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Dimensions of African inequality

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Abstract: This paper discusses dimensions of inequality in sub-Saharan Africa and their causes. It starts with a review of the empirical evidence about inequality during the colonial period as well as the post-independence era. Then it discusses the forces that determine inequality change, focusing on factor accumulation and structural change. Next it considers the relationship between inequality and growth, the role of agriculture in the development process, the relationships between ethnicity and social stratification and governance, and external influences on inequality. The paper concludes with some comments on what policy interventions can do to reduce inequality.

Keywords: inequality, poverty, growth, structural change, endowments, employment, Africa
JEL classification: D31, D33, I24, I32, N37, O15

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1 The historical legacy

There is not much quantitative evidence on the extent of inequality in pre-colonial times in Africa. The meagre evidence there is on economic growth suggests that per capita incomes were virtually unchanged between the years 1000 and 1820 (Maddison 2003). During this period there was external economic involvement in the slave trade and raw material extraction, but by 1820 there were only about 50,000 people of European descent in Africa (half of them in South Africa). This share increased relatively fast once colonial powers took control, and by 1913 the number had increased to 2.5 million (Maddison 2005).

Although it is hard to discern any trend in per capita incomes until the nineteenth century, there were early growth accelerations—typically related to the expansion of raw material exports—in some countries followed by busts (Jerven 2010). The international slave trade, which lasted until 1865, had profound consequences in particular for West Africa. Its end meant that there was scope for the expansion of smallholder cash-crop production with positive income effects.

Colonialism led to increased diversification of these economies and increased inequality. In pre-colonial African societies there had been kingdoms with established elites, but otherwise few people had per capita incomes beyond subsistence levels. This suggests that inequality was fairly low at this time. The inequality increases which followed were related to the arrival of European colonizers. This set off a process of differentiation along the lines outlined in Lewis' (1954) dual economy model. It meant the introduction of modern enclaves in mostly traditional agricultural economies.

Most African countries were colonized by European powers in the late nineteenth century. At that time most parts of sub-Saharan Africa (SSA) had limited contacts with the outside world, while North Africa and South Africa had closer ties. There was trade along the coast, also some long-distance trade, but most of the inland was little integrated with the international economy.

The British colonization of Kenya can serve as an example of the impact of colonialism on economic inequality. In Kenya the inland households were pastoralists, settled farmers, small craftsmen, or traders, but there was limited specialization. At the time of the arrival of the British to East Africa, households generally had access to enough land to ensure a standard of living roughly comparable to that of the other members of the community (Bigsten 1986). Differences in incomes or welfare levels were, therefore, relatively modest.

With the building of the railway to Uganda, the Kenyan inland was opened up to trade and white settlement. The railway construction also brought in Indian workers, and some of those stayed and set up small stores or sought employment in industry or government. A three-layered society emerged, with the white settlers in control. Some Africans became engaged in settler agriculture either as squatters or as contract labour, while others became traders or businessmen (Kitching 1980). By restricting the scope for development on African farms and through hut and poll taxes the British sought to maintain a cheap supply of labour for settler agriculture. Still, there was a gradual expansion of cash-crop production on African farms, so inequality among African smallholders increased. Urban real wages increased significantly after the Second World War, partly due to increased minimum wages. Rural-urban differences in living standards grew, and rural-urban migration accelerated. Independence in Kenya in 1963 brought about a dramatic change in the inter-racial distribution of both political power and incomes. The average income in the post-independence period was still highest for Europeans and lowest for Africans, with Asians in-between, but the overlap increased a lot.

The evolution of inequality in Kenya during the colonial era is typical of colonized SSA, although the share of white settlers was higher in Kenya than in most other countries excluding South Africa, Rhodesia, and the Portuguese colonies. The contribution of inter-racial inequality to overall inequality was higher in those countries than in most colonies. In Kenya overall inequality increased rapidly until 1950, then fluctuated. The income gaps among the racial groups in Kenya at this time were huge. The Asians had 27 times the African average income and the Europeans 95 times (Bigsten 1986). The pattern of change of income inequality (as measured by the Gini coefficient) for Kenya 1914-76 shows that when the modern-traditional income gap increased, the Gini coefficient went up and vice versa. Structural change was then as now a key determinant of inequality change.

The evolution of inequality during colonial rule in Africa was similar in other African countries, where elites of European descent took control and earned very high incomes by African standards. Inequality was highest in the countries where the white minority was strong and tried to maintain white control. In 1980 Rhodesia became Zimbabwe and white control came to an end, and in 1994 South Africa followed, but the racial income gaps remained large.

The evidence for Africa thus suggests that there was a rapid increase in inequality when colonization started at the end of the nineteenth century. The increase in inequality was eventually halted, but inequality has remained very high in Africa.

2 Post-colonial inequality

In the first decade after independence in the early 1960s, African countries grew quite fast, but most of them stagnated from the mid-1970s to the mid-1990s. Then growth recovered, but it was not until 2006 that SSA as a whole achieved per capita incomes higher than the peak in the 1970s. Since then growth has continued with a temporary setback during the financial crisis of 2008-09.

A challenge that one encounters when trying to measure growth or income distribution in African economies is that the database is weak. Gross domestic product (GDP) estimates vary a lot between series with different base years (Jerven 2013), and it is difficult to measure incomes by household or individuals in a systematic fashion. Much of the inequality analysis, therefore, is based on household consumption data. We report here what the available evidence has to say about recent changes in inequality.

Arndt (2012) summarizes changes in poverty in 22 African countries from 1996 to the most recent estimates using national poverty rates and data from World Development Indicators supplemented by data from McKay (2013), who report results for ten African Economic Research Consortium (AERC) case studies. In as many as 19 out of the 22 cases there was a reduction in the poverty rate. Arndt also looks at the evolution of poverty using the World Bank's one-dollar-a-day poverty line. For SSA he notes that poverty rates increased until the mid-1990s (alongside falling per capita incomes), but in 1996 the poverty rate started to decline. When growth is positive poverty tends to fall and vice versa.

Young (2012) constructed an alternative measure of real consumption based upon data from Demographic and Health Surveys. It includes the ownership of durable goods, the quality of housing, the health and mortality of children, the education of youth, and the allocation of female time in the household. These estimates suggest that living standards in SSA have been growing at about 3.4 to 3.7 per cent per year during the two last decades! He paints a more optimistic picture of African development than what consumption estimates suggest.

Less effort has been devoted to the analysis of the evolution of inequality than to the change in poverty. Available estimates of inequality are typically from the household surveys that are used to measure poverty. It is a concern that the poorest and the richest households are poorly covered in the surveys, as these groups are particularly important for inequality measurement. Ravallion and Chen (2012) have computed estimates of inequality on the basis of 850 household consumption surveys for 1979-2008, covering 125 developing countries. They show that SSA has higher inequality than other regions with the exception of Latin America and the Caribbean. They also find that there is no clear trend over time in SSA inequality. It showed some increase from 1999 to 2005 followed by a decline from 2005 to 2008. Overall the level of inequality has not changed much in SSA since the first of those estimates for 1981. Arndt (2012: 14) finds no significant correlation between growth and inequality change. At present we seem to have a distributional-neutral growth pattern in SSA. However, this is based on data on consumption, which typically miss out the highest and the lowest incomes, so we cannot be sure that the conclusion also holds for income inequality.

Although most analysts have looked at income inequality and poverty on the basis of household budget surveys, there are also some alternative estimates. Pinkovskiy and Sala-i-Martin (2010) computed inequality by disaggregating total GDP with the help of distribution functions. Their estimates suggests that inequality for the whole of SSA increased from around 1970, peaked in the 1980s, and was back at the 1970s level in 2006. Inequality within countries was more stable, but showed on average a modest decline from 1990 to 2006.

One can consider the extent of intergenerational mobility as an indicator of inequality of opportunity. Cogneau et al. (2006) find that two countries with relatively low cross-sectional income inequalities, Ghana and Uganda, also display relatively high intergenerational mobility and low inequality of opportunity. Sahn and Stifel (2003) show that urban–rural gaps in living standards are high and show no tendency to decline in the African countries included in their study.

The picture based on income and consumption estimates can be complemented by evidence on other important dimensions of human welfare. The UN's Human Development Report (2013) provides statistics about changes in the inequality of attributes like health and education. For both these indictors SSA shows consistently declining inequality like other regions of the world. Many countries in Africa also show improvements in the specific Gender Inequality Index 2000-12. So a broader measure of multidimensional inequality would indicate that inequality in SSA was declining between 1990-2010, in spite of income inequality remaining essentially unchanged (UN 2013: 32). The indicators here relate to fairly basic needs. The poorer segments of society thus seem to have improved their access to these basic services relative to the richer segments.

3 Factors of production, structural change, and inequality

The distribution of income and its change is strongly related to the distribution and evolution of asset ownership. Factors to consider are capital and land including natural resources (very important in Africa) as well as labour and human capital. The impact of education and human capital on inequality is strongly related to wage and employment determination.

Kuznets' (1955) classical paper suggested that inequality first increases and then decreases as per capita incomes go up. He suggested that early inequality increases are more or less inevitable and that it might be detrimental to growth to try to counteract this. Inequality increases when labour is transferred from a large traditional or agricultural sector to a more productive modern industrial sector. This effect was important in the early stages of modernization in SSA, but the effect on the Gini coefficient declined when the modern income share increased. Still, structural change remains a major determinant of the evolution of income distribution.

African countries are generally poorly integrated, which means that inequalities between regions as well as urban and rural areas are pronounced. The classical Harris-Todaro (1970) model of rural-urban migration was inspired by the experience of migration to Nairobi from the rural hinterland in the face of moderate expansion of formal urban jobs. The explanation they provided in their model was that formal sector wages had been pushed up by minimum wage legislation, and that people moved to Nairobi to have a chance to get these jobs. In the model, those who fail to get a job are assumed to be unemployed without income, but in reality most of them are absorbed in some fashion into the informal sector with modest wages.

To explain changes in inequality we need to look at changes in factor proportions and structural change. Africa is a vast continent with unused land in some areas, but in many parts of the continent there is a rapidly increasing pressure on land due to the rapid growth of the labour force. Typically, models of economic development assume that there is a process of capital deepening, but this process has been slow in Africa. This has had implications for the pattern of structural change. Since capital-to-labour ratios have been stagnant for decades, people that have been pushed out of agriculture have generally not been absorbed by the modern sector. They have instead been absorbed by the informal sector, where incomes are often not higher than in smallholder agriculture. This has meant that the shrinking of the agricultural share has not led to a decline in overall inequality.

Capital-poor countries tend to start from similar patterns of specialization and low wages. Leamer (1987) has developed a useful model of development that helps us understand how the pattern of specialization and then employment changes over time. His model includes three factors of production, namely: labour, capital, and land, and the focus of the analysis is on the impact of capital accumulation on employment structure and wages and other factor rewards. Economies move between patterns of specialization as factor abundance changes. The typical African economy may broadly be divided into four sectors. The non-agricultural part of the economy, where we assume that only capital and labour are used, typically consists of a less capital-intensive or informal sector and a more capital-intensive or formal sector. Then we may distinguish between two agricultural sectors: a smallholder sector using only land and labour, and a modern agricultural sector using all factors, i.e. capital, labour, and land. The relative size of the sectors will be determined by the relative availability of factors. When factor endowments change, the pattern of specialization changes as does the factor price structure. Inequality levels will depend on the relative size of different activities and the relative rewards in those.

We can discuss the process of structural change in four steps. First, we may ask what changes in factor endowments do to the production structure. When capital is accumulated at a rate sufficient to increase the capital/labour ratio, capital-intensive goods will increase their share of production. But if labour grows faster than capital there will instead be a shift towards a more labour-intensive product mix. The outcome will be moderated depending on what happens to the supply of land, but in many parts of Africa it is hard to increase the area under cultivation. An increase in the capital/labour ratio would, therefore, tend to lead to a more capital-intensive mix of production and higher wages. When land cannot grow there will also be an increase in land rentals. What happens to the rate of capital formation is, therefore, crucial for what happens to structural change and inequality in African countries.

A second key aspect concerns how the relationship with the world market, via goods prices, affects factor rewards and the economic structure. Prices can change autonomously or the government can intervene to change the domestic price structure. For example, after independence African countries typically followed an import-substitution strategy with high tariff-protection of the industrial sector. This meant that the wage gap between urban workers and rural labour and urban-rural inequality were pushed up.

A third force that changes the economic structure is technical progress. The effects depend on the character of the technical progress and in which sector it occurs. If technological change is labour-augmenting, it can help increase wages and to some extent compensate for a slow rate of capital accumulation.

Fourthly, there may also be factor market distortions that affect factor rewards. The factor prices will also depend on how the domestic factor markets are integrated with international factor markets. There are barriers to mobility between the informal and the formal labour markets, which imply that labour with similar skills will be paid differently in the two markets (Bigsten et al. 2013). Within the formal market there exist minimum wage legislation and trade union contracts that may generate wages that are different from equilibrium wages.

In the discussion of structural change labour was treated as a homogeneous category, but there is, of course, considerable variation in skills and incomes within the group. Particularly within the urban economy, earnings vary considerably. One important determinant of the evolution of inequality is the expansion of education, which has an impact on overall inequality by affecting the share of incomes that accrues to labour and the dispersion of wages. The latter effect depends on what happens to the structure of wages and the number of employees in the various labour categories. Typically there would be a narrowing of the wage gaps across categories of labour when the relative supply of higher education increases, which has happened in Africa. Knight and Sabot (1990) investigate how the expansion of secondary education in Kenya and Tanzania affected the inequality of pay in those countries and find that there is a compression effect. Education policy can thus be a tool for inequality reduction, but it is not self-evident that this will follow. Education is typically skewed in favour of the rich, and it could possibly function as a tool of exclusion (Gradstein 2003).

What we have discussed in this section is how gross incomes of individuals are determined. But if we want to explain inequality in consumption or net income we need to take various redistribution mechanisms into account. This includes taxation and redistribution by the government, but in Africa there is also redistribution going on within the extended family system. The pension system does not redistribute significant amounts of money in most of SSA, although it is an important equalizer in South Africa.

4 Inequality, poverty traps, and growth

The traditional view of the effect of inequality on growth is that higher inequality makes higher savings possible and provides incentives and, therefore, is growth-enhancing. However, more recent literature suggests that inequalities affect growth negatively (Persson and Tabellini 1994; Alesina and Rodrik 1994). The explanation most discussed in this context relates to the credit markets. There are credit market failures, which negatively affect access of the poor to credit, and this means that large parts of the population are unable to realize their potential (Galor and Zeira 1993). Inequality may also lead to instability and lower investments, rent-seeking, higher transaction costs, and more insecure property rights with negative effects on growth. In Africa rent-seeking is particularly problematic in resource-rich countries, which at least until the last decade had mediocre growth outcomes. There is also extensive rent-seeking and corruption relating to public procurement, which fuels inequality at the same time as it hampers growth. Social protests may create uncertainty about the enforceability of contracts, increase transaction costs for businesses, and force a diversion of public expenditure to security areas from growth enhancing investments. High levels of inequality may also lead to high crime rates and possibly be detrimental to health. Inequality may also reduce possibilities for broad-based participation in the political process, which in turn may lead to political and social instability and reduce the government's ability to pursue efficient policies.

So lower inequality is not only a social target, but it may also have an instrumental value for growth. The effectiveness of growth in reducing poverty is strongly linked to inequality, since the elasticity of poverty reduction with regard to growth falls with the degree of inequality (Ravallion 2001; Bigsten et al. 2003; Bigsten and Shimeles 2007; McKay and Perge 2009; Fosu 2009). Duclos and O'Connell (2009) argue that a development trap exists when low incomes hold back growth for an extended period of time. Low levels of human capital could explain poor returns to investments in situations with low incomes. Poverty-alleviation policies may then also have a functional justification in so far as they improve overall economic performance.

5 Transformation of agriculture and inequality

Structural change is an integral part of economic development. Typically the agricultural sector's share in output and employment shrinks as incomes increase, while the shares of industry and services expand. Gollin (2009) contrasts two extreme views on the role of agriculture in this transformation. One says that agriculture is a source of labour only, while the other says that it must generate growth to be able to release labour. Most SSA countries have two thirds or more of their labour force in agriculture. The gap between non-agriculture and agriculture in labour productivity is according to Gollin 7.8:1. This gap is larger in SSA than in other regions of the world with strong implications for inequality. The reasons for this huge gap include low skills, poor management, and poor technology in agriculture. Africa has, over recent decades, seen very slow growth in agricultural productivity. A key question then is why are so many stuck in subsistence agriculture? Schultz (1953) argued that an agricultural surplus was necessary to start the transformation process, indicating that one should seek policies that boost agricultural productivity. However, it has been hard to sort out causality between agricultural growth and overall growth.

Non-agriculture has to grow faster than agriculture for structural transformation to come about. The role of agriculture is less crucial once the economy is opened up (Dercon 2009), since the crucial demand linkage to agriculture is removed. Labour-intensive growth in other sectors can reduce poverty effectively if it absorbs labour. So the gradual integration of Africa into the world economy would make growth less dependent on the development of agriculture. Still, agriculture supports a large share of the population in Africa and it is particularly important in the land-locked resource-poor economies.

So far we have discussed the change in economic structure from a macro-perspective, but structural change also takes place at the household level. Smallholders in Africa were originally almost exclusively farmers, but over time they have shifted into production for the market and to non-agricultural activities as well. Income diversification is a result of households' allocation of assets across income-generating activities. Households seek to achieve an optimal balance between expected returns and risks in different activities given the constraints they face (Barrett et al. 2006). Income structures vary between households according to endowments and constraints. Since African markets are often poorly integrated, different households have access to different sets of income opportunities. There is also a large variation in transaction costs and market prices, and households differ in terms of property rights, labour availability, and access to credit. Barrett et al. (2006) analyse how income sources and diversification vary in Kenya, Cote d'Ivoire, and Rwanda. They note that households, that do not possess sufficient human and financial resources, do not have access to potentially lucrative activities and are forced to choose low-return activities.

Endowments are, of course, a key determinant of smallholders' activity choices, in a similar fashion that the national endowment structure determines the sector structure of the whole economy. The labour/land ratio of the household is a key determinant of movement into off-farm activities. The human capital of the household is also a key factor determining activity choices. It is clearly easier to diversify out of agriculture if the household has good access to a thriving off-farm sector, which normally would be the case closer to urban areas. Thus, the main factors behind allocation choices and the resulting inequality are differences in endowments, differences in access to markets, and access to finance.

Reardon (1997) concludes from a review of the income diversification literature that non-farm income generally is regressively distributed. This means that households with the highest farm incomes also have the highest incomes from non-farm activities and that diversification generally is a way up the income scale. Bigsten and Tengstam (2011) show that smallholder diversification is associated with higher incomes in the case of Zambia, and that the scope for diversification depends on endowments and access to markets and finance. However, there are also instances where you see distress diversification, i.e. households having to take bad jobs just to survive (Barrett 1998).

6 Inequality and inclusive governance

In recent years there has been an intense debate on the relationship between governance and institutions and economic development. The basic hypothesis in Acemoglu's and Robinson's (2012) theory of development is that economic and political institutions shape the incentives of business, individuals, and politicians. Economic institutions provide incentives to become educated, to save and invest, to innovate, and adopt new technologies. But it is the political processes that determine what economic institutions people live under and how the processes work. Furthermore, it is the distribution of power in society which shapes both institutions and the outcomes of the political process. So while economic institutions determine whether countries are poor or rich, it is politics and political institutions that determine what economic institutions a country has. They also note that there is high institutional persistence because of the way that political and economic institutions interact. Extractive institutions tend to persist because it is in the interest of those in power. Isaksson (2011) argues that social divisions have a negative effect on perceived institutional inclusiveness, which in turn should depress institutional payoffs. Empirical estimations confirm a weaker association between property rights and economic performance in societies marked by social divisions. Since the political institutions have a strong influence on the economic institutions that generate development, their development is clearly crucial. The desired institutional set-up is a system of governance that distributes power broadly in society and subjects it to constraints. This means that political power should rest with a broad coalition or a plurality of groups.

Outcomes depend on which group wins in the political process, which in turn depends on the distribution of political power. And this distribution of power is strongly related to inequality. There is a strong presumption that inequality is a crucial determinant of the inclusiveness of governance and political institutions, and inequality is, of course, affected by governance processes. The question is how one can get into a virtuous circle of improved governance and reduced inequality. Many countries in Africa have been in a vicious circle, which Rothstein (2011) refers to as a low trust–corruption–inequality trap. Lower inequality would increase the prospect of broader coalitions getting together in collective actions to build inclusive governance. But we should note that there have been considerable improvements in governance in Africa, which probably have helped reduce inequality in some broader indicators of development such as health, education, information, security, and political influence. And these factors in turn support the growth acceleration we have observed.

Johnson et al. (2007) discuss whether Africa can achieve sustained growth with the current institutions. They find that there are many shortcomings, but they also find that Africa is not much worse than East Asia was in the 1960s. Therefore, it should be possible also for Africa to achieve economic improvements and to reduce institutional restrictions.

So what constrains the implementation of 'best practice' policies and institutions, which can reduce transaction costs and improve access to the world market? One concern is the vested interests of policy makers, which opens up for rent-seeking behaviour. There is also a lack of skills, which hampers reforms even when the will is there. There is a challenge of formulating policy, but there is an even greater challenge in Africa relating to policy implementation. For policy reforms to be credible and sustainable they should be grounded in a democratic process. The causal link between democracy and growth is somewhat unclear though.

7 Ethnic inequality and social stratification

It is easier to undertake reforms in a socially cohesive society, where citizens feel they are part of the same community, face the same challenges, and reap similar societal benefits (Easterly et al. 2006). In Africa the picture is often very different from this.

Africa stands out as a region where ethnic divisions play the most important role in how the governance of society works. Kimenyi (2006) explains how the most common form of corruption entails the distribution of rewards, jobs, contracts, and promotions, on the basis of ethnicity. This then leads to ethnic and/or regional inequality that affects the level of overall inequality. There is also significant gender inequality in Africa, but since income generally is shared within families it is hard to get good measures of gender differences in consumption standards. There is, however, evidence on other aspects of inequality relating to work and influence.

Policies are often heavily influenced by ethnic loyalties, and this may help explain the under-provision of public goods and the prevalence of patronage goods (Wantchekon 2003; Kimenyi 2006; Habyarimana et al. 2007; Vicente 2013; Baldwin and Huber 2010). It also explains why we often see ethnically and regionally biased allocation of public goods. The extent of ethnic diversity in access varies across types of public goods. Jackson (2013) finds that the supply of community goods, like electricity and water, are more equally distributed than education, where the locally dominating group has better access. Jackson relates this to effects on the demand side, where the dominant group has a higher demand for education because they have better labour market opportunities once educated.

Alesina et al. (2012) show that ethnic inequality is inversely related to per capita income, and that differences in geographic endowments across ethnic homelands explain much of ethnic inequality. These imbalances thus have a long history. They also show that individuals from the same ethnic group are worse off when they reside in districts with a high degree of ethnic inequality. Kyriacou (2013) finds in a cross-section of countries that governance is worse where ethnic group inequality is large. Alesina and Zhuravskaya (2011) show that ethnically and linguistically segregated countries, i.e. countries where these groups live more separately, have a lower quality of government.

South Africa is an extreme case in Africa because of its apartheid history. Post-apartheid growth in South Africa has been sluggish, but there has at least been a modest reduction in poverty (Leibbrandt et al. 2012). The main driving force of inequality change in South Africa post-apartheid was that the share going to the top decile increased. Social grants became much more important as sources of income in the lower deciles, but overall it is the labour market which is the main driver of aggregate inequality. Inequality within each racial group has increased, while the contribution of inter-racial inequality has decreased.

Growth in Africa tends to be concentrated in small geographical areas, so spatial inequality is large (McKay and Perge 2009). In SSA this is often related to the location of natural resources. There are clearly advantages of agglomeration such as economies of scale, lower transport and transaction costs, and forward and backward linkages matter. Spatial imbalances are particularly serious in Africa because of its high ethnolinguistic fractionalization. High spatial inequality can be bad for growth by creating conflicts and tensions and can lead to demands for redistributive measures.

Successful countries are characterized by greater density, shorter distances, and fewer divisions (World Bank 2009). The World Development Report (World Bank 2009) concludes that urbanization and concentration of production are unambiguously good for growth and thus poverty reduction in the long run. The African story does not seem to be one of consistently increasing spatial inequality.

8 External influences on inequality

Africa has for a long time had high and increasing trade intensity, but still it has supplied a smaller and smaller share of global exports (until the last decade). SSA has specialized in resource exports and it has been unable to diversify into sectors with larger spillovers and dynamic externalities. Nissanke (2009) refers to this as a 'commodity-dependence trap'. African countries have been suffering from the consequences of swings in commodity prices, and the international community has not provided any efficient contingency financing. To be able to follow the diversification pattern of Asia, SSA needs to have a level of education that is so high that it can benefit from the dynamic forces of globalization, mainly within intra-firm trade in inputs. SSA needs a strategy for upgrading its comparative advantages and climbing to higher value-added activities. This requires a capable nation state. This process would be easier if trade partners such as the EU had more generous rules relating to African exports. The concern today for poor African countries is not primarily the level of tariffs on final goods, but instead other barriers like rules of origin which make it hard to become involved in global value chains.

One external influence that has been and still is important in SSA is foreign assistance. The impact of aid on inequality depends on how it is allocated across regions and groups. Donors are concerned about the distributional implications of aid, and in recent years the focus has been on poverty reduction. The question is how the aid relationship should be designed to lead to an equitable allocation of the aid. Donors have attempted to use policy conditionality to achieve desired outcomes, but the effectiveness of this mechanism has been weak. Because of this donors have sought other ways to ensure that aid is effectively used, summarized in the Paris

Agenda (DAC 2005). One key dimension there is the emphasis on ownership, i.e. higher recipient control of aid use. The question then is what measures, other than policy conditions, can help keep biased allocations in check? It would, to a higher degree, have to depend on domestic checks and balances.

Many countries in SSA have political systems that deliver poor governance, but donors wanting to reduce poverty there still need to channel money into these countries. When the government lacks capacity to handle aid effectively it may be advisable to seek channels outside the government. Donors could, for example, set up their own non-governmental investment institutions that support private investment directly, rather than trying to do so indirectly via support for the government infrastructure. If this is successful it would also strengthen civil society, which could possibly put pressure on the political and institutional systems to enhance governance.

9 Policy for equity

The development strategy of a country affects poverty via its impacts on growth and income distribution (Bourguignon 2004; Thorbecke 2013). The development policies pursued in Africa since independence have followed the trends in the international development debate closely. In the immediate post-independence period the main strategy was one of import-substitution industrialization. When concerns emerged about the distributional consequences of this trickle-down strategy, the focus shifted to policies such as redistribution with growth and basic needs. In the late 1970s many countries faced large economic imbalances, which meant that the strategy focus shifted to macrostabilization and structural adjustment. This was pursued in the 1980s and 1990s, with moderate short-term success. Around the turn of the century there was again a shift towards a poverty focus and parallel to this a shift in focus from macrostabilization policies to one focusing on governance issues. These shifts in policy have been closely related to perceptions about how inequality and poverty have evolved.

To reduce inequality and poverty Africa needs a strategy that can help absorb the surplus of unskilled labour, and this could be an export strategy based on labour-intensive manufacturing. But agricultural and rural development, with encouragement of new technologies, must also play a role. Investment in physical infrastructure and human capital are crucial. To back this up one needs efficient institutions that provide the right set of incentives to farmers and entrepreneurs. Social policies to promote health, education, and social capital need to be discussed, as well as the scope for safety nets to protect the poor. One needs to address the issue of governance, which is crucial for the development of African economies.

To be able to formulate a policy of redistribution (or poverty reduction) it is important to understand the causes of inequality. It can relate to human and physical capital, land, or public goods. The geographical and sectorial pattern of growth also matters. The most effective policy of redistribution would relate to assets rather than incomes, but asset redistributions are hard to undertake except under exceptional circumstances—often related to political violence. It is easier to redistribute incomes with the help of taxes and transfers, but these may have detrimental effects on growth incentives. By reducing returns on human and physical capital, income taxation reduces incentives to save and invest. If one assumes that it is primarily the rich who have the possibility to save, redistribution away from them in favour of the poor would reduce savings.

Poverty can limit growth in the long run via negative effects on productivity. In such a situation income transfers to the poor groups could be more positive for growth to the extent that they make it possible for them to invest in human and physical capital. Transfers also have an insurance dimension and protect households against negative shocks, and thereby make it possible for them to avoid negative savings or having to take their children out of school. Large income gaps also increase the risk of macroeconomic instability and makes it harder for governments to undertake reforms, which require collaboration and trust among people or groups (Alesina and Perotti 1996). It seems clear that a reasonably even distribution is good for growth. The effect will, however, depend on how one gets to a relatively even distribution when starting from a very uneven one.

Most types of redistribution policy are controversial and to be able to undertake it there must be support from influential groups. It could be argued that it may be in the interest of the elite to see a strong middle class emerge, which might mean that they, for example, may be willing to support a broad push for education. This would be good for growth in the long run, which would be to its benefit, but it could also undermine the power of the elite. Still, the growth of a middle class would tend to reduce social tensions and reduce the risk of future confiscation of its assets.

To be able to reduce poverty, countries need long-term growth. The growth acceleration we have seen in Africa in recent years is primarily due to two factors. First, there have been considerable improvements in the policy environment with regard to macroeconomic policy and extensive structural reforms, reducing market distortions, have been undertaken. Secondly, the natural resource boom has increased incomes in resource rich countries. The number of armed conflicts has been reduced, there were democratic advances and increased political stability, and many countries have received considerable debt write-offs. All these factors have contributed to faster growth.

To reduce poverty and to achieve a more equal income distribution one must build up the resources of the poor such as human capital, but it also requires a growth process that generates demand for the resources of the poor. To get a process that generates jobs is vital for Africa. The developments over the last couple of decades have mainly generated low-paid jobs in the informal sector, and this is not a transformation process that reduces inequality significantly. A policy for formalization should seek to make the formal sector attractive enough by making rules and regulations simple and transparent (Aryeetey 2009).

There is a risk of policy errors if the policy process focuses too much on policies that have short-term poverty-reducing effects. The optimal development path from a poverty reduction perspective would probably best be defined as one that minimizes the discounted sum of future poverty. A policy package that achieves this would be different from one that minimizes poverty in the short term. There are many policies that increase consumption today at the expense of consumption tomorrow. At the same time there are policies aimed at financing investments in infrastructure (e.g. taxation) that generate growth and poverty reduction in the longer term, while they may have negligible or even negative effects on the consumption of the poor today. Redistribution from the future to the present and from the currently non-poor to the poor can reduce poverty in the short term, but the question that needs to be addressed is how it affects future poverty.

The future of inequality in Africa hinges on what happens to structural transformation. To lower inequality and poverty one needs growth that generates labour demand outside traditional agriculture and the natural resource sector. In Asia, successful poverty reduction was achieved by having a rapid increase in the demand for unskilled labour in the manufacturing sector. This change was, moreover, often preceded by a green revolution in agriculture which increased productivity and incomes in that sector. This both created demand for manufactured products and released resources for the expanding sector. We have not seen such a breakthrough in African agriculture yet.

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