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Why growth matters so much for reducing poverty in South Africa

Professor Servaas van der Berg

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For South Africa, a relatively modest acceleration in long-term growth could produce a bigger reduction in poverty than an ambitious reduction in inequality. Getting the economy growing again should therefore be a top priority, writes Prof Servaas van der Berg.

South Africa can follow two broad routes in attempting to reduce poverty. Sustained economic growth can raise average real incomes, while a more equal distribution of income can increase the share reaching poorer households.

The two are not alternatives; ideally, we should achieve both. But they do not necessarily make equally large contributions to poverty reduction.

Poverty and inequality are closely related, but they are not the same thing. Sustained economic growth can reduce poverty substantially by raising incomes, even if inequality changes little. Conversely, a more equal distribution of income can reduce poverty even without economic growth.

How much each route can realistically achieve is therefore the million-dollar question.

To explore their relative importance, I use South Africa's 2023 income distribution and project 15 years into the future. This is long enough for sustained growth and some structural change to have substantial effects, but short enough to remain a meaningful horizon for current policy.

Using Statistics South Africa's upper-bound poverty line as my broad poverty measure, I estimate that at the starting line, about 50.6% of South Africans are poor. The Gini coefficient, an oft-quoted measure of inequality, is 0.635.

First, we consider the growth route. Suppose the economy grows by 3% a year over the next 15 years. This would be a marked improvement on recent performance, but not an especially ambitious assumption: recent IMF estimates suggest that sufficiently ambitious structural reforms could raise annual growth to around 3%.

With the population growing at about 1% a year, the average real income per person would then rise by roughly 2% a year. Even if inequality remains unchanged, simulations show that the poverty rate would fall from 50.6% to about 41.5%.

Second, to compare, what happens if inequality is reduced? Suppose the average real income per person does not increase, but the Gini coefficient falls by six points, from 0.635 to 0.575. A reduction of six Gini points would itself be quite ambitious, as international experience suggests. Our simulations show that it would reduce poverty from 50.6% to 44.2%.

Both routes therefore reduce poverty substantially. But the comparison is important: a relatively modest long-term growth assumption produces a bigger reduction in poverty than an ambitious reduction in inequality. If South Africa is serious about substantially reducing poverty over the next 15 years, getting sustained economic growth going must therefore be a central priority.

Latin America provides a useful benchmark because the first decade or so of this century was a particularly favourable period for inequality reduction. A fall of around three to four Gini points over a decade was more typical, while the much larger declines achieved by some countries were exceptional. Moreover, these rapid declines were not generally sustained, with subsequent reductions becoming more modest or uneven. Against this unusually favourable experience, a six-point reduction in South Africa's Gini over 15 years is hardly a realistic prospect.

Moreover, Latin America's substantial inequality reductions often occurred during periods of good growth. Annual real GDP growth averaged about 3.3% in Brazil, around 5%–6% in Uruguay and 5.2% in Peru over the periods concerned. Thus, even some of the most successful episodes of inequality reduction went together with substantial economic growth. This cautions against interpreting the Latin American experience as showing what redistribution alone can achieve.

South Africa also faces structural obstacles to rapid inequality reduction. This is because much of its inequality stems from exceptionally high unemployment and very large earnings differences among those with jobs: the Gini coefficient for wages among employed South Africans is very high at around 0.60. These wage differences are hard to change quickly because they depend heavily on the distribution of skills, and skills formation is slow and highly unequal. Better schooling mainly affects new entrants to the labour market, so changing the skills composition of the workforce takes decades.

Reducing unemployment is essential for both poverty and inequality. But even large employment gains would leave substantial wage inequalities among those already working. This helps explain why a large reduction in South Africa's Gini is likely to take considerable time.

The policy implications are clear. South Africa needs faster growth, lower unemployment, less poverty, reduced inequality, sustainable public finances and better public services. Different policies affect these objectives over different time horizons. But if substantial poverty reduction is the objective, restoring sustained growth deserves priority.

Growth raises incomes, can expand employment and increases the resources available for social spending. Redistribution can assist poor households more directly, but its scope is limited by available fiscal resources - which themselves depend heavily on economic growth over time.

Slowly reducing income inequality does not necessarily mean a slow improvement in people's lives. Safety, functioning schools, reliable water and electricity, effective municipalities and fair treatment by public institutions all affect people's capabilities and dignity. Growth expands the resources available to the state to pay for these things. Progress in these areas need not wait for a fundamental transformation of the income distribution.

Redistribution is important. But South Africa does not have to wait for a dramatic transformation of its exceptionally unequal income distribution before making substantial progress against poverty. Getting the economy growing again is the fastest route to substantially reducing poverty. It should be South Africa's top priority.

Van der Berg is an emeritus professor of economics at Stellenbosch University. This column is based on his recent ***Economic Research Southern Africa working paper, "Poverty Reduction Under Structural Constraints: Growth, Inequality and Policy Trade-Offs in South Africa".***

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