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Income Inequality in the United States vs. Romania

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For countless generations, the lopsided distribution and allocation of income has plagued society and spurred the creation of social classes based on wealth. No one country is immune to the development as most countries, if not all, suffer from income inequality. Even countries under communist or socialist rule, that dictate the earnings of its citizens, possess a gap between people of all income groups, where they should theoretically earn the same portion of national income. During the fall semester of 2010 our class at DeSales University collaborated with Romanian American University (RAU) in Bucharest and this paper was prepared for such global collaboration. In this paper, we have chosen two countries to analyze their distribution of income and wealth. We have noticed that both the United States and Romania struggle with this growing problem, spawned from numerous economic and social factors that threatens the existence of the middle class and their social mobility. We will demonstrate the major factors contributing to income inequality in both countries and will discuss about its implications.

The United States' economy is the largest and most technologically commanding nation in the world. The Gross Domestic Product (GDP), or the total value of all final goods and services produced within a nation in a given year, is the largest of any nation in the world at $14.26 trillion (2009), and with GDP per capita of $46,400 U.S ranks eleventh (U.S. dollars) (CIA World Factbook, 2010). The American economic system is capitalist, where both private and public firms continuously conduct business with each other with great flexibility and limited government intervention in the market, especially when compared to their counterparts in Europe. The flexibility granted to businesses and firms allows them to expand capital, employ or lay-off workers, offer their services, and respond to market demands faster than otherwise.

Following World War II, the overwhelming advances in technology created a two-tier labor force of unskilled, uneducated workers and educated workers who were able to learn to keep up with the expanding technological changes. This divergence in the workplace created an income inequality amongst the working class still felt by households. As represented in Table 1, personal income is unequally distributed in the U.S., with the top 20 percent of households receiving about one-half of total income. In an equal distribution, all five categories receive 20 percent. Unfortunately, the income inequality gap is widening over time, and it seems that the poor are getting poorer and rich are getting richer. Income inequality, which has been expected to fall as the recession that started in December 2007 knocked the highest earners closer to the pack, was essentially unchanged in 2008 by various census Bureau measures. The top 5 percent of households received 21.5 percent of income in 2008; up from 21.2

percent in 2007 and half of all income went to the top fifth of the American households. What is alarming is that every step up the ladder, the disparity has progressively widened. Over the past 30 years, the share of income generated by the top 10 percent of Americans has grown by about a third; the share of the top 0.01 percent-the 13,000 or so households with average income of $10.8 million in 2002-has multiplied nearly four times (Rattner, 2005).

Table 1: Personal Distribution of Income, 1986, 1996, 2006

Income Segment (Median Income)	percent of Total		
	1986	**1996**	**2006**
Lowest Quintile ($8,596)	3.9	3.7	3.4
Second Quintile ($21,097)	9.7	9.0	8.6
Third Quintile ($35,486)	16.2	15.1	14.5
Fourth Quintile ($54,922)	24.5	23.3	22.9
Highest Quintile ($115,514)	45.7	49.0	50.5

Source: U.S. Bureau of the Census[1]

Regarding Romanian income distribution, review of their economy is helpful. Romania began to transition from Communism to market-based economy in 1989, as their output produced from an obsolete industrial-based system proved unsuited in meeting the country's demand requirements. As of January 1, 2007, Romania became a member nation of the European Union, although it still is not a member of the European Monetary Union (EMU). A combination of corruption and bureaucratic red tape hinders the business environment, making business expansion somewhat difficult to pursue. Over the last decade, increasing domestic consumption and investment has fueled the GDP growth of Romania. This sudden boom in GDP growth has sparked the creation of a new middle class and the means to address the widespread poverty throughout the country, as 25 percent of the population currently falls below the poverty line (CIA World Factbook, 2010). However, the GDP fell 6.9 percent in the 2009 fiscal year to $256.3 billion (U.S. dollars) from $275.3 billion in 2008 as the result of the worldwide recession rendering Romania 44th in the world, in terms of GDP (CIA World Factbook, 2010). The labor market was also affected by the recession, just as in the United States, as the unemployment rate swelled from 4.4 percent in

[1] www.census.gov

2008 to 7.6 percent in 2009 (CIA World Factbook, 2010).

In a society with equal distribution of income, the dispersion of income would be equal among the quintiles of households, where each group would account for 20 percent of personal gross income. In fact, the United States, just like many other nations in the world, has suffered from a disproportionate allocation of income for many generations. Occasionally the income gaps between the five quintiles shrink, bringing them closer to equality; however, the gap remains to be extremely large. Emmanuel Saez, author of the paper *Striking it Richer: The Evolution of Top Incomes in the United States,* stated that "analyzing long-term trends (of income distribution) are often hampered by a lack of good data" since "household income surveys virtually did not exist prior to 1960" (Saez, 2009, p. 1). Therefore, determining actual inequality before the 1960s is nearly impossible to achieve. Saez does conclude, however, that between 1914 and 1945 (the two World Wars through the Great Depression) the U.S. experienced dramatic fluctuations in the proportion of income earned by each group (Saez, 2009, p. 2-3). "The top percentile share declined during WWI, recovered during the 1920s boom, and declined again during the Great Depression and WWII, "resulting in a gradual reduction in the gap between the upper and lower quintiles (Saez, 2009, p. 2). Saez suggests that the top earners were financially hindered during the World Wars and the Great Depression because they were capital owners, or owners of financial assets, and relied heavily on dividend and business income. The shocks of war and the stock market crash adversely affected the top quintile's overall share of national income.

Well into the 1960s, the income inequality gap experienced earlier in the century slowly diminished in the United States. Although, according to Deputy Senior Editor for NPR's National Desk and author of the article "Haves and Have-Nots: Income Inequality in America," Uri Berliner, the top fifth of households still owned a large portion of the nation's income at roughly 40 percent (Berliner, 2007). But during the 1970s, and enduring into the current millennium, there has been a remarkable increase in the top fifth yet again. Berliner stated, "between 1975 and 2005, U.S. households in the bottom 80 percent income bracket saw their share of national income fall," and that "only the top 20 percent of households experienced an increase in their share of the total national income" (Berliner, 2007). The "households in the top fifth of the income bracket earn almost half of the nation's income," according to 2005 statistics (Berliner, 2007). An explosion of top wages and salaries since 1970 have accounted for the surge of income obtained by members in the upper-quintile. Over the past generation, the financial gulf between the rich and everyone else has grown wider. Meanwhile, the unequal income distribution in the United States shows no signs of changing in the near future.

The historical decline of income inequality during the 1960s in the United States can be partly attributed to the expansive modernization of the American education system. Due to technological advances and the development of more efficient production methods, demand for workers with more advanced education and training has increased substantially. In an interview with Jared Bernstein, a chief economist in the Obama administration, by Multinational Monitor in May of 2003, Bernstein theorized that the income disparity amongst education levels has grown over time. Part of the growth that Bernstein has noticed is attributed to the growth of the difference in earning levels between workers with high school diplomas and workers with college degrees. According to Frank Levy, an economist at the Massachusetts Institute of Technology, there has been a rapid increase in income inequality since the beginning of the 1970s, a time of massive technological growth (Levy, 2008). In 1972 college graduates earned 1.43 times as much as highs school graduates and in 1992 that number increased to 1.82. In 1972 workers with advanced degrees earned 1.72 times as much as high school graduates but by 1992 that number had increased to 2.54 (The Roots of Inequality, 1996). Development of the American financial market has created more effective methods of business but has also made income distribution lean heavily in the favor of a higher educated workforce.

Recent trends show that immigration and outsourcing have played major roles in the variance of the distribution of income. Foreigners that recently immigrate to the United States frequently lack the education and training demanded in the U.S. workforce and, therefore, increase the supply of low-income laborers. This increase in supply results in widening the gap between middle level and lower level incomes. In addition to immigration enlarging the lower class, outsourcing has contributed to the decrease of middle level income jobs. Between 700,000 to 900,000 legal immigrants enter the United States each year. There were 34 million immigrates in the Unites states in 2003, amounting to 12 percent of the population (Economic Report of the President, 2005). So much of legal and illegal immigrant labor is concentrated in such low-wage employment.

Economists Tali Regev and Daniel Wilson point out in their FRBSF (Federal Reserve Bank of San Francisco) letter that most jobs being sent offshore are manufacturing jobs, which have traditionally been a major source of employment for middle-income workers (Regev and Wilson, 2007). This growing absence of middle-income jobs has assisted in the reduction of the middle class. As a result of these two factors being a major influence on income distribution, they help to distance the lower class farther from the upper class.

A contributing factor to the degree of inequality recorded yearly in the United States is the amount of workers per household. The Census records income distribution by household in its reports. This presents a widened income gap between multiple and single worker households. Families with multiple workers in their household tend to record more income than families dependent on a single worker. This discrepancy in income records allows for a more unequal distribution to be present in census statistics. This creates a minor issue in accuracy of data reflecting income inequality.

Within all general economic entities, distribution of income is directly related to the distribution of work throughout the general labor force Rea Herdman and Robert Rector both stress in their article "Two Americas: One Rich One Poor?" the importance of considering the amount of work contributed and the amount of income earned. In their article, they claim that households within the top one fifth of income distribution in the United States perform about one third of the total labor. Lower class families on the other hand, have less educated and productive workers and contribute less to the total labor but are compensated for it very generously by taxes. Thus, inequality of income in the United States can be considered a consequence of an unequal distribution of work. According to this theory, the more work a laborer has and does is directly related to the amount of income he or she accumulates.

Economic analysis of distribution of income in Romania: Just as the United States suffers from a wide income disparity, Romania also battles with that dilemma which has proven to be a growing problem over the last few decades. As stated in the article "Romania – Poverty and Wealth," "in 1989, the top ten percent of the population [in Romania] earned around 2.1 times more than the bottom ten percent," and this trend has since been on the rise (Romania-Poverty and Wealth).

Unlike the United States, Romania has an unusually large percentage of the population living in poverty. Romania's rank amongst the world's worst countries in poverty is eighty-third with 25 percent of the population below the poverty level. Romania's extreme amount of poverty can be attributed in part to the unequal distribution of income. Romania has a small upper class, a large bottom class, and a middle class that lacks foundation. The top 10 percent of income households consume approximately 21 percent of the country's total gross domestic product (GDP) while the lowest 10 percent only consumes around 1 percent (CIA World Factbook, 2010).

The grossly lopsided distribution in Romania is the result of numerous factors, but the largest influencing factor has been the transition from communism to capitalism. The inequality that plagues the Romanian economy is a major side effect of the country's economic woes that accompany massive federal change. In 1989, Romania transformed from a command based system to a market system. During this change, the top 10 percent of the population earned around 2 times more than the bottom 10 percent (Romania-Poverty and Wealth). According to a 1994 survey conducted by World Development Indicators, Romania's highest quintile accumulated 37.3 percent of income whereas the bottom quintile earned only 8.9 percent (Romania-Poverty and Wealth). The inequality gap continued to widen throughout the 1990s and into the new millennium. Maria Molnar, senior researcher at the Institute of National Economy - Romanian Academy, and faculty member at the University of Bucharest, stated that in 2008, the "share of the income of the 20 percent of the population with the highest income was almost five times larger than that of […] the population with the lowest income" (Molnar, 2009, p. 5). During that year, the upper quintile received 39 percent of before-tax income whereas the lower quintile earned only 8 percent (Molnar, 2009, p. 5). However, due largely to the worldwide economic crisis and a substantial increase in minimum wage and pensions in Romania, the income gap has been growing at a slower pace than between 2000 and 2006 (Molnar, 2009, p. 6-7). Under the conditions of the crisis and political pressure, Molnar predicts that a continual decrease in the income gap is probable. Nevertheless, even with this recent deceleration, the income distribution in Romania is the widest compared to all other European Union members.

Although Romanian income inequality dramatically increased during the few years after the transition, the country has had an explosion of economic growth over the past ten years. Romania has been one of the leading European countries in GDP growth and in 2006 reported a GDP growth of 8 percent (Romania-Poverty and Wealth). As a result of the large amount of financial expansion, foreign investment in the country has risen. Alongside the setbacks the country has seen from its transition to capitalism, there have also been beneficial changes that have accompanied the economic transformation.

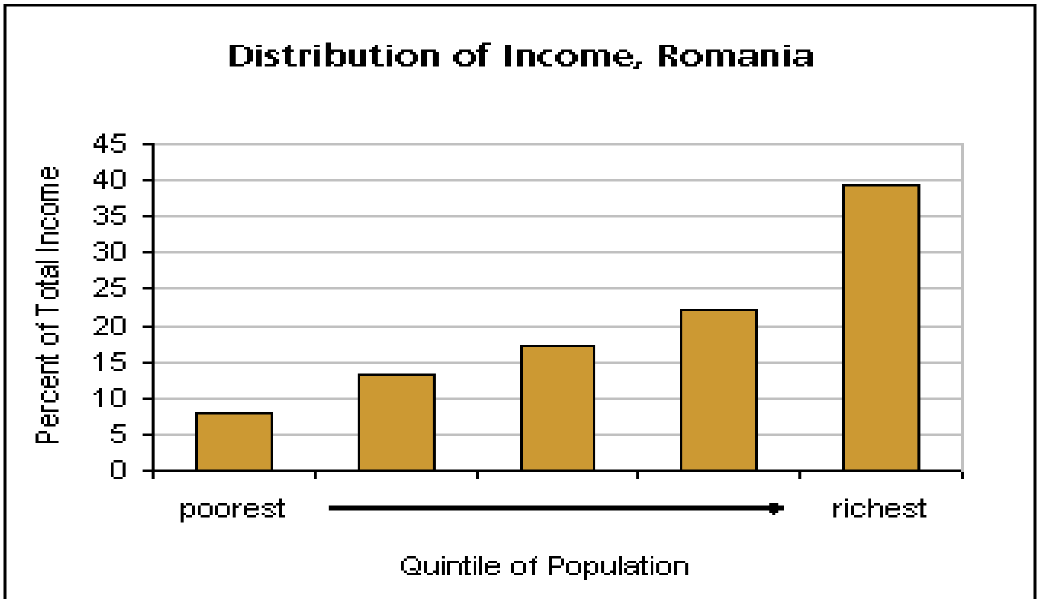

Figure 1: **Source: World Resources Institute**[2]

Another major issue that Romania has had to contend with during the past twenty years has been the corruption that has spread throughout the country's upper class. Corrupt financial and political practices have sprouted from the economic stability that was a result of the government's transition. One of the most notable cases of corruption in Romania was the indictment of former Prime Minister Adrain Nastase. During Nastase's term as Prime Minister between 2000 and 2004, he was accused of numerous cases of bribery and other fraudulent acts, compromising his political integrity. In 2009 alone, 244 high-ranking officials in the administration and politics were sent to court (EU Criticises Judicial Systems in Bulgaria and Romania, 2010). The corruption in Romania has caused income to lean favorably towards the upper class. The weak judicial system allows for dishonest financial practices and prevents citizens from being able to seek justice. A step forward for Romania in fighting corruption has been the creation of the Agency for National Integrity, which is meant to oversee all officials, even those in Parliament.

TABLE 2: Percentage of National Income in the United States, 1967-2009

[2] http://earthtrends.wri.org/text/economics-business/country-profile-151.html

	Lower Quintile	2nd Quintile	3rd Quintile	4th Quintile	Upper Quintile
1967	4.0	10.8	17.3	24.2	43.6
1972	4.1	10.4	17.0	24.5	43.9
1977	4.2	10.2	16.9	24.7	44.0
1982	4.0	10.0	16.5	24.5	45.0
1987	3.8	9.6	16.1	24.3	46.2
1992	3.8	9.4	15.8	24.2	46.9
1997	3.6	8.9	15.0	23.2	49.4
2002	3.5	8.8	14.8	23.3	49.7
2007	3.4	8.7	14.8	23.4	49.7
2009	3.4	8.6	14.6	23.2	50.3

Source: America's Household Income Gap, The State of the USA [3]

TABLE 3: Percentage of National Income in Romania, 1989-2007

	Lower Quintile	2nd Quintile	3rd Quintile	4th Quintile	Upper Quintile
1989	10.0	14.9	18.7	23.2	33.2
1992	9.3	14.3	18.4	23.4	34.6
1994	8.9	13.6	17.6	22.8	37.2
1998	8.7	13.3	17.3	22.6	38.2
2000	8.2	13.0	17.4	23.0	38.4
2001	8.1	12.9	17.3	22.9	38.7
2002	7.9	12.8	17.1	22.8	39.4
2005	8.2	12.8	16.8	22.3	39.9
2007	7.9	12.7	16.8	22.3	40.3

Source: Trading Economics[4]

The working middle class has been considered one of the more important classes in preventing inequality because of its role as a medium for the

[3] http://www.stateoftheusa.org/content/new-census-estimates-provide-snapshot.php

[4] www.tradingeconomics.com

distribution of income. Economist and political philosopher Karl Marx created a federal system that had its foundation built around the working class due to the significance of labor. During the eight years after Romania's transition to capitalism in 1989, the lowest quintile's percentage of national income dropped from 10 to 7.9 percent in 2007. This increase in poverty weakened the middle class and created a distinct separation between the upper and lower classes. As can be seen in Table 3, the first four quintiles of Romania's distribution of national income all declined between 1989 and 2007, while the fifth quintile expanded. The same trend is observed in the United States as shown in Table 2. This example shows the lopsided distribution in Romania that heavily favors the upper class. This distribution problem has carried over to the new capitalist government and has raised concerns in the economy over the enlarged upper class and minimized lower and middle classes. In the article, "Romania; A Wealth of Poverty," Romanian industrial engineer Ioan Gheorghiu expresses his concern for the lack of social stability due to a small middle class as Steven Rattner expressed the same concern about the United States income disparity that limit social mobility, the opportunity for individuals to move up the ladder. The CIA World Factbook's analysis of Romania concludes that the recent economic expansion in Romania has helped to reenergize growth of the middle class, which in turn may help to reduce income inequality in Romania.

Russian-American economist Simon Kuznet won the Nobel Prize in economic sciences for his theories on the relationship between economic growth and income inequality. Kuznet theorizes that there is a u-shape relationship between economic growth and income disparity in countries. Kuznets's theories can be applied to the situations of Romania and the United States in comparing the distribution of income of each country. Due to the restructuring of the Romanian economy, the country has had struggles with poverty and income inequality. As the country has grown and matured, there has been a rebirth of the middle class and the government has undertaken a more active role in narrowing the income gap. Over the years, the United States has made attempts to improve income inequality through increases in minimum wage, government intervention in the market, as well as progressive taxes, but existing data does not support the success of such attempts and the 2007-2009 crisis actually contributed more to the income distribution gap by increasing the underemployment rate along with high unemployment rate of 9.4 percent in January of 2011.

The allocation of national economic output has been one of the most statistically complicated tasks facing countries worldwide in the past two hundred years. Household income measurements, allocation of funds, and balancing class income distributions are just a few of the problems preventing governments from having the capabilities of efficiently allocating income. Romania and the United States are two nations that help represent the current worldwide struggle in achieving an equitable allotment of income.

Each country has taken great efforts to combat the growing income disparity in their regions with little success. This is signified by the widening distribution gap as the largest quintile continues to expand and the other quintiles contract. Upon examination of these two countries, the results indicate an international trend towards unequal distribution levels that lean heavily in favor of the upper classes. A major side effect of this trend is the contraction of the middle and lower class income levels, creating more poverty and decreasing living standards for a large portion of the countries' populations. Both the United States and Romania need to address income distribution, as it should be acknowledged as a primary concern in establishing better economic health. We need to provide more education and training to fix this problem of too many low skilled workers. A thriving middle class is an important component of economic, political, and social stability of any nation. We can provide more protection for those at risk, such as better wage insurance to cushion the effect of globalization. If we do not pursue policies to fix inequalities, social pressures may force unwise, even extremist moves, like protectionism.

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