frustration and discontent, and it may be better to see high levels of unemployment and lack of opportunity as the core source of potential political instability.

In this light, a vital lesson can be learnt from Brazil, our long-time rival for the title of the world's most unequal society. In that country, rapid economic growth, combined with a modest extension of welfare spending, has dramatically reduced poverty – from nearly 30 per cent of the population in the late 1990s to about 16 per cent today – combined with a fall in inequality.<sup>3</sup> The jury is still out on the precision of some of these numbers, but what is abundantly clear from this experience is that rapid increases in the number of people with jobs greatly lightens pressures on politicians to do something about inequality.



Rapid economic growth has a proven capacity to address large-scale poverty and, in time, inequality. It is the only sustainable approach available, and the only approach that will empower millions of South Africans.

In the short and medium term, redistribution cannot do what finding a job can. It can marginally ameliorate the worst poverty, but it cannot create the sense of self-worth resulting from full participation in a society.

South Africa needs to create a more inclusive and larger economy as quickly as possible. Doing that demands high and sustained economic growth, and a massive increase in the number of formal sector jobs.

## ENDNOTES

1. Derived from data in M Leibbrandt et al, Trends in South African income distribution and poverty since the fall of apartheid, OECD Social, Employment and Migration Working Paper No 101, 2010.
2. SASSA, Statistical report on social grants, Report no 26, January 2010, Pretoria, p8.
3. Marcelo Cortes Neri, Consumers, producers and the new middle class: Poverty, inequality and the determinants of class in Brazil, Fundação Gertulio Vargas, 2009, available at [http://www.fgv.br/ibrecps/cpc/index\\_eng.htm](http://www.fgv.br/ibrecps/cpc/index_eng.htm).

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The Round Table and this publication were funded by the  
Open Society Foundation for South Africa. The funders do not  
necessarily agree with the views expressed in this report.