Political Budget Cycle: A Case Study of General Elections in India

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Abstract:
It has been widely observed that the governments have a tendency to increase the spending, creating short term economic boosts just before elections and thereby intending to increase their chance of getting elected. This concept known as the political budget cycle. It can be of great interest to find out whether such a policy is pursued by the ruling government in India or not. The data on public expenditure, subsidies, fiscal deficit from 1971 onwards and general election years in India is gathered. The behaviour of these variables in the election year or a year before that can give a glimpse of presence of this policy. It would not be erroneous to conclude that time and again all the ruling parties have used the fiscal policy as tool to manoeuvre the voters through increased spending in the economy. These short term measures by the government of increase in expenditure and cut in taxes appear to be good in short term but these have long term implications on the health of the economy. The data however cannot validate that this method of creating a feel good factor in the economy helps the politicians to a win the elections. However it can be safely concluded that the political budget cycle has been increasingly.

1. Introduction

India is not only the largest democracy in the world but probably a witness to large number elections too. The three tier structure of governance in India i.e. Union, state and the local level make India a nation of elections. It would not be a fallacy to consider elections in India akin to celebration of festivals. Every elected representative makes all possible efforts to get re-elected. This intention of the elected representatives manifests itself in form of tall promises to the voters and sometimes using the power at the highest level to manoeuvre the economic policies to achieve this objective.
This tendency of the governments is not only limited to India, but it is well documented that such policy is used around the world and more so in developing economies and young democracies. Various researches have been done to understand the use of the economic policies by a ruling government during the elections or just before them and its impact on election results. It has been widely observed that the governments have a tendency to increase the spending, creating short term economic boosts just before elections and thereby intending to increase their chance of getting elected.

This concept known as the political budget cycle. Brender and Drazen (2004) have defined political budget cycle as cycles in some component of the government budget induced by the electoral cycle. According to them, the term broadly means the increase in government spending or the deficit or decreases in taxes (including changes relative to long-term trends) in an election year which are perceived as motivated by the incumbent's desire for re-election for himself or his party.

2. Review of Literature

Rogoff (1990) based his research on an inter-temporal equilibrium model in which both voters and politicians are rational, utility-maximizing agents. The paper highlights that a "political budget cycle" arises due to temporary information asymmetries about the incumbent leader's competence in administering the production of public goods. The model is useful in part because it delivers sharp empirical predictions concerning the timing of budget cycles and elections, and the nature of the induced fiscal distortions. Prior to elections, taxes tend to be sub optimally low and government consumption spending sub optimally high. This public and private consumption binge comes at the expense of government investment.
Sen and Vaidya (1996) in their research paper test the empirical implications of political business cycle theories for the Indian economy. They find a distinct increase in both the budget deficit and in its

monetisation in the years leading to an election. No evidence is found of an electoral cycle in output. While the aggregate price behaviour is found to be unaffected by elections, there is some evidence of a pre-election increase in the price of manufactured products.

Gonzalez (2002) developed a simple econometric model for the case of Mexico's fiscal policy between 1957 and 1997. The estimation reveals the government's strong systematic use of public spending in infrastructure and current transfers as a means to earn votes. Most importantly, we show that the magnitude of the election cycle has been exacerbated during the country's most democratic episodes.

Khemani (2004) estimates the equilibrium effect of elections on public policy in the Indian states—a valuable laboratory to study political cycles in a developing country with a history of regular elections and stable democracy. A methodological innovation employed here is to instrument for the potential endogeneity of the election cycle by distinguishing between constitutionally scheduled and early midterm elections. A pattern of policy manipulation that point to election-year targeting of special interest groups possibly in return for campaign support, as opposed to populist spending sprees to sway the mass of voters is found in her research.

Brender and Drazen (2005) in their study find a political deficit cycle in a large cross-section of countries, but show that this result is driven by the experience of "new democracies". The political deficit cycle in new democracies accounts for findings in both developed and less developed economies, for the stronger cycle in weaker democracies, and for differences in the political cycle across governmental and electoral systems. Their findings may reconcile two contradictory views of pre-electoral manipulation, one that it is a useful instrument to gain voter support and a widespread empirical phenomenon, the other that voters punish rather than reward fiscal manipulation.

Shi and Svennson (2006) in their paper use a large panel data set to examine the relation between elections and fiscal policy. They find evidence of political budget cycles: on average, government fiscal deficit increases by almost one percent of GDP in election years. Moreover, these political budget cycles are significantly larger, and statistically more robust, in developing than in developed countries. They propose a moral hazard model of electoral competition to explain this difference. In the model, the size of the electoral budget cycles depends on politicians' rents of remaining in power and the share of informed voters in the electorate. Using suitable proxies, it is showed that these institutional features explain a large part of the difference in electoral budget cycles between developed and developing countries.

Klomp and Haan (2013) address two empirical questions: Is fiscal policy affected by upcoming elections? If so, do election-motivated fiscal policies enhance the probability of re-election of the incumbent? Employing data for 65 democratic countries over 1975–2005 in a semi-pooled panel model, they find that in most countries fiscal policy is hardly affected by elections. The countries for which they find a significant political budget cycle are very diverse. They include 'young' democracies but also 'established' democracies. In countries with a political budget cycle, election-motivated fiscal policies have a significant positive (but fairly small) effect on the electoral support for the political parties in government.

3. Political budget cycle in India

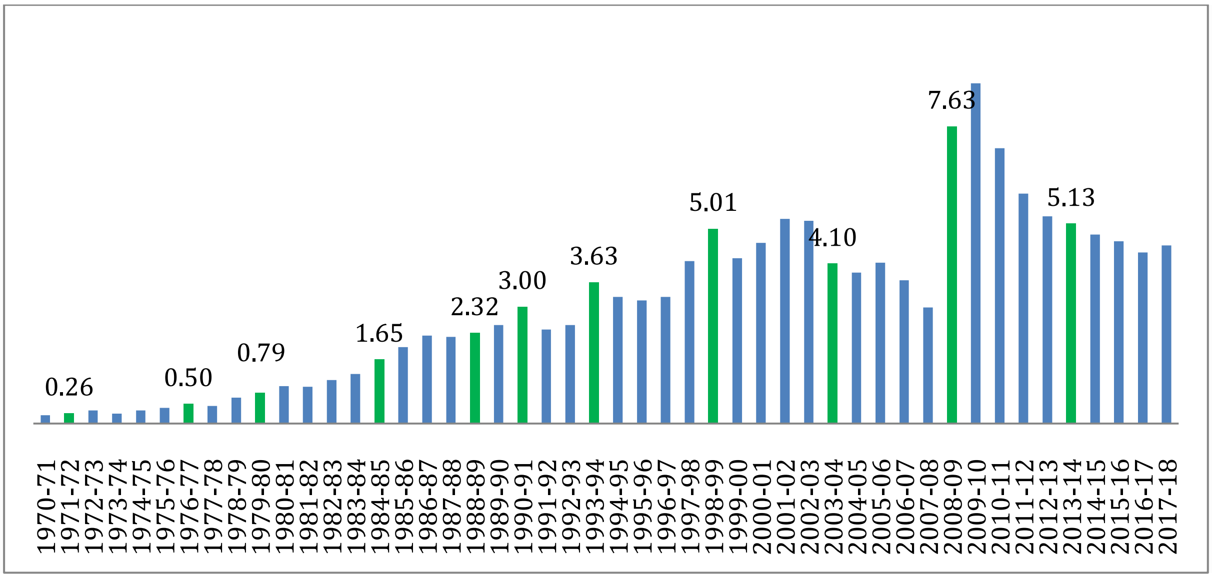
Keeping in view the last general elections in India, it can be of great interest to find out whether such a policy is pursued by the ruling government in India or not. The data on public expenditure, subsidies, fiscal deficit from 1971 onwards and general election years in India is gathered. The behaviour of these variables in the election year or a year before that can give a glimpse of presence of this policy.

Fiscal deficit and general elections

Fiscal deficit is the borrowings of the government. A high fiscal deficit is an indication of greater level of debt and indicates more money supply in the economy. A high fiscal deficit can manifest itself in form of higher inflation. A look at the trend of fiscal deficit as a percentage of Gross Domestic Product (GDP) as given in Figure 1, clearly indicates high fiscal deficit in the election years. The growth of fiscal deficit in the year of elections or a year before it is as high as 156 percent in

2008-09. Another reason for this phenomenal rise can be the Global recession which out pressure on exports and greater current account deficit. How far this rise in fiscal deficit can be attributed to elections can be further analysed by taking a look at the behaviour of public expenditure during the election years.

Figure 1: Fiscal deficit as percentage of GDP



Source: Author calculations

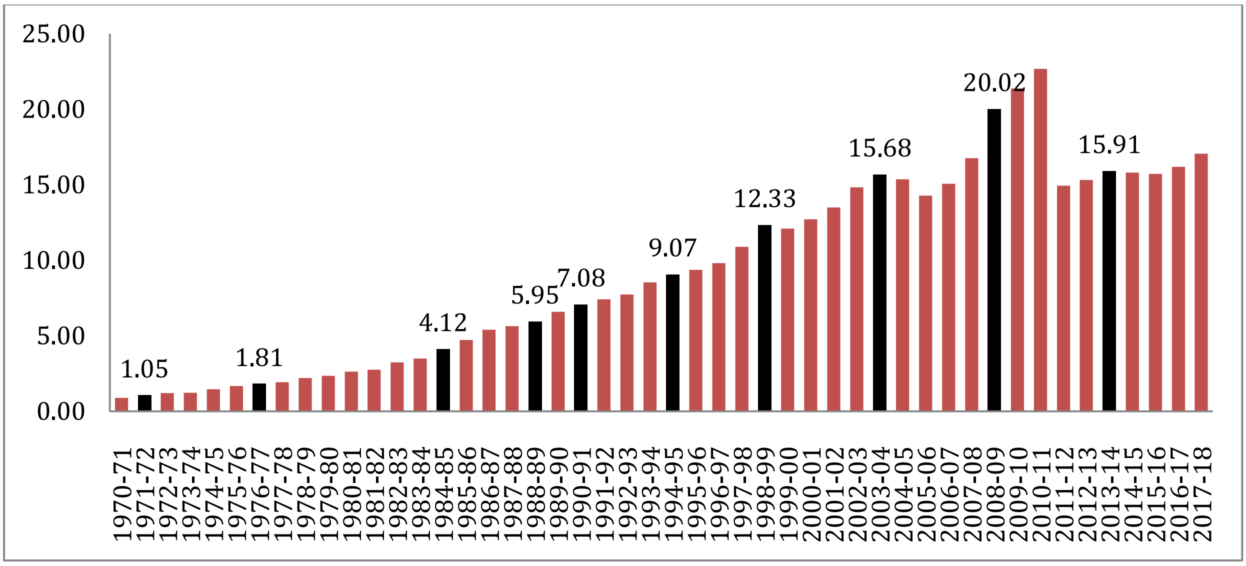
The above chart shows the fiscal deficit as percentage of GDP and every bar corresponding to the election year has been labelled showing the value of fiscal deficit as percentage of GDP.

Public expenditure and general elections

The money spent by the government on salaries, subsidies , interest payments and defence are accounted in revenue expenditure, whereas spending on developmental and planned activities is known as capital expenditure. As highlighted above the political budget cycle argues that the government increases the revenue expenditure in the election year to win the faith of the people and get re-elected in the upcoming elections.

The public expenditure data as a percentage of GDP in India as given in Figure 2 shows that such a pattern does exists, where the government has increased the spending in the economy. A point to be highlighted is that the increase in public expenditure is more in revenue expenditure which is current expenditure rather than capital expenditure. One reason behind this is that people especially the poor give greater weightage to current spending done by the government on them instead of giving importance to construction of infrastructure.

Figure 2: Public expenditure as percentage of GDP

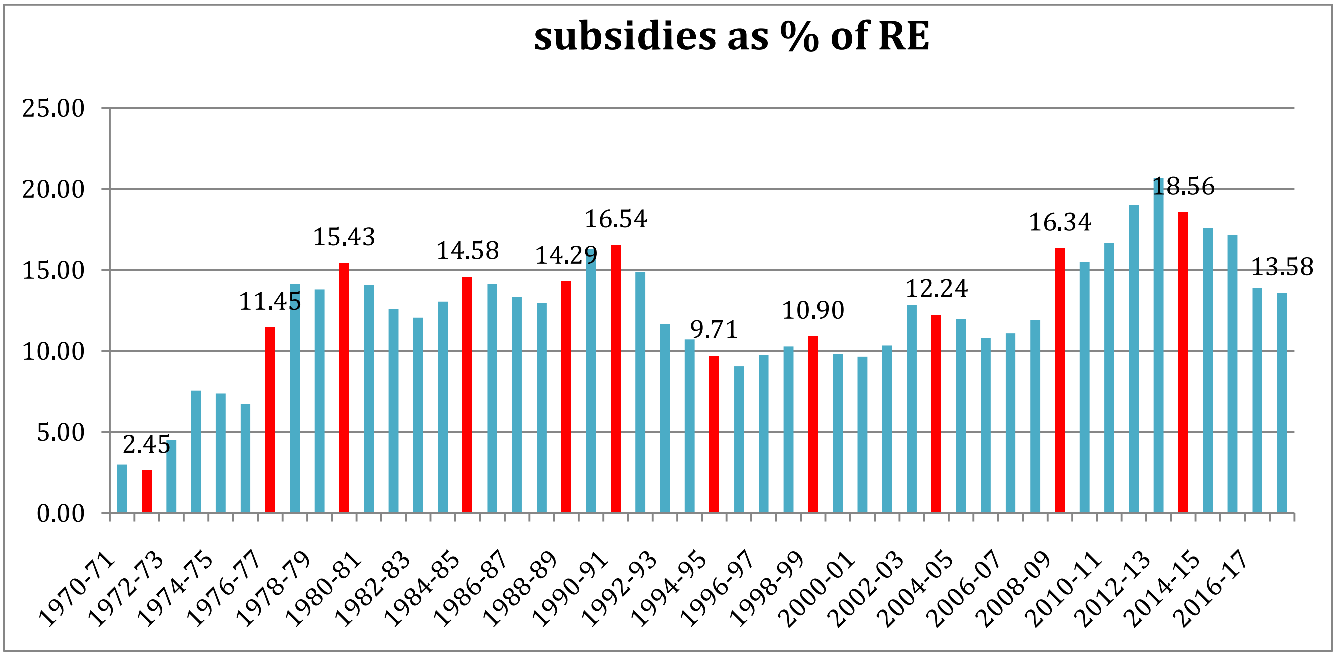


Source: Author calculations

Subsidies and general elections

Subsidies are the direct benefits given to the consumers or producers by the government with the objective of welfare or reduction in cost of production. Being a developing nation with wide inequality, India has many subsidies. Even though objective of the subsidy is to reduce inequality they sometimes lead to market distortions. They are often used as a dole by the state to woo the voters. However these have a lot of fiscal cost for the economy. A look at the subsidies as proportion of Total revenue expenditure shows that invariably their share increases at the time of elections. It is not uncommon to find ruling party giving subsidies on non-merit goods and influence the voters. The red bars in the Figure 3 indicate the share of subsides in the total expenditure of budget of government in the election years. As can be seen the subsidies which were two point six two per cent of revenue expenditure in 1971 elections have gone upto to 18.56 per cent of total revenue expenditure in the last general elections.

Figure 3: Subsidies as % of Revenue Expenditure



Source: Author calculations

4. Conclusion

The above data can be of considerable interest to determine whether these economic variables indicate towards a trend of political budget cycle in India. It would not be erroneous to conclude that time and again all the ruling parties have used the fiscal policy as tool to manoeuvre the voters through increased spending in the economy. These short term measures by the government of increase in expenditure and cut in taxes appear to be good in short term but these have long term implications on the health of the economy. The data however cannot validate that this method of creating a feel good factor in the economy helps the politicians to a win the elections. However it can be safely concluded that the political budget cycle has been increasingly used as a tool for voter wooing India has witnessed contestable democracy. Around two decades after India got independence it was primarily ruled by a single party hence the economic policies were nit used as a means to securing re-election. Ever since India has started witnessing elections and oppositions given a stiff competition to the ruling party, India has seen greater use of political budget cycle by the ruling party for their own gain.

5. References

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