The Economy around elections

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Theory

- Political business cycle (PBC)

  ➢ Seminal survey and formalization by Alesina (1988)

  ➢ In order to secure victory, incumbent has incentive to cause favorable outcomes before elections

  ➢ Testable implications: growth, inflation, public spending

  ➢ Studies of OECD economies suggest some evidence of a PBC

  ➢ Data from developing economies offer little support of PBC (Kaplan, Yale, 2006)

Evidence from India

- Khemani, World Bank, 2004

  ➢ Effect of state assembly elections on the policies of state governments in 14 major states, 1960-94

  ➢ Populist cycles to woo uninformed and myopic voters

  ➢ Signaling models with asymmetric information

  ➢ A moral hazard model with high discounting by political agents

Evidence from India

- Khemani, World Bank, 2004

  ➢Election years have a negative effect on some commodity taxes, a positive effect on investment spending, but no effect on deficits

  ➢ Elections have a positive and large effect on road construction by state public works departments

  ➢ Politicians exert greater effort in managing public works during election years

  ➢ No evidence of a populist spending spree to sway voters just before elections

Evidence from India

- Gupta and Panagariya, 2011

  ➢ Data from 422 races in the 2009 Lok Sabha elections

  ➢ Incumbent parties in higher growth states tend to win re-elections

Evidence from India

- Subramanian and Tantri, Indian School of Business, 2013

  ➤ Huge dataset, 20,000 local and national elections over three decades

  ➤ Strong growth leads to higher likelihood of re-election

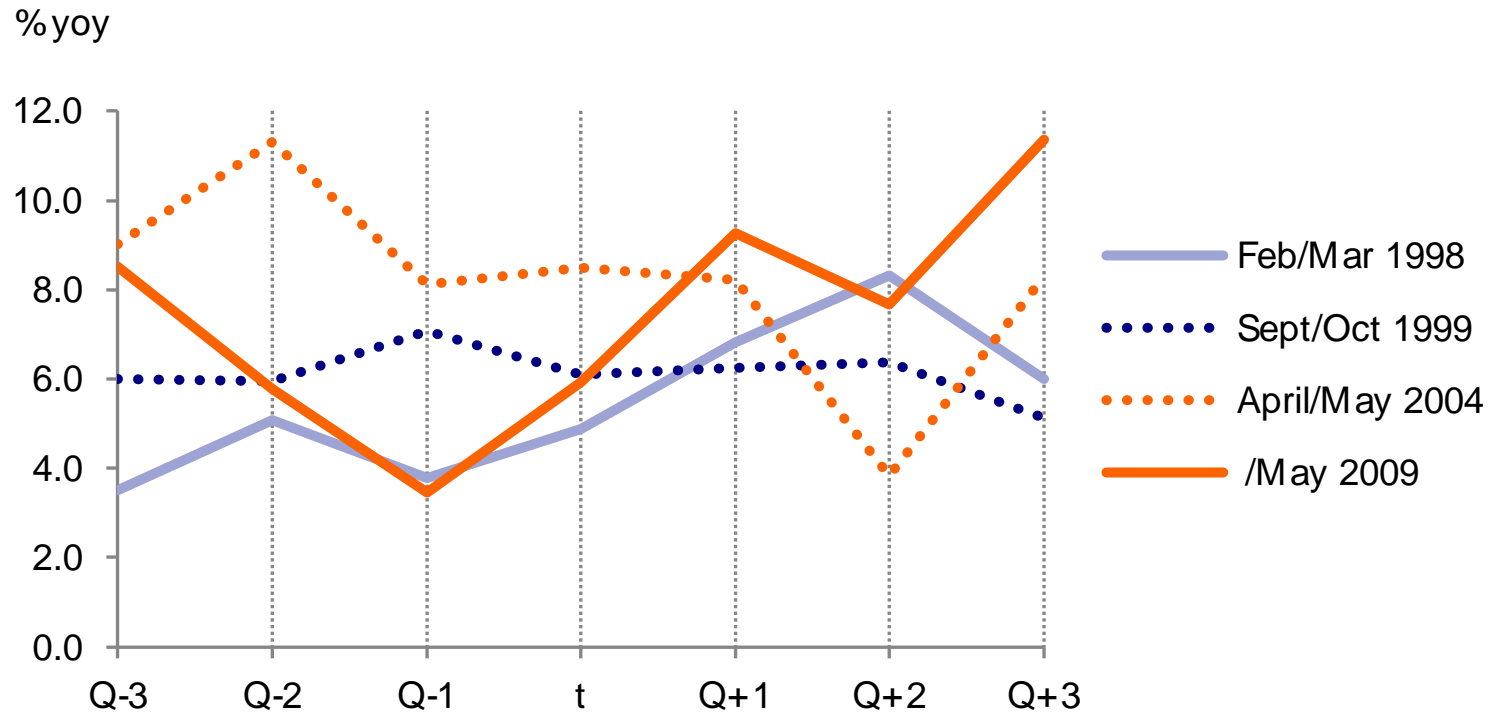 ➤ Voters don't display myopia; late rise in growth does not alter election outcome

Event study approach

➢ Examine mean and variance of some macroeconomic indicators around recent **Indian Lok Sabha** elections

➢ Growth, inflation, rupee, FII flows, fiscal variables

➢ Quarterly data

➢ Beware of external shocks

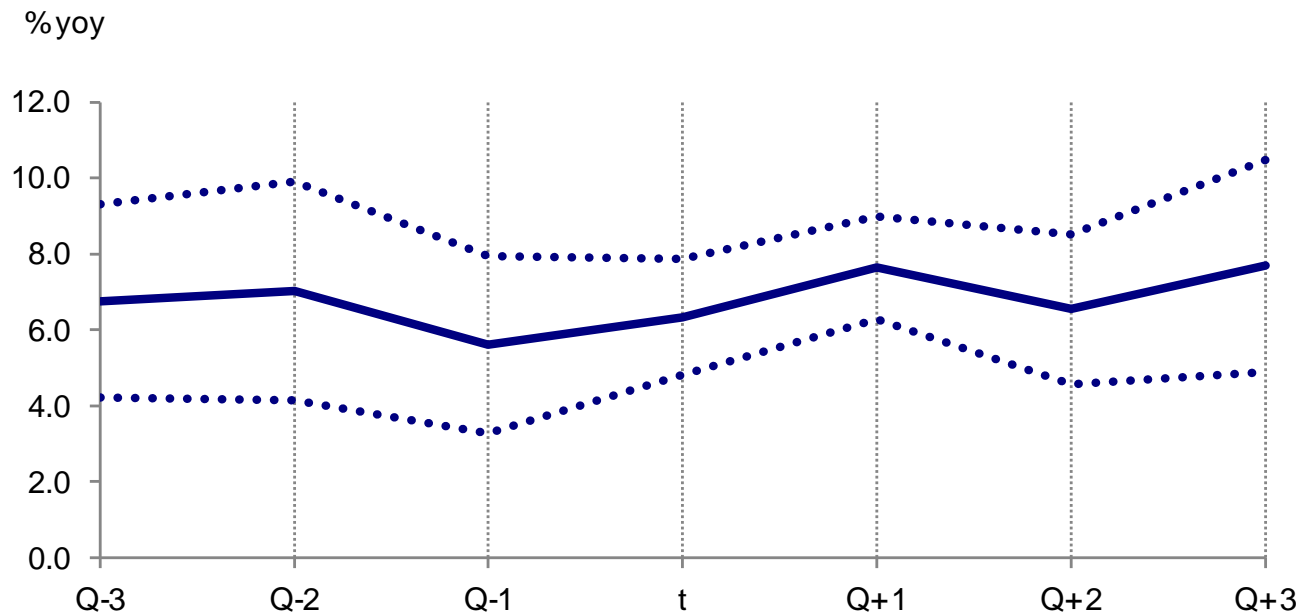➢ Data issue (Missing data from the early 1990s, quality)

Event study approach

➢ Five elections:
  ❑ 11th Lok Sabha, April/May 1996
  ❑ 12th Lok Sabha, February/March 1998
  ❑ 13th Lok Sabha, September/October 1999
  ❑ 14th Lok Sabha, April/May 2004
  ❑ 15th Lok Sabha, April/May 2009

➢ Design event study by examining the data three quarters before and three quarters after the election quarter
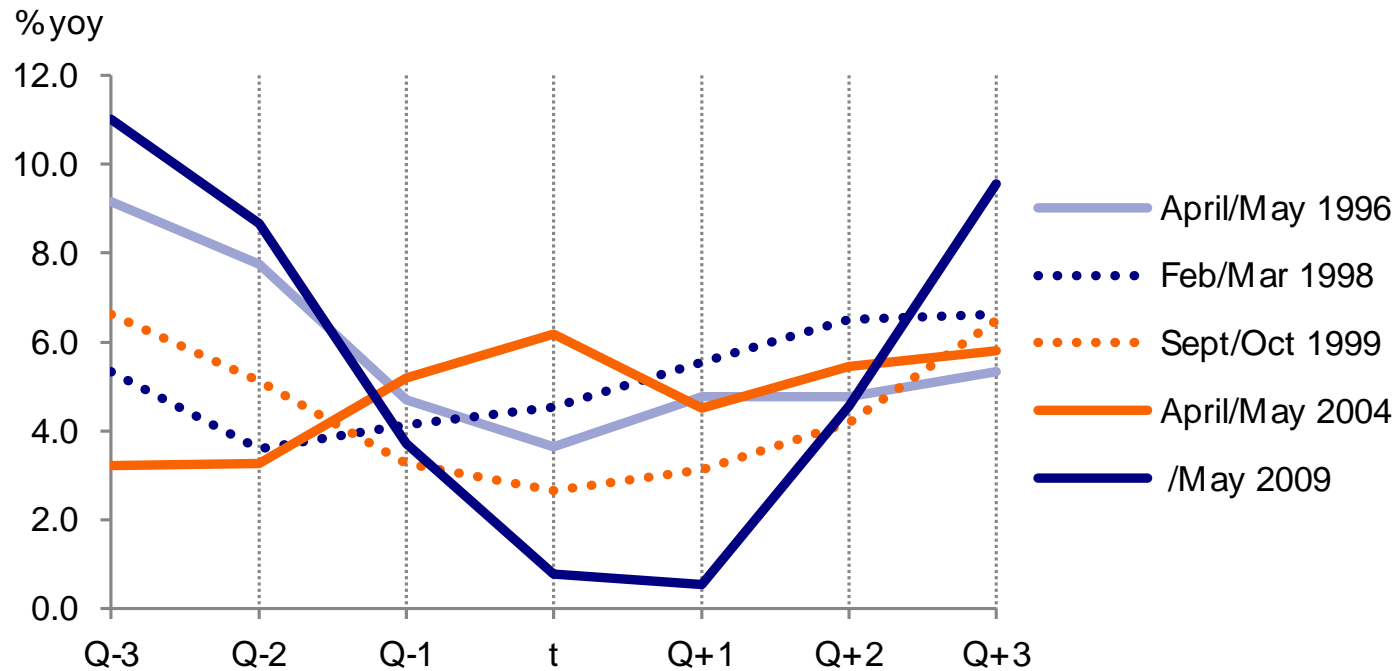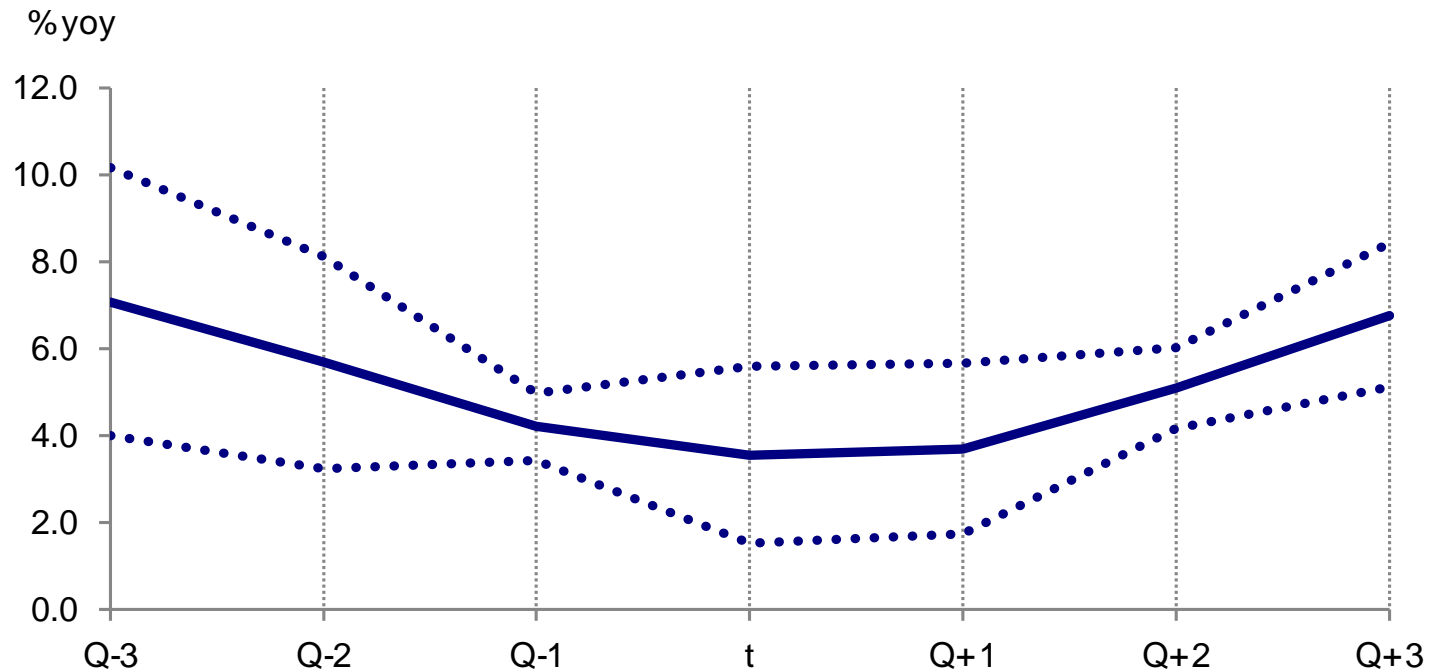
Study indicator: Growth

%yoy

Legend:
- Feb/Mar 1998
- Sept/Oct 1999
- April/May 2004
- /May 2009

X-axis: Q-3, Q-2, Q-1, t, Q+1, Q+2, Q+3

Study indicator: Growth

%yoy

Dotted lines are +1 and -1 std dev bands

Study indicator: Inflation

%yoy

Legend:
- April/May 1996
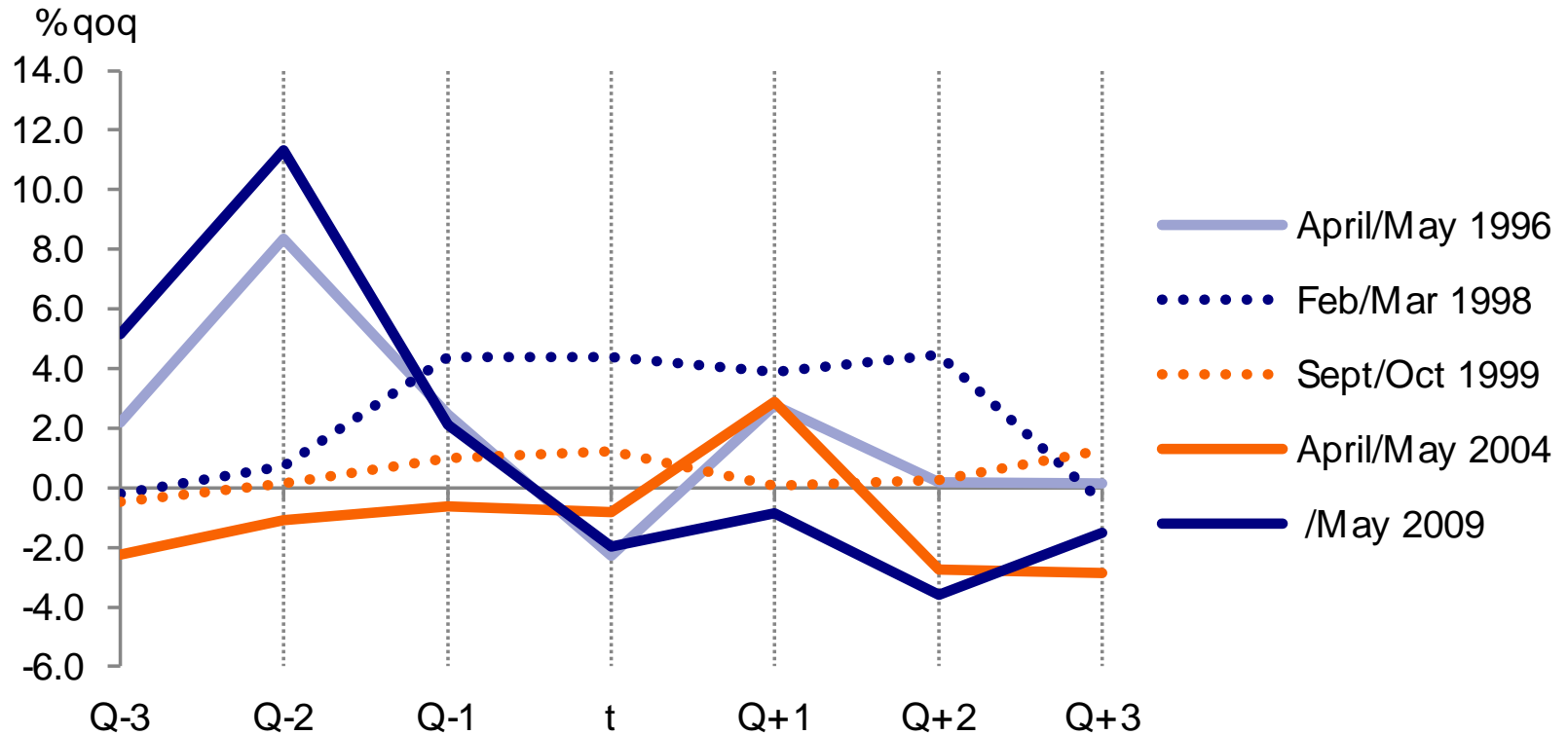- Feb/Mar 1998
- Sept/Oct 1999
- April/May 2004
- /May 2009

Study indicator: Inflation

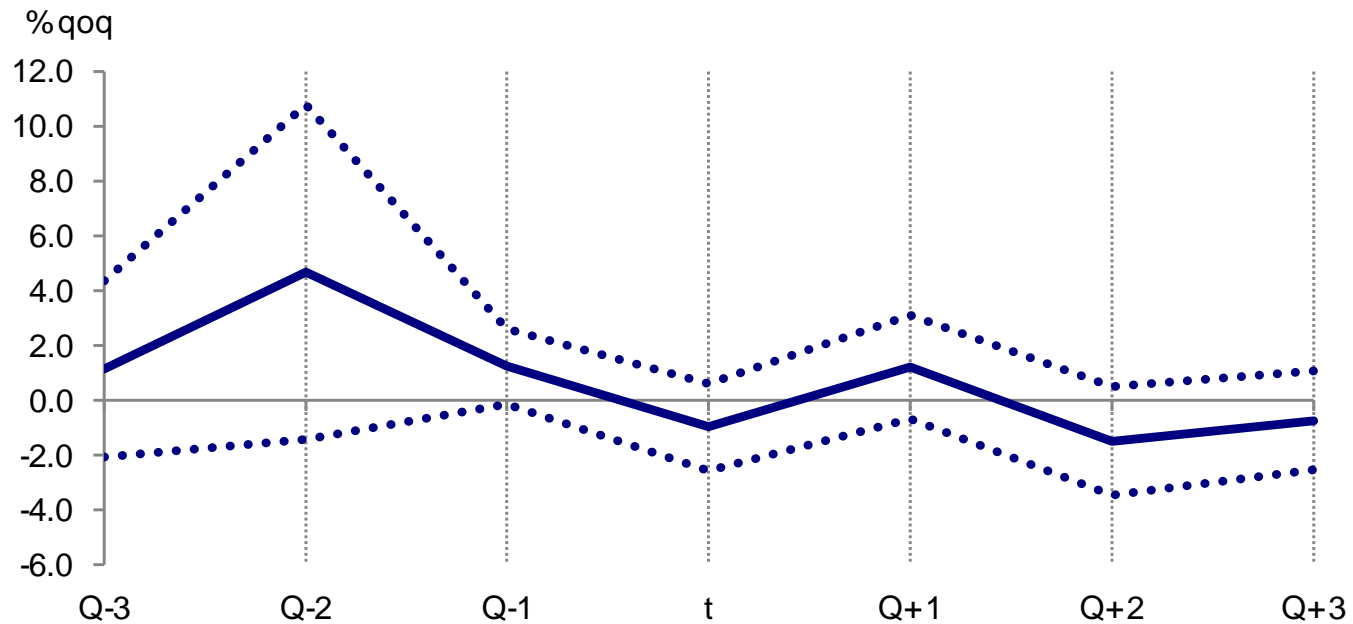Dotted lines are +1 and -1 std dev bands

Study indicator: Rupee

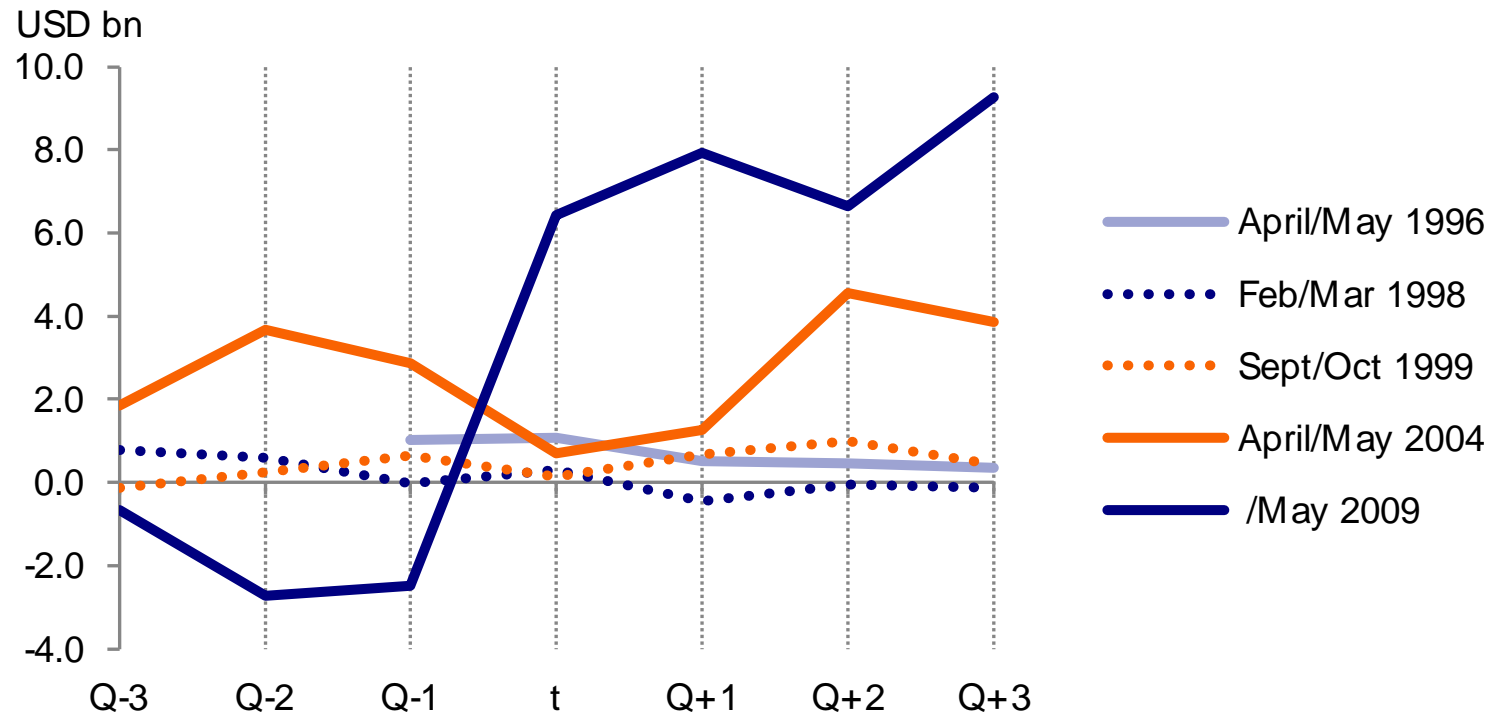# Study indicator: Rupee
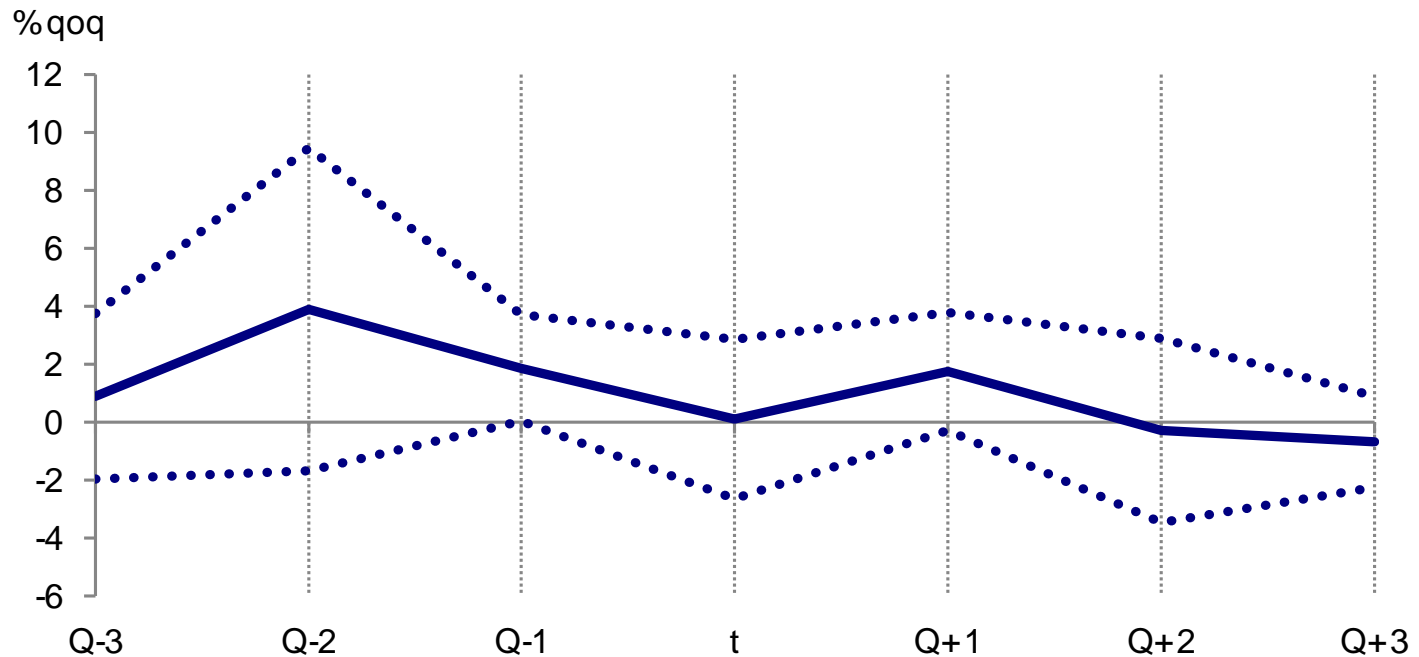
Dotted lines are +1 and -1 std dev bands

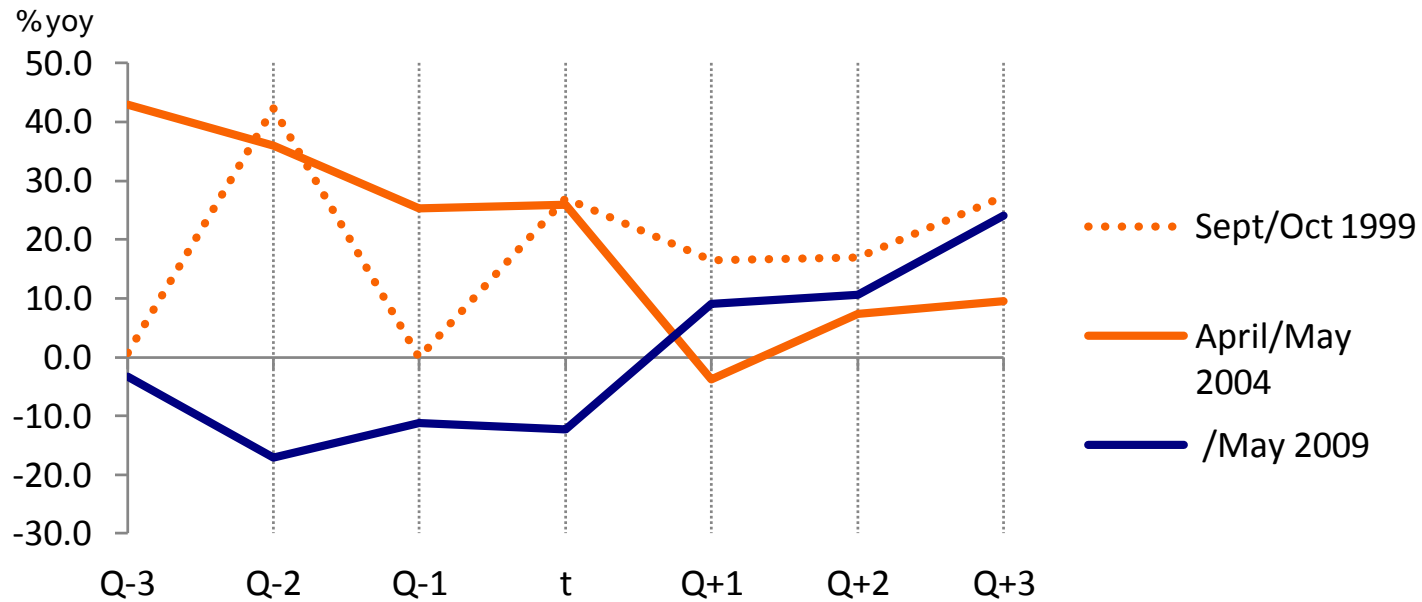# Study indicator: Rupee

Results after removing the Asian crisis data

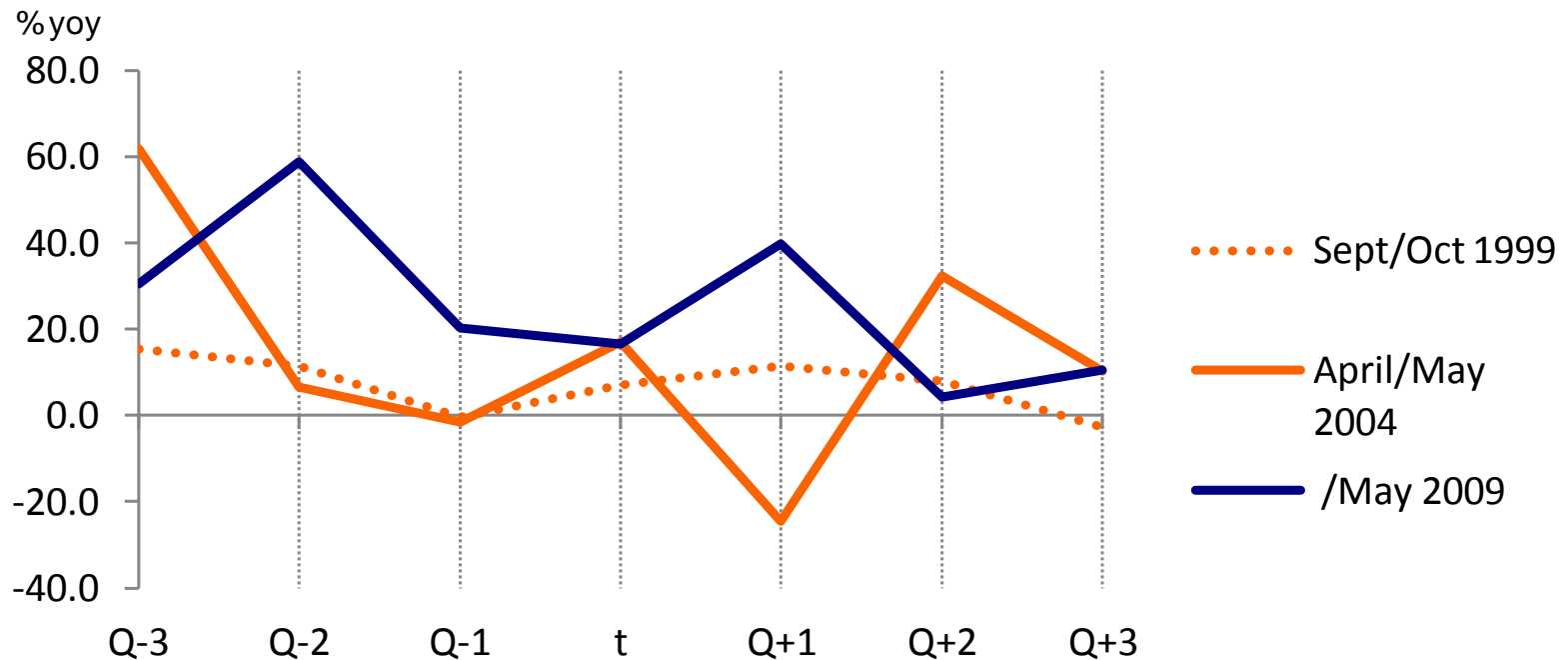Dotted lines are +1 and -1 std dev bands

Study indicator: FII flows

Study indicator: Fiscal (revenues)

Study indicator: Fiscal (expenditures)

Things to do

➢ Need more and better data

➢ 1991 elections

➢ Seasonally adjusted data

➢ Break fiscal data into tax and non-tax revenue, plan and non-plan data, some measure fiscal stance

➢ Try annual data

➢ Try stock market data