**BOX 1.1 Fiscal deteriorations around elections**

Among EMDEs, primary fiscal deficits, primary government expenditures, and government wage bills have tended to rise significantly around election years. While primary spending increases have tended to be partially reversed in the following year, post-election reversals of primary deficit and government wage bill increases have been more variable and at best partial. The consequent ratcheting up of primary deficits around elections in EMDEs can erode fiscal sustainability over the longer term, while the expansion of government wage bills can result in spending rigidities. In South Asia, in particular, fiscal positions have tended to deteriorate around national elections, and, in some cases, there is also evidence of targeted fiscal actions around subnational elections. While this result is true on average for the region, some countries—notably India in its 2023 budget—have avoided the risk of election-induced current spending increases. This points to a way forward for fiscally constrained governments in South Asia.

**Introduction**

In 2023 and 2024, parliamentary or presidential elections will be held in seven out of the eight South Asian countries. With fiscal positions already fragile in several South Asian economies and government debt stocks high, spending increases, or revenue decreases around these elections would add to fiscal pressures.

A well-established literature has documented political budget cycles, in both advanced economies and EMDEs. These have been attributed to three factors. First, incumbents may adopt an expansionary fiscal policy designed to benefit voters directly, thus maximizing their chances of re-election (Nordhaus 1975; Dubois 2016). Second, incumbents may introduce policies ahead of elections to spur economic growth, in the hope of demonstrating the strength of their governments (Higashijima 2022; Han 2022). Third, if the expected outcome of an election is unfavorable for the incumbent or is uncertain, the incumbent may issue debt to constrain their successor’s room for maneuver (Alesina and Tabellini 1990). The government wage bill, which accounted for 25 percent of primary spending in the average EMDE in 2010–20 (and 26 percent of paid workers), can be a particularly important instrument for influencing elections (Endegnanew, Soto, and Verdier 2017).

Several empirical studies have found evidence for election effects. A statistically significant—albeit generally small—political budget cycle has been identified in many cross-country studies. This cycle appears to be more prominent in EMDEs, where income levels and governance are typically weaker than in advanced economies (de Haan and Klomp 2013; Kyriacou, Okabe, and Roca-Sagales 2022; de Haan and Gootjes 2023).

Thus, the evidence is that political budget cycles are common in EMDEs. This box examines political budget cycles for South Asia, in particular, to answer the following questions:

- How pronounced are political budget cycles in South Asia?
- How do political budget cycles in South Asia compare with those in other EMDEs?
- What are the policy implications?

This box contributes to the literature in three ways. First, it examines fiscal positions around national elections in South Asia, whereas the existing literature on political budget cycles in the region tends to focus on specific fiscal actions around subnational elections. Second, it documents that one spending category—the government wage bill—is particularly susceptible to political budget cycles around national elections in EMDEs. In contrast, the existing literature focuses on aggregate spending or fiscal deficits (de Haan and Klomp 2013; Kyriacou, Okabe, Roca-Sagales 2022; de Haan and Gootje 2023). Third, this box documents that political budget cycles tend to be only partially reversed after the election whereas the existing literature focuses on fiscal aggregates in the election year itself (Brender and Drazen 2005; Strong 2023).

This box reports the following findings.

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*a* See Brender and Drazen (2005); Shi and Svensson (2006); Vergne (2009); Klomp and de Haan (2011); Philips (2016); and Strong (2023).

*b* An exception is Ebeke and Ölçer (2017), who report for a sample of low-income countries that governments have tended to raise trade taxes and cut government investment in the two years after elections, with no significant cuts in government consumption.
In South Asia, primary fiscal deficits tended to widen in or just before national elections, on average by 0.5 percentage point of GDP, and only half of this deterioration was reversed in the two years after the election. For several South Asian countries, the literature finds evidence of narrowly targeted fiscal actions around subnational elections.

Among EMDEs more generally, primary fiscal deficits, primary government expenditures, and government wage bills rose significantly around elections, on average by 0.7, 0.5, and 0.1 percentage point of GDP, respectively. South Asia is among the EMDE regions with particularly pronounced election effects.

On average among EMDEs, primary spending increases averaging 0.5 percentage point of GDP were virtually fully reversed within a year following the election. However, increases in the government wage bill—small (0.1 percentage point of GDP) but statistically significant—were not reversed: in fact, they continued. There was wide variation in the extent to which primary fiscal deficit increases in election years were reversed but, on average, the reversal amounted to less than half of the increase during the election years. The consequent ratcheting-up of deficits as well as wage bills around elections could erode fiscal sustainability and lock in spending rigidities over the longer term.

This box draws on data for 122 EMDEs for 1984–2022. Data on fiscal outcomes and country characteristics are from the IMF’s World Economic Outlook and Government Finance Statistics databases, and the World Bank’s World Development Indicators. Election dates are from the Database of Political Institutions until 2020 and assembled from news reports for 2021–2022.

Political budget cycles in South Asia

Fiscal positions deteriorated considerably around several elections in South Asian countries. The literature has also found evidence of more narrowly targeted fiscal actions around subnational elections in several South Asian countries.

Literature review

The literature on political budget cycles in South Asia has identified significant budget cycles around subnational elections in the region’s two largest countries between the 1960s and the mid-2000s.

In India, the existing literature covers the 1960s to the mid-2000s, restricting itself to frequently held subnational elections, and has documented narrowly targeted fiscal actions around state elections. Significant spending increases around state elections have been reported: in infrastructure-related social programs during 1960–2005 (Khemani 2010); in interest spending on subnational debt during 1960–2006 (Saez 2016); in capital spending during 1959–2012 (Ferris and Dash 2019, Khemani 2004); and in farm debt waivers in 2001/02 and 2018/19 (Mahambare, Dhanaraj, and Mittal 2022). State banks appear to have increased agricultural lending around state elections during 1992–1999 (Cole 2009). Similarly, contested constituencies benefited from greater improvements in power supply around state elections during 1992–2009 (Baskaran, Min, and Uppal 2015), while commodity revenue collections declined and capital spending rose around state elections during 1974–1995 (Chaudhuri and Dasgupta 2006).

In Pakistan, government spending was significantly higher in election years and significantly lower after elections during 2000–07 (Nasir, Nazir, and Khawaja 2022). Fiscal deficits were significantly larger in election years during 1973–2009 (Sieg and Batool 2012).

In contrast, for Bangladesh, no study has shown clear evidence of political budget cycles. The one study examining the question fails to find any systematic impact of political factors on disaster relief during 2010–14 (Karim and Noy 2020). However, monetary policy appears to have been significantly more accommodative in election years during 1980–2008 (Joarder, Hossein, and Ahmed 2016).

Event study

An event study of government spending around national elections in South Asia since 1991 suggests the presence of political budget cycles in most countries in the region, although of varying intensity.

Including elections planned for 2023–24, there will have been 53 presidential or parliamentary elections in the region since 1990: seven in Bangladesh; four in Bhutan; eight in India; eight in Pakistan; four in Nepal; twelve in the Maldives; and ten in Sri Lanka.
in South Asia have tended to be bunched together about every five years, as they are again in 2023–24.

For the seven South Asian countries in the sample, on average, the primary fiscal balance deteriorated either in the election year or in the year preceding the election by 0.5 percentage point of GDP; only half of this deterioration was unwound over the two years following the election (figure B1.1.1). In some cases, the widening of primary fiscal deficits in the runup to elections reflected spending increases.

**Political budget cycles in South Asia and other EMDEs**

Data for the South Asia region are severely limited and provide an inadequate basis for reliable policy lessons to be drawn. To broaden the analysis of political budget cycles, the larger group of EMDEs is examined (de Haan, Ohnsorge, and Yu forthcoming). On the assumption that the typical South Asian country behaves similarly to the typical EMDE, once the main country characteristics are controlled for, lessons may be inferred for South Asia.

A generalized-method-of-moments regression is estimated of fiscal outcomes on elections (annex 1.1.1). The fiscal outcomes that are examined are aggregate primary government expenditures, primary fiscal balances, and the government wage bill (all in percent of GDP). The sample includes up to 122 EMDEs for 1984–2022. The regression results are shown in annex tables 1.1.1–1.1.3.

EMDE elections were typically accompanied by a fiscal deterioration (figure B1.1.2). In the average election year, the primary deficit widened by 0.7 percentage point of GDP, mostly because primary government spending rose by 0.5 percentage point of GDP. Government wage bills were higher in election years, on average by 0.1 percentage point of GDP. For robustness, other components of government spending, including government investment, were tested for similar systematic changes around elections but none was found.

Primary government spending increases around elections were short-lived and typically reversed within a year—with the exception of increases in government wage bills, which accounted for about 25 percent of primary expenditures in the average EMDE during 2010–20. Thus, the 0.5-percentage-point of GDP increase in primary government spending in the average election year was virtually entirely unwound in the year after the election. In contrast, the smaller (0.1...
percentage point of GDP) but statistically significant increase in the government wage bill in the election year was not systematically unwound in the post-election year. With regard to the primary fiscal balance, the unwinding was more variable and, on average, smaller, than in the case of primary expenditure: in fact, there was too much heterogeneity in post-election movement for a statistically significant unwinding of the election-year increase to be identified.

Since increases in the primary fiscal deficit and the government wage bill around elections are not systematically unwound after elections, they can cumulate to sizable increases over the course of several elections. Since 1990, for example, the average EMDE in the regression sample has held a presidential or parliamentary election every three years. Assuming that fiscal deficits are financed by increases in government debt, the regression coefficients from annex table 1.1.1 imply that government debt would already be more than 10 percentage points of GDP higher and the government wage bill 0.6 percentage point of GDP higher than initially by the time that the fourth election cycle takes place.

Together with three other regions, South Asia has had particularly pronounced political budget cycles (figure B1.1.3). Election-year increases in fiscal deficits, primary balances, or government wage bills were statistically significant only in three regions, and South Asia was one of the only two regions where all three fiscal outcomes increased significantly. The inclusion of regional dummy variables left other coefficient estimates broadly unchanged. In South Asia, specifically, election years were associated with 0.6 percentage point of GDP higher primary deficits, 0.8 percentage point of GDP higher primary spending, and 0.2 percentage point of GDP higher government wage bills than in non-election years. Two of these three regions (including South Asia) were also the regions with more frequent switches between fully democratic and less democratic political regimes. These two regions accounted for two-thirds of all regime switches in EMDEs during 1975–2022.

Policy implications

The empirical analysis suggests that deteriorations in fiscal positions, stemming particularly from spending increases, have been common in EMDEs at election times, regardless of political regimes. Yet the evidence that such fiscal actions affect election outcomes is decidedly mixed. Insignificant, or even adverse, effects on election outcomes for the incumbent government...
have been reported for the United States (Peltzman 1992), EMDEs in Eastern Europe (Enkelmann and Leibrecht 2013) and Latin America (Kraemer 1997), and a large cross-country sample (Brender and Drazen 2008). However, more recent cross-country studies have reported that incumbents have benefited from fiscal actions in elections (Bojar 2017; Klomp and de Haan 2013), while voters sometimes punished incumbents for fiscal consolidation (Mulas-Granados 2004), although at other times they did not (Alesina 2012).

The lack of reversals of fiscal deficit increases around elections raises concerns about an erosion of fiscal sustainability over the longer term. Similarly, even the small, but statistically significant, ratcheting-up of government wage bills around elections in the average EMDE will tend to lock in spending rigidities that may become difficult to unwind in times of need.

To help prevent fiscal deteriorations around elections and their longer-term consequences, the establishment of more robust fiscal frameworks and institutional arrangements could be considered, as suggested by the experience of other countries.

- **Fiscal transparency.** There is empirical evidence that greater transparency in fiscal policymaking may make election-motivated fiscal policy action less likely by making them more visible (Alt and Lassen 2006a, b; Gootjes and de Haan 2022).

- **Fiscal rules.** Fiscal rules, such as the Stability and Growth Pact in Europe and balanced budget requirements in some U.S. states, can constrain incumbents’ ability to engage in election-motivated fiscal expansions (de Haan and Klomp 2013; Rose 2006; Alt and Rose 2009; Cioffi, Messina, and Tommasino 2012; Ebeke and Ölçer 2017; Gootjes, de Haan, and Jong-A-Pin 2021). A growing number of countries have adopted such institutional fiscal constraints: in 2015, 92 countries had fiscal rules in place, up from 7 countries in 1990 (Lledó et al. 2017).

- **Robust governance and control of corruption.** Political budget cycles have been less pronounced in countries with stronger checks and balances, stronger rule of law, and less corruption (Streb, Lema, and Torrens 2009; Shi and Svensson 2006; Lee and Min 2021). Checks and balances in the political system discourage incumbents from using policy for re-election purposes.

There are indications that, at least in some South Asian countries, the 2023–24 election season may break from past practice. In India, for example, the latest government budget is on track for fiscal consolidation amid upcoming elections (World Bank 2023d).