

Fiscal policy and presidential elections

[Politics](#)



The paper "Fiscal Policy and Presidential Elections" is a wonderful example of a case study on politics. After the recession of 1990–91, the economy was slow to recover. At the time of the 1992 presidential election, the unemployment rate still languished at 7.5 percent, up two percentage points from when President George H. W. Bush took office in 1989. The higher unemployment rate was too much of a hurdle to overcome, and Bush lost his reelection bid to challenger Bill Clinton. Clinton's campaign slogan was: "It's the economy, stupid." The link between economic performance and reelection success has a long history. Ray Fair of Yale University examined presidential elections dating back to 1916 and found, not surprisingly, that the state of the economy during the election year affected the outcome. Specifically, Fair found that a declining unemployment rate and strong growth rate in GDP per capita increased election prospects for the incumbent party. Another Yale economist, William Nordhaus, developed a theory of political business cycles, arguing that incumbent presidents, during an election year, use expansionary policies to stimulate the economy, often only temporarily. For example, evidence suggests that President Nixon used expansionary policies to increase his chances for reelection in 1972, even pressuring the Federal Reserve chairman to pursue an expansionary monetary policy. The evidence to support the theory of political business cycles is not entirely convincing. One problem is that the theoretical limits presidential motives to reelection, when in fact presidents may have other objectives. For example, the first President Bush, in the election year of 1992, passed up an opportunity to sign a tax cut for the middle class because that measure would also have increased taxes on a much smaller group—upper-income taxpayers. An alternative to the theory of political

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business cycles is that Democrats care more about unemployment and less about inflation than do Republicans. This view is supported by evidence indicating that during Democratic administrations, unemployment is more likely to fall and inflation is more likely to rise than during Republican administrations. Republican presidents tend to pursue contractionary policies soon after taking office and are more willing to endure a recession to reduce inflation. The country suffered a recession during the first term of the last six Republican presidents, including President George W. Bush. Democratic presidents tend to pursue expansionary policies to reduce unemployment and are willing to put up with higher inflation to do so. But this theory also has its holes. For example, George W. Bush pushed tax cuts early in his administration to fight a recession. Bush, like Reagan before him, seemed less concerned about the impact of tax cuts on inflation and federal deficits. A final problem with the political-business-cycle theory is that other issues sometimes compete with the economy for voter attention. For example, in the 2004 election, President Bush's handling of the war on terror, especially the war in Iraq, became at least as much of a campaign issue as his handling of the economy. Response:

Fiscal policy is a critical and sensitive issue, especially when correlated to an incumbent's reelection campaign. There are many reasons why a president may choose a different fiscal policy (whether expansionary or contractionary) and his motives must be to secure the economy. Taxation as a component of fiscal policy is an important issue since the tax is the lifeblood of an economy. Whether it was raised for purposes of debt-servicing or cut so that civilians would have a break, it's the government's call.

Besides, a president has an army of economic advisers that guides him on the <https://assignbuster.com/fiscal-policy-and-presidential-elections/>

possible implications of choosing a fiscal policy. Introducing tax-cutting measures such as Obama's proposed plan is a good way to boost capital investment especially for small to medium-sized businesses that need to breathe in this kind of economy. As for whether a President uses this fiscal policy issue for propaganda, the only thing I can say is that as long as it benefits the people in long-term, there is no issue at all.

The Supply-Side Experiment

In 1981, President Ronald Reagan and the Congress agreed on a 23 percent reduction in average income tax rates. Reagan argued that a reduction in tax rates would make people more willing to work and to invest because they could keep more of what they earned. Lower taxes would increase the supply of labor and the supply of other resources in the economy, thereby increasing the economy's potential output. In its strongest form, this supply-side theory held that output would increase enough to increase tax revenues despite the cut in tax rates. In other words, a smaller tax share of a bigger pie would exceed a larger tax share of a smaller pie.

What resulted? Taking 1981 to 1988 as the time frame for examining the supply-side experiment, we can make draw some conclusions about the effects of the 1981 federal income tax cut, which was phased in over three years. After the tax cut was approved but before it took effect, a recession hit the economy and the unemployment rate climbed to nearly 10 percent in 1982.

Although it is difficult to untangle the growth generated by the tax cuts from the cyclical upswing following the recession of 1981-1982, we can say that between 1981 and 1988, the number employed climbed by 15 million and number unemployed fell by 2 million. Real GDP per capita, a good measure

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of the standard of living, increased by about 2.6 percent per year between 1981 and 1988. This rate was higher than the 1.5 percent average increase experienced between 1973 and 1981 but lower than the 3.1 percent annual growth rate between 1960 and 1973.

Does the growth in employment and in real GDP mean the supply-side experiment was a success? Part of the growth in employment and output could be explained by the huge federal stimulus resulting from higher deficits during the period. The tax cuts, in effect, resulted in an expansionary fiscal policy. The stimulus from the tax cut helped sustain a continued expansion during the 1980s—the longest peacetime expansion to that point in the nation’s history.

Despite the job growth, government revenues did not increase enough to offset the combination of tax cuts and increased government spending. Between 1981 and 1988, federal outlays grew an average of 7.1 percent per year, and federal revenues averaged 6.3 percent. So the tax cut failed to generate the revenue required to fund growing government spending. In the decade prior to 1981, federal deficits averaged 2.0 percent relative to GDP. But, deficits doubled to an average of 4.2 percent between 1981 and 1988. These were the largest peacetime deficits to that point on record. Deficit spending stimulated the economy but also accumulated into a growing national debt, a topic discussed in the next chapter.

The question is to cut or not to cut? However, history shows that the trend is more on tax-cutting measures. Consider this “ The tax cuts, in effect, resulted in an expansionary fiscal policy. The stimulus from the tax cut helped sustain a continued expansion during the 1980s—the longest peacetime expansion to that point in the nation’s history.”

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It may be true that tax-cutting measures resulted in a deficit, yet it helps boost the economy from within. It is a one step backward but two steps forward. Besides, who would punish the country for its growing debt? The IMF? The international community? Even if the U. S. accumulates a huge deficit, it is not under pressure like any underdeveloped country saddled with debts. Tax-cutting measures benefit the ordinary citizen and potential entrepreneurs. The country needs sustainable small and medium business so that it can regain from the recession. When these businesses grow, they would eventually contribute in raising the GDP. Isn't that progress? In short, the experiment looks like a failure since deficit raised but in the long run, the economy won.