INCOME INEQUALITY IN AFRICA - CURRENT ISSUES AND PERSPECTIVES

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Abstract

Income inequality in Africa is high and it is growing in recent years. There are various reasons behind this trend and they cannot be limited only to historical context and the changing economic environment. Inequality in Africa has a much more complex characteristics and it is due to a number of factors, including political instability, malfunctioning of institutions as well as climate change. This can be further observed as the most unequal regions in Africa are those of Central and Southern Africa, or the commonly referred to as the Sub-Saharan region. One of the main reasons for inequality in Africa is the presence of sectoral imbalances, i.e. the prevalence of the agricultural sector. Another main reason for inequality is the institutional weakness and the negative experience of malfunctioning and extractive institutions. In order to overcome these negative tendencies, the institutions should be reformed and particular attention should be paid to reforms in taxation, public spending and job regulation.

Key words: *inequality, economic growth, institutions*

1. INTRODUCTION

It is a well-known fact and substantial data exists to support the claim that income inequality in Africa is high and it is growing in recent years. Perhaps it is an irreversible tendency, which requires more efforts in terms of financing and strengthening of institutions, the longer the process lasts. The reasons for this are many and they cannot be limited only to historical context and the changing economic environment. Inequality in Africa has a much complex characteristics and it is due to a multiple number of factors, including political instability, malfunctioning of institutions and climate change. It is in many ways on equal level with Latin America and Central Asia, particularly India. The most unequal regions in Africa are those of Central and Southern Africa, or the commonly referred to as the Sub-Saharan region.

One of the main reasons for inequality in Africa is the presence of sectoral imbalances, i.e. the prevalence of the agricultural sector. It is to a great extent suffering from the change in climate, while at the same time industry and the service sector are under-developed and only present in certain regions, where access to resources creates the required environment for industrial growth. Another main reason for inequality is the institutional weakness, high levels of corruption, and the negative experience of malfunctioning, also called “extractive” institutions [1].

This paper provides an overview of the inequality issues in Africa since 1990, the consequences they have on the economic development of the region and also what solutions can be implemented as government strategies and procedures to improve the work of institutions and their policies in order to stimulate economic growth and significantly contribute to reducing inequalities.

The first part of the paper consists of an overview on income inequality in Africa since 1990, its origins and the current trends, including reflections on indicators in different regions. The second part of the paper is focused on the perspectives for overcoming inequality in Africa. The last section summaries the main findings and concludes.

2. AN OVERVIEW OF INCOME INEQUALITY IN AFRICA SINCE 1990

The origins of African income inequality stem from its historical development and colonial heritage, by no doubts, but they are also due to a number of current economic, political, and environmental factors. Regardless of the existing analysis on poverty levels and deprivation, little is known about the extent of

income inequality across the continent and its evolution over past decades. In addition, regardless of the strong economic growth in many African countries, human development and poverty indicators have not changed as much as expected, which aggravates the current trends and further complicates the prospects for improvement. This phenomenon has led to a renewed interest for the study of inequality in Africa, also claimed as one of the main causes of the weak effect of macroeconomic growth on poverty reduction.

In a recent research done by the World Inequality Database [2] the results outline particularly strong and persistent income gaps between African citizens, which are primarily due to differences in income levels within countries. The very low quality of available surveys distinguish the need for improved statistical capacities and for pan-African data collection initiatives to adequately monitor the distribution of growth in African countries. It is interesting to observe that it has long been thought that Africa was too poor to be unequal, hence this makes African inequality levels subject to strong debates currently. In general, analyses on African inequality levels are made on the basis of household surveys. They obviously provide a substantial set of socio-economic information on inequality but they also have important limitations when it comes to comparing actual income inequality levels across countries.

When discussing inequality levels in Africa we need to take into consideration the process of studying inequality across countries or regions. In this respect it is necessary to compare distributions as systematically as possible. The household surveys carried out in different countries may inform on different types of welfare concepts, including disposable income, taxable income or consumption, and may use different ranking concepts like individual, household or equivalence scales. Therefore, moving from one concept to another might significantly change the income distribution in a given country and the level of inequality observed there. Also, it is accepted that household surveys tend to misreport top incomes due to sampling and non-sampling errors. Such errors typically lead to underestimation of inequality levels.

The analysis of the World Inequality database [2] has aimed at forming a consistent picture of income inequality in Africa and obtaining figures comparable to other world regions. It also has attempted to account for these issues by combining different types of data sources: surveys, tax data and national accounts. Thus, the combination of surveys with tax data in Coˆte d'Ivoire and South Africa, the two countries with availability of administrative data, demonstrates that top incomes are significantly underestimated. The average income of top 1% earners is for example systematically underestimated by more than 50%. Secondly, the analysis combines these estimates with official figures from national accounts. Thus, it is displaying inequality statistics which are fully consistent with macroeconomic growth. Therefore, it helps to understand which income groups in which particular African countries benefited most from economic growth in the past decades.

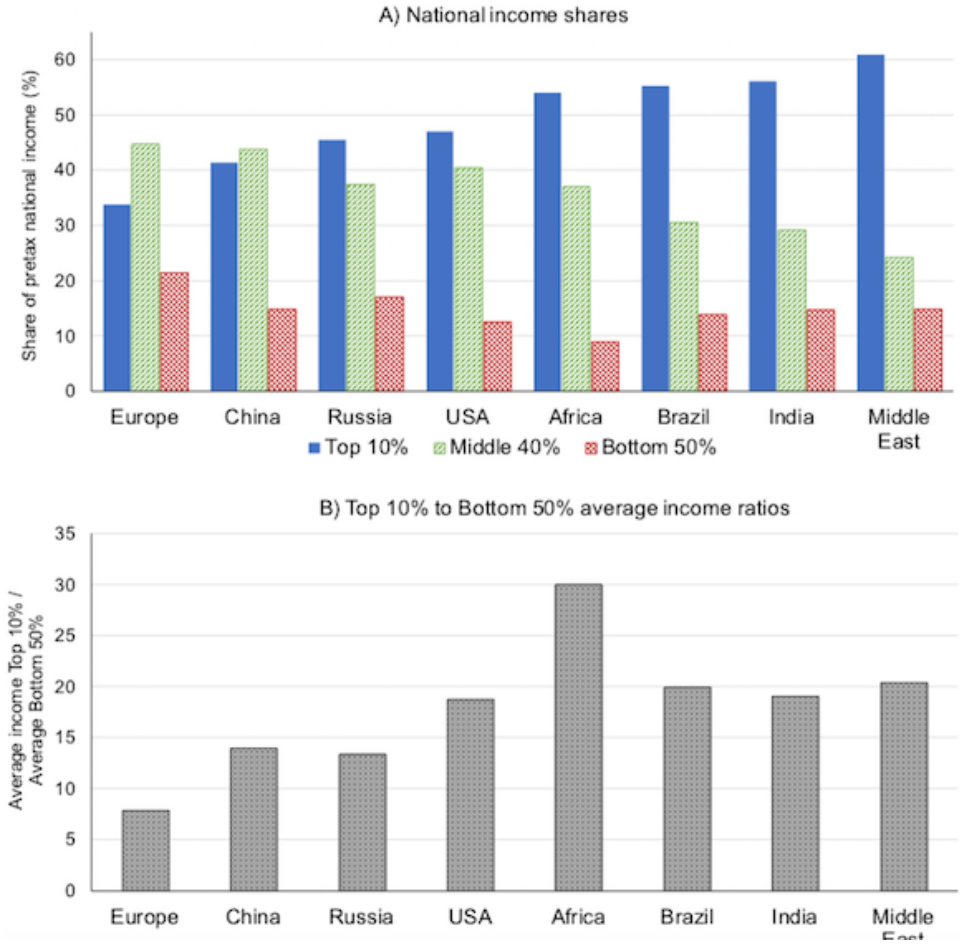

Fig. 1. Inequality levels across world regions, 2017 (Source: [2])

The main finding of the analysis is that Africa stands out as an extreme income inequality region by international standards. The top 10% national income has a share of 54% and the bottom 50% respectively a share below 10% (figure 1).

The observations lead to the implication that Africa has the highest gap between average incomes of the top 10% and incomes of the bottom 50%. Also, average incomes of the top 10% are about 30 times higher than those of the bottom 50% and this is well above the value found in other regions where extreme inequality is identifiable. The gap is found to be approximately twenty times higher in other extreme inequality regions such as the Middle East, India and Brazil. Hence, this proves that the pan-African income distribution has a dual nature, where one can identify extremely low incomes at the bottom and relatively high incomes at the top. It should be however clarified that it also reveals the need to go beyond the Gini coefficient. Hence, this leads to a failure to properly account for the structure of inequality. Important conclusion in the summary to the data is that the income earned by the top 10% of the distribution ranges from 37% in Algeria to 67% in Botswana. The bottom 40% is at most 14% in Algeria, and is as small as 4% in South Africa. Due to the regional character of African economic development, the income gaps are highest in Southern and Central Africa and lowest in Northern Africa.

When it comes to identifying the source of inequality by its regional characteristics, it is mostly the fact that agriculture is a main source of income and economic sector of main priority. The research [2] shows that three groups of countries emerge from the classification of countries according to agricultural employment share, the productivity of labor in agriculture relative to the non-agricultural sector, the unemployment rate, and the share of mining rents in in the gross domestic product. The most unequal one is mostly composed of 10 countries from Southern and Central Africa. These countries are reported to

have a large services sector as well as high levels of informal employment and unemployment. Mining rents are substantial in many countries and agricultural productivity is relatively low (except in Namibia and South Africa). The second group of 22 countries is less unequal and these are countries where agriculture makes a very large share of employment but has very low relative productivity. Another factor adding to the rise in inequality is that there the service sector is rather small and it shows relatively high remunerations - mostly given to administration workers. The third and last group of 16 countries displays even lower inequality levels. In this group like the first one, these countries are relatively urbanised and the service sector gathers a significant share of employment. Yet, in contrast with the first group, mining rents are limited as well as unemployment. Also, in this group the relative productivity of agriculture is much higher.

The conclusion which can be drawn from the above observations is that within country inequality in Africa, apart from its colonial heritage, is largely due to sectoral imbalances and the fact that agriculture has the greatest share in the countries' economies. Those countries which have a prevalence of the service sector obviously demonstrate lower income inequality levels. In addition, and also again linked to the greatest share of agriculture in the sectoral distribution of the economy, there is a clear need for productivity enhancement of the agricultural sector, considering that its impact on inequality is indeed also tightly linked to the distribution of land rights. Property rights and land access reforms are needed. Access to land is a particularly serious problem in Zimbabwe and South Africa, where the agrarian reform failed to solve the issue. It should be observed that the Industrial Revolution has still not spread to Africa because the continent has experienced a long and vicious circle of the persistence and recreation of extractive political and economic institutions (with the exception of Botswana) [1].

It is considered that to a great extent the growth of extractive industries are likely to contribute to unequal growth in Africa. In the most resources-dependent countries, some have rich experience in increase of inequality (like Angola or Chad), while others (like Algeria) followed the opposite pattern of a decrease in inequality. Finally, the role of tax revenue and government spending is important in reducing inequality in Africa. Most African countries have low government revenue, and consequently limited fiscal opportunities for financing. This diminishes their capacity to provide good quality of some very important public services like health services and education, as well as to provide substantial financing for social protection and transfers. Hence and most importantly their influence over income inequality is limited. To make improvement in this direction, it is necessary to reduce substantially tax evasion through better inclusion of informal activities into the tax system or introduction of progressive taxation. By all means, promoting efficient and progressive tax systems is a key factor for fighting inequality in Africa [3]. Therefore, in order to decrease inequality levels, it is of primary importance for most African countries to improve redistribution and tax collection, which should be paired with the implementation of efficient social protection systems and the provision of public services of the required quality and availability to all citizens.

In all aspects of poverty, inequality and hidden hunger, the African region stands out as having all of them and Africa is the second most unequal continent in the world, where seven of the most unequal countries are situated. It is also estimated that the richest 0.0001% of the population in fact own 40% of the wealth of the entire continent. In addition, Africa's three richest billionaire men have more wealth than the bottom 50% of the population of Africa, which is approximately 650 million people. At the same time, Africa is becoming the epicentre of global extreme poverty, where the numbers of people living on less than $1.90 are rising. If these current trends continue, the World Bank estimates that 87% of the world's extreme poor will be in Africa by 2030. In addition, the IMF predicts that 24 of the 45 sub-Saharan African countries, including South Africa and Nigeria, are not likely to see a strong economic recovery and there is great risk of a continental crisis that will undermine development in the future, while at the same time population growth increases [3]. It should be underlined that such economic downturns and continuous periods of poverty increase are in many instances due to reckless lending by European financial markets and Chinese banks, which directs funds to inefficient investments and without a clear institutional strategy for development.

Increased indebtedness is a significant impairment to development and reduction in income inequality, as it blocks the ability of governments to finance public services with high social impact. The process

is additionally aggravated by external factors of global nature, such as the financial crisis and the impact of COVID-19 on the level of country debts. The latter is seen to have greatly contributed to a sharp increase in government debt ratios in many countries. Sovereign debt in many EU economies reached historical highs in 2020 and the key drivers of that debt built-ups are the collapse in revenues caused by the Covid-19 crisis and measures taken to mitigate the impact of the health crisis [4].

The aforementioned lending is often joined by systematic borrowing by a number of African governments, which by its turn is severely affecting spending on public services. For example, in Uganda, debt repayments have reached historic highs, which has forced the government to cut spending on education and healthcare by 12%. However, there are also positive examples, like Namibia, which has introduced successful policies for fighting inequality since 1993 and takes the first place in social spending because the government has made investments to fund public policies, for example free secondary education for all students, and also increased spending on social protection. Therefore, we find both positive and negative examples of policy developments in Africa.

Examples of positive and poor policy choices for reducing inequality in African countries [3]

Positive example – Ethiopia

Ethiopia is one of the poorest countries in the world. However, interestingly it is the fifth- largest spender on education in the world as a proportion of its budget:

• It employs over 400,000 primary school teachers.

• Between 2005 and 2015, it has brought an additional 15 million children into school, from 10 to 25 million, the majority of whom are girls.

Ethiopia still faces serious challenges with learning outcomes and improving the quality of education. Yet, the scale of its commitment and effort to educate students is impressive.

Negative example – Nigeria

Nigeria is at the bottom of the Africa ranking, as well as the global ranking for two consecutive years. Social spending is stagnating at a very low level, and the consequences of underinvestment in health and education are also evident. One in 10 children dies before becoming 5 years old, and more than 10 million children do not go to school, of which 60% are girls.

Seven of the 20 most unequal countries in the world in terms of income inequality are situated in Africa (figure 2) – including the four most unequal: Swaziland, Nigeria, South Africa and Namibia [5]. In addition, over the last 25 years income inequality in sub-Saharan Africa has not changed substantially. In a recent research done by the European Commission it was estimated that, while the period of growth after 2000 did infect increase incomes, the bottom 40% experienced no greater benefit than other income groups [6]. Evidence from the World Bank also highlights the fact that the challenge will be even greater for some African countries. Between 2000 and 2015 consumption actually decreased for the bottom 40% in a third of the sub-Saharan countries.

An interesting observation is that Nigeria is Africa's biggest economy, but this economic growth has not led to increased equality in incomes. Poverty in the country is still very high. Nearly 10 million children are out of school, a quarter of citizens lack access to safe drinking water, and half are living below the $1.90 poverty line. Also, it is estimated that $24n billion of investments would be needed to end poverty in the country, which is less than the combined wealth of the richest five Nigerians. Their $29.9bn wealth is actually more than the country's entire budget for the year 2017 [7].

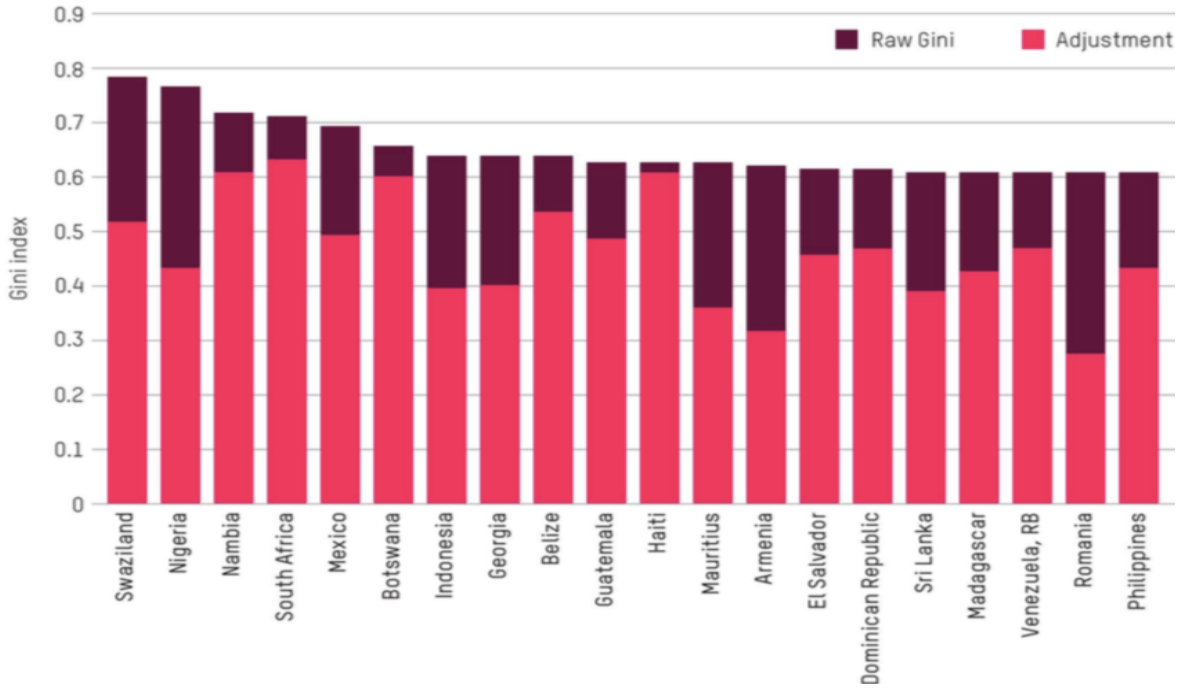

Fig. 2. The 20 most unequal countries, using raw and adjusted Gini measurements (Source: [3])

Also, levels of gender inequality in Africa are among the highest in the world and it is closely related to economic inequality [8]. African women and girls are poor and they do not possess any opportunities to escape poverty. It is reported that three quarters of women are employed in agriculture or in low-paid informal sectors. For example, in Nigeria women represent between 60% and 79% of the rural labour force, and about 37% of active agriculture workers. However, they cannot own their land and they are ten times more likely not to own it than men [9]. One third of African companies have no female director on their board and women comprise only 23% of Africa's parliamentarians [10].

3. PERSPECTIVES FOR OVERCOMING INEQUALITY IN AFRICA

The reasons for inequality in Africa are numerous, but as it was already mentioned, their roots are in the colonial heritage and the extractive nature of institutions. The debt crisis in the 80s and 90s contribute to reforms which led to privatisation, deregulation, tax cuts for people with high incomes as well as reduced public spending. These were in fact the major cause for inequality gaps to deepen in almost all African countries. It is interesting to note that the same factors contributed to deepening inequality in Eastern Europe after the transition to market economy in the early 90s.

Hence, the approaches needed to overcome poverty and inequality in Africa can be found in taking corrective actions in respect of the identified reasons for it to occur in the first place. Most importantly, they are related to reforming institutions and making them become more inclusive while developing pluralism and increasing the potential for economic growth through creative destruction and innovation.

The solutions per se include [3]:

- public spending on free public services and social safety nets;
- efficient and progressive tax systems; and
- decent work and wage policies.

According to Oxfam and Development Finance International an index is needed to measure government

performance on tackling inequality and they developed Commitment to Reducing Inequality (CRI) Index.

On the first place, providing for a good programme of social support is a fundamental part of redistributive fiscal policy as it corrects income inequality through in-kind transfers like health and education, along with cash transfers that comprise of social protection. According to a European Commission study of sub-Saharan Africa, it highlighted the importance of education as a tool to reduce income inequality and found that schooling raised the income share of the bottom 80%, mainly at the expense of the top 10% [11]. In addition, cash transfer schemes also redistribute by using public money. Thus it provides direct income top-ups and safety nets including pensions, unemployment benefits and sick pay [12]. Also, public spending on services and transfers contributes to reducing gender inequality, while social protection schemes can reduce the burden of care work that otherwise is taken up by women and girls. A survey of the World Bank has found that one additional school year can increase the overall earnings of women by 10% to 20% [13].

Secondly, progressive tax systems pay a double dividend in the battle against inequality. They directly reduce the gap between rich and poor people and also raise revenue which can be further invested in social spending. In addition, a research from the IMF highlights that tax systems that redistribute wealth and enable spending on public services are one of the most effective ways for governments to reduce inequality and poverty while at the same time sustaining growth [14].

It also deserves mentioning in this respect that corporate tax incentives and exemptions are a major issue for African countries, and they additionally contribute to increasing inequality levels. They have grown substantially in recent decades, especially during the period between 1980 and 2005, when the number of sub-Saharan African countries offering tax holidays to companies doubled from 40% to 80% [15]. It is a common approach that the reduced tax rates are introduced by governments in order to attract investments. The same approach has been applied by some Eastern European countries (particularly Bulgaria) to attract foreign direct investments and thus to encourage growth and increase the standard of living. However, there is little evidence that such exemptions actually contribute to achieving this end and the African case proved that as well. According to a World Bank survey of investors in East Africa, 93% claimed that they would have invested even if tax incentives had not been available to them [16]. Hence, tax exemptions are clearly not the proper means of achieving neither economic growth through encouraging investments, nor social welfare by decreasing inequality. To the contrary, they decrease the prospects of growth while increasing at the same time income inequality.

Finally, a key factor for reducing inequality is decent work and adequate remuneration. In essence, underemployment and the precarious nature of jobs affect almost the entire African population of working age. Another important feature is that in Africa the labour market is almost entirely informal and they are poorly paid. Most work (approximately 80%) is almost self-employment. According to estimations of the African Development Bank in Senegal only 3.8% of jobs are formal [17].

4. CONCLUSION

Income inequality in Africa has been significantly increased in the past thirty years. There are a number of reasons, which shaped this process. It is partly the colonial heritage that introduced the model of extractive institutions. They shaped a wrong and inefficient model of the economy, where the agricultural sector prevails but does not offer increasing productivity. Development is lagging behind and it is a major reason behind increasing income gaps and inequality, poverty and reduced spending in the public sector, particularly for education and healthcare. Additionally, the COVID-19 pandemic has resonated in damaging the health systems and increasing country indebtedness across the globe [4] and particularly in Europe and some EU countries like Bulgaria [18], [19].

There are three identifiable approaches towards reducing inequality - increased public spending with a particular focus on education, progressive taxation and increased payment through formal jobs. All these

reforms need to be introduced through more effective and inclusive institutions, through increased transparency of social policies, public social spending to increase sustainability [20], and reduced levels of corruption.

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