Current Path

The interplay between inequality and growth

Jakkie Cilliers

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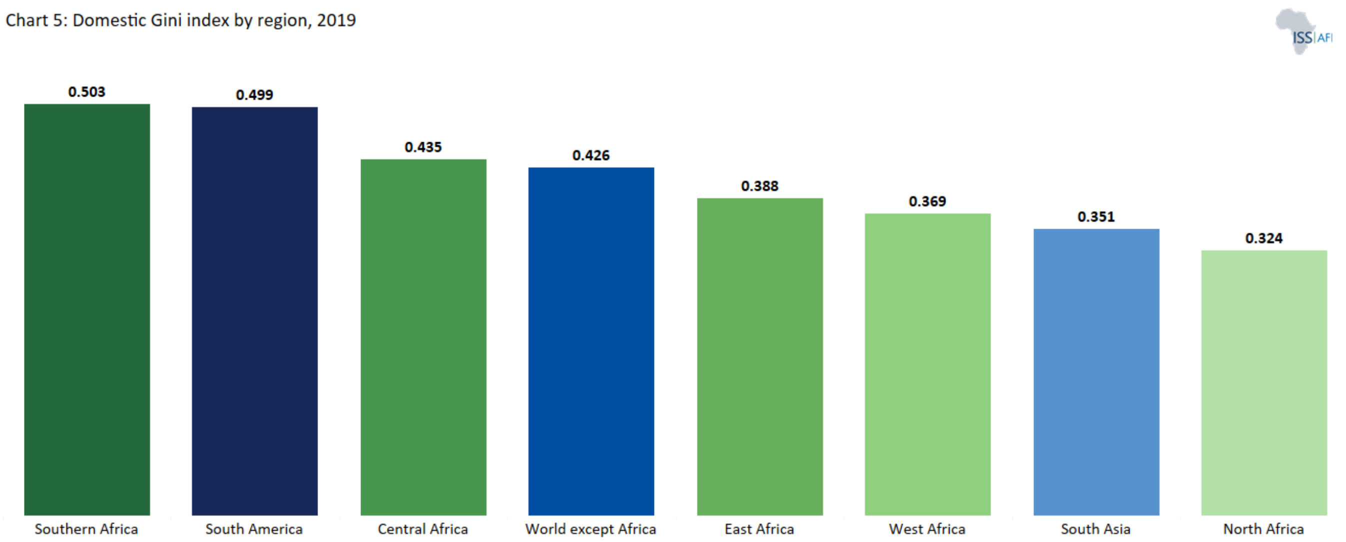
The interplay between inequality and growth

Economic growth and income distribution are the two key variables when forecasting poverty rates at a national level. In general, higher economic growth rates translate into higher rates of poverty reduction, but high levels of inequality limit the extent to which that can occur. If too large, wealth, income and consumption inequalities constrain economic growth. They hinder educational opportunities, human capital formation and intergenerational mobility. A growing economy must, in particular, increase the number of formal-sector jobs and the amount of money in circulation to provide more revenues to the government to invest in infrastructure, health and education (and hence improve the quality of its human capital), as well as for use in more direct measures of poverty alleviation such as social grant programmes.

The most widely used measure to express income distribution is the Gini index, which ranges from 0 to 1. A score of 0 corresponds to complete equality (i.e. everyone earns the same), whereas 1 represents complete inequality (i.e. all the income accrues to only one person in society). Being a summary measure of income distribution, the Gini index does not identify whether a change in inequality is triggered by shifts at the bottom, middle or top of the income distribution. In addition, it is based on survey data that is often unsuited to capturing very high or very low incomes. This challenge is particularly acute in many developing countries, which generally do not have much information on income distribution.

These limitations aside, when comparing regions according to the Gini index, North Africa is significantly more equal than any other African subregion (Chart 5)—largely a function of the central role that the state has played in providing all kinds of services and subsidies, often on the back of oil or gas income. Southern Africa is the most unequal region globally. Central, West and East Africa are somewhere between Southern and North Africa.[1]

Chart 5: Domestic Gini index by region, 2019



Source: IFs 7.84 initialising from World Development Indicators data

Inequality is a complex phenomenon, well illustrated by the Freedom and Dignity Revolution (the Tunisian name for the so-called Arab Spring or Jasmine Revolution) that occurred in North Africa, despite its relatively low levels of inequality.[2]

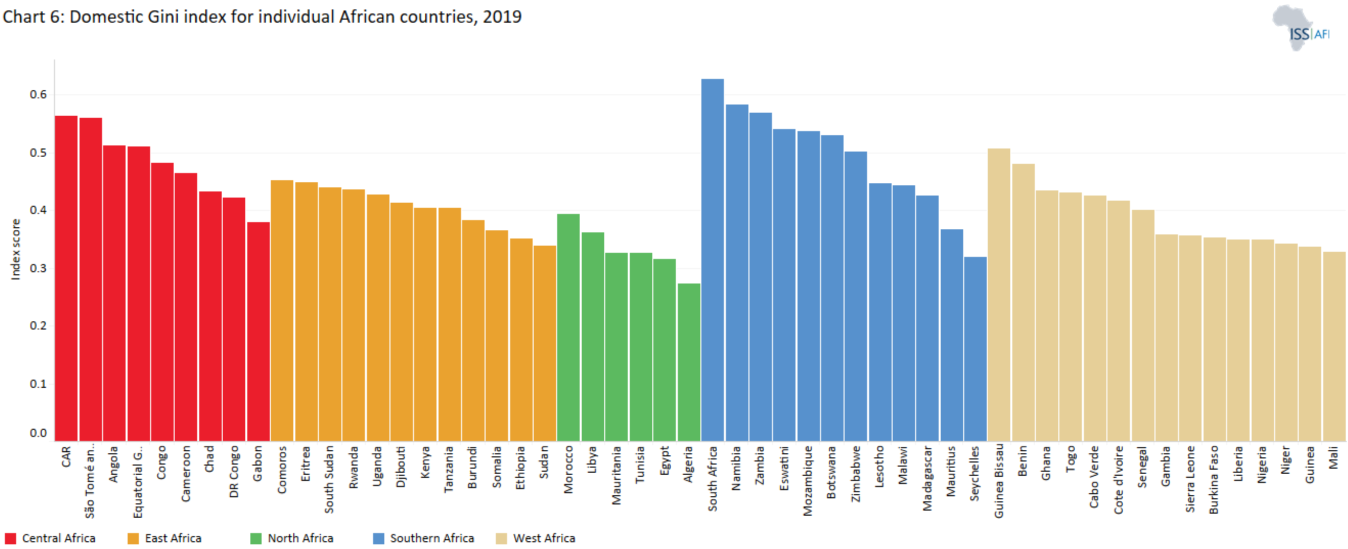
The promise of the Arab Spring has not alleviated the deep frustration among the citizenry. Tunisia is the only country in N orth Africa that has transitioned to democracy but is now increasingly fragile. The progress in education, women's rights and general positive macroeconomic indicators since independence several decades ago conceal deep frustration in a populace weaned on large state subsidies of petrol, water, food and a vast array of state-owned enterprises that consume large amounts of revenue, fuel corruption and limit opportunity. Special interest groups constrain political, social and economic opportunity. The impact is to confine the vast majority of the population to dependence. It is no surprise that frustration continues to simmer. With little economic growth expected, the potential for violent disruption is high.

These concerns and caveats aside, countries with low levels of inequality, such as Ethiopia, with a developed bureaucracy can generally grow rapidly and translate that growth into extraordinary reductions in poverty. This is until, of course, its ethnic divisions rise to the fore, as happened in Tigray in 2020. Much more is required than economic growth, of course.

For example, since the early 1960s, Botswana has consistently grown its economy more rapidly than Ghana and did so until very recently. The average growth rate for Botswana from 1961 to 1999 was 10.1%, whereas for Ghana it was only 2.5%. But because Botswana has higher levels of inequality (as shown in Chart 6), poverty reduction in the two countries does not differ as much as expected.[3] From 1970 to 1996, poverty in Botswana reduced by 25 percentage points but by 14 percentage points in Ghana (using the US$1.90 poverty line).[4] Growth matters, but so do levels of inequality and considerations such as the effectiveness and quality of government. Whereas Botswana is generally an island of stability and good governance in its region, Ghana has suffered from a series of coups, significant political instability and high levels of corruption for much of its independent history.

Chart 6 presents the Gini index for each African country in 2019, arranged by region.

Chart 6: Domestic Gini index for individual African countries, 2019



Source: IFs 7.84 initialising from World Development Indicators data

Endnotes

1. The IFs forecast on poverty levels uses the average levels of income and a log-normal distribution as indicated by the Gini index. However, as the internal calculation using those variables will almost inevitably produce a rate of poverty at odds with those provided by national surveys, the system computes an adjustment in the first year for the subsequent forecast years.
2. North Africa has relatively high levels of education compared with the rest of Africa and scores higher on almost all indicators of human development than sub-Saharan Africa.
3. By about 19 percentage points.
4. In 1970, Botswana still had an average GDP per capita that was US$1 246 below that of Ghana. Within four years, average income levels in Botswana surpassed Ghana's and, by 1999, GDP per capita in Botswana was four times higher (US$7 167) than in Ghana.

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About the authors

Dr Jakkie Cilliers is the ISS's founder and former executive director of the ISS. He currently serves as chair of the ISS Board of Trustees and head of the African Futures and Innovation (AFI) programme at the Pretoria oce of the ISS. His 2017 best-seller Fate of the Nation addresses South Africa's futures from political, economic and social perspectives. His three most recent books, Africa First! Igniting a Growth Revolution (March 2020), The Future of Africa: Challenges and Opportunities (April 2021), and Africa Tomorrow: Pathways to Prosperity (June 2022) take a rigorous look at the continent as a whole.

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