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The Impact of Democracy on Distribution of Income in a Selection of Member Countries of OECD and Member States of the Islamic Conference (2001-2014)

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Abstract

As a socioeconomic index, inequality in distribution of income and wealth is considered as a marginally sensitive political variable that is simultaneously highly prone to being affected by political structures. On this basis, the recent process of democratization has yielded in occurrence of a series of economic evolutions among which, the most disputed one is redistribution of income and inequality of the former and wealth. The objective of the present research is to investigate and compare the relation between democracy and distribution of income in a selection of member countries of OECD and those of The Islamic Conference between 2001 and 2014. The econometric method used in this research is panel data regression. Results indicate that democracy has a significant impact on GINI coefficient among member countries of OECD and The Islamic Conference. In terms of reduction GINI coefficient, democracy has a greater impact on member countries of OECD compared to those of The Islamic Conference. This shows that compared to member countries of The Islamic Conference, member countries of OECD are more sensitive to democracy. In other words in such societies the right for having a voice expands to the lower classes and economic decision makings are removed from the mere dominance of the few wealthy. In this case, the voters are those who belong to classes of lower incomes and respectively, the tax rate that determines the amount of redistribution and is obtained through polling, increases and resultantly redistribution increases. This is followed by improved living conditions among the poor and the needy people.

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Keywords: Distribution of income, GINI coefficient, democracy, member countries of OECD, member countries of The Islamic Conference.

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Introduction

Explaining the theory of distribution of income has remained as one of the main axes of theories of economists since the earliest economic texts. There have been several theories developed regarding investigation of personal distribution of income. According to history and the relation between theories, the theories regarding distribution of income have been divided to The Ability Theory; The Stochastic Theory; The individual Choice Theory; The Human Capital Theory; Theories of Educational Inequality; The Inheritance Theory; The Life Cycle Theory; Public Income Redistribution Theories; More complete Theories and the Theories of Distributive Justice (Basset et al. 1999).

Previous studies have shown that democracy has certain impacts on certain economic variables such as economic growth, economic development, and distribution of income, inflation and unemployment. Among these variables, the distribution of income is one of the few which are affected by democracy. Through the process of income distribution, society's income is shared between its members. This sharing is one through either ways of Size Distribution of Income or Functional Distribution of Income (Comeau, 20003).

One of the definitions of the whole economics science is the science of investigation of processes of production, distribution and exchange. This is why the issue of manner of distribution of income among individuals and households is usually brought up along with the issue of National Income. As a result of different political, societal, cultural and economic structures in societies, certain deviations are yielded in the process of distribution of income. These deviations may further result in emergence of problems and certain imbalances in society. Income inequality is a fact that has always remained interesting for human beings. In fact this issue is of a crucial importance for political and social reformists. The history of criticizing the inequality of income goes as far as the history of the world goes. The ultimate purpose of equality has influenced the supporters of ethics, revolutionists and government figures. The importance of this issue has resulted in the fact that in current era, the belief of seeking equality has been the main motivation for several political, social and religious movements. For example in French Revolution, three popular slogans of freedom, equality and brotherhood were extremely reflected in Babeufism. Following the repression of the former movement, its entire legacy was inherited by those secret organizations of the 19^{th} century which sought equality in wages. In fact it was the very same movement of Babeufism which provided the contexts for socialistic and communistic ideas through its desire for equality (Tropeano et al. 2008).

In this regard several efforts have been made for progression towards more equality of wages. Among these efforts, the following thee authentic intellectual flows can be mentioned:

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1- Socialism, private ownership, heritage and income without work

2- Advocates of role of character who emphasize the right for every human being for having the minimum level of social access.

3- Keynesian intellectual flow which opposes income inequality under the title of total employment. In this regard, it explains how this inequality is incapable of satisfaction of demands for consumer goods.

On the other hand, hard economic and social changes which are certain characteristics of the current era have resulted in increased tendencies towards security. This in turn has resulted in a sort of tendency towards redistribution of income. When the amount of GDP (Gross domestic production) is low, the issue of distribution of income gains new importance. This is because the more unequal the income distribution is, the more demand and total production are influenced by consumption preferences of the wealthy stratum. The wealthy people's purchasing power can twist production and imports towards luxurious products even while masses of people are living with difficulties. This is while if incomes are distributed equally, the demands pattern becomes more related to production of food and other necessary products. This trend helps with eradication of poverty (Ross, 2006).

Considering these information, the aim of the present research is to answer the question that if democracy has impacts on distribution of income among member countries of OCED and those of The Islamic Conference? For this purpose, initially the theoretical foundations related to research subject are made note of and next, the research model and variables are described. Afterwards the research model is estimated through the collected data and ultimately, research results and recommendations are noted.

Theoretical foundations

Intellectual foundations of democracy belong to ancient Greece and scholars such as Aristotle. Aristotle considered democracy as a type of ruling in which free men are rulers. In his view, the first type of democracy was the one closest to the principle of equality. In this type of democracy, the law doesn't honor the rich over the poor and doesn't also consider any of the former or latter dominant over the other; rather it considers everyone as equal (Siegel et al. 2004).

As an interesting issue for Aristotle, the principle of equality is considered as one of the most important principles of democracy. However, the core of this dispute is what is meant by equality. As an answer to this question, it can be said that all citizens must be seen as equal by the law (Vega and Alvarez, 2003). There are two perspectives regarding the dispute if this equality is only political or whether it includes other contexts or not. First perspective believes that in terms of a democratic system, the principle of equality is only a political subject and doesn't exceed these political boundaries. Yet the proponents of this perspective also agree that political equality is only possible through economic equality in terms of distribution of wealth, income and etc. the second perspective implies that equality may exceed political boundaries and adopt the meaning of equality of opportunities in all contexts (economic, education and etc.). To be clear, in terms of the first perspective equality is considered as an instrument or intermediary objective; but for the second perspective, economic equality is the objective and democracy would not shape if its' not met (Haan and Sturm, 2003).

In fact economic equality is a component of democracy rather than being an outside issue which is later attached democracy. By taking this description of democracy into account, two opposing fronts have been formed in terms of effects and impacts of democracy on inequality of incomes. The first groups of scholars who believe that democracy doesn't result in an equal stratification system belong to two schools of Functionalists and Marxists. Functionalists believe that no matter if the shape of government is democratic, non-democratic, socialist or non-socialist; it has no effects on stratification system since the needs of new industrial economics create similar income differences between occupational groups in addition to similar movement levels and similar government policies. Every change in the system of distribution is explained as the outcome of the dialectics of industrial system. Industrial and technological evolutions result in a convergent pattern of development of stratification systems in every advanced industrial society. Similar to functionalists but for different reasons, Marxists assume that at least as it has been experienced in non-communist societies, policies have very little impacts. Through its economic power, the wealthy stratum is able to dominate government or control it and it will also use its influence on government for maintaining its economic condition. As a result, democracy is basically a fraud (Hewitt, 2008).

On the contrary there are other scholars who believe that democracy is an element for elimination of inequalities. Several reasoning and argumentations have been stated in defense of this perspective. Those who believe that there exists a difference between democracy and development point to the different political orientations in democratic and nondemocratic nations and argue that governments of those countries which possess a democratic system should obtain the support of majority of voters. In order to maintain this popularity, these states are forced to adopt policies which can potentially satisfy public demands for more welfare costs through redistribution (Kurzman et al, 2002). Democratic systems have to focus their entire attention on the issue of redistribution and forget about the issues related to investment and capital accumulation. In other words, democracy relies on public allurement policies. In terms of creating balance between policies which emphasize on allocation of resources, democratic systems on the one hand lead to growth and on the other hand, policies that are focused on redistribution prioritize equality over efficiency (Libman, 2009).

Another important reasoning that exists here lies on distribution of political power. Democracy transfers the distribution of political power from the rich to the poor. The reason for existence of such a procedure is tied to the activities of the interest groups in a democratic society. In autocratic governance, people are less provided with this right and are not able to create groups and parties for pursuing their lost rights. Yet while the inequalities are reserved and incomes continue to be distributed unequally, people will find out that they can play roles in political exchanges through formation of political parties and interest groups. As a result people are gradually organized within parties and interest groups. Ultimately the necessary contexts are provided and those who used to be

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deprived of economic benefits may gain benefits through democracy (Acemoglu et al. 2006).

Gung-Shen (2002) counted the principal foundations of democracy and compared it with authoritarianism according to three main axes of power distribution, difference in political orientations and effects of interest groups. He concluded that with assumption of equality in terms of all other conditions between two democratic and authoritative societies, the system of democracy is closer to equality in distribution of income. Considering this description of effectiveness of democracy on inequality, eventually the manner of the process of democratization of the structure of distribution of income is under debate.

In some cases, when a complete sort of democracy is not present and people are not provided with equal rights and equipment, in fact there is another group with more access to equipment and resources. In this situation even if efficiency is increased but only special to a specific group in society, there is no doubt that other groups of the same society will be deprived of certain advantages of increased efficiency including wages. As a result distribution of income becomes worse and the GINI coefficient increases respectively (Gupta et al. 2009).

Alavuotunki and Pirttil (2014) carried out a study titled as “Impacts of value added tax on inequality of income in developing countries”. In this paper the authors stated that VAT is one of the most important tax policies throughout the world, yet these taxes are still one of the hottest issues under debate. While there are some bodies who claim that VAT is a beneficial tool for increasing government’s income in developing countries; there are others who believe that this type of tax is some sort of regressive tax which helps with increased inequality in developing countries. In this regard, this paper uses macro-economic data for estimation of the income yielded from VAT and its effects on inequality in macro societal levels. Results yielded from estimation of instrumental variables used in this article shows that positive income consequences of VAT are less than results shown by previous studies. On the other hand, other findings of this research have shown that effects of implication of VAT on inequality are small. This in turn shows that moving towards VAT and development of it will not result in reduction of justice and equality in society.

Boustan et al. (2013) carried out a study titled as “effects of increased income inequality on taxes and public expenses: evidence from municipalities and educational spaces”. The authors of this research have stated that income distribution has significantly increased among developed countries between 1970 and 2000. In this regard, some scholars claim that income inequality is a societal problem that results in diminished motivation among voters for supporting public expenses. On the contrary, this article shows that growth of income inequality is related to development in income and spending of the state in a vast range of services in municipalities and educational spaces of The United States. This variable is an instrumental one that considers for inbreeding of distribution of local incomes. In addition, it can be seen that results of this research are inconsistent with those anticipation models which have stated that heterogeneous societies produce lower levels of public goods.

Ghoreishi et al. (2012) performed a study and used sectional data belonging to developing countries between years 1987 and 2010. They made use of a generalized moment method for investigation of the mutual relation between democracy and GDP per capita. Results of this study provide evidence in support of effectiveness of square of democracy on GDP per capita. These results suggested that GDP per capita increases for the initial and lower levels of democracy, but it decreases after reaching the mid-level of democracy.

Bastagli et al. (2012) carried out a study titled as “income inequality and financial policies” and investigated this issue. They concluded that in many advanced economies and developing economies, inequality of incomes has increased. This is tied to a vast range of elements including globalization and technological evolutions. The most interesting point in this regard is that in some regions, inequality of incomes can be considered for differentiation between levels of tax policies and related expenses. In terms of financial stabilization in many economies, tax indexes and indices of spending should increase or at least maintain the distributive effects of financial policies while simultaneously supporting economic efficiency as well.

These indices include reduced chances for tax invasion and evasion avoidance, progressive increase of income tax, reduction of non-generative expenses and expansion of programs based on evaluation of affordance of people. On the other hand, increasing the distributive effect of financial policies in developing economies requires improved capacity for increasing tax income and spending these resources in more effective and fair ways.

Bargain et al. (2011) carried out a study titled as “financial policies and inequality of income in U.S. during 1978-2009: an analytical approach”. They have provided the possibility for consideration of mechanical effects resulting from changes in income prior to application of tax. This is resulted from direct effects of political reformations. Several tax reformations including EITC (1990) and ARRA (2009) have been prescribed for democrat states. These reformations have similar effects on the half below the average of distribution. These similar effects are due to reformations of the Republican Party and reduction of taxes for families with high levels of income.

Libman (2009) performed a study and investigated the effects of democracy and bureaucracy size on economic growth in Russia during 2000-2004. In this research, the author uses the square of index of democracy for investigation of the nonlinear relation between economic growth and democracy. In addition to providing evidence regarding existence of a nonlinear relation between democracy and economic growth, results of this study have shown that in areas with high levels of democracy, the performance and function of economy are better than in areas with combined systems. On the other hand, results have shown a negative relation between bureaucracy size and economic performance.

Mueller and Stratmann (2003) divided the data belonging to 76 countries into two groups named strong democracy and weak democracy. They used this data for investigation of direct and indirect effects of democratic participation on GINI

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coefficient. Estimated regressions indicated that the direct effect of participation on income inequality is negative in all countries. However, its indirect effects on inequality are different among different countries. In other words in countries with strong democracy and non-Latin-American countries with weak democracies, the indirect effect of participation is negative; it means that increased participation in these countries is associated with income inequality.

Davoodi et al. (2000) carried out a study titled as "distribution of income, tax and policies related to social spending of the state in developing countries". The authors of this article have stated that in developing countries, distribution of income prior to application of tax is more unequal compared to developed countries. Yet in contrast to developed countries, developing countries have been able to use financial policies for reduction of income inequality. During the 1980s and 1990s, many of the developing countries experienced an increase in inequality of incomes. In developing countries, governmental health services and elementary schooling programs are experiencing lack of proper targeting but their general process is growing.

Milanovic (2000) made use of data belonging to 24 democratic countries including 79 observations in order to test the theory of mid-voter with regard to inequality of income and redistribution. He considered the lower 20% of the income distribution as poor and very poor groups and concluded that in countries in which distribution of incomes is more unequal based on production elements, redistribution goes towards poor and very poor groups.

Research model

In terms of purpose, the present study is considered as an applied research and also in terms of research methods, it is considered as a descriptive-analytic research. Data collection methods include library studies and collecting research findings from statistical information centers and the World Bank website. This research has made use of data belonging to the period between 2001 and 2014. Since the purpose of the study is investigation and comparison of relation between democracy and distribution of income, the overall research model has been set as follows:

$$ {}_{it}\ \boldsymbol{\varepsilon}\ \mathbf{LIT}_{it} + \beta_{5i}\ \mathbf{DEM}_{it} + \mathbf{GINI}_{it} = \beta_{0i} + \beta_{1i}\ \mathbf{INF}_{it} + \beta_{2i}\ \mathbf{GOVEX}_{it} + \beta_{3i}\ \mathbf{NI}_{it} + \beta_{4i} $$

The variables in the above equation include:

GINI: GINI coefficient

INF: Inflation

GOVEX: Government Expenses

NI: National Income

LIT: Literacy

DEM: Democracy

Ɛ: Including residuals (errors)

I: representative of country

T: representative of year

The population of this research is consisted of member countries of OCED and those of The Islamic Conference. A sample consisted of a selection of these countries is as follows:

OCED member countries: Australia, England, Italy, Germany, U.S, Japan, Sweden, France and Canada

The Islamic Conference member countries: Iran, Afghanistan, Emirates, Azerbaijan, Turkey, Tunisia, Iraq and Arabia. Data required for this research are collected from the World Bank Website and belong to the period between 2001 and 2014.

Results of testing the stability of research variables

Prior to estimating the model, first the stability of the entire variables used in this estimation must be tested. This is because lack of stability results in occurrence of spurious regression problem. In these tests, here the zero hypotheses are lack of stability. Stability of research variables is further investigated for both the member countries of OCED and those of The Islamic Conference.

Table 1: results of stability of variables for member countries of The Islamic Conference

Symbol	Variable	Levin, Lin and Chu test	Probability	Result
INF	Inflation	-7.00370	0.0000	I(0)
GOVEX	Government Expenses	-3.45817	0.0003	I(1)
NI	National Income	-3.79016	0.0001	I(0)
LIT	Literacy	-2.30763	0.0105	I(0)
GINI	GINI coefficient	-3.13430	0.0009	I(0)
DEM	Democracy	-2.98879	0.0014	I(0)

Table 2: results of stability of variables for member countries of OCED

Symbol	Variable	Levin, Lin and Chu test	Probability	Result
INF	Inflation	-6.73454	0.0000	I(0)
GOVEX	Government Expenses	-3.79736	0.0001	I(0)
NI	National Income	-4.21829	0.0000	I(0)
LIT	Literacy	-7.34605	0.0000	I(0)
GINI	GINI coefficient	-6.39638	0.0000	I(1)
DEM	Democracy	-3.89927	0.0000	I(0)

Results of stability tests indicate that for member countries of The Islamic Conference, every variable was stable except the government expenses variable which has been stabilized through a differencing.

In addition, in terms of the OCED countries, entire variables were stable except for the GINI coefficient which has been stabilized through a differencing.

Results of the F Lemar and Hausman tests

in order to find out whether to use the panel data method or the pool data method for estimation of the model; the F Lemar test is used and in order to indicate which method is best suited for estimation, the Hausman test is used. Results of these tests are shown in tables 3 and 4.

Table 3: results of the F Lemar test

Group countries	Statistics	Probability	Accepted methods
Member countries of the Islamic Conference	19.6846529	0.0000	Panel data model
OECD countries	2.866310	0.0141	Panel data model

As you can see in table 3, results show that the null hypothesis is rejected. Therefore, the panel data method is accepted for both groups of member countries of OCED and those of The Islamic Conference. Therefore, we further are required to perform the Hausman test in order to be able to choose between available methods.

Table 4: results of the Hausman test

Group countries	Chi-square statistics	Degrees of freedom	Probability	Test results
Member countries of the Islamic Conference	3.444224	5	0.6318	Random effects
OECD countries	4.180535	5	0.5237	Random effects

As you can see in table 4, results show that the null hypothesis is rejected. Therefore, the panel data method is accepted for both groups of member countries of OCED and those of The Islamic Conference. Therefore with respect to results of the aforementioned tests, the research model will be estimated using panel data with random effects. Results of estimation of model are shown in tables 5 and 6.

Model estimation

Results of estimation of model are shown in tables 5 and 6.

Table 5: Estimation of research model using the panel data for member countries of OECD (dependent variable: GINI coefficient)

Symbol	Variable	Coefficient	T statistic	Probability
C	Intercept	-2.108611	-0.835650	0.4057
INF	Inflation	0.038786	5.622137	0.0000
GOVEX	Government Expenses	0.725412	2.503938	0.0237
NI	National Income	-0.621253	-2.357634	0.0308
LIT	Literacy	-0.819662	-3.853683	0.0057
DEM	Democracy	-0.620018	-6.028372	0.0000
R^2=0.832431	R^2 adjust=0.825163		Durbin Watson=1.799823	

Table 6: Estimation of research model using the panel data for member countries of The Islamic Conference (dependent variable: GINI coefficient)

Symbol	Variable	Coefficient	T statistic	Probability
C	Intercept	5.621890	5.043977	0.0000
INF	Inflation	0.030263	2.077384	0.0421
D(GOVEX)	Government Expenses	0.257112	3.051233	0.0093
NI	National Income	-0.499513	-2.343692	0.0319
LIT	Literacy	-0.246975	-1.921958	0.0577
DEM	Democracy	-0.415722	-5.380041	0.0000
R^2=0.798988	R^2 adjust=0.770470		Durbin Watson=1.580551	

Considering the results of the table number 5 and 6 and the yielded results for the Durbin-Watson statistic, it can be observed that the research model has a 79 and 83 percent explanatory power for respectively member countries of The Islamic Conference and member countries of OECD.

Results have shown that inflation has a positive effect on GINI coefficient in both member countries of OECD and those of The Islamic Conference. In OECD member countries, inflation has a stronger effect on increase of GINI coefficient and this shows that OECD member countries are more sensitive to inflation compared to member countries of The Islamic Conference. Inflation reduces a country's currency's purchasing power and also results in lack of stability in macroeconomics and resultantly leads to increased inequality of income.

Results have also shown that government expenses' impact on GINI coefficient is significant both for the member countries of OECD and those of The Islamic Conference. In OECD member countries, government expenses have a stronger effect on increase of GINI coefficient and this shows that OECD member countries are more sensitive to government expenses compared to member countries of The Islamic Conference. In fact government expenses have no direct effects on society's overall production capacity. Rather it creates income for certain people and then creates demands which may appear as new investments. Increased government expenses results in lack of production. It also leaves a significant impact on distribution of income and is usually covers the high-income groups of the society and doesn't provide the lower classes with the possibility for increased benefits.

Results have also shown that national income's impact on GINI coefficient is significant both for the member countries of OECD and those of The Islamic Conference. In OECD member countries, national income has a stronger effect on increase of GINI coefficient and this shows that OECD member countries are more sensitive to national income compared to member countries of The Islamic Conference. As the national income increases, investment rates are increased as well and ultimately, inequality of income reduces.

Results have also shown that education's impact on GINI coefficient is significant both for the member countries of OECD and those of The Islamic Conference. In OECD member countries, education has a stronger effect on increase of GINI coefficient and this shows that OECD member countries are more sensitive to education compared to member countries of The Islamic Conference. On this basis and according to the micro-economics theory, since workforces receive wages proper for their efforts and that education is one of the most important determining elements for efficiency of workforce, as people are more educated, they are more prone to be freed from poverty.

Results have also shown that democracy's impact on GINI coefficient is significant both for the member countries of OECD and those of The Islamic Conference. In OECD member countries, democracy has a stronger effect on increase of GINI coefficient and this shows that OECD member countries are more sensitive to democracy compared to member countries of The Islamic Conference. In this case, the voters are those who belong to classes of lower incomes and respectively, the tax rate that determines the amount of redistribution and is obtained through polling, increases and resultantly redistribution increases. This is followed by improved living conditions among the poor and the needy people.

Results and conclusion

Results have shown that inflation has a positive effect on GINI coefficient in both member countries of OECD and those of The Islamic Conference. Therefor governments are recommended to think of solutions for reduction of income inequalities.

Results have shown that government expenses have a positive effect on GINI coefficient in both member countries of OECD and those of The Islamic Conference. Therefor governments are recommended to determine the extent of participation of the state in economy, clarify its policies for private sectors, adopt non-exclusive policies and create a support atmosphere for presence of the private sector, replace financial disciplines with financial expansion or contraction.

Results have also shown that national income's impact on GINI coefficient is significant both for the member countries of OECD and those of The Islamic Conference. Therefore governments are recommended to provide solutions for reduction of inequality of income in order to increase their national incomes. Among these solutions it can be referred to the following:

1- Exploiting and selling natural resources

2- Money publishing machine in central bank

3- Working through expansion of investments

4- Exclusiveness of technologies resulting from inventions, researches and technological growths

Results have also shown that education's impact on GINI coefficient is significant both for the member countries of OECD and those of The Islamic Conference. Therefore governments are recommended to improve their educational infrastructures and prioritize free education.

Results have also shown that democracy's impact on GINI coefficient is significant both for the member countries of OECD and those of The Islamic Conference. With respect to research findings it can be recommended that every country in the world can improve their democracies and provide the suitable contexts for realization of this goal in order to improve their income distributions. This is mainly because the main goals and objectives of every state and government and society has always been the welfare of the society. This goal can be achieved more rapidly through improvement of democracy and distribution of incomes.

With respect to methods stated in this research, researchers can:

1- Make use of the stated methods and other new methods for investigation of these variables (democracy and distribution of income) and providing new models.

2- Make use of new methods for investigation of the relation between the aforementioned variables especially in developing countries

3- Make use of other objectivity methods including GMDH network objectivity for determining the relation between aforementioned variables of democracy and income distribution.

4- Put more efforts on stating solutions for improvement of democracy and effective mechanisms of this variable on distribution of income to be used in other studies.

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