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Income variability in Romania: Decomposing income inequality by household characteristics

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Abstract

This paper aims at contributing to the better understanding of the income inequality determinants in Romania. In spite of positive economic evolutions and considerable governmental concerns, income inequality is still high in Romania and has remained almost unchanged during the past 15 years. Neither economic growth, nor the economic crisis that followed during recent years, has been equally distributed across households. The contribution of our paper lies in the decomposition of income inequality by groups of households based on socio-economic characteristics and the estimation of between and within group inequality. We assess the size of income inequality by using the Theil inequality index. Our findings suggest that education and status in employment are amongst the main determinants of income variability.
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1. Introduction

The Romanian population is highly vulnerable against income inequality, being among the first countries in the European Union in this regard. This is a serious concern, considering both the negative developments in recent years, but also the close relation of income inequality with the relative poverty indicator. Unfortunately, in Romania poverty has remained a pressing social and economic problem despite pre-crisis positive economic developments. The fight against poverty and social exclusion has to start with the analysis of inequalities in society, and continue

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with considerable involvement from governments, policy makers and society. The issue of income inequality becomes very important because the distribution of economic resources can have a direct influence on social inclusion and poverty reduction.

Worldwide, income inequality has increased both between and within countries as a consequence of the globalization process. The Nobel laureate for economics, Joseph Stiglitz argues that increasing inequality in most countries can be explained through the process in which the money has gone from those who were able to spend it toward those who already had so much money that they could not spend it all. Thus, he claims that the increasing economic inequality was the main cause that triggered the financial and economic crisis. For the Romania's case, one can observe that right before the burst of the economic crisis, the level of income inequality was extremely high. Sir Anthony Atkinson, another influent economist in this field, believes that real household income stagnation caused households at the bottom of the income distribution (households with low incomes) to borrow in order to maintain a certain level of living and because these loans were not sustainable, they led to unprecedented pressure on financial institutions.

Our paper aims at contributing to the better understanding of income inequality in Romania by analysing the influence of certain household characteristics on income variability. The paper is organized as follows. The next section is briefly reviewing the relevant literature in the area of income inequality, than we expose our methodology, data and main results. The paper ends with a section of concluding remarks.

2. Literature review

Economic inequalities accounted for a long period a major socio-political debate. Although in times of economic growth in North America and Western Europe, this subject has been neglected, in the 60's there was a turning point in the interest of researchers for the topic. Some of the first significant theoretical researches on economic inequalities belong to Sen in 1973 and Atkinson in 1975, while pioneers of income inequality are Kuznets (1955) and Mincer (1958). Kuznets has promoted the idea that between economic development and income inequalities there is a relation of a form of an inverted U-shaped curve. This relationship has been in the focus of many researchers since then and their findings show that this issue is far from being solved (Bourguignon and Morrisson, 1998; Ravaillon, 2004a,b), as may other variables than economic development have strong influences on income inequality, such as demographical, social and cultural factors (Checchi, 2000).

Income inequality is closely related to economic efficiency: it is desirable that the use of resources, which are limited, to be based on criteria of economic efficiency. This, however, may lead to benefits for some, but also to disadvantages for others. In addition, in any society a degree of inequality is not only unavoidable, but it is also necessary for a healthy functioning of the economy (Welch, 1999). Despite this, and even if the inequality is not a problem by itself, the causes and consequences of income inequality should be considered, analysed and mitigated (poverty, social exclusion, the level of delinquency, life expectancy, health - Salverda, Nolan and Smeeding, 2009), especially since recent research emphasizes that high levels of inequality could be a barrier to economic growth.

The income inequality is the core of economic inequality. When analysing these inequalities is particularly important to define the concept of income: income before transfers and taxes, disposable income, market income (Smeeding and Weinberg, 2001), because economic development can lead to increased income inequality, while fiscal and social policies (through taxes and social benefits systems) can counterbalance the effects of the economic growth.

Income inequality analysis is based on household income distribution, the latter being influenced primarily by employment gains of household members. Other sources of revenue may be financial income (from rents, dividends, interest, etc.), income from social transfers (allowances, pensions, unemployment benefits, etc.). When analysing the income distribution one must consider its dynamics, as both income and household composition evolves over time (Salverda, Nolan and Smeeding, 2009). However, special attention must be paid when determining the period considered for investigation (Atkinson, 1983). Regarding the demographic unit referred to, it may be the household, the family unit, the taxation unit, the individual (Atkinson and Brandolini, 2001). This should be carefully selected, the more the unit of reference widens, the more the income inequality tends to diminish, due to aggregation of individual dispersions (Redmond, 1998).

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