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Carolyn Jenkins and Lynne Thomas
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**ABSTRACT**

The dispersion of racial incomes in South Africa has been declining since the mid 1970s. This has been accompanied by rising within-group inequality, especially amongst blacks, driven by growing unemployment. Consequently, there has been little improvement in aggregate indicators of inequality. In this study, it is argued that labour market changes resulting from the breakdown of apartheid in the workplace dominated shifts in the distribution of income during the 1970s and 1980s. Subsequently, the effects of liberalization have been more influential. Since the political transition in 1994, South Africa's government has sought to address the legacy of extreme racial income disparities within the framework of a broadly conservative macroeconomic strategy designed to stimulate private investment. However, economic growth has, to date, been insufficient to reverse declining formal-sector employment. Slow reform is likely to be more sustainable, but this means that inequality will probably remain a defining feature of South Africa for many years.

# I INTRODUCTION

Addressing a legacy of extreme racial inequality is one of the chief objectives of South Africa's current government. During the 1960s legal and administrative restrictions on black labour produced increasing racial inequalities of income; by 1970 the per capita income of whites was 15 times higher than that of blacks.[1] During the 24 years from 1970 to the change of government in 1994, racial disparities in income actually declined as apartheid was eroded in the workplace, although falling inequality between races—achieved primarily by a redistribution from whites to blacks—was accompanied by rising inequality within race groups. When government was transferred to the majority, deprivation remained characteristic of most black households.

Since the political transition in 1994, policies to address South Africa's inequalities have been pursued. These were set out in the Reconstruction and Development Programme and a variety of legislative initiatives. However, the government's ability to address social problems has been constrained by its commitment both to implement strict fiscal policies and to pursue structural economic reforms (which inevitably have short-term social costs). The underlying theme of economic policy documents like Growth Employment and Redistribution (GEAR) of 1996 (RSA, 1996) reflects a view—strongly influenced by neoclassical orthodoxy—that South Africa will be able to overcome permanently the economic legacies of apartheid only through long-term economic growth. What is unclear is whether the growth generated will be sufficient to address inequality—or even begin to make a difference in the medium term—or whether there are aspects of inequality which require more direct policy responses.

This study reviews the evolution of inequality in South Africa (Section 2) and draws together the findings of other authors to highlight the primary sources of changes in the nature of inequality (Section 3). The evolution of economic policy and performance is then assessed (Section 4), drawing a distinction between the apartheid years and the post-1994 period. The paper then considers the post-transition policy framework in more detail. Policies targeted at the structural causes of poverty are discussed briefly in Section 5. Section 6 focuses on the likely impact of the macroeconomic policy framework on the income distribution (unfortunately, data are not yet available to assess the redistributional impact of post-1994 policy in terms of standard measures of

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[1] The racial classification used in this study is in accordance with South African definitions: Asians, blacks (indigenous people), coloureds (mixed race people), and whites.

inequality). It is argued that changes in labour markets resulting from the breakdown of apartheid in the workplace dominated the observed shifts in the distribution of income during the 1970s and 1980s. However, there is evidence that the shift towards neo-liberal orthodoxy is increasingly affecting the income distribution.

## II THE EVOLUTION OF INEQUALITY IN SOUTH AFRICA

### 2.1 The context: South Africa in comparative perspective

Early studies of income inequality found that South Africa had the most unequal distribution of income in the world amongst countries where comparable information was available (McGrath, 1983; Simkins, 1979). South Africa still ranks amongst countries with the most skewed distribution, as is evident from Table 1.

Table 1 presents 1995 per capita GDP, Gini coefficients and the human development index[2] for a selection of developing countries. The choice of comparator countries is determined largely by the availability of (reasonably) recent Gini coefficients. In terms of GDP per capita and 'human development', South Africa compares with Ecuador, Romania, Indonesia, and Peru. However, Gini coefficients show that inequality in South Africa is more typical of highly unequal societies, like Chile and Brazil (where per capita income is considerably higher) or Zimbabwe, which has a similar colonial heritage (but is considerably poorer).

Although South Africa's per capita income is sufficiently high for it to be rated 'upper middle-income' by the World Bank, inequality in the distribution of personal income, compounded by historical underinvestment in human capital (health and education) for the majority of the population, means that poverty is widespread.

### 2.2 Trends in the distribution of income and poverty in South Africa

Up until 1970 job reservation for whites ensured their protected employment at high wages and the crowding of the rest of the population into low-skilled, low-paid jobs. The disparity between white and non-white, especially black, wages

[2] The human development index is a measure of social development calculated by the UNDP and is based on indicators of GDP per capita, life expectancy and literacy and school enrolment rates.

widened considerably, and by 1970 the per capita income of whites was 15 times higher than that of blacks (Whiteford and McGrath, 1999: 1). Monopsonistic employment practices in mining meant that black wages did not rise in nominal terms for about 50 years; black wages in agriculture were also stagnant (Lipton, 1985: 44, 388). Some real growth did occur in manufacturing wages, as higher skills are required (Lundahl, Fredriksson and Moritz, 1992: 299), although blacks tended to occupy lower skilled positions.

TABLE 1
INTERNATIONAL INDICATORS OF INEQUALITY

| | GDP per head (PPP, 1995 $) | Gini coefficient* | Human development index (1995) |
|---|---|---|---|
| Chile | 9,930 | 56.5 | 0.893 |
| Thailand | 7,742 | 46.2 | 0.838 |
| Brazil | 5,928 | 60.1 | 0.809 |
| Ecuador | 4,602 | 46.6 | 0.767 |
| Romania | 4,431 | 28.2 | 0.767 |
| South Africa | 4,334 | 59.3 | 0.717 |
| Indonesia | 3,971 | 36.5 | 0.679 |
| Peru | 3,940 | 46.2 | 0.729 |
| Philippines | 2,762 | 42.9 | 0.677 |
| Zimbabwe | 2,135 | 56.8 | 0.507 |
| Zambia | 986 | 49.8 | 0.378 |
| Tanzania | 636 | 38.2 | 0.358 |

Note: * based on survey data from various years: Chile, 1994; Thailand, 1992; Brazil, 1995; Ecuador, 1994; Romania, 1994; South Africa, 1993-94; Peru, 1996; Indonesia, 1996; Philippines, 1994; Zimbabwe, 1990; Zambia, 1996; and Tanzania, 1993. Care must be taken in comparing these indicators as surveys may differ in context and coverage.
Sources: UNDP (1998), World Bank (1999a).

After 1970 there was a redistribution of income from whites to blacks. The share of total income accruing to whites (13 per cent of the population in 1991) fell from 71 per cent in 1970 to 61 per cent in 1991, while that of blacks (about 75 per cent of the population in 1991) rose from 20 per cent to 28 per cent over the same period. The remainder went to groups classified as coloureds and Asians. However, for each race group the share of total income accruing to the lowest 40 per cent declined in the two decades to 1991, while the share of the top 10 per cent increased. This was most dramatic for blacks: the share in black household income of the poorest 40 per cent of black households decreased from 12 per cent to 6 per cent, while that of the richest 10 per cent increased from 32 per cent to 47 per cent.

Measures of inequality bear this out. Using census data,[3] Whiteford and McGrath (1999: 13) show that the Gini coefficient for household income of the whole population did not change significantly between 1975 and 1991.[4] However, racial Gini coefficients all increased (Table 2).

TABLE 2
GINI COEFFICIENTS: HOUSEHOLD INCOME BY RACE, 1975 AND 1991; 1990 AND 1995

| | Whiteford and McGrath | | Hirschowitz (12 main urban areas) | |
|---|---|---|---|---|
| | 1975 | 1991 | 1990 | 1995 |
| Asian | 0.45 | 0.49 | 0.29 | 0.46 |
| Black | 0.47 | 0.62 | 0.35 | 0.51 |
| Coloured | 0.51 | 0.52 | 0.37 | 0.42 |
| White | 0.36 | 0.46 | 0.50 | 0.44 |
| Overall | 0.68 | 0.68 | 0.63 | 0.55 |

Sources: Whiteford and McGrath (1999); Hirschowitz (1997).

Data computed by Hirschowitz (1997) for the 12 main urban areas also show rising inequality for all racial groups, except for whites, and declining overall urban inequality. These coefficients, based on the same definitions of income and the same recipient units, show very strong increases in inequality, especially amongst black households. It therefore appears that within-group inequality rose.

It is not possible to be certain about what happened to overall inequality over this period. Table 3 records calculations of Gini coefficients from a range of different sources.

It is not at first clear from these figures whether there is a trend in overall inequality, although comparing like with like allows several observations to be made. The first is that measures of inequality of formal incomes, which tend to be higher than those which take into account all income sources, fell in the 1970s. The second is that calculations made by the same authors (and therefore using the same definitions of income and recipient) tend to indicate a marginal fall in overall inequality in the 1970s and 1980s. The third is that inequality in

3 These data probably overstate the extent of inequality, as it is likely that household incomes, especially among poor households, are underestimated by census enumerators. However, there is no other source which provides information on economy-wide income distribution over time. Alternative, one-off, sources, especially the Living Standards and Development Survey (LSDS) of 1993, tend to yield lower estimates of both inequality and poverty.

4 The Gini coefficient calculated on a per capita basis was even higher, at 0.71.

total income accruing to urban households appears to have fallen in the first half of the 1990s (although urban inequality is generally less than overall inequality). Together these indicators point to some decline in overall inequality, although the change may be small.

TABLE 3
SOUTH AFRICAN GINI COEFFICIENTS FOR DIFFERENT YEARS, 1959-95

| | Gini | Income definition | Recipient | Source |
|---|---|---|---|---|
| 1959 | 0.52 | income | person | Cromwell (1977) |
| 1960 | 0.55 | income | person | Lachman and Bercuson (1992) |
| 1965 | 0.58 | income | person | Jain (1975) |
| 1965 | 0.56 | income | person | Lachman and Bercuson (1992) |
| 1965 | 0.56 | income | person | Lecaillon (1984) |
| 1965 | 0.58 | income | person | Paukert (1973) |
| 1970 | 0.53 | income | person | Lachman and Bercuson (1992) |
| 1970 | 0.71 | income (formal) | person | Simkins (1979) |
| 1975 | 0.49 | income | person | Lachman and Bercuson (1992) |
| 1975 | 0.68 | income | household | McGrath (1983) |
| 1976 | 0.65 | income (formal) | person | Simkins (1979) |
| 1980 | 0.50 | income | person | Lachman and Bercuson (1992) |
| 1980 | 0.57 | income (formal) | person | Devereaux (1984) |
| 1985 | 0.51 | income | person | Lachman and Bercuson (1992) |
| 1987 | 0.48 | income | person | Lachman and Bercuson (1992) |
| 1990 | 0.63 | income | urban household | Hirschowitz (1997) |
| 1991 | 0.68 | income | household | Whiteford and McGrath (1999) |
| 1993 | 0.62 | income | household | World Bank (1996) |
| 1993 | 0.58 | expenditure | person | World Bank (1999b) |
| 1995 | 0.55 | income | urban household | Hirschowitz (1997) |
| 1995 | 0.59 | income | household | Hirschowitz (1997) |

Source: see last column.

An alternative inequality index provides further support for the argument that within-group inequality rose, while overall inequality did not change significantly. The Theil entropy index[5] has an advantage over the Gini coefficient in that it can be additively broken down by subgroup. The advantage of using group-decomposable inequality measures is that inequality between groups, as well as within groups, can be compared. Theil indices calculated by Whiteford and McGrath for 1975 and 1991 are recorded in Table 4. They show that inequality within both black and white population groups rose during the 1970s and 1980s. The increased disparity in the black group is

[5] The Theil index defines inequality as the distribution of income per individual (or adult equivalent) over households: $T = (Y_i / Y) \ln (NY_i / Y)$, where i = 1, ..., N; $Y_i / Y$ is the share of the ith person in total income, and N is the total sample population. The index is equal to zero where perfect equality obtains.

particularly high. The within-group component is now the primary contributor to overall inequality,[6] accounting for 38 per cent of total inequality in 1975 and 59 per cent in 1991. By contrast the between-group component has fallen, primarily as a result of some redistribution from whites to other groups.[7] Other calculations confirm this finding: racial differentials narrowed even before the change of government in 1994, while inequality within both the black and the white groups rose (Leibbrandt, Bhorat and Woolard, 1999; Moll, 1999).

TABLE 4
THEIL INDICES OF INEQUALITY, 1975, 1991

| | 1975 | 1991 |
|---|---|---|
| Asian | 0.20 | 0.20 |
| Black | 0.19 | 0.34 |
| Coloured | 0.25 | 0.22 |
| White | 0.12 | 0.18 |
| Within-group component | 0.14 | 0.23 |
| Between-group component | 0.23 | 0.16 |
| Total population | 0.37 | 0.39 |

Source: Whiteford and McGrath (1999: 15).

Apart from the strong racial characteristics evident in the income distribution, several other features of inequality in South Africa have been identified. For instance, rural households tend to be more well represented in the lower end of the income distribution; female-headed households on average are poorer than male (Hirschowitz, 1997; Budlender, 1999). Access to wage-earning opportunities is also crucial. In two different analyses of poverty in South Africa, Budlender (1999) and Seekings (1999) identify layers of disadvantage:[8] fewer adults are economically active in poorer households, and fewer of those who are economically active find employment. Budlender also notes that access to wage income is highly correlated with other measures of well being: rural households with little access to basic services have diminished chances of finding income-earning activities.

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6 Overall inequality measured in this way appears to have risen slightly.

7 The sizes of the indices are sensitive to the relative sampling of poor and non-poor households in the surveys used to generate the data. Racial Theil indices calculated by Leibbrandt, Bhorat and Woolard (1999) using both 1993 and 1995 household income data are considerably higher than those of Whiteford and McGrath. However, their calculations are consistent in that they also show that within-group inequality contributes more (64 per cent) to inequality than do racial differences.

8 Budlender's analysis is based on the October Household Survey and the Income and Expenditure Survey of 1995; Seekings's work uses the 1993 SALDRU data.

Calculations of poverty in South Africa indicate high levels of deprivation. Whiteford and McGrath (1999) find that, in 1991, almost half of all households were below the Minimum Living Level (MLL) for (urban) African households.[9] Their calculations also indicate that poverty is highest in the former 'homeland' areas (predominantly rural), where over three-quarters of households were below the MLL, and that incidence is highest amongst black households, two-thirds of which were below the MLL. However, they argue that the MLL is generously high (Whiteford and McGrath, 1999: 15). Since their calculations reveal that 7 per cent of whites fall below the same MLL, it is distinctly possible that the MLL overstates the extent of poverty in South Africa. Nevertheless, their estimates of the extent of overall poverty in South Africa using three different poverty lines—the MLL, a poverty line of 75 per cent of the MLL and one of 50 per cent of the MLL—still show that a significant proportion of households live in circumstances of destitution (Table 5).

TABLE 5

SHARE OF HOUSEHOLDS LIVING IN POVERTY, 1991 (%)

| | |
|---|---|
| Asians | 18 |
| Blacks | 67 |
| Coloureds | 38 |
| Whites | 7 |
| Overall (MLL) | 49 |
| Overall (75 per cent of MLL) | 32 |
| Overall (50 per cent of MLL) | 25 |

Source: Whiteford and McGrath (1999), using 1991 census and various income and expenditure surveys.

Compared with similar calculations of the extent of poverty in 1975, it appears that the percentage of households in poverty fell in all racial groups, with the exception of whites. The decline was particularly marked amongst coloured and Asian households. For black households, the depth of poverty increased between 1975 and 1991, as the incomes of the poorest 60 per cent of black households fell (Whiteford and McGrath, 1999: 18). These findings provide some confirmation for the view that the redistribution which occurred after 1970 was from whites to Asian, coloured and the richer black households.

[9] The MLL is calculated by the Bureau of Market Research.

## III EXPLAINING THE OBSERVED CHANGES IN INEQUALITY: WAGES AND EMPLOYMENT

While political apartheid ended in the 1990s, economic apartheid had started to crumble during the 1970s. In manufacturing, strong growth during the 1960s had created shortages of skilled and semi-skilled labour (Bell, 1985: 24–6), and the removal of discriminatory practices by foreign-owned multinational companies in the 1970s was followed immediately by domestic firms competing for workers. When in the 1970s job reservation in the mines was removed, and the industry was hit by a series of strikes by black miners, the rapidly rising gold price permitted wage increases for the first time since 1911.[10] In 1980 black trade unions were legalized. The net effect of these (and other) changes was an erosion of discriminatory practices against blacks (Knight and McGrath, 1987), especially in younger cohorts (Moll, 1992). Towards the end of the 1980s, some firms began to adopt affirmative action rules, a process which accelerated after the change of government in 1994.

Moll (1999: 2-3) argues that the removal of discrimination in employment practices has three effects. First, the wage gap between black and white workers of equivalent experience and qualification is narrowed. This process is concentrated in the middle of the wage and occupation distribution, where different race groups compete for similar jobs, whereas at the bottom or top of the distribution there is little by way of racial overlap. Second, more blacks are promoted into the most senior occupations, but, because of the relative scarcity of sufficiently skilled black workers, they do not compete away the rents that this group enjoys. At the same time, the demand for semi-skilled blacks is insufficient to draw large numbers out of unskilled positions, so earnings inequality amongst blacks rises. Third, as white unions lose their hold over the semi-skilled occupations, poorly skilled whites fall into lower-paid occupations, so that earnings inequality amongst whites rises.

If a process like this does explain the simultaneous fall in racial inequality and rise in within-group inequality, it suggests that inequality in the distribution of income is driven by what happens to wage income. If, as will be argued, the effect of reduced discrimination in the labour market has been reinforced by increasing unemployment, this would underscore the importance of formal-sector wages in driving overall inequality.

[10] Between 1971 and 1975 black wages trebled on the gold mines (Lipton, 1985: 388).

### 3.1 The role of wage differentials in explaining inequality

The importance of wage income in determining inequality in South Africa is emphasized in a study by Leibbrandt, Woolard and Woolard (1996). By decomposing Gini coefficients for black households according to income components,[11] they show, not surprisingly, that wage income contributes most to overall income inequality. This inequality across the population of black households depends both on the distribution amongst those that are earning wages and on the proportion that have no access to wage income. Leibbrandt, Woolard and Woolard argue that it is primarily the latter—that is, the extent of unemployment—that contributes to a high Gini coefficient (0.66) for wage income.

For the subset of rural black households, their findings are similar. Although remittances and transfers are relatively more important, wage income still contributes significantly to inequality.[12] For rural black households below the Household Subsistence Level (HSL), remittances and welfare are much more important as an income source—the share of wage income is 23 per cent compared to 63 per cent for those households above the HSL[13]—but wages are still the primary source of inequality.

What drives inequality in the distribution of wages has been explained in several recent studies. Fallon and Lucas (1998) argue that racial wage differentials have narrowed since the 1970s, but the precise behaviour of black wages has been subject to conflicting pressures: rising unemployment has exerted downward pressure, but greater freedoms to work and the rise of African trade unionism have offset this. Nevertheless, they find that wage differentials resulting from institutional factors remain high by international standards: wages paid are still heavily influenced by race and gender, barriers to mobility, and job-related characteristics, like union membership and public sector versus private sector. At the same time, 'productive differences', such as schooling and years of experience, do also matter.[14]

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[11] The data used are those from the 1993 SALDRU sample. Income is divided into that from wages, remittances, state transfers, agriculture, capital, and self-employment.

[12] In a study of rural households in the Eastern Transvaal, Sender and Johnston (1995) find that (casual, often unrecorded) women's wages and working conditions on all types of farms are probably the critical determinants of the standards of living of most of the poorest households.

[13] The corollary is that access to wage income is an important factor in escaping from poverty.

[14] Their findings are based on 1993 SALDRU data.

Moll (1999) traces these factors over time, using 1980 and 1993 data to decompose the white-black earnings gap into 'explained' (productive) components, like education and experience, and 'unexplained' components, like occupational and wage discrimination.[15] He finds that wage discrimination fell from 1980 to 1993, partly due to the improvement of the educational qualifications of blacks and partly because of decreased labour market discrimination. Occupational discrimination rose, but this was because, although the numbers of blacks in higher occupations rose dramatically, the numbers possessing appropriate qualifications rose even more quickly, which increased the proportion (of those qualified) who were excluded.

Using more recent data,[16] Jensen (1999) also analyses wage differentials and also finds that much of the difference in wages can be attributed to racial differences in the distribution of education, occupation and urbanization.[17] Like Moll, he finds that the racial distribution of occupations is skewed, with Africans underrepresented in technical, professional and management positions. However, he notes some striking differences across sectors. In the private sector, low levels of education contribute most to relatively low black wages at the bottom end of the distribution, while much of the premium earned by whites in high-wage jobs cannot be explained by observable characteristics. In the public sector, productivity-related characteristics are more important in accounting for wage differentials, although, at the upper end, Africans appear to earn a racial premium beyond what can be accounted for by their observable productivity-related characteristics.

## 3.2 The role of unequal access to employment in explaining inequality

The study by Fallon and Lucas (1998) investigates the probability of being unemployed (in the formal economy) across different population groups. They find wide differences in probabilities, which appear to be influenced by both productivity-related and non-productive characteristics, with those who face the

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[15] Data used are the 1980 census and the 1993 SALDRU survey. Moll uses a multinomial logit approach to analyse the gross differential between white and black log wages.

[16] Jensen uses the 1995 October Household Survey of the Central Statistical Services. In this paper, log wage densities are decomposed to study the contribution of various productivity-related characteristics in explaining wage differentials between men in different racial groups (gender-driven inequality is specifically excluded).

[17] These observable characteristics, particularly education, explain between 50 per cent and 90 per cent of the differences at various parts of the distributions in both sectors.

greatest risk of unemployment being women, black, or those having less (or poorer quality) education.[18]

This has important implications for the distribution of income. Seekings (1999) shows that the unemployed are concentrated amongst the poorest households. Kingdon and Knight (1999: 1) and Standing, Sender and Weeks (1996: 110) point out that it is not inevitable that unemployment will be associated with poverty; because the poor cannot survive unemployment, in many underdeveloped economies they enter the informal sector and are underemployed. Under these circumstances, employment in the informal sector rather than open unemployment is associated with poverty. Kingdon and Knight contend, however, that South African data do not support this view and that open unemployment is an important source of poverty. They find that the unemployed are the most deprived group and that job search itself is subject to greater impediments if one is poor, black, uneducated, or living in a remote (rural) area.

### 3.3 Explaining the changes

The overwhelming conclusion is that wage income is the most important source of inequality, both racial and geographical. The shift in income from whites to blacks (and Asians) was caused by considerably slower growth of real white per capita incomes from 1970 to 1991—17 per cent for whites compared with 51 per cent for blacks and 103 per cent for Asians. In spite of economic slowdown from the mid 1970s, average non-white wages outside of agriculture rose because of both occupational mobility and a sharp rise in wages for skilled and semi-skilled blacks and Asians (especially men). After the legalization of black trade unions in 1980, their growing influence on wage setting caused marked increases in black wages across the spectrum from least skilled to highly skilled (Hofmeyr, 1999). In other words, the narrowing of racial wage differentials was a result of the removal of discriminatory behaviour in both wage-setting and occupational structures, so that average non-white wages rose sharply to catch up with those of white counterparts. In spite of this, discrimination still accounts for a large portion of remaining racial differentials.

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18 Another interesting feature noted by Fallon and Lucas is that, in contrast to other developing countries, subsistence agriculture does not soak up excess labour in rural areas, and there is a larger probability of unemployment in rural as opposed to urban areas. This point is borne out by Budlender (1999), who notes that opportunities for small-scale farming to supplement income for poor rural households are limited. Seekings (1999) goes so far as to say that smallholder agriculture is so negligible that it makes no sense to categorize South Africa as a society of peasants.

The primary cause of the growing inequality amongst blacks is rising black wages simultaneous with rising black unemployment. Average real wages of blacks in manufacturing, for example, rose 70 per cent between 1972 and 1990, while recorded unemployment rose from under 10 per cent to 25 per cent. Other factors were also at work. There was rapid upward mobility of a small number of educated blacks, and, with economic recession in the 1980s, white unemployment occurred for the first time since the 1920s. At the same time, the growing power of the trade unions resulted in a new form of segmentation in the South African labour market: the main distinctions are now between the unionized and non-unionized parts of the formal sector and between the formal and non-formal sectors (Hofmeyr, 1999). Several severe droughts during the 1980s also caused rural incomes to contract, exacerbating inequality between black incomes.

The net result implies that much of the redistribution which occurred prior to the change in government was from whites to the richest of the black households. Redistributive policies which have an impact on the poorest households may therefore require direct interventions rather than simply the erosion of discriminatory labour market practices which characterized the period 1970 to 1994.

In other words, while the findings of Leibbrandt, Woolard and Woolard (1996) point to the need for changes in the labour market to drive changes in inequality, it is clear that the policies must go beyond narrow labour market interventions. Short-term policies affecting remittances and transfers and micro-level labour market interventions may help to improve welfare for the poorest, but any improvement in inequality in the longer term must come through creating wage-earning opportunities for poorer households, especially rural black households. Fallon and Lucas (1998) argue that, in the long term, sound macroeconomic policies will encourage employment-creating growth, and competitive pressures are needed to remove discrimination.[19] But, as argued elsewhere (Whiteford and McGrath, 1999), growth may not be sufficient to make an acceptable dent in inequality in a reasonable timeframe.[20]

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[19] Shorter term policies include support for SMEs and land reform targeted at creating productive opportunities in the rural sector. Other areas mentioned are promoting education and training for the disadvantaged, encouraging the positive aspects of trade unionism, encouraging labour-intensive techniques in infrastructure projects, and facilitating national tripartite agreements on labour and related issues.

[20] They estimate that, at the current distribution and (real) poverty line, it will take 24 years for the *average* income of the poor to equal the poverty line at an annual real growth rate of 5 per cent, 47 years if growth averages 2.5 per cent a year, and 117 years at an average real growth rate of 1 per cent annually.

It is at least implicit from the above discussion that access to formal-sector employment is an important factor in improved levels of income. It would therefore appear that policies affecting employment creation play a vital role in reducing inequality and poverty. The following sections review the evolution of the policy framework and economic performance in South Africa. Policy under the ANC-led government is then assessed more closely, particularly in terms of its likely impact on employment creation and income distribution.

## IV THE EVOLUTION OF ECONOMIC POLICY AND PERFORMANCE

### 4.1 Policy and performance under the apartheid government, 1960-94

#### *4.1.1 The evolution of economic policy*

Although the South African economy is not a command economy in any sense in which the word is normally used, the drive towards industrialization from the mid-1920s and the institutionalization of apartheid from the late 1940s meant that by 1960 the South African economy was subject to a comprehensive range of controls.[21] The government was also involved in establishing large parastatal corporations and development finance institutions.

In line with the experience of other non-oil-exporting countries, economic growth slowed in South Africa in the 1970s. At the same time there was a loss of political direction as both internal dissent and external pressure for change were increasing. Moreover, world ideology was shifting towards neoclassical orthodoxy, and this seemed like an answer to a regime which was contemplating 'reform' without a sense of direction. A series of government-appointed commissions of enquiry recommended wide-ranging reforms, most of them in a more liberal direction.[22]

In the mid-1970s, trade reform began with the introduction of export incentives to reduce the anti-export bias. The substitution of tariffs for quantitative

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[21] Interest-rate controls, exchange controls, price controls, import controls, wage controls, controls over trade union membership, and controls over land ownership and place of residence, as well as other apartheid laws.

[22] For example, 1973 Reynders (export trade), 1979 Rieckert (black urban affairs), 1980 Wiehahn (labour, including trade unions), 1981 De Lange (education), 1981 Schlebusch (constitutional affairs), 1984 De Kock (monetary policy), 1987 Margo (taxation).

restrictions followed in the 1980s, although tariff reduction did not begin until after the change of government. Black trade unions were legalized in 1980, and restrictions on the movement of black labour were eased during the decade. Comprehensive liberalization of monetary and exchange-rate policy was undertaken in the early 1980s. A shift towards market-oriented policy instruments, including positive real interest rates, was initiated; monetary targeting was adopted as the primary means of controlling inflation; the dual exchange-rate system was abolished, although later reinstated during the debt crisis of 1985, and a managed float of the rand was introduced. Commercialization (rather than privatization) of parastatals commenced.

Fiscal policy has generally been comparatively conservative. Until the mid-1970s, the government endeavoured to finance current spending out of current revenue, so that only capital expenditure was financed out of public debt. Although this objective was dropped from 1976, the government initiated a particularly restrictive fiscal policy in an attempt to crush accelerating inflation. This restraint could not be maintained, and from 1981 not only did current spending rise sharply, but there was an increasing tendency for the authorities to exceed budget estimates.[23] The burden of (domestic) government debt grew as a result.

### *4.1.2 Economic performance: 1960 to 1994*

From 1974, South Africa's long-run growth rate began to decline, and the cyclical pattern of economic activity became more unstable (Table 6). The slowdown was caused by a combination of external shocks and domestic structural problems, which, amongst other things, reduced the profitability of investment. Labour productivity was falling because of skills shortages, partly the result of historical underinvestment in education. Political unrest, frequently expressed by strikes, was also driving up real unit labour costs. The growth of the capital-labour ratio accelerated (in an attempt to maintain productivity). Consequently, the capital-output ratio rose sharply, causing the profitability of investment to fall (Gelb, 1991: 19-23). Insufficiently developed export capacity, together with a high propensity to import investment goods, placed a foreign-exchange constraint on growth. This was exacerbated by an overvalued exchange rate and by calls for international sanctions.

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[23] High and increasing levels of government spending were almost inevitable, with high population growth, an ageing white population and rapid urbanization, with the extension of democracy and equal opportunities, and with growing strategic and security needs. Even though tax increases were introduced, the gap between revenue and expenditure rapidly increased.

Although an increase in the price of gold in the early 1980s helped partially to insulate South Africa from the balance-of-payments crises which were a factor in driving many developing countries into debt, falling world demand contributed to declining production and rising unemployment. The government's almost complete disinterest in stimulating alternative employment for blacks (Thomas, 1990: 255), and the deliberate dualism in both agricultural development and skills acquisition made it difficult to absorb new job-seekers: job creation fell from 157,000 a year (1960-74) to 57,000 a year (1974-85).

TABLE 6
ECONOMIC PERFORMANCE INDICATORS (% PER ANNUM)

| | 1960-74 | 1975-84 | 1985-94 |
|---|---|---|---|
| Rate of change in GDP | 5.0 | 2.7 | 1.0 |
| Rate of inflation | 4.2 | 12.8 | 13.8 |
| Rate of formal absorption of new jobseekers* | 80.0 | 30.0 | 8.5 |
| Ratio of investment to GDP | 26.2 | 28.5 | 18.8 |

Note: *there is considerable debate about the rate of formal unemployment, with current estimates ranging from 33% to almost 50 %.
Source: Calculated using data from the South African Reserve Bank.

Financial sanctions imposed in the mid-1980s precipitated a debt crisis, although, unlike other developing countries, debt-service difficulties arose from the structure of foreign debt (predominantly short-term loans) rather than the magnitude of this debt. Increasing social conflict, political uncertainty and tight monetary conditions necessitated by financial sanctions caused private investment to fall. The costs of production rose sharply: of capital, because of a shift in policy towards maintaining positive real interest rates and a weaker currency, of labour, because union pressures saw wage increases outstripping productivity improvements and because of a huge increase in politically motivated strikes, and of raw materials, because of domestic inflation and a weaker currency. The economy stagnated.

## 4.2 Policy and performance since the political transition, 1994–9

### *4.2.1 The economic policy framework*

During the period of negotiation leading up to majority rule, fears were expressed by some commentators that a majority government, dominated by the ANC, would reverse many of the liberalizations that had taken place since the 1970s. In the debate about the post-apartheid economy, two issues were seen to be important: economic growth and the redistribution of resources to the previously disenfranchized majority. The pressures for redistribution in the context of resource constraints were very similar to those faced by most other post-colonial governments in Africa and elsewhere.

Contrary to these expectations, during the new government's first term in office, economic policy grew steadily more orthodox, and liberalization was accelerated. The ANC-led government pledged itself to fiscal discipline, aiming to redistribute resources by reorienting rather than increasing expenditure (or taxation). It initially maintained both the finance minister and the central bank governor of the previous regime. It opted for a more neutral trade policy, with a simpler, transparent tariff structure and with tariffs reduced in line with GATT requirements, and it signed an agreement with the WTO in 1994. It abolished exchange controls on non-residents in 1995 and began to relax exchange controls on residents. Its Growth, Employment and Redistribution (GEAR) strategy, released in 1996, committed the government to reducing the fiscal deficit to 3 per cent of GDP in five years, to deepening the trade liberalization, to promoting macroeconomic stability, and to injecting greater flexibility into the labour market (RSA, 1996). In other words, the ANC-led government adopted a policy package that was almost classically 'Washington consensus'. The rationale was that this package would enhance investor confidence, through building credibility, and promote growth, job creation and redistribution.

Much of the policy strategy promised in GEAR has been implemented, although rigidities remain in the labour market, and these are frequently blamed for contributing to the failure of the strategy to create jobs. At present, wage-setting institutions set minimum wage floors and protect the wages of low-paid workers, and new labour legislation has made mandatory the extension of collective agreements to non-parties. In the presence of rapidly falling trade barriers and rising international competition, this could push up unskilled unemployment. Even though its primary objective is dealing with unemployment, especially amongst the less skilled, the government has not opposed trade unions on issues of conditions of employment, in spite of vociferous criticism from the business community.[24]

### *4.2.2 Economic growth since 1994*

With the change of government came the lifting of economic sanctions and a surge in confidence. Average annual growth accelerated to between 2 and 3 per

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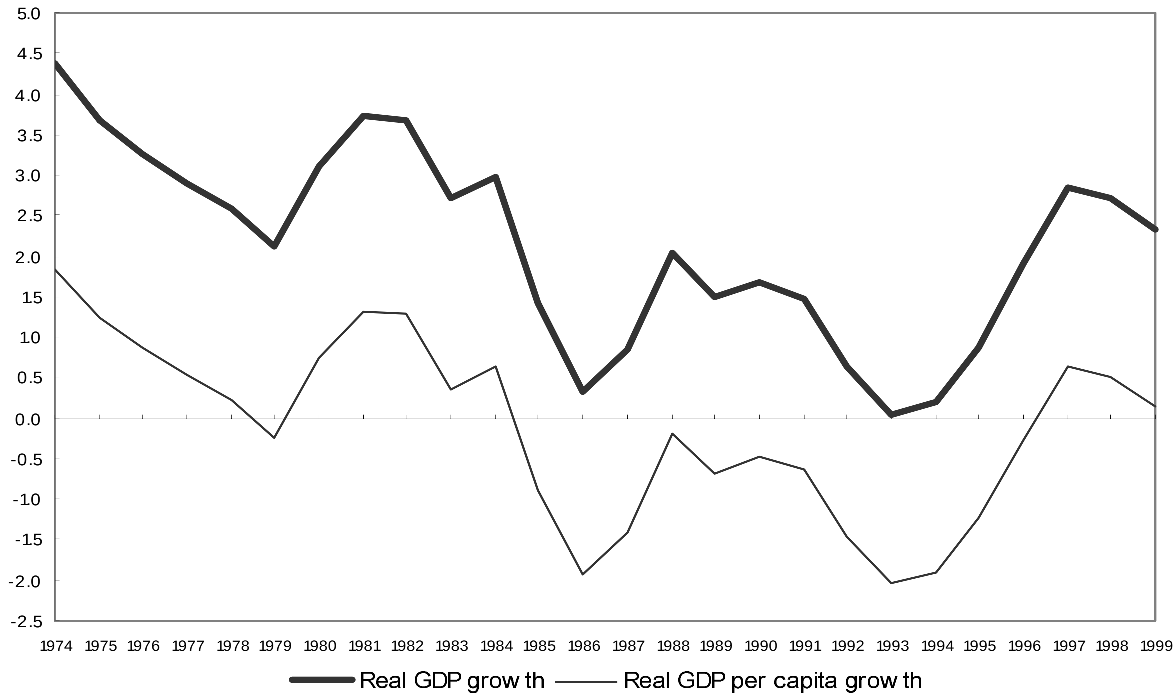
[24] Historical ties between the ANC and the labour movement are strong, although they should not be exaggerated. The government has, for example, dismissed organized labour's opposition to both trade liberalization and privatization.

cent, although this was slower than the GEAR's projected increase. Overall, economic performance has disappointed expectations as to the benefits of liberalization. The slowdown in growth that began in the early 1970s was not quickly reversed, and, in per capita terms, real growth was negligible (Figure 1). One important reason for growth's being slower than expected has been the series of external shocks to the economy in the form of contagion from emerging market financial crises—although South Africa managed to avoid the depth of financial distress and subsequent recession that these crises caused in several emerging economies. The macroeconomic impact of the GEAR strategy (in terms of employment and growth) should be considered in the context of the external pressures that South Africa has faced.

FIGURE 1
REAL ECONOMIC GROWTH IN SOUTH AFRICA, 1970-99
(FIVE-YEAR MOVING AVERAGE)



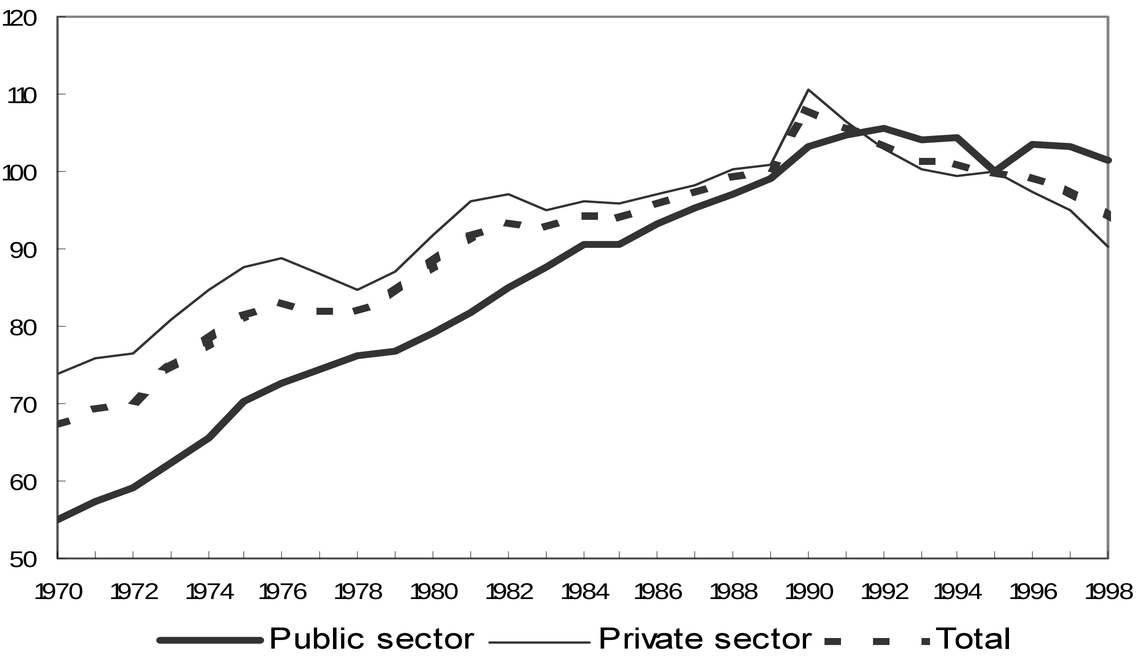

Source: authors' calculation.

The growth path is nevertheless consistent with that of other countries which have undergone contractionary reform under structural adjustment. The policy package, designed to stimulate growth, may have had adverse effects. For example, it is possible that government deficit reduction has reduced rather than stimulated private domestic investment in the short term, due to the contraction of demand. Structural changes occurring as a result of trade liberalization, the relaxation of exchange controls and deregulation may have increased uncertainty for investors in the adjustment period. It is even more possible that the tight monetary environment for a sustained period—successful in reducing inflation from over 18 per cent to under 7 per cent per annum—has severely held back growth. Furthermore, the business community has argued that the policy package is being undermined by a lack of flexibility with respect to labour market policy.

### *4.2.3 Employment and wages*

These effects also appear to have had an impact on rate of job creation (Figure 2). Private-sector formal employment has contracted steadily since 1990 following a period of rapid growth in the 1970s and slow growth from the early 1980s (the rate of non-agricultural private-sector job creation was below the rate of growth of the labour force for most of the 1980s). Public-sector employment, on the other hand, grew strongly between 1970 and 1990 and then began to drift down between 1990 and 1998. At the same time, wage indices (Figure 3) show that private-sector real wages have grown since the beginning of the 1990s, following a period of stagnation in the late 1980s. Real public-sector wages also rose in the 1990s.

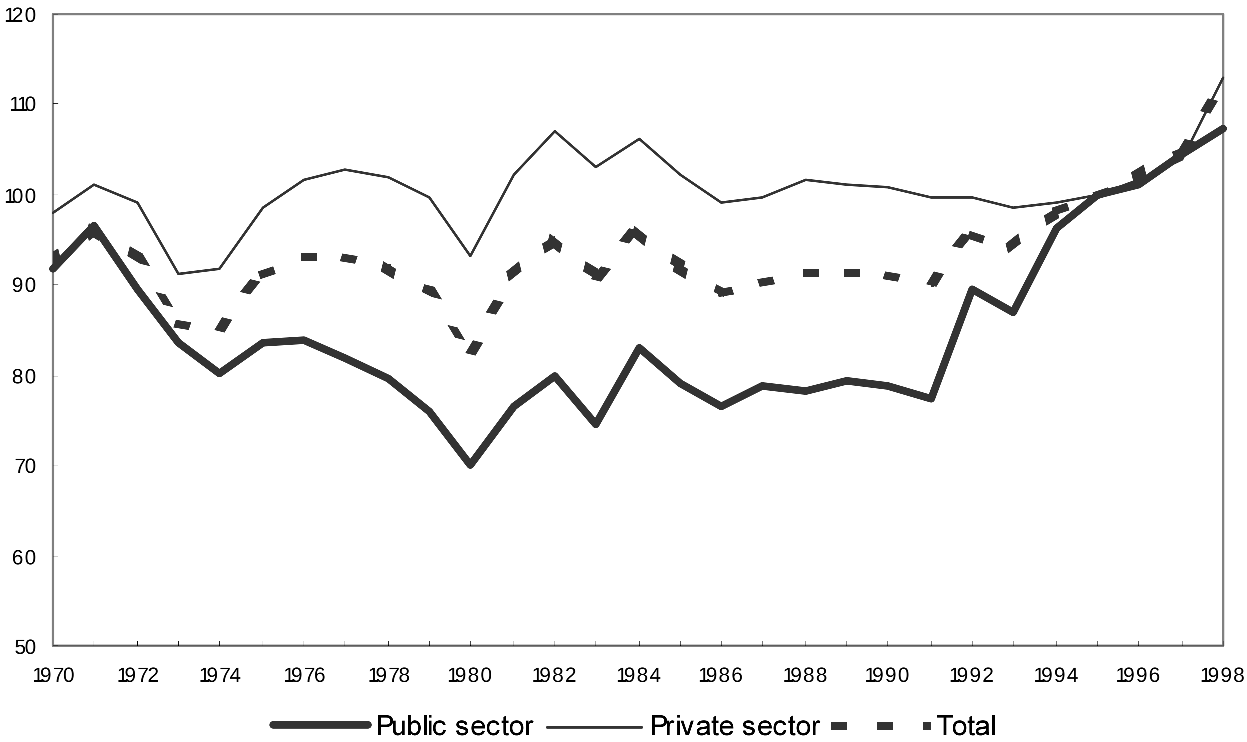
FIGURE 2
INDICES OF FORMAL NON-AGRICULTURAL EMPLOYMENT, 1970-98
(1995=100)




Source: authors' calculation.

The combination of declining formal employment and rising real wages is consistent with the argument that inequality between the employed and unemployed has worsened in recent years: fewer people are now employed, and those in employment receive higher real wages. It is also consistent with the insider-outsider view that trade unions have protected formal wages at the expense of the unemployed.

FIGURE 3
INDICES OF REAL NON-AGRICULTURAL WAGES, 1970-98 (1995 = 100)



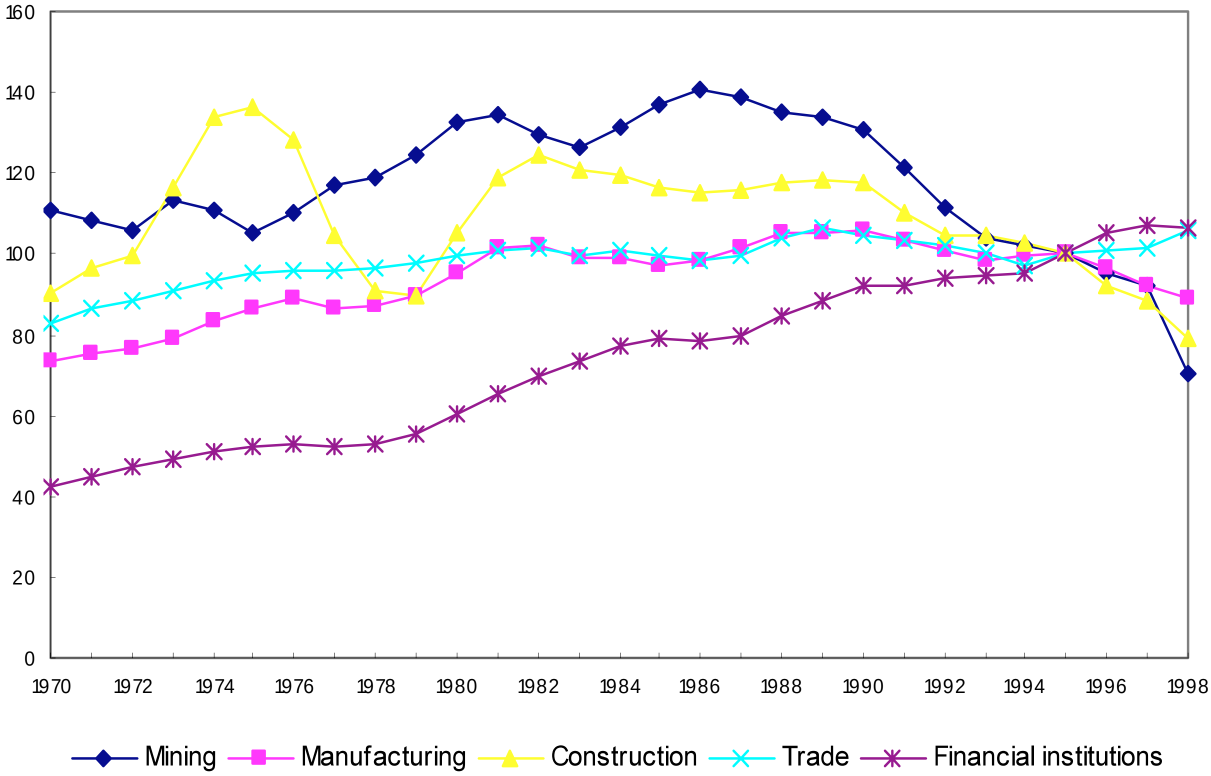

Source: authors' calculation.

Sectoral employment indices for the non-agricultural private sector show that manufacturing employment has been in decline since the early-1990s, while service sectors, particularly financial services, have displayed strong and steady growth (Figure 4). Employment in mining has declined significantly since the mid-1980s. Mining and manufacturing have historically been important employers in South Africa, and job shedding in these sectors appears to be the key to explaining the decline in total private-sector employment.[25] The net result is that the service sector is an increasingly important employer in South Africa, even more so if we include government. A contraction of employment

[25] While a comparable index of agricultural employment is not available, other sources suggest that this sector now represents a relatively small section of the labour force – 10.7 per cent (Fallon and Lucas, 1998), following a marked shift in the labour force away from agriculture between 1960 and 1990 (Fallon, 1992).

in mining and manufacturing has thus coincided with the recovery in the rate of economic growth. The possible reasons for this are discussed below.

FIGURE 4
PRIVATE-SECTOR EMPLOYMENT, SECTORAL INDICES, 1970-98 (1995 = 100)




Source: authors' calculation.

Unemployment remains South Africa's most pressing problem. While the policy framework is intended to provide a more favourable climate for investment, it is, of course, unable to ensure that the private-sector response will be forthcoming, particularly if real interest rates remain high in order to protect foreign-exchange reserves. Indeed, private-sector investment has not yet shown any significant increase, and the level of foreign direct investment remains low in comparison to other financial flows. At the same time, domestic savings (out of which future domestic investment is financed) are still declining: in 1990 South Africa's gross domestic saving was 19.1 per cent of GDP; by 1999 the ratio had fallen to 14.5 per cent.

At present, the government's energy remains concentrated on overcoming the legacy of apartheid. The following sections consider the policy framework in more detail to assess what progress has been made.

# V CHANGES IN THE STRUCTURAL CAUSES OF POVERTY AND INEQUALITY SINCE 1994

Traditional explanations of poverty and inequality include a skewed distribution of both real assets and human capital. It is argued that these explain much of the variation in cross-country inequality, although less of its change over time (Cornia, 2000: 21). Even so, it is argued, any strategy seeking to alleviate poverty should include policies to improve the access of the poor to social services, especially education, and land. The equalization of education spending per head across race groups might assist in reducing income disparities over time. However, the evidence that increasing public spending on education raises enrolment rates is weak (Checchi, 1999); it is also possible that more spending will not necessarily raise the quality of education.

## 5.1 Education and social expenditure

Prior to the 1970s, it was a matter of explicit policy not to provide more than a basic education for Africans, who were viewed by the apartheid government as an unskilled workforce. Accompanying this was a strategy of capital-intensive import-substituting industrialization, one aim of which was to provide employment for the small, highly skilled white workforce. As political protests intensified in the 1970s, and as the government began to move pro-actively towards promoting export diversification, investment in black education rose rapidly from its historically low level, contributing to the improvement in racial income distribution in this period. Despite the increase, however, racial disparities in the quality of education provided by the state remained extreme.

Since 1990 and especially after 1994, spending on education and other social services has started to rise in line with the government's redistributive goals. Table 7 records the shares of non-interest expenditure[26] averaged over four broad periods from the early 1980s. There has been a marked shift in expenditure towards social services and away from economic services and, to a lesser extent, protection services. Social services now account for more than half of non-interest expenditure, compared with 46 per cent in the early 1980s. Within the social sector, the expenditure shares of education and social security and welfare have both increased over time, and health is planned to receive a larger share in recent budgets. It is also worth noting the shift in expenditure away from defence towards policing and justice—in the context of South

[26] Expenditure on servicing government debt accounts for a significant proportion of the overall total and represents a severe constraint on the government's ability to use the budget to pursue redistribution.

Africa's high level of crime, improving the safety of the poor will play an important role in improving standards of living.

TABLE 7
TOTAL GOVERNMENT EXPENDITURE
(AS A PERCENTAGE OF *NON-INTEREST* EXPENDITURE)

| | 1983-9 | 1990-3 | 1994-7 | 1998-2002 |
|---|---|---|---|---|
| General services and unallocable | 12.9 | 14.3 | 13.7 | 14.0 |
| Protection | 21.9 | 21.4 | 18.0 | 18.9 |
| defence | 14.9 | 12.1 | 7.6 | 6.8 |
| public order and safety | 7.0 | 9.3 | 10.3 | 12.1 |
| Social services | 45.9 | 48.0 | 53.9 | 56.3 |
| education | 20.5 | 22.3 | 24.2 | 26.3 |
| health | 11.1 | 10.7 | 11.0 | 16.6 |
| social security and welfare | 7.0 | 8.7 | 12.2 | 10.7 |
| housing and community services | 5.4 | 4.6 | 4.5 | 2.3 |
| recreation and culture | 1.8 | 1.6 | 2.0 | 0.4 |
| Economic services | 19.3 | 16.4 | 14.5 | 10.8 |
| fuel and energy | 0.3 | 1.1 | 1.6 | 0.2 |
| agriculture, forestry and fishing | 4.2 | 3.3 | 2.4 | 1.9 |
| mining, manufacturing + construction | 3.7 | 2.4 | 1.1 | 0.1 |
| transportation and communication | 8.9 | 6.3 | 6.1 | 4.7 |
| other economic services | 2.2 | 3.3 | 3.2 | 3.9 |

Sources: Data for 1983 to 1997 are from the South African Reserve Bank; data from 1998 on are from the *Budget Review 2000*, South African Department of Finance and are estimates only. Sixty percent of the national budget is transferred to other levels of general government; this inevitably means that the detailed breakdown of consolidated expenditure is available only with a lag.

Expenditure shares are not necessarily an indicator of achievement in addressing poverty. There have been both successes and failures in the strategy to address poverty. In the ANC-led government's first term of office, 2.5 million people were given access to tap water as part of the aim of improving the health of the poorest, and 5.5 million households were electrified, providing opportunities for job creation through small-scale cottage industries. At the same time, problems with service delivery meant that the target for building new houses was missed (Standard and Poor's, 1999). The most serious delivery failure has been in education, where both availability and standards for the previously disadvantaged majority are yet to show a marked improvement. There appears to be a lack of clear direction in education policy, in a context where radical change is needed, in spite of the increasing share of expenditure, which is high by international standards[27]—evidence that simply spending more money does not necessarily solve problems.

### 5.2 Land

Land redistribution is unlikely to play a significant role in the strategy to reduce poverty in South Africa. In spite of a history of dispossession of the indigenous population, the current government is concerned to create a climate of certainty with respect to land tenure as soon as possible. The government allowed for a three-year period in which claims for land restitution could be lodged—a period which has now expired. A Land Court was established to consider all claims, but there is no evidence to suggest that large-scale redistribution will be the result. Money has been set aside in each budget since 1994 for restitution and land reform, but most urban claims are being handled by blanket payments to claimants of the value of a serviced site in their area of residence. Some land restitution is planned in rural areas, but the focus of rural development is a multi-billion rand programme of finance to small-scale farmers.

Despite its perceived political importance, there is evidence to suggest that land redistribution is not an effective way out of poverty, that it reduces poverty by very little, and that a land policy entails both a leakage to the non-poor and imperfect coverage of the poor (Ravallion and Sen, 1994: 1). Most of Africa's ultra-poor own or operate significant amounts of farmland, and the problem is one of land quality, remoteness and fragmentation of land rather than landlessness (Lipton, 1988: 54). Even where there is land hunger, as in Zimbabwe, the redistributive process proves complex and, probably most significantly, if not dealt with conclusively soon after the transition to majority rule, a simmering political problem.

## VI THE IMPACT OF ECONOMIC POLICY SINCE 1994

A growing literature is raising the concern that the shifting of policy in a neo-liberal direction may have actually worsened the distribution of income in many developing countries. There are reasons why South Africa's experience may differ from that of many developing countries. Although it now has a fairly orthodox macroeconomic package, the changes to the policy framework have been introduced over 25 years in a phased manner in response to the

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[27] CREFSA (1995) shows that the share of expenditure on education was higher in South Africa than it was in a broad selection of other comparable emerging economies.

perceived needs of the economy rather than in pursuit of an ultimate ideologically driven objective. This phased approach, modified by the need of the previous government to ward off political dissent by spreading the benefits of production more widely and the need of the current government to satisfy the aspirations of the newly enfranchized majority, may contribute to an improvement in the distribution of income.

### 6.1 The effects of stabilization: inflation and interest rates

The poor generally suffer most from high inflation because they are less able to index their incomes, and the real value of their assets (savings) is eroded. High (and variable) rates of inflation also raise the risks (as well as direct costs) for investors, with implications for employment. However, it has been found that, to the extent that stabilization is contractionary, it tends to be 'disequalizing' in developing countries (Cornia and Kiiski, 1999). Tight monetary policy not only discourages new investment, but raises the cost of servicing existing debt. Even if firms are not forced to close, they are forced to reduce variable costs. The flexibility of low-skilled wages, the readiness of firms to shed labour, and the inadequacy of social safety nets mean that the burden of adjustment frequently falls on those at the bottom of the distribution, especially where the informal sector is small. Moreover, the contractionary impact tends to be greater on wages than on profits.

In South Africa, the tight anti-inflationary stance of the central bank has been criticized by some commentators for undermining the growth and employment objectives of economic policy. However, continued high interest rates have been, in part, a response to external shocks. A key structural weakness in South Africa is the low savings rate. This means that the economy relies heavily on foreign capital inflows, mostly in the form of portfolio investment, to finance the savings-investment gap. High real interest rates have been maintained in order to continue to attract inward flows of capital, or at least to limit the outflows in times of crisis. Thus, while the policy implications of managing the impact of volatile capital flows appear to contradict the goals of growth and employment creation, without access to foreign savings it is unlikely that South Africa could make much progress towards these goals.

Table 8 shows that real interest rates have been historically high since the election of the ANC-led government. Simultaneously, average annual growth has been at its most rapid since the gold boom period of the early 1980s,[28]

[28] Note that the averages presented in the table mask significant differences in growth on a year-by-year basis.

although insufficient for an acceleration of per capita income growth. As inflation has fallen, nominal interest rates have fallen by much less, so that real interest rates have generally remained stubbornly high especially when compared to their (negative) level in the early 1990s.

TABLE 8
REAL INTEREST RATES AND GROWTH IN SOUTH AFRICA

| | GDP growth | GDP per capita growth | Core consumer price inflation | Real T-bill rate* | Real long-dated yield** |
|---|---|---|---|---|---|
| 1976-9 | 2.2 | -0.2 | 10.7 | -3.15 | -0.28 |
| 1980-4 | 3.0 | 0.6 | 12.2 | 0.39 | 0.64 |
| 1985-9 | 1.5 | -0.7 | 17.0 | -3.22 | -0.48 |
| 1990-4 | 0.2 | -1.9 | 14.5 | -0.31 | 0.83 |
| 1995-9 | 2.3 | 0.1 | 7.9 | 6.28 | 6.87 |

Note: * Annual average discount rate on three-month Treasury bill rate, adjusted using core consumer price inflation rates. ** Annual average yield on government bond traded on the bond exchange with maturity of 10 years or more, adjusted using core consumer price inflation rates.
Source: Calculated using data from the South African Reserve Bank and the International Monetary Fund.

The effects of stabilization on poverty and income distribution are not clear-cut. Lower inflation may be associated with better growth performance in the long run, as lower inflation has a positive impact on domestic savings and investment. Moreover, where lower inflation provides greater protection of the real value of income and savings for the poor, then it is important for reducing poverty. However, as argued above, poverty in South Africa is strongly associated with unemployment. To the extent that high interest rates have retarded employment creation, then the poverty and distributional effects are likely to have been negative, at least in the short term.[29]

Of course, stabilization is not a short-term process, and only by the end of 1999 were market interest rates beginning to fall. Whether this decline will continue, or at least be sustained, is likely to depend to a great extent on the success of the government's inflation targeting strategy, announced in March 2000. At the same time, the credibility of an inflation target is likely to require on-going restraint in government expenditure, to which the analysis now turns.

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29 It is also worth noting that high real interest rates mean that holders of financial assets have experienced higher than average income growth at the expense of consumers and firms who borrow. This does *not* mean that the holders of financial assets have necessarily gained at the expense of the poor, however, as the poorest in South Africa are effectively excluded from the formal financial sector.

## 6.2 Fiscal policy

A worsening of the income distribution as a result of recession may be reinforced by a tight fiscal policy, as cuts in recurrent expenditure reduce public-sector employment, or public services, or both. Even using the fiscus for specifically redistributive objectives has tended to have much smaller effects in developing countries than in industrialized countries. In a comprehensive review of studies of the distributional effects of tax and expenditure reforms in 19 developing countries, Chu, Davoodi and Gupta (1999) find that, in spite of attempts to raise progressivity, many developing countries have experienced an increase in both before-tax and after-tax inequality. The reasons are that weak tax administration makes governments more dependent on indirect taxation, which can be regressive; capital and wealth taxes are limited, and formal cash-transfer and social-protection programmes are confined. Moreover, corruption limits the effectiveness of taxes and transfers as redistributive instruments. Nevertheless, they find that countries pursuing sound macroeconomic and social policies (like well-targeted health and education programmes) tend to improve their income distribution even if the equity objectives of tax reforms are limited. The scope for redistribution has generally been greater in middle and higher income economies with a pro-poor political economy (Cornia and Kiiski, 1999).

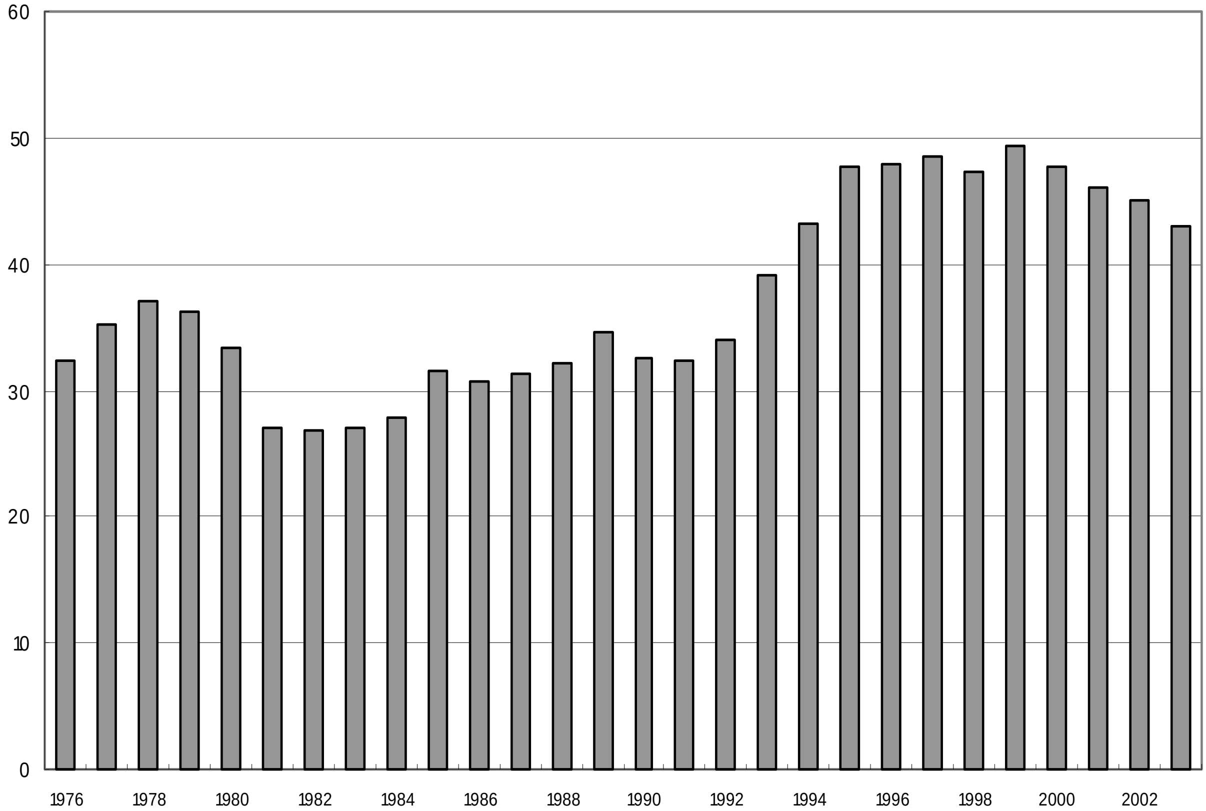
As redistribution through expenditure reform is one objective of the South African government, it is distinctly possible that fiscal policy is contributing to greater racial equality. However, pressure from the servicing of government debt, within the context of reducing the fiscal deficit, has limited the government's ability to promote redistribution through expenditure.[30] Meaningful comparisons of government debt over time are difficult: the data published by the Department of Finance in its annual *Budget Review* are complicated by the inclusion of the debt of the former 'homelands' in total government debt in 1994/5. Bearing this caveat in mind, we present the debt-GDP ratio since 1976 in Figure 5. Government debt peaked at nearly 50 per cent of GDP at the end of fiscal year 1998/9. Privatization proceeds are being used to retire debt in an attempt to reduce the interest burden on the budget. Asset sales, together with declining financing requirements, mean that debt is expected to fall to around 43 per cent of GDP by the end of 2002-3.

The impact of the debt burden on the budget, in the context of the commitment to reducing the budget deficit, is shown in Table 9. The budget deficit as a

[30] In other words, monetary policy may have limited the government's ability to use the budget as a means of redistribution, since high interest rates have raised the cost of servicing an increased public debt.

proportion of GDP peaked at 9 per cent in the last year of the apartheid government. The new government has rapidly decreased the overall deficit in line with its commitments in GEAR, providing additional credibility with the establishment of the Medium Term Expenditure Framework (MTEF) in 1998 as a publicly announced constraint on expenditure over a three-year horizon.

FIGURE 5
GOVERNMENT DEBT AS % OF GDP




Source: authors' calculation.

The decline in the deficit has been achieved by ensuring a primary surplus (the budget balance, excluding interest payments) in each year since 1995. The debt burden is evident in the share of total expenditure accounted for by interest payments. This rose to 20 per cent in the fiscal year 1998/9, although it is projected to fall to around 18 per cent by 2002/3. Underlying the decline in the deficit are reduced expenditure and increased tax revenue. Much of the rise in revenue is due to improvements in tax collection and compliance following the establishment of the semi-autonomous South African Revenue Service. The early success of SARS and other initiatives in addressing the inherited 'non-compliance' culture has allowed the government some flexibility in expenditure. Nevertheless, the combination of the debt burden and the public commitment to decreasing the deficit has presented a significant constraint on overall expenditure.

TABLE 9
INTERESTPAYMENTS AND THE BUDGET DEFICIT[a]

| | Interest payments (% of total expenditure)[b] | Overall deficit (% of GDP) | Primary deficit (% of GDP)[c] |
|---|---|---|---|
| 1990/91 | 12.4 | 3.3 | -0.8 |
| 1991/92 | 12.4 | 4.5 | 0.5 |
| 1992/93 | 12.8 | 8.3 | 4 |
| 1993/94 | 13.2 | 9.1 | 4.4 |
| 1994/95 | 13.5 | 5.0 | 0.1 |
| 1995/96 | 13.6 | 5.1 | -0.1 |
| 1996/97 | 17.7 | 4.6 | -0.7 |
| 1997/98 | 19.0 | 3.8 | -1.8 |
| 1998/99[a] | 20.3 | 2.3 | -3.4 |
| 1999/2000[a] | 19.8 | 2.4 | -3.1 |
| 2000/1[a] | 19.1 | 2.6 | -2.6 |
| 2001/2[a] | 18.9 | 2.5 | -2.7 |
| 2002/3[a] | 18.3 | 2.2 | -2.7 |

Note: a. Figures for 1998-2003 are projections based on the Medium Term Expenditure Framework. b. Figures for 1990 to 1995 are from the South African Reserve Bank and may not be strictly comparable with later data from the Department of Finance. c. A negative number indicates a primary *surplus*.
Sources: *Budget Review*, South African Department of Finance; *Quarterly Bulletin*, South African Reserve Bank.

Despite this, the government has not lost sight of the need for redistribution and the ability of the budget to provide a tool—albeit a limited one in the conservative policy framework—to achieve this goal. This is demonstrated in Table 7 above, where the shift in non-interest expenditure towards social services is evident. This suggests that, as in other middle income economies with a pro-poor political economy, there is (limited) scope for using fiscal policy to achieve redistribution.

## 6.3 Trade liberalization

To the extent that trade liberalization exposes previously protected firms to competition from more efficient foreign producers, short-term job losses are inevitable as firms adjust. In the longer term, displaced workers should find alternative employment in expanding exporting industries. However, it is possible that opening an economy will lead to technological changes. This is even more likely if greater global integration attracts foreign investment. In this case, the demand for labour might shift from less- to more-skilled workers as capital-intensive technology is introduced. Where protection has permitted the payment of higher wages than might have been paid in a more competitive environment, then permanent job losses are possible. Moreover, in an open global economy in which rich countries can subsidize and protect the sectors where poorer countries might be able to compete, unilateral trade liberalization by poorer countries can have perverse effects.

Unlike in East Asia, trade liberalization in Latin America during the 1980s and 1990s appears to have been accompanied by slower employment growth and widening inequality. Competition from Asia's large low-income manufacturing exporters depressed the demand for less-skilled labour in the middle income developing countries of Latin America—unskilled employment and wages have therefore fallen (Wood, 1997). The reluctance of Latin American countries to reform labour markets during trade liberalization may have exacerbated unskilled unemployment (Nattrass, 1999: 13). In skills-abundant OECD countries, the liberalization of labour markets and the erosion of minimum wages appear to have caused inequality to widen (Cornia and Kiiski, 1999).

The combination of falling demand for less-skilled workers in middle income economies as a result of increasing trade openness and the persistence of labour market rigidities in South Africa is likely to have important implications for inequality. In the presence of labour market policies aimed at reducing wage differentials in the formal economy, with an informal sector that does not generate significant income-earning opportunities, it is to be expected that unemployment and overall inequality should both rise in South Africa, even if the dispersion of formal incomes falls.

As shown earlier, a contraction of employment in private-sector industry has coincided with the recovery in the rate of economic growth. The historic nurturing of capital-intensive production has meant that many large capital-intensive firms have been able to take advantage of the opportunities created by trade liberalization, even when, in theory, relative prices have moved in favour of labour-intensive production (Harvey and Jenkins, 1992). As in other middle income countries, as trade liberalization has progressed, South African exports have become more capital and skill intensive.[31] Standing, Sender and Weeks (1996: 39) point out that import-substituting sectors are more labour intensive than are export-oriented sectors (without explaining why). Tsikata (1998: vi, 28) attributes South Africa's 'paradoxical' export structure to comparatively

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[31] This phenomenon emerged early; 1978 estimates of South Africa's comparative advantage concluded the fact that the country had a comparative advantage in large capital-intensive production (see Holden and Holden, 1978).

high wages relative to productivity, which reduces the competitiveness of less-skilled-labour-intensive exports.[32]

The emphasis on capital-intensive production raises the possibility that manufacturing exports may not generate significant numbers of jobs. The ILO found that employment losses in South Africa were greater in capital-intensive export industries than in import-competing industries between 1994 and 1997 (reported in Nattrass, 1999: 16). At the same time, some (but not all) labour-intensive manufacturing sectors have declined. There is therefore evidence that South Africa is moving towards more skill-intensive production, with technological change in manufacturing resulting in an increased demand for skilled labour. This is not only consistent with what is predicted in the literature, but it provides support for the explanation advanced earlier for widening within-group inequality between the high-wage, high-skilled workers and the unemployed.

## 6.4 Financial liberalization

Financial liberalization generally leads to the growth of the financial sector and a substantial increase in the rate of return to financial capital. As a result, the share of GDP accruing to non-wage earners increases (Cornia and Kiiski, 1999). Rising real interest rates also generate redistribution from taxed labour and profits income to bondholders as government interest payments rise relative to other spending. This is exacerbated if increasing reliance is placed on indirect taxation and if the ownership of government bonds is highly concentrated.

Comprehensive and sustained financial-sector reforms in South Africa have led to a strong growth in the size of the sector relative to primary and secondary sectors. By making it easier to borrow money to finance consumption, reforms and financial innovation are partly responsible for the decline in personal savings (Aron and Muellbauer, 1998).[33] This has contributed to the dependence on foreign-capital inflows, which in turn has necessitated tight monetary policy. It seems likely that the high real interest rates generated have contributed to an increase in the share of income accruing to the holders of financial assets (see below).

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[32] However, she is optimistic that South Africa is able to position itself to compete in niche markets producing high value-added goods, including some that are labour intensive.

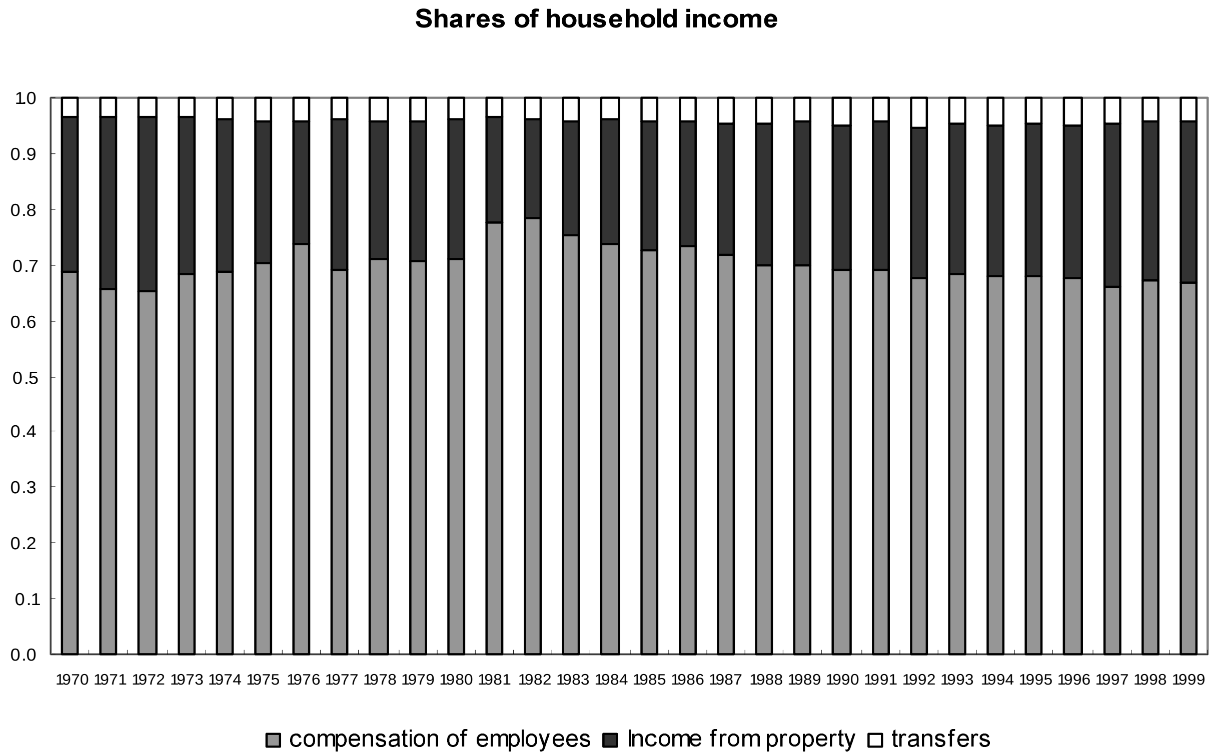
[33] Liberalization has not, however, led to the large-scale extension of financial services to the poorest, such that the provision of credit to small-scale entrepreneurs has been dominated by development-oriented institutions.

## 6.5 Labour institutions

The erosion of labour institutions may worsen inequality during liberalization (Cornia and Kiiski, 1999). It is therefore possible that the income distribution would actually deteriorate if trade unions were undermined in South Africa. It is significant that redistribution away from labour and towards profits, rents and other property income has been a feature of neo-liberal reform. Figure 6 shows

FIGURE 6

SHARES OF TOTAL HOUSEHOLD INCOME ACCRUING TO DIFFERENT FACTORS OF PRODUCTION, 1970-99




Source: authors' calculation.

the shares of current household income[34] accruing to labour and capital and arising from transfers. Transfers are typically between 3 per cent and 5 per cent of current household income. However, income from property has risen steadily from 18 per cent of the total in 1981-82 to 29 per cent in 1998; the share of income accruing to labour has fallen 11 percentage points over the

[34] 'Household' refers to private households (including pension and insurance funds), non-incorporated businesses and private non-profit organizations providing community services to households. Income from property includes dividend receipts, interest receipts less interest payments, rent receipts less maintenance costs, mortgage interest and consumption of fixed capital, and the profits of non-corporate business enterprises after consumption of fixed capital and inventory valuation adjustment (SARB, 1999).

period. This shift away from labour to capital occurred after the legalization of black unions and during the period of rising union strength. Moreover, it has not been reversed by the change of government in 1994.

There are several implications arising from the shift in shares of income from labour to capital. First, it is consistent with the prediction that structural adjustment, in particular monetary and financial reform, favours the owners of capital, especially financial capital. Second, it is consistent with the prediction that in developing countries recession has a greater impact on wages than it does on profits, as safeguards for labour are weak. Third, it provides some support for the earlier proposition that, across all groups in South Africa, the richest became richer (although it cannot be argued from this evidence that the poor necessarily became poorer). Fourth, it implies that union strength may not be as overwhelming in South Africa as is often claimed.

## VII CONCLUSION

There has been a decline in the dispersion of racial incomes in South Africa since the mid-1970s. This has been accompanied by rising within-group inequality, most markedly amongst blacks, which make up the largest population group. As a result, there has been little overall improvement in aggregate indices of inequality, although formal incomes appear to be more evenly distributed. The problem is growing unemployment, which increases the number of people with no access to formal incomes, the best predictor of poverty.

Changes in structural factors in the 1970s were important in reducing racial inequality: wage and occupational discrimination decreased, and there was some improvement in black education. Later, the legalization of black trade unions assisted in the rapid real growth in non-white formal wages. While trade unions have been successful in reducing the skewness in formal incomes, they have been less successful in preventing redistribution from labour to owners of property. This suggests that the liberalization of markets has been more important than other structural factors in shaping the distribution of income in South Africa in recent years. In other words, labour market reforms through the erosion of apartheid practices in the 1970s were an important force behind the shifting distribution; thereafter, liberalization in other areas of the economy has tended to dominate changes.

The adoption of 'Washington consensus' policies has been phased rather than occurring as a package for simultaneous implementation. Initially, the changes were accompanied by falling growth and falling employment, but the deepening of liberalization has been simultaneous with more rapid (but still limited) economic growth. This does not imply causation (either when growth was slow, or when it was more rapid), but it does indicate that contraction is not an inevitable result of liberalization. Nevertheless, employment is still falling; growth remains insufficient to raise per capita incomes, and some aspects of the package have worsened inequality.

The role of labour policy involves trade-offs. On the one hand, trade unions play an important role in equalizing formal incomes by defending, in particular, the conditions of employment of workers in the lower and middle ranges of the wage spectrum. On the other, high wages relative to productivity undermine international competitiveness, encouraging the bias towards capital-intensive production which contributes to overall inequality, as increasing numbers are unable to find formal-sector jobs.[35] These trade-offs are yet to be fully resolved by government, labour and business.

Job creation is important in shifting people out of poverty. The objective of employment-creating growth is driving the current reform programme. However, growth appears to have been stifled over a long period by sustained tight monetary policy (since the late-1980s) and a climate of uncertainty, as well as by external factors, such as global economic instability in the 1970s, economic isolation in the 1980s and, more recently, the contagion effects of emerging economy crises in the 1990s.

The government's other priority is the need to redistribute income and wealth. While redistribution is clearly necessary, a fundamental restructuring which shifts resources away from the elite creates a strong impetus to emigrate, particularly among the better educated. This creates a delicate problem for the government. Against the pressure for radical redistribution must be set the need to keep skills and savings within the domestic economy and to allow sufficient wealth accumulation to attract foreign investors. This will inevitably slow the rate at which redistribution can be achieved.[36]

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[35] This does *not* imply that unions are responsible for unemployment. Relatively high formal wages are an exacerbating factor, not a cause.

[36] In the longer run this may be better for the country's economic growth rate, as redistribution of wealth can retard economic growth (Alesina and Rodrik, 1994). By contrast, evidence cited elsewhere in this volume suggests that it is inequality itself that retards growth.

At present the government's energy is concentrated on overcoming the legacy of apartheid, primarily through a redirection of government spending. The economic policy framework is likely to continue to be comparatively conservative, driven by the need to restructure and liberalize the economy and the need to attract sufficient foreign capital inflows to finance longer term growth. Investing in human resources and providing a policy environment which is, at the very least, not hostile to private investment may well be the optimal solution in the longer run. Slow reform may yet prove to be more sustainable, but it also means that inequality is likely to remain a defining feature of South Africa for many years to come.

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