Since the outset of the new democracy, South Africa used its tax resources to expand social assistance and increase spending on education and health services thereby reducing poverty. Achieving greater income equality has however, remained a challenge. Household consumption inequality, measured by the Gini coefficient, increased from 0.67 in 1993 to 0.69 in 2011, which is among the highest in the world. This potentially ranks South Africa as one of the most unequal countries amongst middle-income countries.

In November 2014 the World Bank released its “South Africa Economic Update. Fiscal Policy and Redistribution in an Unequal Society.” The Update looks at the role of fiscal policy in addressing poverty and inequality in South Africa and sets out to answer two main questions, namely: (i) how do taxes and spending in South Africa redistribute income between the rich and poor? And, (ii) what is the impact of taxes and spending on the rates of poverty and inequality in South Africa? The analysis concludes that South Africa is managing a sizeable reduction in poverty and inequality through its fiscal instruments compared to certain other countries. The Update seeks to measure the impact of fiscal policy on inequality and poverty in South Africa compared to 12 middle-income countries. These countries include a set of comparable
middle-income countries namely Armenia; Brazil; Bolivia; Costa Rica; El Salvador; Ethiopia; Guatemala; Indonesia; Mexico; Peru; and Uruguay.

The Update finds that the South African tax system is slightly progressive, whilst spending is highly progressive. In other words, taxes in South Africa are born by the rich, and the tax resources are redirected to the poor. South Africa’s fiscal policy appreciably reduces poverty and income inequality, and represent the highest reductions in the emerging market countries under study. A tax is progressive if the cumulative share of a tax paid by the bottom income earners of the population is lower than its share in income. A transfer or spending program is progressive if the cumulative share of the total spending on the transfer received by the bottom income earners of the population is higher than its share of market income.

The South African fiscal policy applies a mix of progressive direct taxes and slightly regressive indirect taxes which, if combined, results in a slightly progressive tax system. Direct taxes, including personal income and payroll taxes are progressive, as the rich pay a proportionally higher share of total direct tax compared to their share of income. As these taxes comprise a relatively high share of GDP, they decrease the income gap between the rich and the poor. South Africa has a steeper personal income tax rate structure which peaks at 40% compared to 27.5% in Brazil. Although direct taxes in South Africa are progressive they are less so than in other countries. Indirect taxes are slightly regressive. The study concludes that the regressivity at the lower income levels largely reflects the impact of excises, as value-added and fuel taxes are progressive. VAT, excises on alcohol and tobacco, and the fuel levy comprise 9% of GDP, or a third of South Africa’s tax base. VAT comprises approximately 25% of tax revenue. South Africa’s indirect tax burden as a percentage of disposable income is relatively even across the
income distribution compared with other middle-income
countries. In Brazil and Mexico the overall burden of indirect
taxation rises more progressively with income than in South
Africa.

South African fiscal policy achieves the largest reductions in
poverty and inequality of the 12 countries studied. The South
African fiscal system, elevates 3.6 million people from
poverty (i.e. those living on less than $2.50 a day
(purchasing power parity dollars)), which reduces the rate of
extreme poverty by half. The population living on $1.25 a day
or less reduces from 34.4% to 16.5%, as a result of the impact
of cash transfers and free basic services net of taxes. Income
inequality is reduced from a situation where the income of the
rich is more than 1,000 times higher than that of the poor to
about 66 times higher. This decreases the Gini coefficient
from 0.77, pre-taxes and social spending, to 0.59 post fiscal
interventions. However, inequality remains higher than all the
other countries in the study before they apply fiscal
policies. South Africa’s population living in poverty is
33.4%, which is higher than many other middle-income countries
with similar levels of GNI per capita. For example, the
poverty rate is 11% in Brazil and 4% in Costa Rica.

South Africa, compared to middle-income counties, generates
considerable tax revenues for potential redistribution. More
than 50% of South African’s tax collections of 27.1% of GDP in
2010/11 came from direct taxes, including personal income tax,
corporate income tax, and payroll taxes in the form of
unemployment insurance and the skills development levy. The
study also shows that South Africa relies more on personal
income tax and less on indirect or consumption taxes than the
other countries studied.

South Africa’s government spending of 32.2% of GDP in 2010/11,
excluding interest payments, exceeds the average of middle-
icome countries which is 27.6% of GDP. South Africa’s
government social spending (as a % of GDP) is higher than most
of the countries studied. South Africa also spends relatively more on education and less on health and direct cash transfers than countries like Brazil, but has more direct cash transfers than Bolivia. South Africa spends more than 50% of its expenditure on social spending. During the past decade, the number of social grant beneficiaries almost doubled from (8 million in 2003/04 to 15.8 million in 2013/14), reflecting the expansion of direct cash transfers to children and the elderly.

South Africa’s fiscal policy goes a long way towards achieving income redistribution but poverty and inequality in South Africa after taxes and spending remains too high. However, more needs to be done to improve the quality of service delivery although South Africa’s fiscal deficit and debt limits the fiscal space to spend more to achieve even greater redistribution. Addressing poverty and inequality going forward in a way consistent with fiscal sustainability will require higher and more inclusive economic growth. This would need to focus on job creation and narrowing the income gap between the rich and the poor and reinforce the effectiveness of fiscal policy.

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