Impact of General Elections on Indian Economy

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DOI: 10.55662/AJMRR.2024.5302

Abstract

India is the world's largest democratic country with around 900 million voters, 8 national parties, 57 state parties, and 2,764 unrecognised parties, 4,123 seats in state legislative assemblies, and 543 representatives in Parliament. This research paper will discuss the impact of general elections on different economic indicators such as inflation, exchange rates, stocks, and deficits. Analysing electoral and economic data spanning from 1970 to 2019, it can be concluded that there is no permanent, and predetermined pattern in these economic variables before and after the election. From the late 1980s to 1999, the political landscape in India was characterised by instability, marked by rare occurrences of governments completing their full five-year terms. The Indian public goes to the ballot almost every year to elect their representatives at the - national, state and regional level. The high frequency of elections coupled with various other factors (like international situations at that time) might be the reason that we don't find political business cycles or political budget cycles in India.

***Keywords**:* Political Budget/Business Cycle, Political Budget/Business Model, PBC Model/cycle, Indian Elections, Economy and Elections

Introduction

Elections in India play a crucial role in shaping the country's political landscape and have a significant impact on its overall progress and development. The electoral processes contribute both positively and negatively to the economy. Historical data provided by Reserve Bank of India, suggests that the Indian economy often experiences a slowdown in the period leading up to the Lok Sabha elections. Major macroeconomic indicators, including output, unemployment, and inflation demonstrate a noticeable pattern during election years. Throughout the electoral period, a sense of unease is palpable across various segments of society, whether on Dalal Street or within the everyday labour force.

The increase in the fiscal deficit ahead of elections is because the actual spending exceeds the budgeted estimates (Vaidya & Kangasabapathy, 2014). The governments in most democracies are tempted to raise spending before elections, which has long been recognized by political business cycle theorists such as - Drazen (2001), Chauvet and Collier (2008), Lessem and Urban (2013), Kaplan (2006) etc. And India’s recent history suggests that political parties have good reasons to pay attention to such theories.

Most Union governments have resorted to fiscal expansion in the year ahead of general elections. Not only do governments raise overall spending before elections, they also tend to spend relatively more on subsidies and transfers. This means that the elections are very expensive to conduct. Apart from the direct expenses involved in conducting such a huge event, there are also many indirect costs.

Positive Impacts of General Elections

Reduced Taxes

Taxes evoke strong sentiments among voters globally, as the introduction of new taxes or the rise of taxes can lead to a decline in government popularity. In India, taxes are often decreased as a strategy to attract voters. While announcing the Union Budget in 2023, Union Finance Minister Nirmala Sitharaman said, "The government proposes to increase the income tax rebate limit from Rs 5 lakh to Rs 7 lakh in the new tax regime." Conversely, repealing or reducing

ISSN 2582 8088
Volume 5 Issue 3 – May June 2024

taxes increases the popularity of the government. This is why pre-election budgets frequently feature tax cuts aimed at the general population.

More spending on Public Welfare Schemes

Government officials underscored the extensive oversight of 148 major schemes, affirming an ample allocation of funds for welfare initiatives. Officials emphasised a commitment to ensuring financial adequacy, stating a willingness to provide additional funding during the revised estimate (RE) stage if necessary. In reference to the Ayushman Bharat scheme, characterised as the government's primary healthcare coverage initiative, an official source indicated its provision of medical insurance, amounting to ₹5 lakh annually per family, benefiting over 100 million impoverished families, approximately 500 million individuals. Another official outlined an ambitious goal of enrolling an additional 70 million families within the forthcoming four months (Chatterji, 2023). Such schemes are frequently employed by the ruling party as strategic measures to influence voter sentiment.

Change in Power

Frequently, electoral outcomes in India witness shifts in power, as ruling parties commonly experience defeat at both national and state levels, resulting in approximately half of the incumbent Member of Parliaments (MPs) or Member of Legislative Assembly (MLAs) losing their positions. This transition may introduce a change in ideological orientation, as happened in the 1977 elections, when Indira Gandhi (with her socialist approach) was defeated, and replaced by Morarji Desai (having a capitalist stance). This trend continued when Gandhi returned to power after the 1980 elections, adopting a more business-friendly stance. Hence, previous detrimental economic policies are often overturned, making way for the implementation of new economic strategies.

Negative Impacts of General Elections

Increase in National & State Debt

The first and most obvious impact of an election is a significant increase in national & state debt being taken by the government. In India, elections are marked by implementation of policies that may be economically unsound but yield political advantages. These policies or schemes are fuelled by debts, taken by the government. Voters often focus on the short-term benefits that they are likely to receive which causes governments to spend a lot of money trying to look good just before the elections. This trend is not exclusive to the ruling party, as opposition parties also engage in a competitive effort to attract voters through various welfare schemes.

The exact fiscal impact of election-time promises on taxpayers may only be felt after about 12-18 months of the government being formed, by when the schemes have been fully implemented. Although assessing the exact cost of such promises can be challenging, a recent SBI Ecowrap report on the Arithmetic of the Karnataka Budget estimated that almost Rs 60,000 crore annually would be required to fulfil the five pre-poll guarantees made by the current government. Sacchidananda Mukherjee, Professor at the National Institute of Public Finance and Policy (NIPFP) in Delhi, has identified fiscal stress among 18 major and nine minor states in the Revised Estimates of 2022-23.

According to a recent report called State of State Finances 2023-24 by PRS Legislative Research, highlights several states continue to budget revenue deficit, thus constraining capital outlay. The outstanding liabilities or accumulated debt of states has also risen again in recent years, partly due to expenditures, such as farm loan waivers and debt takeover from the UDAY scheme. In 2020-21, states’ fiscal deficit limit was increased to 5 percent of GDP.

In the year 2020-21, the states' fiscal deficit limit was raised to 5 percent of the GDP. By the conclusion of 2022-23, the outstanding liabilities of states were estimated to be 29.5 percent of the GSDP, marking an increase from 26.7 percent recorded at the close of 2019-20.

Delays

Industrialists often refrain from making significant decisions during an election year due to the potential for government priorities to shift with a change in government. The fear of policies altering the feasibility of their projects leads them to adopt a cautious "wait and watch" approach. Unfortunately, this strategy negatively affects the economy as it delays economic output and the creation of potential jobs.

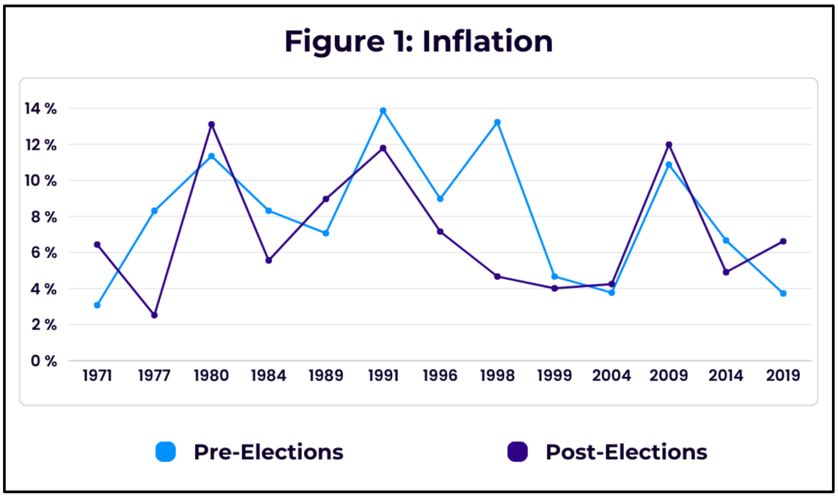
The commercial real estate sector is facing significant challenges, with banks decreasing their involvement in risky assets. The last source of concern for the sector appears to be the elections. According to data from the Centre for Monitoring Indian Economy (CMIE) project tracking database, there has been a consistent decline in real estate launches during each pre-election year over the past two decades. One reason is that real estate investments lie in the rise in policy uncertainty ahead of elections.

The US housing market asserts that the policy uncertainty stemming from elections prompts individuals to postpone investments associated with significant costs of reversal (Canes-Wrone & Park, 2014). This, in turn, leads to declines in sectors like real estate in the period preceding elections.

Weaker Credit Growth

The decrease in industrial projects undertaken by entrepreneurs has led to a decline in the need for substantial lending by banks. Consequently, this decelerates the pace of credit expansion, exerting a negative impact on the overall economy. Additionally, there might be less altruistic motivations influencing election-related trends. Notably, business figures tend to withdraw their funds from banks to financially support the election campaigns of their favoured political parties during the election season. Research conducted by political scientists The real estate sector experiences a downturn preceding Lok Sabha elections, as builders redirect funds towards covertly financing political campaigns (Kapur & Vaishnav, 2018). The withdrawal of funds results in a reduction in overall bank deposits, further constraining credit growth due to the limited availability of deposits, particularly during election years.

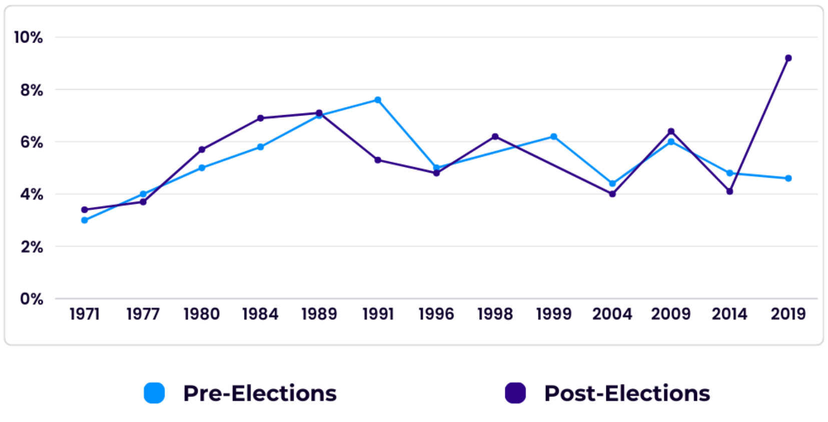
Figures



Source: https://www.macrotrends.net/countries/IND/india/inflation-rate-cpi

The graph represents India's historical inflation rates spanning from 1970 to 2019. Pre-election years, such as 1991, 1996, and 1998, exhibit higher inflation rates, indicating economic uncertainty and government spending to boost popularity before elections. Post-election years, such as 1984, 1999, and 2014, show lower inflation rates, suggesting stabilisation efforts by newly elected governments. However, there are exceptions like 2010, which saw a high inflation rate, due to global economic factors or domestic policy changes. Overall, these fluctuations highlight the intricate relationship between political cycles and economic indicators in India.

Figure 2: Gross Fiscal Deficit



Source: RBI official site

The graph presents India's historical gross fiscal deficit percentages from 1970 to 2020, showcasing fluctuations over the years. There seems to be a pattern where fiscal deficits rises in pre-election years- 1971, 1980, and 1984, due to increased government spending to lure voters. Conversely, fiscal deficits appear to decrease in post-election years - 1977, 1991, 1996, 2004 and 2014, likely reflecting efforts to stabilise the economy after the electoral cycle. These patterns underscore the interplay between political cycles and fiscal policy in India, with pre-election periods marked by fiscal prudence and post-election phases often witnessing expanded deficits.

General Elections of

1971

The illicit economy continued its expansion, escalating from an estimated 4-5% of the gross domestic product (GDP) in 1955-56 to 7% by 1970 (Wanchoo Committee Report, 1975). This trend contributed to increasing policy failures and eroded confidence in government intervention, as public services faced deterioration. During this period, crony capitalism thrived, fostering the growth of robust monopolies and oligopolies with political backing (Hazari Committee Report, 1969).

In 1973-74, inflation in India surpassed 20% for the first time since gaining independence. The nation's heavy reliance on oil imports led to elevated domestic fuel prices, causing a ripple effect on various consumer goods. The period from November 1973 to December 1974 witnessed the country's most severe inflation crisis, where the inflation rate remained consistently above 20%, reaching above 30% for four consecutive months starting from June 1974. From 1974-75, the gravity of the inflation, particularly in agricultural commodities, noted that the customary seasonal decline in prices, especially for agricultural goods, did not occur over the preceding two years (Reserve Bank of India's Annual Report, 1975).

Indira Gandhi secured a decisive victory in the general elections held in March 1971, propelled by her iconic slogan 'garibi hatao' (remove poverty). Following her triumph, she emerged as the unchallenged leader of both the Congress party and the nation. However, her tenure as Prime Minister was marred by significant challenges, including severe criticism despite the success in the Bangladesh War. These challenges encompassed soaring inflation triggered by the war, a 0.9% decline in per capita income in 1971-72, drought in various regions (Maharashtra from 1970-73), and the 1973 oil crisis. It's worth noting that the elevated inflation might not be solely attributed to the elections but rather to a confluence of other events mentioned. We observe a lack of evidence supporting the existence of a political business cycle; instead, we notice occurrences that run counter to it.

1977

Indira Gandhi faced the wrath of discontented Indians for declaring Emergency, leading to the Janata Party's victory in the 1977 elections. Upon assuming power, Prime Minister Morarji Desai implemented ‘Demonetisation 1.0’ by withdrawing the legal-tender status of ₹1,000, ₹5,000, and ₹10,000 banknotes to curb illicit wealth. The legalisation of strikes, previously banned by Gandhi, and the reinstatement of trade unions had a significant impact on economic activity. George Fernandes, a symbol of resistance during the Emergency, was appointed Industries minister and compelled IBM and Coca-Cola to adhere to the Foreign Exchange Regulation Act, limiting foreign investors' ownership to 40% in Indian enterprises. Consequently, both multinational companies closed their operations in India. Despite these actions, the Janata government struggled to make a lasting impact through economic reforms.

During the pre-election period, the deficit as a percentage of GDP witnessed a rise of approximately 17%. This escalation in the deficit could be attributed to heightened spending in the election year, as there were no notable events impacting the economy during that period. It's worth noting that India was experiencing a deflationary phase in 1975-76, induced by a state of emergency. Data (Fig. 1 & 2) suggests that the presence of a political budget cycle can be observed through inflation and deficits; it remains uncertain, as the decline in agricultural output resulting from drought during that period could also have played a role in driving inflation.

1980

Indira Gandhi regained power in 1980 following the unravelling of the Janata Party government, plagued by inherent contradictions. Despite her left-leaning populist stance until the 1970s, Gandhi implemented significant economic reforms to secure an International Monetary Fund loan. The sixth five-year plan (1980-85) committed to a series of measures aimed at enhancing the economy's competitiveness. This included lifting price controls, launching fiscal reforms, restructuring the public sector, lowering import duties, and dismantling the Licence Raj, essentially freeing the domestic industry from licensing restrictions.

During this election year, a comparable trend can be observed to the previous election cycle, wherein government spending rose before the elections and subsequently returned to previous levels in the post-election years. With no other notable events occurring during that period, it can be inferred that the heightened inflation indicated the existence of the PBC model.

1984

Under the leadership of Rajiv Gandhi, with Pranab Mukherjee serving as the Finance Minister, the government introduced liberalised industrial policies. This marked the initial phase of a shift in policy towards embracing freer markets as a crucial approach to poverty eradication and economic growth.

The pre-election reforms and policy adjustments implemented from 1980-84 garnered significant investor interest, leading to a surge in stocks during that period. The subsequent return to normalcy in the post-election period suggests a strong correlation between the electoral process and the observed market fluctuations. The increased fiscal deficit after the elections, shows the existence of a PBC cycle.

1989

In the previous elections, there was a lack of external influence on the economy; however, the current election is demonstrating a contrary impact to the predictions of PBC models regarding deficit data. The Sensex moved upwards before the election year, which contradicts with the fact that PBC is present in India. Though the inflation data after the elections shows the existence of a PBC model.

1991

Starting in late 1990, India faced a severe balance of payments crisis, triggered by a slowdown of inward remittances and a rise in the price of oil following the invasion of Kuwait by Saddam Hussain. The current account of the balance of payments faced a dual challenge, reduction of receipts and a rise in the value of imports. The current account deficit expanded to 3 percent of the GDP in 1990-91, reaching its highest level in two decades by a significant margin. The import cover afforded by India's reserves plummeted to a historic low of three weeks at the peak of the crisis. There were speculations regarding the possibility of India defaulting on its external payment commitments. The assassination of Rajiv Gandhi in 1991 further exacerbated existing market volatility, with the economy grappling with elevated Gross Fiscal Deficit, inflation, and limited Forex Reserves.

Nonetheless, under the leadership of PV Narasimha Rao, the government implemented numerous policy measures in areas such as industrial delicensing, foreign investment, trade policy, and financial and capital markets. The Congress party succeeded in restoring market confidence by liberalising the economy and attracting global investors.

The inability of the previous government to manage inflation was hindered by reduced agricultural output and a balance of payments crisis. So, there is no evidence to suggest the presence of a PBC for this election.

1996

The economy during this election was not significantly impacted by external influencing factors. Under the administration of the previous government, the economy experienced robust growth, with positive indications in various economic factors.

In this election, the preceding government likely implemented strategies to attract voters, yet the data (Fig. 1 & 2) indicates a contrasting outcome. This divergence could be attributed to economic advancements potentially overshadowing the impact of the political business cycle.

1998

The Asian Crisis significantly influenced economic dynamics in India, particularly impacting the movement of the Sensex. Following the crisis, there was an upward trend in the Sensex as the situation was resolving. Post-election, there was a sudden decrease in inflation, possibly attributed to the new government's stringent measures to control the economy. The preceding government introduced a new public distribution system, and lethargic industrial growth led to a shortfall in indirect tax collections, causing a rapid increase in the deficit in the pre-election year. Additionally, the exchange rate experienced an upward trajectory due to declining exports, influenced by stricter quality standards, testing requirements, and low export prices both before and after the elections.

The election provides indications of the existence of a political business cycle, with elevated deficits and inflation in the year preceding the election, followed by a subsequent reduction in these factors post-election.

1999

The 1999 General Elections were triggered by the loss of majority by Vajpayee's government. The All India Anna Dravida Munnetra Kazhagam (AIADMK), led by J. Jayalalithaa, withdrew its support after 13 months, resulting in the government losing a crucial vote of confidence in the Lok Sabha by a single vote on April 17, 1999. Subsequently, as the opposition failed to gather sufficient numbers to form a new government, the Lok Sabha was dissolved once again, leading to the conduct of fresh elections.

The existence of the political budget cycle during this election year cannot be guaranteed, because in a short tenure of 13 months no major scheme could be announced by any government, to attract voters. At the same time the Kargil War emerged, the changes in economic indicators could be attributed to external factors.

2004

The election marked a crucial period for India's rapid growth, resulting in the formation of a new government led by the Congress party. In the initial year of Dr. Manmohan Singh's tenure as the Prime Minister, the Sensex experienced a significant surge, attributed to robust IT advancements and elevated optimism surrounding Dr. Singh's leadership, given his esteemed reputation as an economist.

In 2004-05, the year in which it came to power, the fiscal deficit was 3.88%, down from 4.48% in the previous year. The gross fiscal deficit contradicts the expectations of the political budget cycle, while inflation data suggests the presence of a political business cycle. The pre-election inflation rate stood at 3.81%, but post-elections, it declined to 3.77%. The Sensex saw improvement due to the policies implemented by the preceding government.

2009

The election took place amid the backdrop of the global financial crisis, impacting various economic factors. Preceding the election, the government raised the Minimum Support Price (MSP) for agricultural produce and implemented loan waivers for farmers, leading to increased inflation, a rise in fiscal deficit, and repercussions on the exchange rate.

The presence of a political budget/business cycle in this election is apparent. However, attributing it solely to political factors is challenging, given the existing economic downturn. The government implemented measures to curb the decline, leading to a high fiscal deficit and high inflation as funds were injected into the markets. Additionally, the Sensex faced pressure due to the global economic situation.

2014

Between 2009 and 2014, the government introduced numerous schemes to attract voters, given the backdrop of numerous corruption scandals (Coal scam, 2G spectrum scam, Chopper scam, CWG scam etc.) and the need for a political comeback. These initiatives were carried out during the government's tenure, contrasting the pre-election expenditures on programs. The government implemented stringent measures to enhance the economy, and the decrease in crude oil prices aided in reducing deficits, inflation, and stabilising the exchange rate. Empirical data indicates that the impact of inflation and deficits contradicts the anticipated effects of the political budget/business cycle.

2019

Between 2014 and 2019, the Modi government implemented various reforms and initiatives such as demonetization, the introduction of the Goods and Services Tax (GST), Ujjwala Yojana, Jan Dhan Yojana, and more, employing a combination of legislative and policy changes. The PM Kisan Samman Nidhi Yojana was launched on February 1, just before the 2019 elections. Despite the government's success in keeping inflation in check, there was a downside. Priyanka Kishore, head of India and South-east Asia economics at Oxford Economics in Singapore, noted, "While Modi has managed to keep inflation under control, it has come at a cost." The slow increase in inflation just before the elections, coupled with falling rural incomes and farm distress, dimmed one of the key achievements of the Modi government. India's fiscal deficit remained relatively stable during this period.

The elections do not provide any indication of the existence of a political business cycle, as the increased inflation and the gross fiscal deficit the following year, was due to COVID-19 pandemic.

Conclusion

During election years, both the government and citizens tend to prioritise immediate impacts of policies rather than focusing on long-term results. This shift in focus adversely affects long-term projects like infrastructure development, leading to a slowdown in economic growth during every Indian election year since independence. Notably, there is no specific pattern found in indicators such as Sensex, Deficit, Inflation rate, and Exchange rate, during General Elections, indicating a lack of evidence for a political business or budget cycle in India. The absence of a clear pattern may be attributed to the varying timing of elections, including state and general elections, and the frequent occurrence of elections, with at least one state election occurring each year.

An election does not adversely affect all industries. For some industries, the impact is very positive. For instance, companies which provide rental equipment for organising events see a brisk increase in business because of political rallies. Since a significant number of event management and security personnel are required, large-scale temporary employment is offered to facilitate the organisation of political rallies.

Uncertainties are always associated with elections, which confuses the potential investor to invest in the market as the market becomes unpredictable. The stability and consistent implementation of work are fundamental factors influencing the economy.

Though elections are a drain on the national economy. Certainly, while elections are crucial for defining democracy, their frequency imposes significant economic costs. Therefore, a country could benefit economically by minimising the occurrence of elections.

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