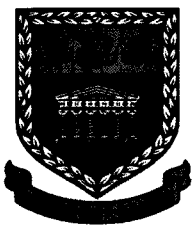

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WESTERN CAPE

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Assessing the Impact of Government Grants on Poverty and Inequality: a Microsimulation Study in South African

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- Counterfactual
- Impact
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Abstract

Poverty and inequality are the major challenges of the post-apartheid government of South Africa. In order to address these challenges, the government designed a range of policies and strategies including social grant programs. The main objectives of social grants in South Africa focus on relieving poverty and enabling the previously disadvantaged communities to access basic social services. However, poverty and inequality remains high in the country (statistics SA, 2014). The main objective of this study is to critically examine the impact of selected government grant programs on poverty and inequality in South Africa. The study estimates households' consumption function using the third wave of National Income Dynamics Study (NIDS) of South Africa and simulates the impacts of government grant on poverty and inequality. It examined how these impacts vary across population groups, gender and geographical locations. The findings indicate that monthly government grants decrease the head count poverty by between 3.7% and 4.4%, the poverty gap by between 1.9% and 2.7% and severity of poverty by between 1.2% and 1.9%. Government grants also reduce the odds of being in a state of poverty by approximately 59.1%. In terms of inequality, the findings show that government grants have little to do with reducing inequality (1.6%).

Declaration

I declare that the study *"**Assessing the Impact of Government grants on Poverty and Inequality: a Microsimulation Study in South Africa**"* is my own work, that it has not been submitted for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged by complete references.

Full name: Seyfe Tadesse Wurku Date: 25/02/2015

Place: Cape Town, South Africa Signature: _____

List of Abbreviations/ Acronyms

CDG	Care Dependency Grants
CSG	Child Support Grant
DASP	Distributive Analysis Stata Package
DG	Disability Grants
FCG	Foster Care Grants
FGT	Foster-Greer-Thorbecke
IES	Income and Expenditure Survey
KIDS	KwaZulu-Natal Income Dynamics Study
LPL	Lower Bound Poverty Line
PIR	Poverty and Inequality Report
PSU	Primary Sampling Units
PPP	Purchasing power parity
PIR	Poverty and Inequality Report
NPC	National Planning Commission
NIDS	National Income Dynamics Study
SA	South Africa
SOAP	State Old Age Pensions
UPL	Upper Bound Poverty Line

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CHAPTER ONE: INTRODUCTION

1.1. Introduction

Poverty and inequality remains a major challenge confronting many countries in the world. Almost half of the world's population lives below the poverty line of $2 per day, whereas other parts of the world continue to enjoy enormous technological and economic advancement (Shepherd et al., 2014; Kharas, 2010; Haughton and Khandker, 2009 and Ferreira, 2008). In developing countries more than one billion people live on a per capita income less than $1 per day. Surprisingly, in these countries inequality is also a big problem. Most of the countries with a high Gini coefficient (higher than 0.5) are developing countries (Word Bank, 2009:81). South Africa is one of the countries with high poverty as well as wealth inequality.

Since the fall of apartheid and inception of a democracy in South Africa in 1994, the government designed a national strategy for social development, which was accompanied by the White Paper on Developmental Welfare (Dinbabo, 2011). The White Paper on Social Welfare (1997) marked a fundamental shift in South Africa's welfare strategy, with the government developed various policies and complementary programs. These included "government grants, unemployment insurance, public works programs for the working poor and the 'social wage' package, which comprises access to education, health and other services" (Woolard and Leibbrandt, 2010:4). The government grant program aims to provide support for the poorest of the poor and the vulnerable. Currently the program, which is executed by the South African Social Security Agency (SASSA), supports more than 30% of the population (SASSA, 2013).

The main purpose of this study is to critically examine the impact of government grant programs in South Africa. The study uses quantitative methods of research and makes use of the Foster-Greer-Thorbecke (FGT) index of poverty, logit regression and Gini coefficient measurements of inequality. Furthermore, the study used a microsimulation model to analyse the various possible scenarios of the social policy changes.

This chapter is divided into the following sections (1) the background and contextualisation of the study, (2) the significance/ rational of the study (3) problem statement, (4) aim and objectives of the study, and (5) research questions.

1.2. Background and contextualization

South African economy is the second largest in Africa (McKinsey Global Institute, 2014:2). It is a productive and industrialized one with different characteristics that are present in developing countries, such as labour division between the formal and informal sector and an unemployment rate of 24.1% in 2014 (statistics SA, 2014: 14). Most South African households are exposed to high levels of poverty or are continually vulnerable to poverty (Gradín, 2011 and Finn and Leibbrandt, 2013a). According to Statistics SA (2014), 20.1% of South Africans lived under $2 a day in 2011. The human development is also low: the country ranked 118 from 187 countries in the Human Development Index (HDI) in 2014 and was categorized as a Medium Human Development country (UNDP, 2014). In addition to the high levels of poverty, South Africa is among countries with the highest income and wealth inequalities in the world. In 2011, the Gini coefficient was 0.69 (statistics SA, 2014).

Poverty in South Africa is more visible because it coexists with high wealth inequality, and also due to the fact that inequality has a correlation with race (see- Bhorat, et al. 2013, Yu, 2010; van der Berg et al., 2008 and Ozler, 2007). In 1994, the majority of Africans, for the most part were poor, whilst the majority of Whites were rich. A study by Gradín (2011) also indicates that the poverty level among most African is worse than the Coloured, who are poorer than the Whites. In 2008, the per capita income of the Whites was 8 times higher than that of Africans (Finn and Leibbrandt, 2013b). In 2008, using an upper bound poverty line of R946, Gradín (2011) discovered that 77% of Africans, 49% of Coloured, 9% of Asians/Indians, and only 1.5% of Whites fell below the threshold.

In order to address the problem of poverty and inequality, the democratic government introduced the Reconstruction and Development Program (RDP) which emphasised on economic growth and employment creation as essential components for reduction of poverty and inequality in the country (May, 2000). Furthermore, the program introduced the Poverty and Inequality Report (PIR) in 1997. The report aimed at analysing existing policies and identifying the cross cutting issues that affect the implementation of government policies and emphasises the importance of social welfare grants to reduce poverty and inequality.

Furthermore, the government expanded the scope and amount of government grant programs that support the disabled and vulnerable people. This study evaluates the impact of State Old

Age Pensions (SOAP), Disability Grants (DG), Child Support Grants (CSG), Care Dependency Grants (CDG) and Foster Care Grants (FCG) in reducing poverty and inequality.

1.3. Significance/rationale of the study

South Africa cannot eliminate poverty and inequality unless suitable policy measures are put in place to support the poor and vulnerable groups. Poorly designed policies and inefficient institutions can lead to wastage of resources and eventually fail to reach target beneficiaries. This makes impact assessment studies crucial and knowledge gained from such studies offers opportunity for the appropriate design of future projects and policies. Therefore, this research does not only contribute to existing knowledge and literature, but can be used by the government of South Africa, researchers, policy makers, and other relevant stakeholders to develop and implement strategies that can uplift the lives of the poor and reduce inequality.

1.4. Problem statement

Over the past two decades, major political and social changes have been made by the current South African government taking the lead role in introducing a range of social welfare policies and implementation modalities. Dinbabo (2011) notes that the major objectives of social welfare policies in South Africa include alleviating poverty and enabling the previously disadvantaged communities to access basic social services. However, poverty and inequality are still very high in the country (statistics SA, 2014). The Gini coefficient increased from 0.51 in 1959 to 0.63 in 2009 and 0.69 in 2011. While different studies (Bhorat, et al. 2013; Dinbabo, 2011; Yu, 2010; van der Berg et al., 2008; Ozler, 2007; Devereux, 2002; Case and Deaton 1998) have been carried out to determine the impact of different government grant programs [Old Age Grant (OAG); Disability Grant (DG); Child Support Grant (CSG); Foster Child Grant (FCG); Care Dependency Grant (CDG), War Veteran's grant (WVG), and Grant in Aid (GIA)] on household poverty, child poverty and inequality in South Africa, there are few studies which simulate the impact of social welfare policy change on poverty and inequality.

Therefore, undertaking empirical research to investigate the relationship between social welfare policies and poverty/inequality reduction in South Africa using a microsimulation model is crucial in making a contribution to the academic literature as well as informing policy.

1.5. Aim of the study

The main aim of the study is to evaluate the impact of government grants on poverty and inequality in South Africa.

1.6. Specific objectives

The following specific objectives are drawn on the basis of the general objective:

- Estimate, household consumption function using wave three of the National Income Dynamics Study (NIDS) of South Africa.
- Simulate the impacts of government grants on poverty and inequality.
- Assess the impact of government policy changes (no household will receive cash transfer) towards government grant on poverty and inequality.
- Make recommendations to government, policy makers, NGOs and other principal stakeholders of the programme to help enhance programme efficiency.

1.7. Research questions

The study attempted to answer the following questions:

- What are the impacts of government grants on poverty [(poverty rate (P0), poverty gap (P1), poverty severity (P2)] and inequality (Gini co-efficient)?
- What will happen to poverty [poverty rate (P0), poverty gap (P1), poverty severity (P2)] and inequality (Gini co-efficient), if the government decided to remove the existing cash transfers such as: State Old Age Grants, The Disability Grant, The Child Support Grant, The Foster Care Grant, Care Dependency Grant?
- Do government grants reduce the probability of households being in a state of poverty?

CHAPTER TWO: CONCEPTUAL AND THEORETICAL FRAMEWORK

2.1. Introduction

In this section, the study presents the theoretical underpinnings and conceptual framework within which the research was analysed. It also provides a review of literature on the concepts of poverty, inequality and government grants and more so, highlights the interplay between government grant programs, poverty and inequality.

2.2. Rawls' theory of justice

Rawls' theory of justice is based on philosophical and ethical foundations, which deal with the basic structure of society (Rawls, 1971). The theory tries to solve the way in which the distribution of fundamental rights and duties affect the division of advantages in a society. It provides a reasoned argument why it is socially just to distribute goods equally in a society and argues that the state has to redistribute wealth to the poor and vulnerable. According to Dinbabo (2011: 27), Rawls' theory of justice also explains "the principles of how society should be structured, how basic rights and duties should be assigned to individuals, and how social and economic advantages should be distributed to all members of society".

For Rawls, the concept of justice is defined by "the role of its principles in assessing rights and duties and.... appropriate division of social advantages." For him, justice has two principles that apply to the basic structure of society. "First: each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others. Second: social and economic inequalities are to be arranged so that they are both (a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all under conditions of fair equality of opportunity " (Rawls, 1971: 266). Based on the above principles Rawls explains that the less fortunate members of the society should be compensated, so as to "maximize the worth to the least advantaged of the complete scheme of equal liberty shared by all" (Rawls, 1971:179).

Hence, Rawls theory of justice can be used to explain the importance of social protection programs in compensating the poor and vulnerable ('least advantaged' in Rawls's term) in order to have a just society. Dinbabo (2011) used Rawls' theory of justice to examine the effectiveness of and the extent to which the social welfare policies respond to child poverty. As part of the theoretical and conceptual framework of the study, Rawls theory of justice is

appropriate and applicable in terms of analysing the impact of government grants on poverty and inequality in South Africa.

2.3. The definition and measures of poverty

2.3.1. Definition of poverty

Poverty is a multidimensional and relative social phenomenon and as such it may have different meanings. According to the World Bank (2000:15), poverty is defined as "pronounced deprivation in well-being". In this definition, well-being is linked with the access to commodities. This view, according to Haughton and Khandker (2009), sees poverty largely in monetary terms. Perhaps in a broader way Sen (1990) articulates poverty as the failure of some basic capability to function. For him well-being comes from a capability to function in society. Thus, poverty arises when people lack such capabilities. Statistics South Africa (2000:54) defines poverty as "... in a broader perspective than merely the extent of low income or low expenditure in the country. It is seen here as the denial of opportunities and choices most basic to human development to lead a long, healthy, creative life and to enjoy a decent standard of living, freedom, dignity, self-esteem and respect from others."

In 2000, World Bank published "*voices of the poor*" in an attempt to understand poverty from the within. A poor man, in Kenya 1997 brought out his definition of poverty by describing his living conditions "... Look at the house and count the number of holes. Look at my utensils and the clothes that I am wearing. Look at everything and write what you see. What you see is poverty". Another man in a poor area of Latvia in 1998 defined poverty as "humiliation, the sense of being dependent on them, and of being forced to accept rudeness, insults, and indifference when we seek help". Many scholars (Alcock, 1997 and Alkire, 2008) agree that the definition of poverty has to be understood, at least in part, in relation to particular social, cultural and historical contexts.

2.3.2. Measures of poverty

According to Coudouel, Hentschel and Wodon (2002:30), computing poverty measures requires three ingredients. "First, one has to choose the relevant dimension and an indicator of well-being. Second, one has to select a poverty line, that is, a threshold below which a given household or individual will be classified as poor. Finally, one has to select a poverty

measure to be used for reporting at a population level as well as for population sub-groups only." The following section expands on the three ingredients of poverty measures.

2.3.2.1. Indicators of poverty

Both monetary and nonmonetary indicators of poverty have been identified by different scholars (Ferreira, 2008: Frye, 2005 and Coudouel et al., 2002). Monetary indicators could be either income or consumption. Both of these indicators have their advantages and disadvantages. Income is generally seen as being easier to measure than expenditure; this is mainly because individuals or households can fail to remember everything that they have spent over a certain period. Coudouel et al., (2002:30), on the other hand, argue that "Consumption better reflects a household's actual standard of living and ability to meet basic needs". They further explain that consumption does not only indicate the amount of goods and services that households consume by current income, but also the possibility of accessing other sources such as: credit market or savings. For the purpose of this study household monthly consumption is used as an indicator of poverty.

Non-monetary poverty indicators mainly include health, education and living standards (Leibrandt and Woolard, 2013). The establishment of the multidimensional poverty index is also an important step to recognize the importance of the multidimensional aspects of poverty. The index uses the three main dimensions of Human Development Index to identify deprivations across the three dimensions.

2.3.2.2. Poverty lines

Martin (1998:3), defines the poverty line as "the monetary cost of a given person, at a given place and time, of a preference level of welfare". Martin further explains that people who do not obtain that level of welfare are considered poor". Coudouel et al., (2002:30) also define a poverty line as "the cutoff points separating the poor from the non-poor". The line, according to Coudouel et al., (2002:30), can be monetary (for example, a certain level of consumption) or non-monetary (for instance, a certain level of literacy).

There are two main ways of setting poverty lines: absolute and relative poverty lines (Frye, 2005 and Coudouel et al., 2002). Absolute line is a situation in which people are considered poor in comparison to certain criteria's (Haughton and Khandker, 2009). According to World Bank, one of the main criteria is the $2 a day. This is based on the assumption that this

amount of money has to cover the basics of food, shelter and water. The need for medicine, clothing and school books are not on the priority list. The other is by considering relative poverty line a situation in which people are considered poor in contrast to other people. Here an attempt will be made to compare between persons within the lowest income section and those of the upper income section (Ibid).

In South Africa there are three national poverty line measures based on the cost of basic needs in the country: the food poverty line (FPL), the lower-bound poverty line (LPL) and upper-bound poverty line (UPL) (statistics SA, 2014). The FPL measures the consumption level that people need in order to have an adequate diet. Individuals below the FPL consume insufficient calories. For 2011 the FPL was R321 (in 2011 prices) per capita per month. Both LPL and the UPL were derived based on the cost of adequate food and non-food items. However, for individuals below the LPL it is hard to consume both non-food and food items and they have to sacrifice non-foods. On the other hand, households at UPL can purchase both adequate food and non-food items. The upper-bound poverty line (UPL) was R620 (in 2011 prices) and the lower-bound poverty line (LPL) was R433 per person per month (in 2011 prices) (Ibid).

2.3.2.3. Poverty measures

There are alternative measurements of poverty, but the most commonly used measurement is the Foster-Greer-Thorbecke (FGT) measurement of poverty. FGT is based on calculations of poverty measures taking income shortfalls of the poor themselves as weights (Foster, Greer and Thorbecke, 1984). This helps to analyse the implications of social transfers on incidence, depth and severity of poverty. It has three components; the headcount index (P0), poverty gap index (P1) and poverty severity index (P2). The headcount index (P0) measures the percentage of the population that is poor. However, it does not indicate to what extent they are poor. It is popular because it is easy to understand and measure. The poverty gap index (P1), on the other hand, measures the degree to which individuals fall below the poverty line (the poverty gaps). By adding these poverty gaps, one can get the minimum cost of eliminating poverty. The squared poverty gap index (also known as the poverty severity index, (P2)) averages the squares of the poverty gaps relative to the poverty line.

2.2.4. Poverty in South Africa

South Africa is a country undergoing different fundamental transitions. Since 1994 different changes have taken place in the social, economic and political spheres. The post-apartheid government has put forward different program and strategy plans to eradicate poverty from the country. Some of the main programs and strategies include the Reconstruction and Development Plan (RDP) (Meeting basic needs), Accelerated and Shared Growth Initiative for South Africa (AsgiSA) (halve unemployment and poverty) and National Development Plan (NDP) (eliminating all poverty by 2030) and Twenty Year Review, 2014). In addition to the above programs and strategies, the government increased the scope and amount of social security programs to uplift the disabled and vulnerable groups.

Despite the different socioeconomic policies and programs in the post-apartheid period, there is an academic consensus on the rise of monetary poverty in the late 1990s. However, according to Seekings (2007), the findings differ in specific data used and assumptions made in the analysis. Carter and May (2001) using the first two waves (1993 and 1998) of the KwaZulu-Natal Income Dynamics Study (KIDS) found an increase in poverty among Black household in KwaZulu-Natal province. Meth and Dias (2004), who used expenditure data from the 1999 OHS and a 2002 LFS, discovered that both the number and proportion of households and individuals living in poverty had risen. Hoogeveen and Özler (2004) using the 1995 IES/OHS and the 2000 IES/LFS data on real per capita expenditures show that the number of poor people grew between 1995 and 2000. Grieger, Williamson, Leibbrandt, and Levinsohn (2013) used the first two waves of NIDS and discovered that 34% of the sample that were poor in 2008 was also poor in 2011. Finn and Leibbrandt (2013) also used the 3 waves of NIDS data from 2008 to 2011 learned that most of the poor were trapped in severe poverty, with income per capita less than half of the poverty line.

However, a recently released Statistics South Africa (2014:12) report, which used Income and Expenditure Survey (IES), found that the percentage of the population that is poor or lives below the national upper-bound poverty line (UPL) of R620 (in 2011 prices) decreased from 27 million people (57.2% of the population) in 2006 to 23 million people (45.5% of the total population) in 2011. Population living in extreme poverty or below the lower-bound poverty line (LPL) of R433 per person per month (in 2011 prices) also reduced from 26.6 million people in 2006 to 10.2 million people in 2011. Different studies (Economic Policy