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Inequality is the binding constraint to growth

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Inequality is not only a moral and political issue in South Africa but a core structural constraint on economic growth. Despite significant progress in income redistribution since 1994, the South African economy remains stuck in a cycle of stagnation, high unemployment, and deepening exclusion. The dominant development model—focused on enabling markets and fixing the state—lacks a transformative vision capable of shifting the underlying structures of economic power and production. This can be remedied by a shift in emphasis from income redistribution to the redistribution of assets and endowments, including land, housing, education, and access to capital.

Introduction

The relationship between inequality, redistribution, and growth is a central policy problem facing South Africa. A persistently high level of inequality limits the rate of economic growth through a multitude of channels. Inequality is also self-reinforcing. The rising incomes that growth generates accrue to large corporations and affluent investors. Growth that results from the extension of markets generates lower costs and efficiency gains but often entails new forms of exclusion or dispossession.

A progressive policy agenda must envisage a path in which economic growth and social change are connected and mutually reinforcing. This requires revisiting some of the assumptions made in previous attempts to connect redistribution and growth.

In the past 30 years, the democratic state has enacted a significant increase in income redistribution through fiscal means (i.e. taxation to finance income and services for the poor). However, this path of redistributing income has reached its limits. I suggest those concerned with growth and egalitarian transformation should shift their attention from income transfers towards the redistribution of assets and endowments.

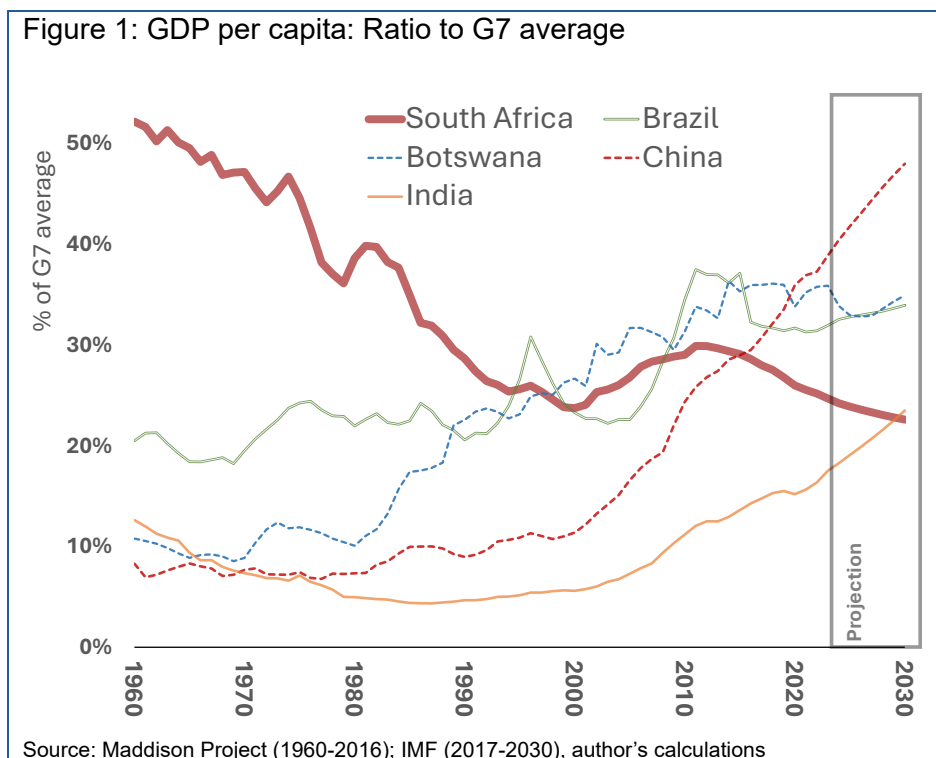
South Africa's development trap and the GNU program

Increasing GDP may not be the central goal of South Africa's development agenda, but it is an indispensable measure of progress. In South Africa, GDP per capita—the broadest measure of national economic welfare and productivity—has stagnated for more than a

decade. Moreover, if we benchmark SA's GDP per capita against the most developed economies, the country has fallen behind since the mid-1970s (see **Figure 1**).

During the heyday of apartheid, between 1950-1970, the economy grew at more than 5% on average over twenty years. That period's growth model involved strong repression of black workers and suppression of black consumption to raise white consumption levels to "first world" standards. South Africa's largest export (gold) served as the monetary base of global capitalism, its price literally fixed in US dollars, sheltering the country from global volatility.

These conditions sustained the rule of a violent white-supremacist minority, which enjoyed the fruits of rising income and asset accumulation on the backs of the majority. But when global conditions changed in the 1970s, this path of extractive growth became increasingly untenable. The social and economic destruction wrought by apartheid became a notable constraint to economic growth. Millions rallied behind the cause of a non-racial and democratic society, and the democratic breakthrough of 1994 opened the prospect of a new development path.

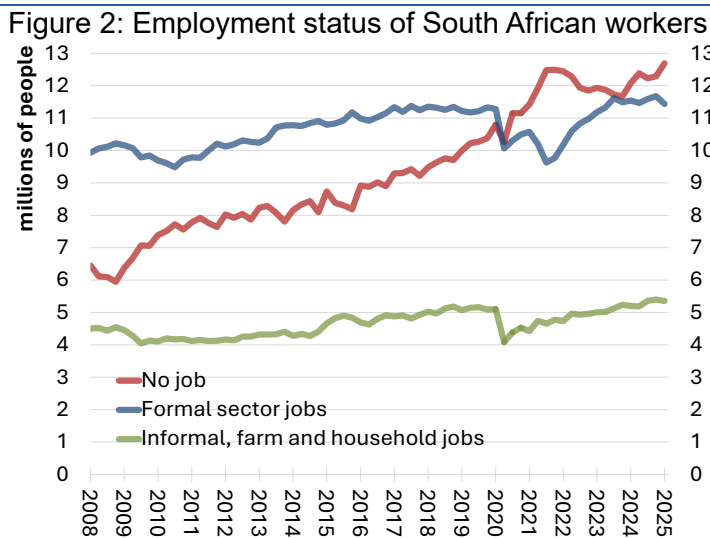


Many hoped the democratic transition would overcome the "organic crisis" of SA capitalism. Popular energy, mobilised through legitimate and democratic political institutions, would drive the economic and social transformations required to place South Africa on a new path of growth and development. And democracy did have profound economic consequences. There was a historic relocation of the population towards urban centres as apartheid spatial imbalances unwound in dramatic fashion. Formal-sector workers, including those in the public sector, made large gains in pay and power. The political freedoms and social reforms associated with the democratic transition expanded the circle of inclusion, driving economic expansion and change in the 1990s. Apartheid restrictions had actively suppressed black consumption for generations, and these conditions led to a surge in spending by an unshackled middle class. Increased government consumption combined with higher government transfers supported an expansion in demand.

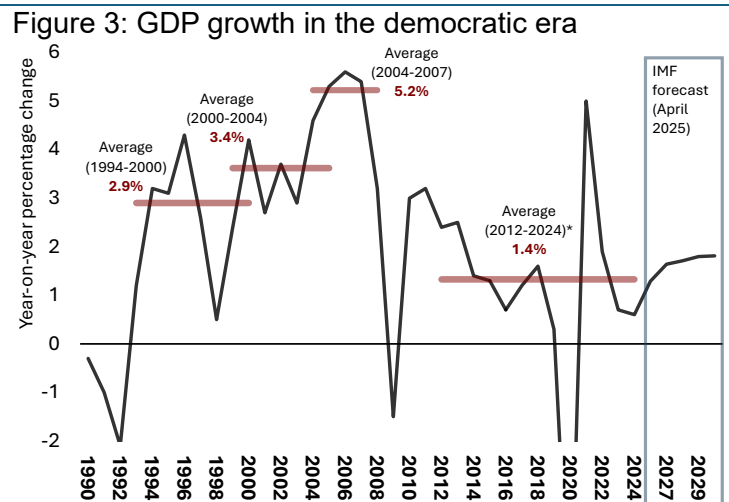
But hopes that democratic institutions would bring about a change in economic structure or the direction of accumulation have been sorely disappointed. Production remained focused on an extractive and stagnating mineral and energy core. Manufacturing continued to decline along a path of premature deindustrialisation. New sectors have emerged, but growth has been concentrated in financial and business services for the corporate sector, government services for poor households, and private services for affluent households. Employment creation, where it exists, has been concentrated in these (relatively) low-productivity sectors. A fundamental change in the dynamic path of the South African economy was not realised.

In the past two decades, fiscal pressures have mounted, and years of austerity have eroded public employment and service provision, adding new risks to the fragile social compact without stabilising the rising cost of debt.¹ But the crisis of sustainability South Africa faces is not primarily fiscal. Between 2008 and 2024, the number of unemployed people more than doubled, from approximately six million in 2008 to over twelve million today (see **Figure 2**). Those with a formal-sector job fell from 49% of the labour force to just 40%. Those with more vulnerable and lower-paying jobs, such as informal sector workers, domestic servants and farm labourers, decreased from 22% of the labour force to just 18%. Those without a job increased from 29% to 42%. This trajectory of rising numbers of unemployed is more profoundly unsustainable than any fiscal metric.

Amidst long-term and persistent stagnation, the past five years have been particularly challenging, as COVID-19, load-shedding, dysfunctional logistics, rising fiscal stress, and global turbulence all conspired to hinder growth. The last elections took place at an economic low point, a cyclical nadir amidst a longer-term structural crisis (see **Figure 3**). In these circumstances, a revival in investment is clearly needed to turn South Africa's dismal performance.



Source data: StatsSA (QLFS) “No job” reflects the expanded definition of employment



* Average for 2012-2024 excludes 2020 and 2021
Source: SARB (1990-2024), IMF (2025-2030) and author's calculation

¹ See Sachs, Amra, Madonko, & Willcox (2023). *Austerity without consolidation: Fiscal policy and spending choices in Budget 2023*. SCIS Working Papers, 60.

The Government of National Unity (GNU) was cobbled together in May 2024 on the basis of a correct assessment that the single most important short-term goal is to revive growth and private investment, which is a necessary condition for delivering progress on any other goals. Since then, a programmatic consensus has emerged in government around two pillars: enabling markets and fixing the state.

The first pillar is a commitment to extending the scope of markets and leveraging private-sector capabilities. Key to the second pillar, fixing the state, is stabilising South Africa's fiscal position. Private investment and market regulation depends on a credible fiscal state that can backstop investment risks by providing specific guarantees to private capital and ensure financial stability. Fixing the governance of state-owned companies and local government is essential since these deliver the public utilities that underpin private capital accumulation. "Inclusive growth" is only possible if there is an improvement in the state's provision of basic needs to the poorest, including education, health, and welfare. Lastly, the state's security arms must be fixed to protect investments and act against the criminality and corruption that disrupts business activities.

The parties to the GNU are united on these interventions but remain divided about the nature of social and economic transformation. To change the historical path of South African growth will require a program to mobilise the country behind real economic transformation. Government needs to directly confront the institutions that reproduce economic exclusion and perpetuate stagnation. In other words, it needs to reassess the relationship between growth and redistribution.

Growth and redistribution in retrospect

A lively South African debate about redistribution and growth fed into the 1994 Reconstruction and Development Programme (RDP), the democratic state's first attempt at a national development strategy. Underpinning the RDP was an assumption that industrial growth and investment would create decent jobs, reduce mass unemployment, and generate the resources necessary for redistribution. Industrial growth would be the surest path to addressing poverty and inequality.

Successive government policies – GEAR, ASGISA, New Growth Path, and the NDP – built on this foundation and sought to raise the growth rate through a combination of industrial policy, public investment, and other measures to address the "binding constraints" to GDP expansion. From 2000 onwards, increase in public spending supported a large expansion of the welfare net and expanded public services, supported by increased public employment and better pay for government employees.² The mass rollout of public housing increased access to electricity, water, and sanitation. There were sustained increases in public infrastructure spending for electricity generation, trade infrastructure, national roads, and passenger rail.

In the lead-up to the 2010 World Cup, these approaches appeared to have paid off. A range of social, economic and political indicators suggested that South Africa had converged on a new growth path. The magnitude of economic growth far outpaced the increase in population for the first time in years. The budget recorded a surplus, unemployment fell, and investment increased.

² See Sachs (2021) *Fiscal Dimensions of South Africa's Crisis*. Southern Centre for Inequality Studies Working Paper.

In hindsight, however, it is clear that much of this growth acceleration was dependent on uniquely favourable global conditions. Reinhart et al (2016) describe this period in the history of the world economy as “the second longest boom in real commodity prices since the late 18th century and one of the four longest [capital] inflow episodes”.³ For South Africa in particular, the surge in real export prices between 2000 and 2011 was historically unprecedented. Global buoyancy raised national income, eased fiscal and financial conditions, and reinforced the consumption boom in both private and public sectors. With growth accelerating and interest rates low, the debt burden fell even as tax rates were lowered.

However, these global conditions unravelled after 2011. The “double bonanza” of high commodity prices and buoyant capital flows was followed by a double crisis for all emerging markets.⁴ South Africa’s growth rate, which had rebounded strongly from the global financial crisis, began to slow down.⁵ The fiscal position suddenly looked unsustainable and debt began its unstoppable rise. Moreover, the weak foundations of the preceding decade’s public infrastructure drive became increasingly apparent. Large investments in electricity generation, logistics infrastructure, and social provision failed to deliver on the promise of transformation. Extensive income redistribution had eased poverty but made only a small dent in the level of inequality. Spatial patterns of apartheid inequality had deepened. South Africa remained as dependent as ever on commodity exports. Instead of inaugurating a level path of growth and development, high levels of public investment left in their wake a fiscally weakened state owning a portfolio of bankrupt public companies presiding over stranded assets.

Of course, Jacob Zuma’s second term then made matters far worse, but the seeds for the coming stagnation and fiscal crisis had already been sown because the state had failed to transform the previous decade’s nominal boom in income into a meaningful transformation in social and economic conditions. Instead, the structural faults in the real economy were reinforced, and once supportive global conditions changed, South Africa returned to its historic path of falling productivity, rising unemployment, and stagnating GDP per capita.

Inequality and income redistribution in South Africa

It is widely accepted that South Africa has extremely high levels of inequality, and most agree that this is a fundamental constraint on growth. Comparative data show that South Africa’s fiscal system is highly effective in redistributing income from the affluent minority to the excluded majority. Its level of progressive income taxation is far higher than that of other countries at a similar level of development, as shown in **Figure 4**.

Figure 5 shows the comparative impact of fiscal operations in a study by Norah Lustig.⁶ South Africa’s budget reduces the Gini coefficient from more than 0.75 to about 0.60, the

³ Reinhart, Reinhart and Trebesch. 2016. *Global Cycles: Capital Flows, Commodities, and Sovereign Defaults, 1815-2015*. American Economic Review, 106 (5): 574–80.

⁴ Ibid

⁵ South Africa’s pattern of growth during this period was strongly correlated with that of other middle income countries with a similar export profile.

⁶ Lustig, N. (2016). *Inequality and Fiscal Redistribution in Middle Income Countries: Brazil, Chile, Colombia, Indonesia, Mexico, Peru and South Africa*. Journal of Globalization and Development, 7(1). More precisely, **Figure 4** assesses the distributional impacts of taxes and transfers in several countries, showing the Gini coefficient for four different definitions of income. Market income is gross (pre-tax) wages and salaries in the formal and informal sectors (also known as earned income), as well as income from capital, own production, imputed rent, and private transfers. Disposable income is market income minus direct personal income taxes on all

strongest fiscal effort of the seven middle-income countries she studied. **Figure 6** shows that the extent of fiscal redistribution is not only high but also particularly well-targeted.

This is an essential pillar of South Africa's political settlement. The “social wage” plays an indispensable role in combating poverty, eliminating hunger, reducing inequality, creating employment, and developing human capabilities. Sustaining this level of investment in social services is also essential for raising long-term productivity.

However, as **Figure 5** shows, even after fiscal interventions South Africa still has the highest Gini coefficient in the study group. **Figure 7** places South African in an even wider global context, using OECD data.

Figure 4: Tax to GDP ratio of middle-income countries

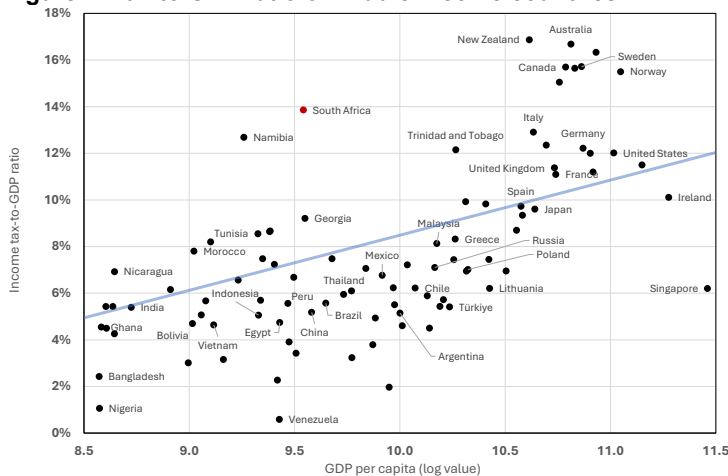
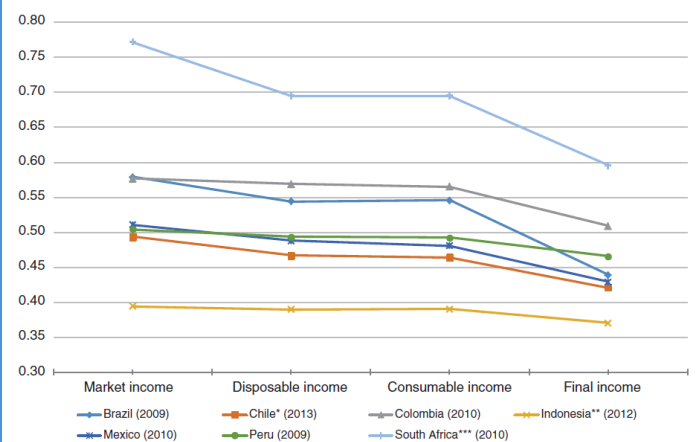
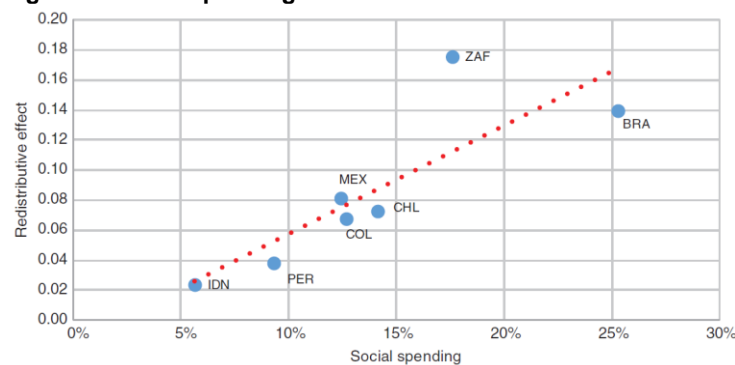


Figure 5: Fiscal policy and inequality
Gini coefficient for market, disposable, consumable and final income



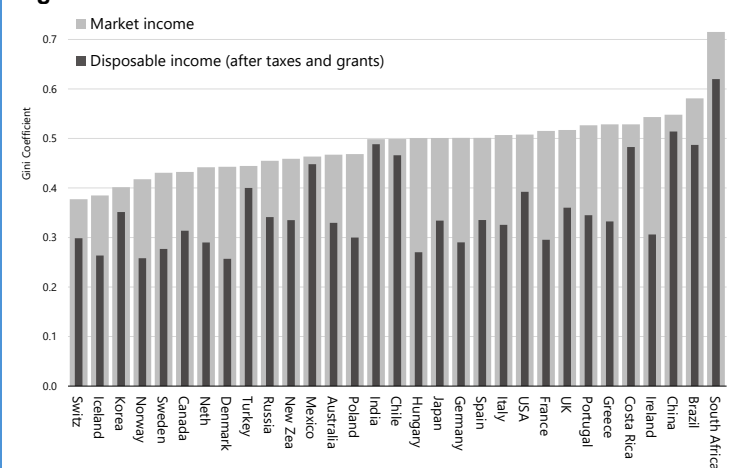
Note: In this Figure, contributory pensions are defined as deferred income. See Lustig (2016) Source: Lustig, N. (2016). Inequality and Fiscal Redistribution in Middle Income Countries: Brazil, Chile, Colombia, Indonesia, Mexico, Peru and South Africa. Journal of Globalization and Development, 7(1)

Figure 6: Social spending and redistributive effort in 2010



Source: Lustig, N. (2016). Inequality and Fiscal Redistribution in Middle Income Countries: Brazil, Chile, Colombia, Indonesia, Mexico, Peru and South Africa. Journal of Globalization and Development, 7(1)

Figure 7: OECD estimates of before and after Gini-coefficient



South Africa's redistributive effort is strongly targeted because social policy in South Africa is directed at providing for the basic needs of the poorest citizens. Public healthcare,

income sources that are subject to taxation plus direct government transfers. Consumable income is disposable income minus indirect taxes (e.g. VAT) plus indirect subsidies (e.g. food and energy price subsidies). Final income is consumable income plus government provision of free or subsidised services in education and health (minus co-payments or user fees, when they exist).

education, social infrastructure, human settlements, and cash subsidies are universally available. But those with even modest means opt out of public services into privately-financed social goods (e.g. private security, education, healthcare, and neighbourhoods). The increasing segregation of neighbourhoods and social services into affluent and low-income niches raises the costs of public services and infrastructure. In a growing mixed-income neighbourhood, private and community contributions augment financing through user charges, ensuring better accountability and more effective services. Where government sets out to provide services in a ghetto of poverty and exclusion, the cost is likely to be higher and the quality lower. It is likely that in these conditions the inequalities in service levels received by poor and affluent citizens in South Africa will diverge into a widening chasm in the quality of life.

The dry statistics about Gini coefficients fails to capture the quality of everyday life that extreme inequality represents, a multi-dimensional character that is captured well in Göran Therborn's description:

Inequality is a violation of human dignity; it is a denial of the possibility for everybody's human capabilities to develop. It takes many forms, and it has many effects: premature death, ill-health, humiliation, subjection, discrimination, exclusion from knowledge or from mainstream social life, poverty, powerlessness, stress, insecurity, anxiety, lack of self-confidence and of pride in oneself, and exclusion from opportunities and lifechances. *Inequality... is a socio-cultural order*, which (for most of us) reduces our capabilities to function as human beings, our health, our self-respect, our sense of self, as well as our resources to act and participate in this world.⁷

This visceral sense of inequality is also the terrain on which political entrepreneurs find fertile grounds for popular mobilisation in South Africa. Movements that pass off these narrow and short-sighted interests as the common aspirations of the people are likely to be a permanent feature of the political landscape. Such forces can offer a clear program of direct and immediate redistribution of rents to local and provincial elites with a popular base in excluded communities.

Moreover, the GNU's attempts to fix the state and unleash markets will provide them with a fertile flow of opportunities for mobilisation. In many cases, reform aims to disrupt the flow of rent to important and well-organised networks in the political class and broader civil society. Fiscal consolidation implies a reduction in the headcount and pay of teachers, nurses and police officers, which the coalition is still grappling with. Market reforms to infrastructure services may well be necessary to raise efficiency, but they can easily worsen economic exclusion and result in separate and unequal services. Whatever its economic merits, a program focused solely on enabling markets and fixing the state is likely to fail politically.

*See the next edition of Econ3x3 for Part 2 of this article: **A new focus***

⁷ Therborn, Göran. (2013). *The killing fields of inequality*. Polity Press. p1. Italics not in the original