

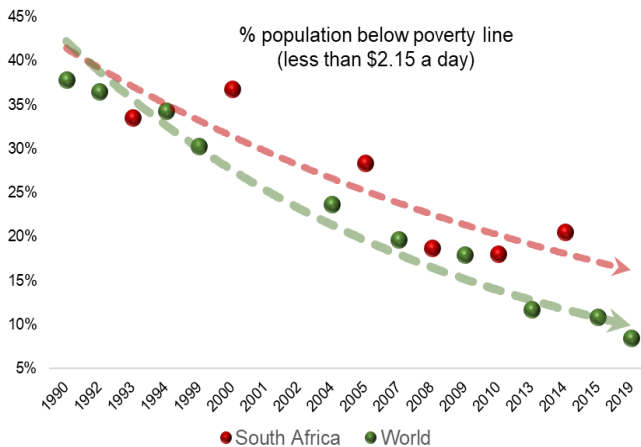
# Chapter 3

## Income and Wealth Inequality

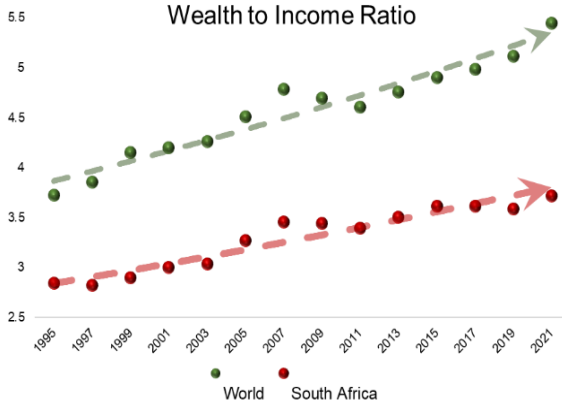
Ivan van der Merwe

### Introduction

Over the last 50 years, the world has experienced an increase in the pace and extent of change, both for the good and the bad. Negative developments include the occurrence of viruses like HIV, pandemics, climate change, financial crises, and low economic growth.<sup>1</sup> Positive developments include the rise of economic disruptors like China, information technology, and new developmental goals, but also the fall of catastrophes like communism, infant mortality and global poverty. Despite the strides that have been made to reduce poverty levels (see Figure 1) the world no longer seems to be on track to meet its goal of ending extreme poverty by 2030.<sup>2</sup> A contributing cause for this is the upsurge of wealth inequality, which is steadily rising back to levels not seen since World War II (Figure 2).



**Fig. 1:** Global poverty reduction. Source: Hasell *et al* (2023)<sup>3</sup>



**Fig. 2:** Global rise in wealth inequality. Source: World Inequality Database<sup>4</sup>

Inequality has several dimensions and rarely are those dimensions as pertinent as in South Africa, where, almost 30 years since the dawn of democracy, the country is still plagued by declining economic growth, increasing unemployment, high income inequality, and extreme levels of wealth inequality. While income inequality measures the distribution of income received by households in the form of salaries, wages, interest, and profits, wealth inequality measures the distribution of household assets that were either accumulated by past savings and investment, or through transfer or inheritance between generations.<sup>5</sup> The purpose of this chapter is to focus on the state of wealth inequality in South Africa and to reflect on why reducing it is crucial for the country’s future.

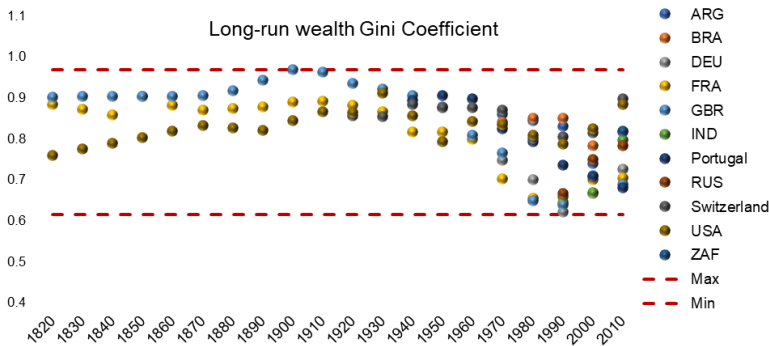
Wealth is measured as the difference between household assets and debts, as defined in the United Nations System of National Accounts (SNA). Assets consist of financial assets like cash, bank deposits, pensions, life insurance, bonds, and shares, and non-financial assets that mostly reflect housing and business ownership. Debts, in turn, mostly include liabilities like mortgages and various types of personal loans.<sup>16</sup>

1 For income, an often-used measure is the amount people earn before income and wealth taxes are deducted, and after pension

Wealth inequality has many aspects, but literature on the matter often highlights some persistent and interrelated issues, including the following: 1) high levels of wealth inequality globally, 2) a high correlation between wealth and income inequality, 3) more wealth inequality than income inequality, 4) higher growth in wealth inequality, and 5) limited policy options to solve wealth inequality.<sup>7</sup> What follows is a brief overview of these five issues, with specific focus on the South African case.

### Issue 1: High Wealth Inequality Globally

Wealth inequality is a global occurrence, and this has been the case for centuries.<sup>8</sup> For instance, using the Gini index for net personal wealth as an inequality measure shows that wealth inequality has been extremely high (above 0.7) in developed nations like France, the US, and the UK for at least the last two centuries (see Figure 3).



**Fig. 3:** Wealth inequality over the long run around the world. Source: Alfani and Schifano (2021)<sup>9</sup>

While the occurrence of the Great Depression and two World Wars during the first half of the 20<sup>th</sup> century caused global wealth inequality to gradually reduce, it started to reverse course since the 1980s.<sup>10</sup> This change in direction gained traction in the mid-1970s when the developed world started experiencing sluggish economic growth and higher inflation. The reason for low growth,

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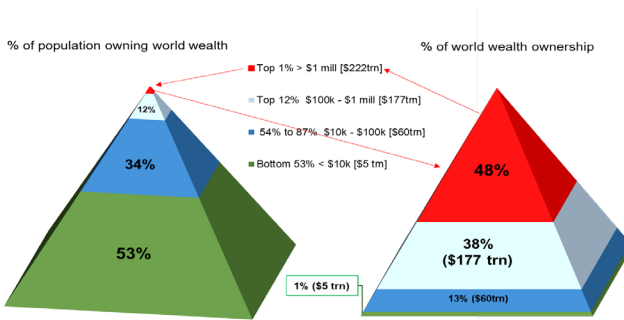
and retirement transfers are added. However, after-tax measures are also used.

according to Thatcherism and Reaganomics, was the result of leftist policies such as high minimum wages, strong unions, regulation, and high taxes. Accordingly, the period that followed focused on policies to reduce these perceived hinderances, including less progressive taxation, lower inheritance taxes, and deregulation in the financial sector. One consequence of this is that it resulted in market share concentration, causing few firms to capture large market share, individual investors to become super-rich, and the overall rise in both inter-country and intra-country wealth inequality. The rise of the financial sector also played a role, particularly in terms of income inequality, since employees in the financial sector received more than other workers with comparable skills.<sup>11</sup> The growth in wealth inequality was also compounded by increasing life expectancy rates, which caused the aging population to accumulate more wealth for longer.<sup>12,13</sup>

On the developing side of the world, China's market reforms and India's liberalisation of their economy in the 1980s resulted in tremendous economic growth and reduced poverty levels in those countries. Countries like Taiwan, South Korea, Thailand, and Indonesia also showed rapid growth, but the inverse link between economic growth and inequality was not universal in these countries.<sup>14</sup> For instance, in many countries around the world, people in the bottom income quintiles found themselves in a poverty trap that inhibited the intergenerational mobility of income, human capital, and wealth, thereby also limiting wealth accumulation.<sup>15</sup>

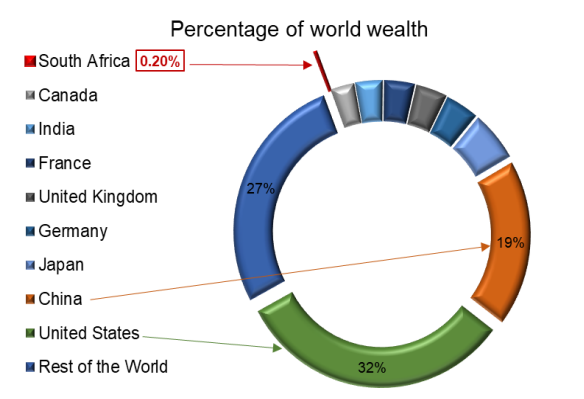
The result of all the above factors was large and growing levels of global wealth inequality. This is evident from global wealth ownership percentages that show that just over 1% of the world population owns almost half of the world's wealth, while half of the world owns less than 1% of the wealth (Figure 4).

## Income and Wealth Inequality



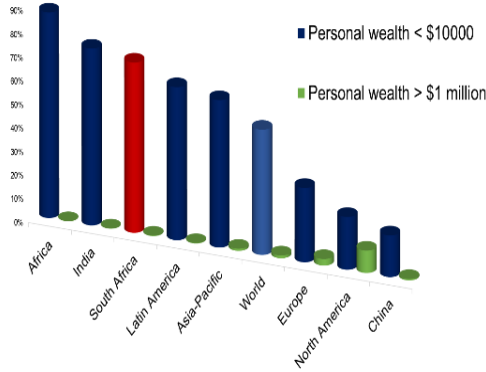
**Fig. 4:** Small percentage of world population has majority wealth ownership. Source: Credit Suisse (2022)<sup>16</sup>

The fact that only a few million individuals own so much wealth is exacerbated by the fact that most of that wealth belongs to individuals located in a few countries. More than 50% of the world’s wealth belongs to the United States and China, while a small developing country such as South Africa has less than 0.2% (see Figure 5). This also reflects in the fact that most individuals around the world exhibit wealth levels that are much lower than those living in North America, Europe, and China (see Figure 6). As such, it is also important to measure and monitor wealth inequality between countries (inter-country inequality) and not just inequality within a country (intra-country inequality).



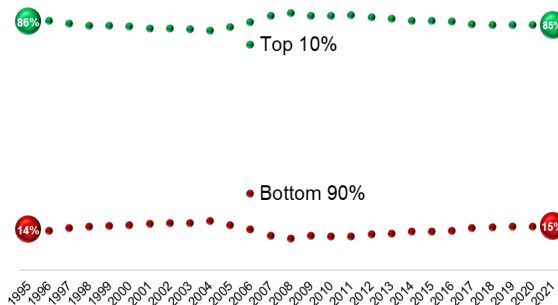
**Fig. 5** Wealth distribution by country. Source: Credit Suisse (2022)

## A Fair Share: Reflecting Essays on Economic Inequality in SA



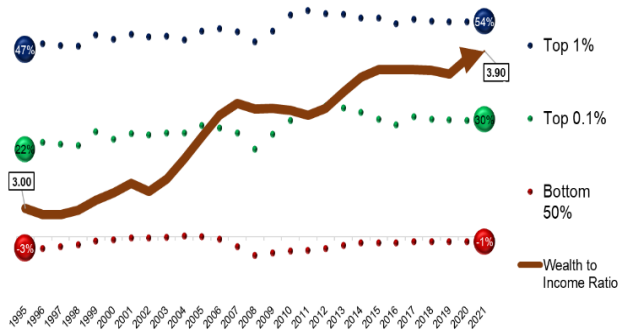
**Fig. 6:** Wealth inequality in world regions Source: Credit Suisse (2022)

Although South African citizens own only around 0.2% of total world wealth, the level of wealth concentration is quite extreme, which contributes significantly towards making South Africa the most unequal country in the world. What compounds this problem is the fact that, since the start of democracy in 1994, there has been no change in the percentage of wealth owned by the bottom 90% of the population.<sup>17</sup> As shown in Figure 7, this percentage of net personal wealth has been stable at around 15% for the last 26 years, while wealth of the top 10% remained at around 85%.



**Fig. 7:** Wealth distribution in South Africa - top 10% versus bottom 90%. Source: World Inequality Database<sup>18</sup>

## Income and Wealth Inequality

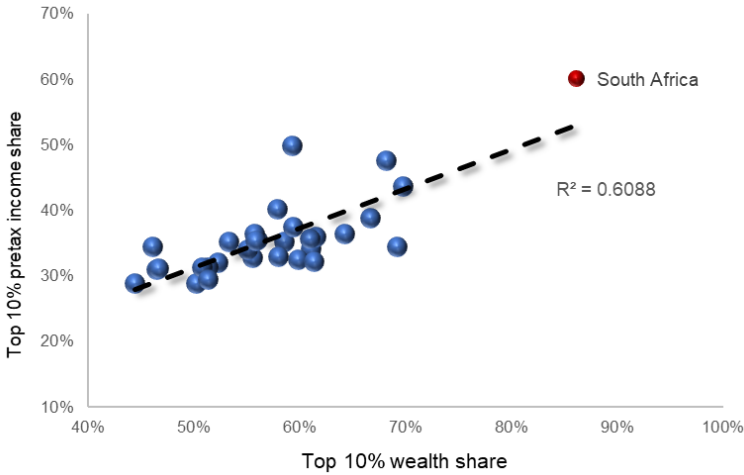


**Fig. 8:** Wealthiest in South Africa are getting wealthier. Source: World Inequality Database<sup>19</sup>

Perhaps more sobering are the statistics that relate to the wealthiest of the South African adult population. As of 2021, the top 1% owned more than half of South Africa's household wealth. This means that the average wealth level of this group is 340 times larger than that of the average adult in the bottom 90%. A more extreme statistic relates to the fact that roughly 3 500 adults in South Africa (the top 0.01%) collectively have more wealth than 32 million individuals who make up the bottom 90%. Given such extreme wealth advantage, it becomes self-fulfilling that the wealthy cohort is getting even wealthier when measured with metrics like South Africa's wealth-to-income ratio. This would perhaps not be so disconcerting if it was not for the fact that, since 1994, the bottom 50% consistently experienced a negative net wealth figure, where more than half of them have liabilities that exceed their assets (see Figure 8).<sup>20</sup>

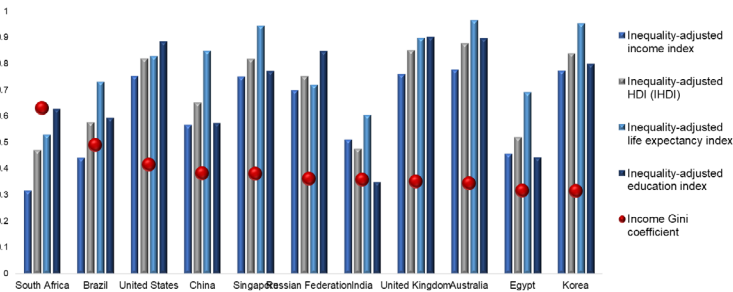
### Issue 2: High Correlation Between Wealth and Income Inequality

It has been well documented that South Africa has become probably the most unequal country in the world in terms of both wealth and income inequality.<sup>21</sup> The fact that these two measures coincide is not unique to South Africa, and both inequality measures are relatively highly correlated in many regions of the world, especially where overall inequality is high (Figure 9).



**Fig. 9** High correlation between wealth and income inequality. Source: World Inequality Database<sup>22</sup>

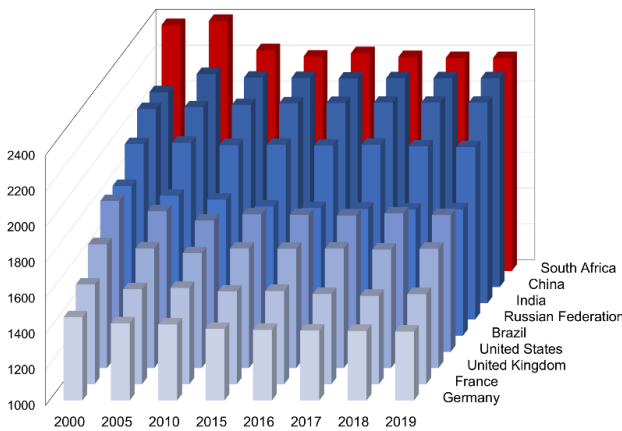
Such high levels of inequality also tend to reflect in other measures of overall wellbeing and quality of life. The data confirm that, for a country like South Africa, the extreme level of inequality also reflects in other quality-of-life measures like human development and education, which also shows how much South Africa lags behind many countries (Figure 10).



**Fig. 10:** Relationship between inequality and other quality of life indicators. Source: UNDP (2022)<sup>23</sup>

The high correlation between wealth and income inequality does not necessarily mean that one causes the other or *vice versa*.

However, the presence of both causes the web of inequality to stretch out even further. For example, countries with low incomes – and, by implication, less wealth – also tend to work longer hours. In South Africa, full-time employees work around 2 100 hours per year, while their richer counterparts in the US and Europe only work around 1 750 and 1 550 hours per year respectively (Figure 11).<sup>24</sup> This means that inequality of income earned per hour is even worse than a more general income inequality measure.<sup>25</sup>



**Fig. 11:** Average annual hours worked in selected countries around the world. Source: Penn World Table (PWT 10.01)

Economic theory states that more labour (hours and workers) is required whenever productivity is lower due to factors like insufficient physical capital (e.g., machinery, equipment, and technology) and/or insufficient human capital (e.g., skills, health, and education). Less productivity, in turn, leads to lower wages, income, and wealth levels. Based on the economic theory perspective, it seems reasonable to conclude that an increase in capital endowments of low-income groups presents a solution to reducing global inequality. It thus seems obvious that the only realistic way this can occur would be if sufficient wealth transfer occurred to facilitate more investment in human and physical

capital to benefit the poorest. The challenge lies in finding the political will to initiate and facilitate this type of wealth transfer.<sup>26</sup>

### Issue 3: Wealth Inequality is Much Worse than Income Inequality

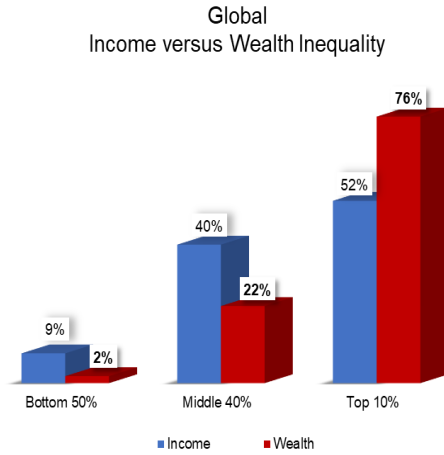
Wealth inequality is more severe than income inequality, and this has been the status quo for at least the last 35 years. Factors like a rapidly growing and skewed wealth distribution in places like China and Russia are causing wealth inequality to become more extreme. This occurs globally and is reflected not only in the increased concentration (narrowing range) of wealth inequality measures like the wealth-Gini coefficient, but also in the widening difference between such inequality measures for wealth and income respectively (Figure 12).



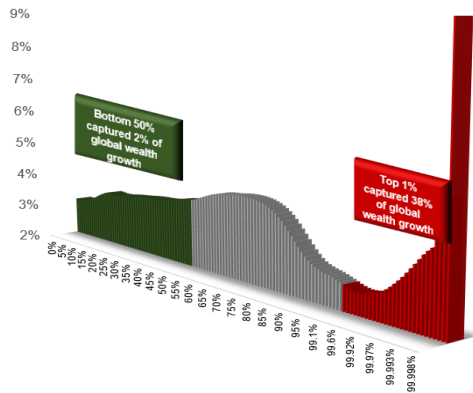
**Fig. 12:** Wealth inequality versus income inequality in countries around the world. Source: Our World in Data<sup>27</sup> and World Inequality database

Figure 13 provides another perspective on how extreme wealth inequality overshadows income inequality around the world. While the bottom 50% of the world earns about 9% of the income, their wealth percentage is far less, at only about 2%. This stands in stark contrast to the wealth amassed by the wealthiest top 10% of the world, which stood at 76% in 2021, while their percentage

of income earned was only 52%. The difference between income and wealth in the middle-40% segment is also striking. While this segment earned about 40% of world income in 2021, they only amassed 22% of the wealth.<sup>28</sup>



**Fig. 13:** Global income versus wealth inequality. Source: World Inequality Report 2022



**Fig. 14:** Inequality around the world. Source: World Inequality Report 2022

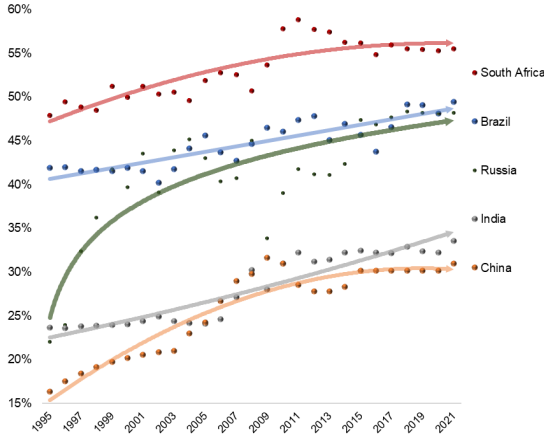
Not only is wealth inequality much higher than income inequality in absolute terms, but also in terms of their growth rates. During the period 1980–2016, the poorest 50% of the world experienced real income growth of between 60% and 120%, causing them to earn about 12% of total income growth over this period.<sup>29</sup> Although a positive result, it predominantly reflected the rise of emerging economies like China and India and, combined with the fact that income growth of the richest 1% was more than twice as much over this period, confirms that income inequality is growing.<sup>30</sup> However, this difference in income growth between rich and poor pales in comparison with growing wealth inequality. For instance, over the period 1995–2021, the wealthiest 1% in the world experienced real growth in their wealth of around 9% per year, causing them to achieve average growth in wealth over this period that was almost 20 times larger than that of the bottom 50%, which only captured 2% of the wealth growth (see Figure 14).

Although empirical research still focuses mainly on income inequality, the issues raised above accentuate why the scale and scope of wealth inequality is perhaps more serious and in need of more concrete research and effective policy decision-making. This rings particularly true in South Africa, where the country maintains its status of being the most unequal society in the world in terms of both inequality measures.

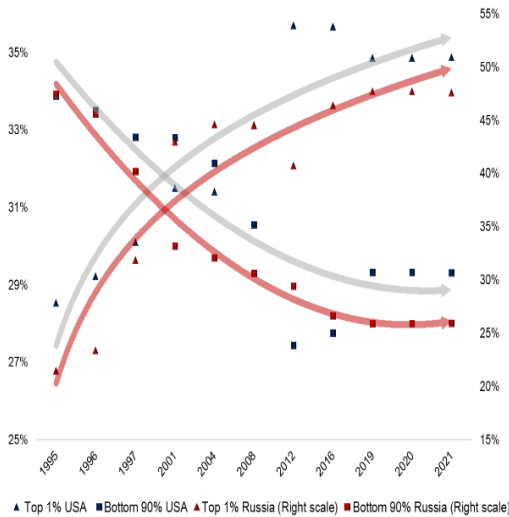
#### **Issue 4: Wealth Inequality is Growing**

Another disconcerting phenomenon is that, over the last four decades, many countries in the world are exhibiting growing levels of wealth inequality. For instance, Figure 15 illustrates that the richest 1% is getting richer in all the BRICS countries, notably India and Russia. Even in China, a previously highly socialist country, rapid inequality growth has caused the top 1% and the bottom 90% to now own roughly the same wealth percentage. Figure 16 indicates how this pattern is not only occurring in BRICS countries such as Russia, but also in Western countries like the United States. Globally, the richest 1% has accumulated almost 50% of all new wealth over the last decade, and just since 2020 they amassed nearly two-thirds of all new wealth (\$26 trillion of

the estimated \$4.2 trillion) – almost twice as much as the bottom 99% combined.<sup>31</sup>

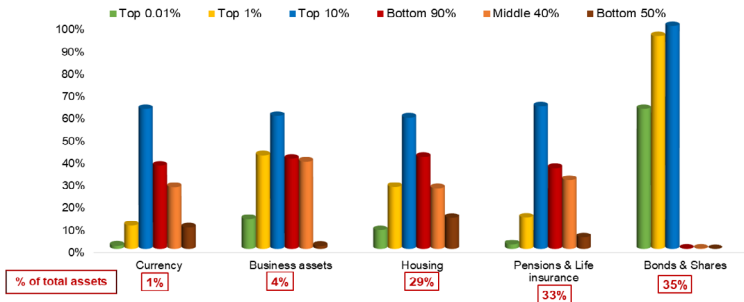


**Fig. 15:** Wealth share of top 1% in BRICS countries. Source: World Inequality database



**Fig. 16:** Growing wealth inequality from East to West: Russia vs the US. Source: World Inequality database

In South Africa, growing wealth inequality (particularly of the top 1%) over the last three decades has also been noticeable, especially since this occurred after the end of apartheid and during a period when South Africa experienced positive real income and wealth growth.<sup>32</sup> A major reason for this stems from the fact that wealthy individuals have much more wealth and income to start with, and thus they save more than poorer individuals. Thus, when the wealthy earn returns on their assets, their balance sheets grow even more. Piketty (2014) notes that wealth inequality increases whenever the rate of return on capital exceeds the growth rate of GDP.<sup>33</sup> This assertion fits the narrative for South Africa over the last decade very well, especially since most assets performed much better than the domestic growth rate and the wealthiest 10% own more than 50% of all assets, including about 60% of housing property and almost 100% of direct share and bond holdings (Figure 17).

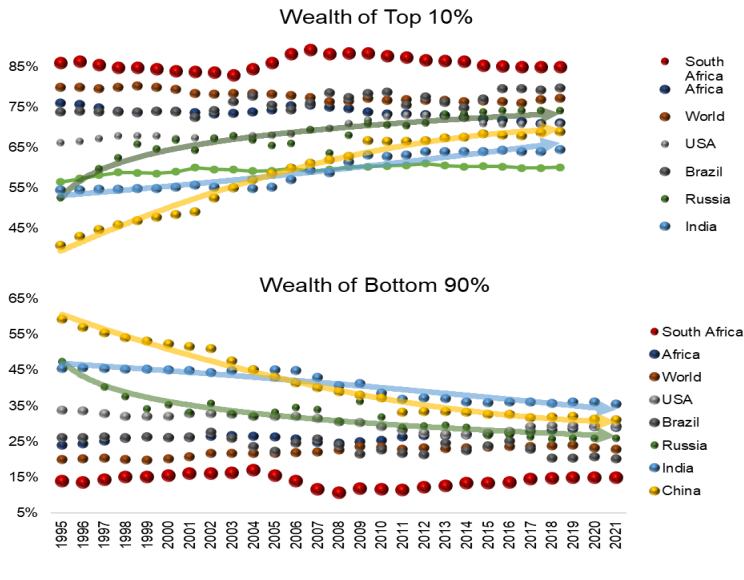


**Fig. 17:** Asset ownership in South Africa (2017). Source: Chatterjee, Czajka & Gethin (2020)<sup>34</sup>

This substantial asset ownership, combined with accommodating monetary policy since the 2008 global financial crisis, provided the perfect background for wealthy individuals to earn attractive rates of return on assets like real estate and equity, and to experience rapid wealth accumulation in the years following the crisis.<sup>35</sup> In contrast, since the poorest 50% of the population have almost no direct holdings of shares, bonds, and property, and

own only 5% indirectly through life insurance and pension fund investments, they benefited minimally.<sup>36</sup>

This increase in wealth inequality is also visible in most other parts of world, and the trend is not showing any signs of slowing down. Figure 18 indicates how the percentage of wealth owned by the bottom 90% is decreasing globally, while that of the top 10% is increasing.



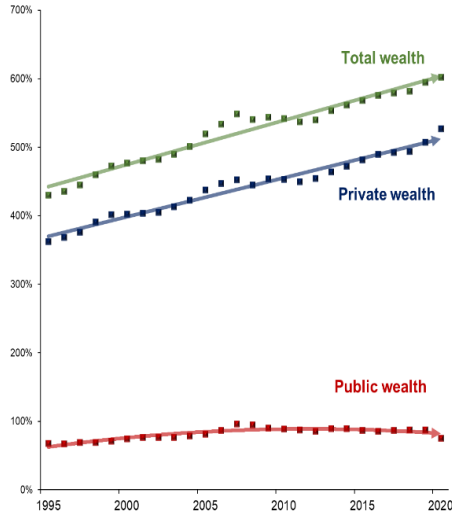
**Fig. 18:** Asset ownership in South Africa (2017). Source: World Inequality database

Even though South Africa has the highest wealth inequality, countries like Brazil and Russia are catching up quickly. In Russia, for instance, wealth owned by the top 10% increased from 50% to about 70% in just 25 years, while China doubled its inequality level in just 30 years. Countries like Singapore also exhibit similar levels of extreme wealth inequality as SA, but much lower unemployment, more economic growth, and a bigger tax base allows Singapore to manage the impact of this inequality much better. Although extremely concentrated wealth levels are thus quite common around the world, a distinguishing factor for South

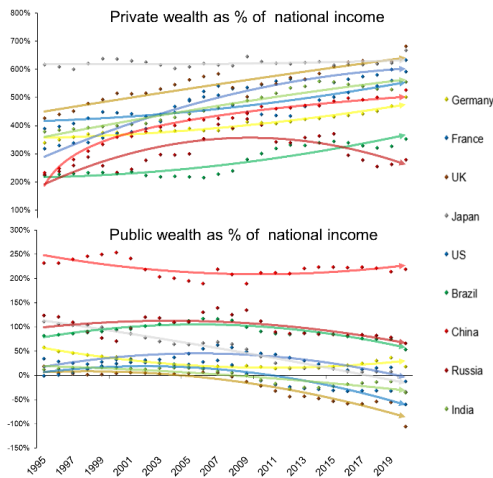
Africa is the absence of any wealth concentration at the bottom half of the scale.

The increasing nature of wealth inequality is also prevalent in another dimension, namely large transfers from public to private wealth. This leads to a widening difference between private and public wealth. Public wealth refers to all the assets (financial and non-financial) that a government owns, minus all government debts. This includes all public-owned infrastructure such as roads, railways, buildings, and state-owned enterprises (SOEs), but also all public-owned financial investments in private companies. Figure 19 indicates that, although global wealth levels are rising, this increase is dominated by private wealth, while public wealth is actually decreasing. This occurs mainly due to increasing government debt levels, but also because of some privatisation initiatives that mainly benefit small groups like the oligarchs in Russia or Black Economic Empowerment initiatives in South Africa. For some countries, like the US and UK, the ratio of public wealth to national income has even become negative (Figure 20). This means that, even if these countries sold all their assets to repay existing debts, there would not be enough assets to settle outstanding debts, and thus private wealth would theoretically own all public assets. This would effectively be an extreme form of privatisation, with immense power transfer to the wealthy private sector. Many are of the view that such power transfer is already present due to the currently extreme levels of wealth concentration.

## Income and Wealth Inequality



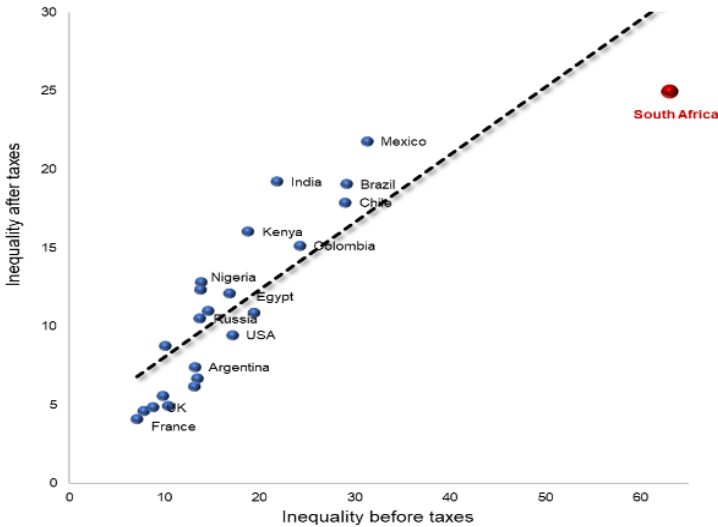
**Fig. 19:** Global wealth relative to global income (1995–2020).  
Source: World Inequality database



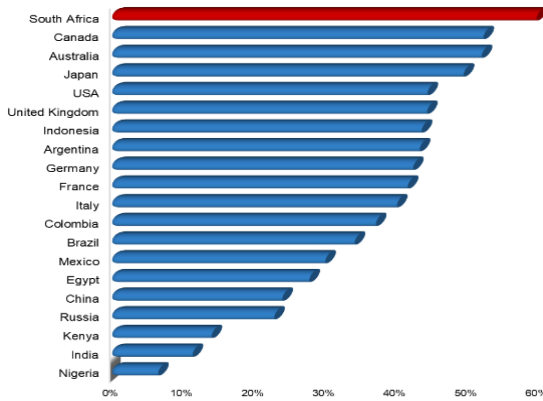
**Fig. 20:** Rising private wealth and declining public wealth in countries (1970–2020) Source: World Inequality database

## Issue 5: Limited Scope for Inequality Reduction by Using the Existing Income Tax System

The income tax system in South Africa has had a significant redistribution effect, resulting in the largest reduction in income inequality of all countries measured in the World Inequality Lab database. This assertion stems from data that estimate a reduction of 60% in the ratio of earnings before taxes of the top 10% relative to the bottom 50% (T10/B50), after factoring in taxes (see Figures 21 and 22).<sup>37</sup>



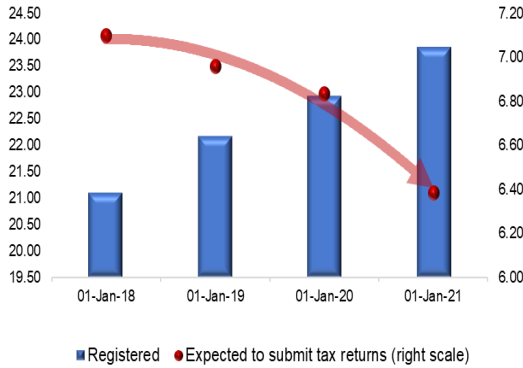
**Fig. 21:** Inequality (T10/B50 income gap) before and after taxes 2018–2021. Source: World Inequality Report (2022)



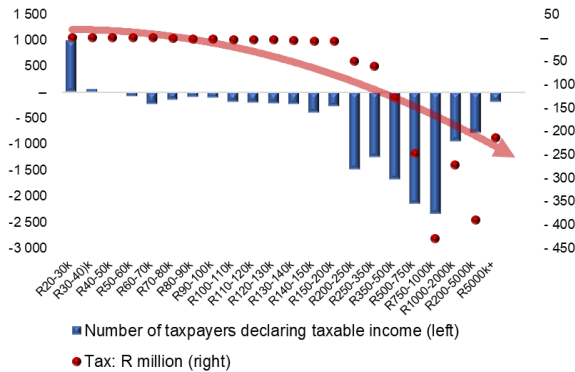
**Fig. 22:** Income inequality reduction due to taxes 2018-2021.  
Source: World Inequality Report (2022)

However, with a T10/B50 ratio of 25 after the redistributive effect of taxes, the income gap in South Africa is still significantly larger than Central Asia or the US, where this gap reduces to about 10, or Europe, where it reduces to about 6.28. The problem facing a country like South Africa is that it is limited in terms of raising more funds through indirect and income taxation. In recent decades, governments increased indirect taxes on goods and services, which disproportionately impacts low-income individuals. In South Africa, the use of value added tax, a fuel levy, and excise duties greatly affects the poorest 50%, and this limits government's ability to use such taxation more. Similarly, the high level and progressive nature of income taxation that prevails leaves limited scope for expansion. The highest marginal income tax rate has been increased from 41% in 2016 to 45% in 2018, and personal income tax already accounts for about 45% of gross domestic product and 40% of total tax revenue.<sup>38, 39</sup> Although these income tax percentages are lower than in other developed parts of the world, it hides the fact that only about 50% of registered taxpayers in South Africa pay tax, due to extreme unemployment. This figure reduces to about 30% if the SARS taxpayer registration policy as adopted in 2010 is used.<sup>40</sup> The high unemployment rate and tax burden partly explains why, even with a growing tax-paying population, the number of expected

tax assessments is decreasing (see Figure 23). More importantly, the high level of taxation could also partly explain why a growing number of individuals cease to be South African tax residents and why income declared and tax payable in South Africa by these wealthy individuals decreased by 48.5% over the last decade (see Figure 24).<sup>41</sup>



**Fig. 23:** Registered taxpayers vs expected tax returns, 2018 – 2021 (millions). Source: National Treasury and South African Revenue Service (2023)<sup>42</sup>



**Fig. 24:** Tax (per income group) from individuals who changed SA residence status (2021 vs 2012). Source: National Treasury and South African Revenue Service (2023)<sup>43</sup>

There are clearly limits to the extent that government can use indirect and income taxes to increase state coffers, since it already has a significant effect on both top- and low-income groups.<sup>44</sup> In addition, the extent to which redistributive income tax strategies have managed to reduce wealth inequality, especially racial wealth inequality, has been negligible. The conclusion that must be made is that, with limited scope for increasing income taxes, the South African government is running out of options and should consider alternative avenues such as implementing some kind of progressive wealth taxation system.

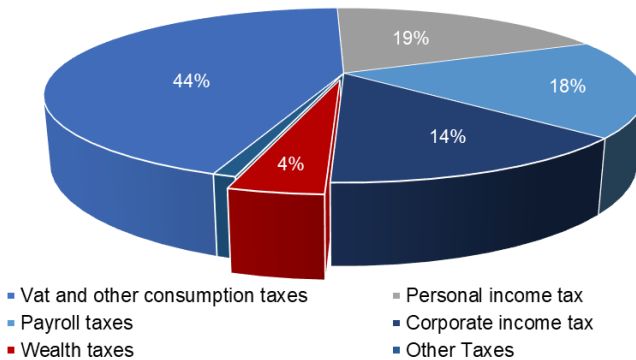
### **Wealth Tax as a Possible Solution for Reduced Wealth Inequality**

As mentioned at the start of this chapter, wealth includes all financial and nonfinancial assets, minus any debts. Accordingly, wealth tax refers to taxes levied on such wealth of individuals, and this tax is usually progressive and annual. Progressive tax means that a higher tax percentage is paid by those that are wealthier.<sup>45</sup> The idea of wealth taxation, especially on the extremely wealthy, is, in principle, an ideal solution to alleviating wealth inequality. For instance, recent research suggests that implementing a “moderate” wealth tax on the richest 1% of South Africans could raise approximately R130 billion per year. This equals about 40% of all value-added tax collected and would be enough to cover about 85% of South Africa’s massive debt-service costs, or about 60% of all social protection expenditures (including social grants), or almost 75% of health spending.<sup>46</sup> Such research results make a convincing argument in favour of wealth taxation. It does, perhaps, also create the impression that such taxation is easy to implement and will automatically be an effective process. However, the next section briefly highlights some challenges with a wealth tax system.

### **Challenges with a Wealth Tax System**

If wealth taxation is such a clear and simple solution to reduce inequality, one would expect this type of taxation to be prevalent globally, but the opposite seems to be true. Ever since the

Reagan and Thatcher eras from the early 1980s, there has been a significant and global reduction in wealth taxes. For instance, the number of Organisation for Economic Co-operation and Development (OECD) member countries that collect wealth taxes has reduced from 12 in 1996 to only five in 2020. In these countries, wealth tax revenues also made up only about 1.5% of total revenues in 2020, and some countries, like France, are reducing this tax even further by limiting it to property only. As a result, it is estimated that only 4% of global tax income now comes from outright wealth taxes (Figure 25).<sup>47</sup>



**Fig. 25:** Global tax revenues by category Source: Oxfam

An immediate issue relates to the definition and measurement of wealth. It is not so straightforward to determine the value of assets, which – unlike liabilities, such as loans – often have values that are difficult to determine. A seemingly simple solution would be to use asset values as determined by prevailing market forces of demand and supply. However, how does one determine the market value of, say, a house or other property if it is not actually “supplied” in the market to obtain a realistic “demand” offer? Similarly, financial assets like shares can often experience extreme value changes within days, while long-term bonds are very sensitive to small interest rate changes. Many of these assets are also not easily valued because of lack of liquidity, or because

they are not publicly listed. These are important issues, since most wealthy South Africans' wealth consists largely of direct holdings of financial assets like bonds and shares.

Several related issues exist and must first be addressed before wealth taxation can become an operationally viable and effective system. For instance, should pensions and other similar retirement savings be taxed? How would wealth held abroad or in legal entities that are difficult to trace be assessed and taxed? Since wealth tax is usually a progressive tax system, it also requires that wealth thresholds be set to distinguish those who should pay such tax from those who are exempt. Should a wide taxation 'catching net' approach be followed, or should it be restricted to include only the extremely wealthy? How would the wealth increments that determine wealth tax brackets be determined? How would this taxation system be administered to ensure that individuals above the non-exempt threshold do not 'manage' their wealth assessment to fall below the threshold? A country like South Africa already has an extremely complicated tax system. The implication of this is that wealth tax already exists in the form of taxes on interest, dividends, capital gains, estates, and the transfer of property. As such, the base of all these taxes largely overlaps with the base for wealth taxation.

A solution to many of the above-mentioned issues would be to suggest that a realistic, reasonable, and acceptable wealth tax should only apply to the extreme upper tail of wealth distribution. However, at what level would "extreme wealth" be classified? The top 1% or top 0.1% or top 0.01%? Proposals for any additional wealth tax should also head the arguments against wealth taxation. For instance, casting the wealth tax "net" too wide could be detrimental to entrepreneurial spirit and risk-taking, harm innovation, new business ventures and foreign investment, and reduce sustainable employment and growth. An example to learn from is France, where the recent reduction in wealth taxes was largely driven by the need to attract more foreign investment.<sup>48</sup> In South Africa, an obvious elephant in the room also relates to the maladministration of public finances. Wealth taxes would make the proverbial cookie jar much larger, but will it make inequality

less? These are all crucial factors to consider before implementing any form of wealth tax, especially in a country like South Africa.

## **Conclusion**

Wealth inequality can lead to several potential negative consequences, including the empowerment of the wealthiest to influence policymakers and institutions, strengthening anti-competitive behaviour, eroding social cohesion, and resisting more equitable distribution of wealth and income to the poor.<sup>49</sup> Reducing wealth inequality will undoubtedly improve overall social welfare and cohesion in the most unequal country in the world. This will require commitment from the high-wealth segment of the population to help redistribute wealth and resources, but also trust in the government to apply such a system effectively. Of these two crucial elements, it is perhaps the latter that is currently the major obstacle. What is clear is that, if the status quo is maintained, government will remain unable to facilitate sufficient transfer of resources and the reduction of poverty and inequality, especially if they are forced to cut public spending due to low or no economic growth.

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