Inequality in South Africa

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South Africa is one of the most unequal countries in the world. It is often said to be the most unequal, but that is incorrect. A number of countries, for example Namibia and Seychelles, have higher gini coefficients (the measure most often used to measure income distribution) than does South Africa[1]. There are a number of other countries that are clearly very unequal – some major oil producers for example – but, for obvious reasons, choose not to measure the extent of their inequality.

It should be noted that published gini coefficients measure distribution of income not distribution of wealth. This is because household wealth is notoriously difficult to measure. Other than the value of property, and possibly share ownership on the stock market, it is hard to know how wealthy individuals are. Even property and shares may be held in trusts that are not easily linked to individuals. Prices of assets, including shares, may fluctuate considerably and the values of, say, paintings or jewellery cannot be determined until they are sold.

Wealth is also not the same as income. There are many examples of wealthy individuals living in homes that have over time appreciated hugely in value, but whose incomes are dramatically lower than their wealth suggests. Many individuals with high incomes consume all they earn and may even borrow heavily to support lavish lifestyles. Their wealth may actually be very low. Despite these problems, many commentators switch between talking about income and wealth inequality as if the two terms are synonymous. The importance of distinguishing between the two will become obvious later.

Inequality Matters

Why does inequality matter? For decades following the work of Kuznets[2] many economists argued that inequality was an inevitable part of economic development. Kuznets argued that in developing countries economic growth initially leads to increasing levels of inequality. Rich people save more than poor, so inequality aids the process of capital accumulation in poor countries. But as economies develop, larger portions of their populations move from agriculture into other sectors of the economy and their skills bases expand. Therefore a point is reached where inequality falls. Rich countries, according to Kuznets, should be more equal than poor countries.

In the 1960s and 1970s this observation was supported by the empirical evidence. But more recently inequality has clearly been increasing in developed countries. A number of developing countries, such as Brazil and indeed most of Latin America, have substantially reduced their levels of inequality. Processes other than those identified by Kuznets have clearly been at work.

There are also clear moral and political reasons why inequality is bad. The Financial Times' Martin Wolf notes that rising inequality is "incompatible with true equality as citizens"[3] which is a central tenet of democracy. A 2012 World Bank report on South Africa[4] traced the differences in life opportunities for South African children and unsurprisingly found large differences based on race, gender, location and household income. It notes:

> "An equitable society would not allow circumstances over which the individual has no control to influence her or his basic opportunities after birth. Whether a person is born a boy or a girl, black or white, in a township or leafy suburb, to an educated and well-off parent or otherwise should not be relevant to reaching his or her full potential: ideally, only the person's effort, innate talent, choices in life, and, to an extent, sheer luck, would be the influencing forces. This is at the core of the equality of opportunity principle, which provides a powerful platform for the formulation of social and economic policy—one of the rare policy goals on which a political consensus is easier to achieve." [5]

Such differences of opportunity are morally reprehensible. Also, by preventing an economy's best talent from expressing their true potential, economic and social development are retarded.

A further reason why inequality is bad, especially when the inequality is easily identifiable along racial lines as in South Africa, is that it enables politicians to dodge difficult economic questions and promote seemingly simple solutions to what are very complex problems. Poverty, lack of job creation, lack of public service delivery can all be blamed on inequality rather than policy or political failure. If inequality is the cause of all problems, then the solution to all problems must be to take from the rich and give to the poor. It can then be argued that it is the selfish unwillingness of the rich to share what they have gained at the expense of the poor that holds back economic salvation.

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Chang *et al* [6] have shown that nationalisation of mines occurs most often in economies that are unequal. In South Africa the former President of the ANC Youth league, for example, was able to promise university students that all education in SA would be free if the mines were nationalised,[7] even though the arithmetic shows that this clearly would not be possible. So high levels of inequality mean that necessary, but difficult, policy decisions are avoided. Economic performance and welfare suffer as a consequence.

The focus on inequality received new impetus with the onset of the global financial crisis in 2007/08. Exposure of the enormous bonuses and salaries earned by the financiers whose excessive risk taking had plunged the developed world into crisis provoked public outrage. This was compounded when the costs of rescuing the financial system from implosion were absorbed by taxpayers, but the risk takers who had caused the problem almost immediately started earning large bonuses again. Organisations such as the "Occupy Movement" enjoyed widespread sympathy in this environment.

Capital in the twenty first century

Against this backdrop, the publication of the book "Capital in the Twenty-First Century" by French economist Thomas Piketty[8] earlier this year enjoyed instant acclaim. Piketty has been described by some commentators as enjoying "rock star status" in the capitals of the West, including Washington. Former US Treasury

Secretary Larry Summers has described his work as having "transformed the discourse and is a Nobel Prize-worthy contribution"[9].

In a complete reversal of the arguments of Kuznets, Piketty argues that inequality is the inevitable outcome of capitalism. He argues that periods of falling inequality – as in Western Europe in the 1950s and 1960s – are aberrations caused by particularly aggressive policy (steeply progressive income tax and the welfare state). Falling inequality over this period, he argues, was also caused by the massive destruction of the inherited property of the wealthy during World Wars 1 and 2. Central to Piketty's thesis is that the returns on capital always exceed economic growth. Thus the earnings of the owners of capital (the rich) always grow faster than the earnings of labour (the poor). The rich save enough of their earnings to ensure that their stock of capital always grows at least as fast as the economy and so inequality widens.

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To combat widening inequality Piketty calls for much higher marginal income tax rates for the wealthy and for a global wealth tax. The wealth tax is needed because in Piketty's view wealth is the source of income inequality. Without taxing wealth, inequality cannot be reduced because of the ability of the wealthy to hide their true income. The tax must be global because wealth is highly mobile and the wealthy will move it to more favourable tax regimes should individual countries seek to tackle the sources of inequality on their own.

Herein lies a critical weakness in Piketty's remedy. Because wealth is highly mobile it is clearly in an individual county's interest to break ranks and not impose a wealth tax. This country will benefit from inflows of wealth and of the wealthy who are typically high mobile, but at the expense of those countries seeking to reduce their inequalities of wealth.

Larry Summers points to a more fundamental concern with Piketty's analysis. Noting that after Piketty's work on rising inequality "there can never again be a question about the phenomenon or its pervasiveness"[10], he argues that Piketty's central belief that the return on capital always exceeds over time the rate of growth in the economy is supported neither by economic theory nor by the large bulk of empirical research. Once capital depreciation is taken into account, Summers warns that he knows of no study that supports Piketty's claim that the return on capital exceeds growth of the economy. But he knows of "quite a few suggesting the contrary".[11]

Summers also questions Piketty's claim that the rich always save and reinvest a substantial proportion of the income they receive from their wealth. He notes, for example, that the Forbes list of the 400 wealthiest Americans in 1982 and 2012 found that less than one tenth of those on the list in 1982 were still there in 2012. Instead of growing their wealth, as Piketty claims, Summers notes that "they did not, given pressures to spend, donate, or misinvest their wealth" [12].

If Piketty is wrong about the causes of the growing inequality which he has so clearly identified, what then is the true cause? Summers confesses that "no one really knows"[13]. Summers warns, however, against the assumption that the obscene bonuses generated, for example, in the financial services industry must be unrelated to productivity. Technology and globalisation have made it possible for innovators to operate on a global stage, generating previously unthinkable returns as a result. This has benefited the top "1%". Globalisation has moved low-skilled jobs to developing countries such as China where wages are much lower. He warns that technology and automation are likely to work increasingly against those performing relatively low-skilled repetitive tasks such as in manufacturing. In this regard he warns that "the trends are all in the wrong direction, particularly for the less skilled as the capacity of capital embodying artificial intelligence to replace white-collar and as blue-collar work will increase rapidly in the years ahead"[14].

What are the implications of this analysis for South Africa?

The first point to note is that just as Piketty turned Kuznets' analysis on its head by showing that inequality is growing in developed countries, so it has also been challenged by the narrowing of inequality in many developing countries where previously it was greatest. 20 years ago most Latin American countries rivalled South Africa's high inequality. While inequality remains very high it has narrowed virtually across Latin America over the past decade. Social transfers and higher minimum wages have helped increase the income of the poorest. Probably the most important cause of reduced inequality in Latin America was rising employment.

In South Africa, by contrast, income inequality has hardly changed despite the introduction of social transfers that now reach 16 million poor South Africans. Inequality remains high partly because the number of jobs created over the past 20 years barely kept pace with growth in the labour force. As a result, unemployment remains between 25% and 35% depending on whether one counts as being unemployed discouraged workers who have given up looking for a job. Our transfers system provides only for children from poor households, the elderly and the disabled. No provision is made for the unemployed. As a result, inequality in South Africa is so high both because of high wage inequalities within the workplace as well as the wide gap between those who are employed and those who are unemployed.

The impact of the possible higher taxes on the rich on government's ability to expand the existing grants system is therefore negligible.

What if social transfers were raised to improve income distribution and taxes on the rich were raised for this purpose? An analysis of who pays tax reveals that even much more punitive marginal tax rates on the rich make little difference to government's ability to spend on transfers. Tax collection statistics[15] show that in 2010 only 2.3% of South African taxpayers earned more than R750 000 per annum. These 100 312 taxpayers earned 17.8% of taxable income and paid 30.3% of personal tax. Their average rate of tax paid was 35.2%. To estimate the impact of raising this rate of tax, two sets of calculations were made in which this average rate is raised by raising tax rates across the highest income brackets. If the average rate of tax for those earning more than R750 000 in 2010 rises to 41% this brings in only an additional R8.1 billion in income tax – or 1.4% of total tax revenue. A more dramatic rise in tax rates so the average tax rate for those earning above R750 000 rises to 46% raises an additional R16.0 billion - just 2.7% of total taxes. R84.8 billion was spent on existing social grants in 2010. The impact of the possible higher taxes on the rich on government's ability to expand the existing grants system is therefore negligible.

A recent study by Statistics South Africa[17] shows that 76% of the 6.2 million jobs created in South Africa between 1994 and 2004 were skilled or semi-skilled. 2 million skilled jobs were created over this period compared with just 1.4 million low-skilled jobs.

If social grants cannot be extended to the unemployed by taxing the rich, the answer to inequality in South Africa then appears to be to generate millions of jobs, no matter how low paying they might be, so that the 8 million people currently unemployed can start earning at least some income. Such a strategy would reduce poverty, but work by van der Berg[16] shows that its impact on income inequality would actually be quite modest. This is because of the high degree of income inequality within the workplace. The largest cause of income inequality in South Africa lies within the workplace. Thus, even if all those currently unemployed earn the current incomes of low-skilled workers, overall income inequality in South Africa will fall only modestly and will still be very high by global standards. The unemployed need to move also into higher wage jobs for the impact on reducing inequality to be substantial.

This need is borne out also by the current realities of the South African labour market. A recent study by Statistics South Africa[17] shows that 76% of the 6.2 million jobs created in South Africa between 1994 and 2004 were skilled or semi-skilled. 2 million skilled jobs were created over this period compared with just 1.4 million low-skilled jobs. South Africa needs to grow faster and generate many more jobs, but without significant structural changes in the economy a high proportion of these will be skilled and semi-skilled jobs. To fill these positions the unemployed and new entrants into the labour force require the necessary skills. Such skills are sadly lacking as a result of South Africa's poorly functioning education system.

Fixing South Africa's education system, van der Berg[18] argues, is therefore necessary to reduce unemployment and inequality in South Africa. The unemployed will gain access to semi-skilled and skilled jobs only if they are better educated. At the same time, an increased pool of educated workers will reduce the premia paid to the educated who are currently in short supply. Both poverty and inequality will fall as a result. Van der Berg concludes:

> "Job creation, though crucial for poverty reduction, will also do little to reduce overall inequality. The weak endowments of those currently unemployed would not assure them of high labour market earning. Thus even if they were employed, it would probably be at low wages, thus leaving wage and hence aggregate inequality high and little affected. Thus the labour market is at the heart of inequality, and central to labour market inequality is the quality of education. To reduce income inequality substantially requires a different wage pattern based on better human capital for the bulk of the population"[19].

The report by Statistics South Africa[20] shows that qualitative changes are required to education attainments as much as quantitative changes. 42% of South African workers with less than a matric qualification are unemployed, but unemployment remains as high as 34% for those with a matric. For those with a matric and some tertiary qualification unemployment is 14%. Unemployment of university graduates is just 5.2%. More matric and tertiary qualifications are needed, but the quality of these passes must improve substantially to provide access to better paid jobs.

Conclusion

There are no quick and easy solutions to South Africa's inequality problem. Without substantive improvements in the human capital of the poor income inequality will remain unacceptably wide. Fixing the education system lies beyond the scope of this article or the competencies of this author. Much is made of the fact that South Africa already allocates a high share of resources to education relative to other developing countries. Given the backlogs and wide disparities in our society inherited from apartheid possibly even greater resources are needed. But even increased resources will help only if they are well used. This will happen only with far greater political will and focus than is currently apparent.

NOTES
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4 World Bank, 2012. South Africa Economic Update: Focus on Inequality of Opportunity. World Bank, Washington DC.
5 Ibid. p. xii.
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10 Ibid. p.95-96.
11 Ibid. p.94.
12 Ibid. p.96.
13 Ibid. p. 96
14 Ibid. p.97
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19 Ibid. p.19.
20 op. cit,