From Polls to Policies: The Economic Impact of Elections

Das, Abhirup and Rajan, Bhargav Raman and Santosh Bandi, Syam Sai and Udandarao, Vikranth

Indraprastha Institute of Information Technology Delhi

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Abhirup Das, Bhargav Raman Rajan, Syam Sai Santosh Bandi, Vikranth Udandarao

{abhirup22019, bhargav22135, syam22528, vikranth22570}@iiitd.ac.in

Indraprastha Institute of Information Technology Delhi

Abstract

Elections play an essential role in shaping domestic and global economies. This review paper examines the effect of election cycles on economic outcomes, mainly focusing on the United States while analysing other countries, including China, India, and other developing countries. The paper explores how different political strategies and policies influence economic indicators such as the Gross Domestic Product, unemployment rate, inflation, trade and nominal income. Analysis reveals that electoral pressures often drive short-term economic manipulation at the expense of long-term fiscal health. The paper states the influence of leadership changes on market volatility and trade and fiscal policies using statistical insights and models. The paper goes over the implications of elections and the need for policies prioritising long-term fiscal health over electoral gains.

Keywords: Elections, Fiscal Health, Electoral Gain, Political Strategies, Policies, Voter Accountability

JEL Classification Codes: D72, E62, P16

Introduction

Elections shape the economic landscape. They determine political leaders and influence policies, voter behaviour, and international relations. The periodic nature of elections leads to economic fluctuation driven by these policies. Hence, governments adopt short-term measures such as public spending and reduced taxes, leading to elections that maximise electoral gain. The downside of this is the long-term implications, including but not limited to increased inflation, poor fiscal health, and economic instability.

Taking the United States into focus, we find that elections induce significant economic manipulation, which is not seen to such an extent in countries like Germany and Israel. The implications of a manipulated economy are analysed via metrics such as Consumer Confidence Index, Economic Policy Uncertainty, etc. These implications are also studied globally, focusing on China, India, and other developing countries.

Through this analysis, the paper aims to explain how electoral politics shape economic outcomes and global market stability.

Analysis

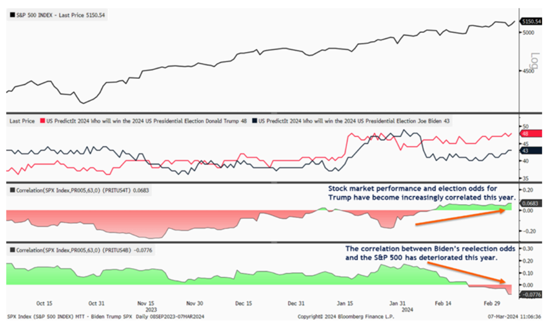
Buchanan and Rowley (1978) discuss government interventions that stabilise the economy. They talk about how the governments seek to maximise votes initially and later adopt deflationary policies to reduce inflation. Governments strategically reduce unemployment and stimulate income growth in the years leading to an election. Inflation rises post-election as the consequences shift to the next government, which results in a cycle. Once re-elected, governments revert to the previous policy since the pressure of rising inflation does not harm their immediate political prospects.

This was seen in the U.S., where the nominal income of citizens was maximised just until the elections, after which they dropped. This vote maximisation had a higher effect in the U.S., whereas, in Germany and Israel, there was a consistent pattern in nominal income and employment rates before and after the elections.

Benedictis-Kessner and Warshaw (2020) observe the extent to which people hold elected officials accountable for the overall status of the economy across different levels of the government. The authors find that a one-percentage-point increase in county-level wage and employment growth increases the incoming president's party vote share by approximately 0.10-0.15 percentage points, indicating how economic factors shape voting behaviours across levels.

Voters selectively bestow economic responsibility, putting greater responsibility for economic outcomes on the president and governors than other state and local officials. This could be a boon or a disadvantage for the incumbent president, while local officials tend to escape this accountability. It shows that the president has more significant incentives to target economic growth initiatives in heavily contested states. This behaviour is supported by past studies, which found that federal resources were allocated based on their strategic importance.

Guru, S. (2024) and Wu, G. (2021) explore the relationship between U.S. presidential elections and their immediate impact on their economy. They aim to analyse how political cycles correlate with economic growth, using the election cycles of 2020 and 2024 as experiments. They find that government changes bring about economic shifts and that the party the president belongs to is more important than the president themselves. Republicans typically advocate for lower taxes to stimulate growth, while Democrats often prioritise social programs and wealth redistribution through higher taxes. This influences voter preference and strategies, and the policy changes make the market more volatile.



Source: LPL Research, Bloomberg. PredictIt.org 08/22/2024

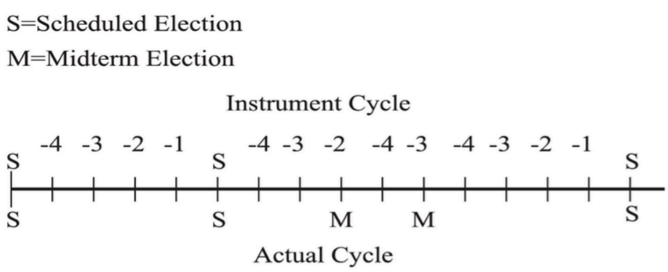
Wu, G. (2021) uses trade statistics and prediction models to estimate how the U.S. election outcome affects the Chinese economy, such as inflation, trade, and foreign investment. They show that the growth rate of real Gross Domestic Product (GDP) and the private sector's contributions has increased under the Democratic party. They further speculate about the policies that would be implemented depending on the party in charge and proceed to design a model that analyses the state of the economy after the elections.

Boumans et al. (2024) discuss the U.S.'s global influence and the significant impact that a change in leadership has on the global economy. It uses the 2020 presidential election as an experiment and conducts a survey. They utilised the Economic Experts Survey at the Information and Forschung (IFO) Institute and the Center for Economic Studies International Research Network (CESifo). They received responses from 837 experts and separated them into two groups: a control group and a treatment group, with responses taken a week before and after the elections. The experts were then asked to report their expectations of their country's macroeconomic indicators.

Baker et al. (2020) also look at the effects of the U.S. elections and provide a comprehensive analysis of 22 other countries. While the research done till now looks at measures like GDP, unemployment rate, inflation and trade exports, Baker et al. (2020) utilise a measure called Economic Policy Uncertainty (EPU), a metric developed by Baker et al. (2016). Elections are classified based on their degrees of closeness and polarisation. However, polarisation needs to be a statistic that is measured better in all the countries except the U.S. Therefore, two separate models are made: using polarisation and other features in the U.S. and without polarisation in the other countries.

Chauvet and Collier (2009) and Khemani (2004) examine some developing countries and their challenges. The former look at the positives and negatives of democratic elections and observe that while they lead to more policies to improve living standards, they also lead to many short-term benefits that might not be beneficial in the long run. Khemani (2004) observes that many developing economies have frailties in economic policies because of weak institutions, leading to more significant political influence over policy instruments. Compared to developed countries, they have seen more excellent expansionary monetary and fiscal policies before elections.

Khemani (2004) considers India a developing country because of its unique characteristics. The different states have diverse cultures and economic needs, almost resembling countries in themselves. Khemani (2004) looks at 14 states from 1960-1992 and their respective elections in India and tries to observe patterns. She takes mid-term elections into account, something the rest of the studies do not consider. Then, she looks at the trends in spending and other indicators to see the effects of these state elections.



Khemani, S. (2004). Political cycles in a developing economy: Effect of elections in the Indian states.

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A separate financial instrument is made, which takes the "years to the next election" into account. The figure above shows how this gets reset when there is a mid-term election.

Chauvet and Collier (2009) used two measures: Country Policy and Institutional Assessment (CPIA) and The International Country Risk Guide (ICRG). The former is a rating of 20 different economic aspects given by economists in the World Bank, a controversial measure because of its subjective nature. The ICRG considers the nature of governance, whereas the CPIA looks more into the policies.

Most economists use regression models stemming from decades of research into mathematical prediction models. Baker et al. (2020) measure EPU by fitting a regression model on the data obtained from the countries, with features that include a fixed bias unique to each country and a feature that denotes historical trends. Chauvet and Collier (2009) fit a logit regression and a probit model that uses the time passed since the last election, the stage in the political cycle and whether it was the first election or not.

Results

First, the impact of U.S. elections on their economy and the global economy is analysed. Wu, G. (2021) sees that on average, under a Republican President, the GDP and private sector payrolls grow by 2.5% and 1%, whereas under a Democratic President, the GDP grows by 3.9% and 2.5%, respectively. It shows that unemployment and debt will be higher, and GDP growth will be lesser with Trump as compared with Biden. The model made by Baker et al. (2020) indicates that if the election is polarised, the uncertainty increases by 12.2%. If it is a close election, it is 18.6% higher, and if both are true, then the uncertainty increases by 27.6%. Other trends indicate this uncertainty has increased, especially in the U.S., with an EPU level sky-high since we entered the 2000s.

Figure 2

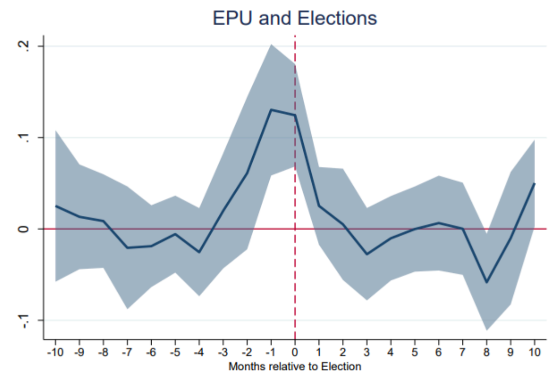
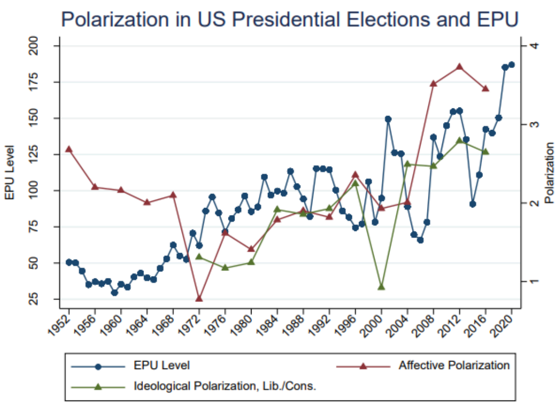


Figure 1



Baker, S., Baksy, A., Bloom, N., Davis, S., & Rodden, J. (2020). *Elections, Political Polarization, and Economic Uncertainty* 19-20. https://doi.org/10.3386/w27961 CC BY

The model created by Wu, G. (2021) indicates that China's economy would thrive more if Trump were elected president, whereas Biden would try to decelerate the Chinese economy by switching to other countries for manufacturing. This is supported by the fact that there was an increase in China's exports under Trump despite trade barriers.

Regarding other countries, the model made by Baker et al. (2020) indicates a 13.2% increase in uncertainty in the period before the elections. However, Boumans et al. (2024) see that experts in their respective countries improved their forecasts when they learnt that Biden had won the 2020 elections, with a significant increase in the expected GDP growth rate, foreign trade volume and unemployment rate post elections. Expected inflation was not affected.

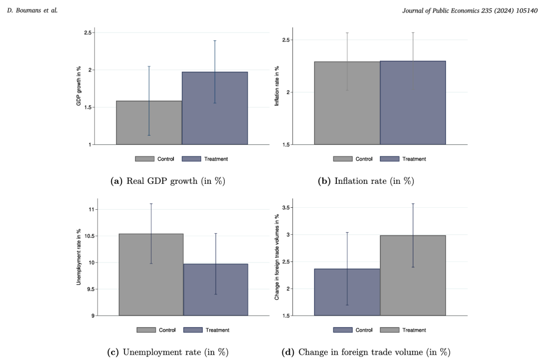


Fig. 2. Means of expert expectations, pre-election versus post-election. *Notes*: The figure shows sample means of expectations regarding our four key macroeconomic variables (real GDP growth, inflation, unemployment, and changes in trade volumes). The figure shows mean levels of expectations separately for both waves of our global survey. Yellow bars refer to the randomly chosen group of experts surveyed in wave 1 prior to the election (labeled "Wave 1 (control)", the control group of our survey experiment). Blue bars refer to the group of experts polled after the election (labeled "Wave 2 (treatment)", the treatment group of our survey experiment). Results are shown for experts from countries with at least four respondents. (For interpretation of the references to color in this figure legend, the reader is referred to the web version of this article.)

Boumans, D., Gründler, K., Potrafke, N., & Ruthardt, F. (2024). Political leaders and macroeconomic expectations: Evidence from a global survey experiment Journal of Public Economics, 235, 105140. p.5 https://doi.org/10.1016/j.jpubeco.2024.105140 CC BY.

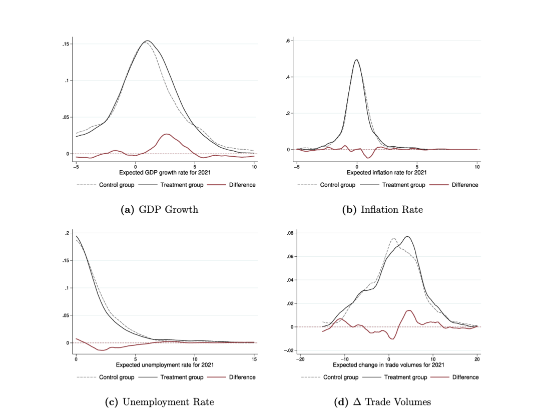


Fig. 6. Distribution of macroeconomic expectations, control-group, treatment-group and differences. *Notes*: The figure shows the distribution of macroeconomic expectations for experts in the control group (dashed gray line) and experts in the treatment group (solid black line). The solid red line plots the differences between both distributions. The figures visualize densities conditional on the variables included in the empirical model (Eq. (1)) employed to obtain the baseline estimates reported in Table 1. Densities refer to the model of non-US-based experts. (For interpretation of the references to color in this figure legend, the reader is referred to the web version of this article.)

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Boumans, D., Gründler, K., Potrafke, N., & Ruthardt, F. (2024). Political leaders and macroeconomic expectations: Evidence from a global survey experiment. Journal of Public Economics, 235, 105140. p. 12 https://doi.org/10.1016/j.jpubeco.2024.105140 CC BY.

In developing countries, Chauvet and Collier (2009) find that more frequent elections, coupled with a limit on the maximum length of a government term, can lead to better policies. However, policies are much worse if elections are infrequent.

In India, Khemani (2004) observes that the taxes in the latter half of a state government's rule are less than those of the first 2 years but higher during mid-term elections. Elections have no significant effect on state sales tax (items that the typical public buys) but instead on businesses by reducing excise duties on liquor. In terms of capital spending, i.e. spending done on investments, there was roughly a 9% increase in election years, and during mid-term elections, there was a drop in spending compared to regular elections. There is an increase in current spending, i.e. the money spent on subsidies, salaries, general spending, etc., in the years after the election to fulfil the promises made during the election but 3% less than the average current spending during the election year. They also observe a 3 times increase in the construction of national highways during an election year.

Conclusion

The review highlights how electoral cycles influence short-term economic manipulation, be it increased expenditure or a reduction in taxation, at the expense of long-term fiscal health. A quick comparison between developed and developing countries reveals that the influence over the economy is more significant in the latter due to weaker institutions. While frequent elections encourage more reforms and accountability, they also increase fiscal pressures, as seen in India. Transitioning to a stable and collaborative leadership can reduce uncertainty and help instigate economic growth. The authors concluded that the world would be more stable with Biden in power, whose policies benefit sectors that rely on global corporations, technology and manufacturing. The populous also saw this view, which placed higher confidence in him as uncertainty was believed to lower mitigating market volatility. The results of an election signal a shift in the policies of trade. This emphasises the importance of putting policies that put long-term fiscal health over immediate short-term electoral gains, giving economic stability across nations.

Limitations

The review mainly focused on some countries, lacking analysis of others with smaller economies and unique political systems whose inclusion could have given a more general and broader outlook. It also does not include autocratic systems where elections might have different economic effects. Some limitations of the paper include the authors' reliance only on specific periods and subjective measures like CPIA, thus presenting the challenge of separating the impact of elections from other economic factors, limiting generalizability.

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