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The Economy and the 2004 Election

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Outline of Today's Talk



- **The Connection Between Economic Performance and Presidential Elections.**
- **Can we Accurately Predict the Outcome of Presidential Elections using Economic Statistics?**
- **What is THE Major Economic Issue for Your Generation?**

The Connection Between Economic Performance and Presidential Elections

▶ People often “vote their pocket books.”

▪ Important economic indicators that people look at:

- **Real GDP** — broadest measure of economic growth
- **Unemployment Rate** — % of labor force unemployed
- **Job Growth** — a key indicator of economic conditions

“A recession is when your neighbor loses his job; a depression is when you lose YOUR job; a recovery is when President Carter loses his job.” Candidate Ronald Reagan, 1980

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- **Stock Market** — more important now in a 401(k) world?
- **Inflation Rate** — rising inflation is destabilizing
- **Consumer Confidence** — gets a lot of attention, but how useful?

The Connection Between Economic Performance and Presidential Elections

- ▶ People often “vote their pocket books.”
- ▶ U.S. history is replete with examples of economic events changing the course of public policies.
- ▶ **Some examples include:**
 - **the Great Depression;**
 - **“stagflation” during the late 1970s;**
 - **“it’s the economy, stupid” from the 1992 election.**

The Connection Between Economic Performance and Presidential Elections

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- ▶ Some examples include:
 - the Great Depression;
 - “stagflation” during the late 1970s;
 - “it’s the economy, stupid” from the 1992 election.
- ▶ **Internationally, a good example is the German hyperinflation after World War I that helped to usher in Hitler’s Nazi Govt.**



In Germany in 1923, a typical workingman carted his weekly salary home in a wheelbarrow. Housewives used the nearly worthless government currency to light household fires. An armload of banknotes might buy a loaf of bread. These absurdities were some of the more visible results of the economic inflation that wiped out people's savings and crippled Germany's Weimar government during the interwar years before Hitler.

Do Voters Reward Good Economic Performance?

▶ Let's look at the economic record of the past five incumbent presidents who were re-elected and their share of the popular vote.

Economic Records of Incumbent Presidents Running for Re-election

Incumbent President		<u>Real GDP Growth</u>	<u>Inflation Rate</u>	<u>Employment Growth</u>	<u>Average Unemp. Rate</u>	<u>Stock Market</u>	<u>Share of Popular Vote</u>
Clinton (93:Q1 to 96:Q4)	D	3.3	2.8	2.5	6.0	64.0	43.0
<i>Previous 4 Years (Bush I)</i>		2.1	4.2	0.6	6.3	47.8	37.5
Reagan (81:Q1 to 84:Q4)	R	3.2	5.3	1.4	8.6	23.0	58.8
<i>Previous 4 Years (Carter)</i>		3.2	10.1	3.1	6.5	37.9	40.6
Nixon (69:Q1 to 72:Q4)	R	3.3	4.6	2.1	4.8	16.3	60.7
<i>Previous 4 years (Johnson)</i>		5.0	3.2	3.9	3.9	20.5	37.5
Kennedy-Johnson (61:Q1 to 64:Q4)	D	5.2	1.2	2.3	5.8	30.3	61.1
<i>Previous 4 Years (Eisenhower)</i>		2.0	2.0	0.5	5.5	31.7	38.5
Eisenhower (53:Q1 to 56:Q4)	R	2.8	0.8	1.5	4.3	84.5	55.2
<i>Previous 4 Years (Truman)</i>		6.2	3.0	3.1	4.4	76.4	44.3
Average, Democratic Incumbents vs. Republican Challengers		4.3 2.1	2.0 3.1	2.4 0.6	5.9 5.9	47.2 39.8	52.1 38.0
Average, Republican Incumbents vs. Democratic Challengers		3.1 4.8	3.6 5.4	1.7 3.4	5.9 4.9	41.3 44.9	58.2 40.8

SOURCE: "Assessing President Bush's Fiscal Policies," Mark Zandi, Chief Economist, Economy.com (July 2004), and Federal Reserve Bank of St. Louis (author's calculations).

Economic Record of President Bush

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Bush (2001:Q1 to 2004:Q2)	2.7	2.2	-0.3	5.5	-1.7	?
<i>Previous 4 Years (Clinton II)</i>	3.9	2.4	2.3	4.4	74.4	?

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What Does the Economic Research Tell Us About Predicting Elections

- ▶ **State and local economic conditions matter less than national economic conditions**
- ▶ **The nation's economic performance in fourth year of the incumbent's term matters more than that in the first three years**
- ▶ **Economic conditions seem to matter more for the following demographic groups: blacks, females, and the non-elderly**
- ▶ **Economic issues are not heightened when the incumbent's party also controls Congress**

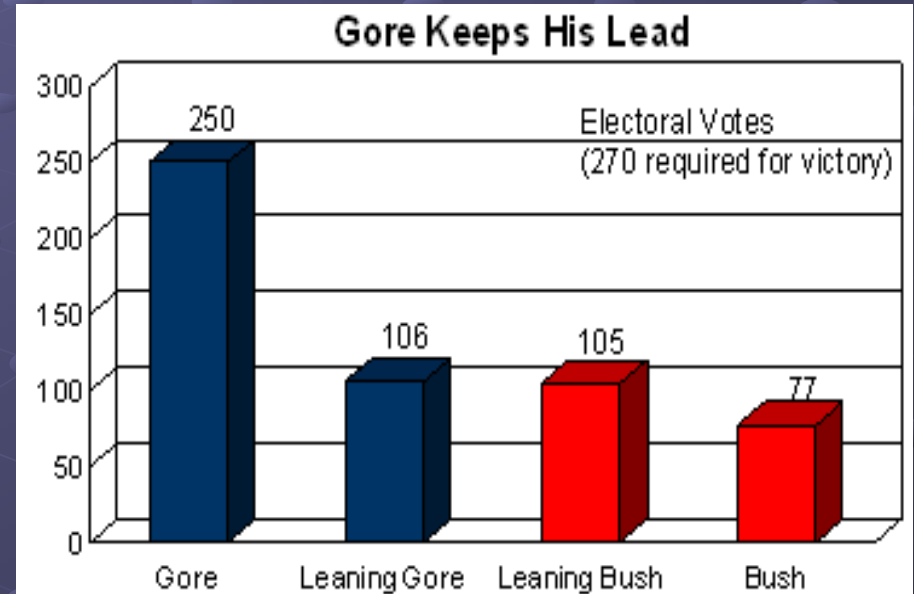
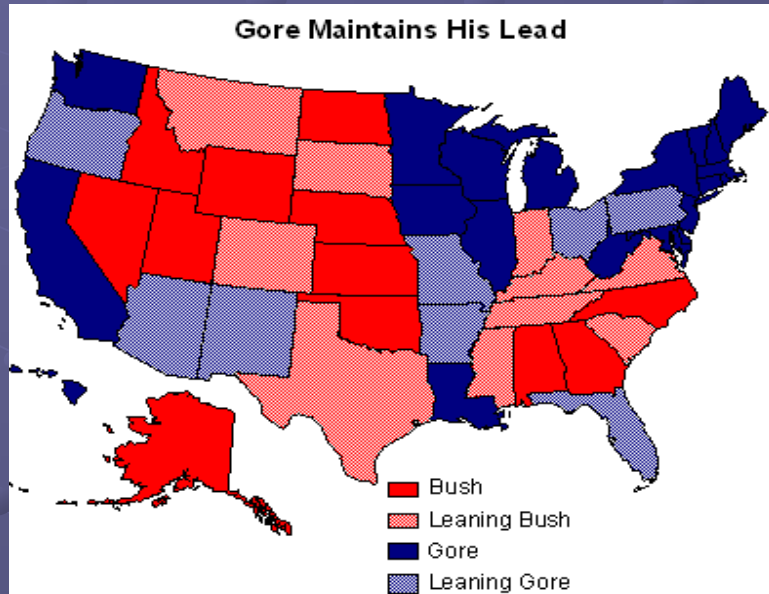
There are Several Methods Used to Predict Presidential Outcomes

- ▶ **Public Opinion Polls**
- ▶ **Forecasting Models that Use Economic Data (i.e., “Pocket book issues”)**
 - **This will be our focus**

Can We Accurately Predict the Outcome of Presidential Elections using Economic Statistics?

- ▶ Some economists have developed “statistical” models that are intended to predict the outcome of a general election based on economic conditions just prior to the election.
- ▶ These models typically use important economic variables like real GDP growth, unemployment rates and inflation rates and, in some models, state-by-state employment growth.
- ▶ There are two well-known Presidential election forecasting models:
 - ▶ (1) Economy.com & (2) the Fair model

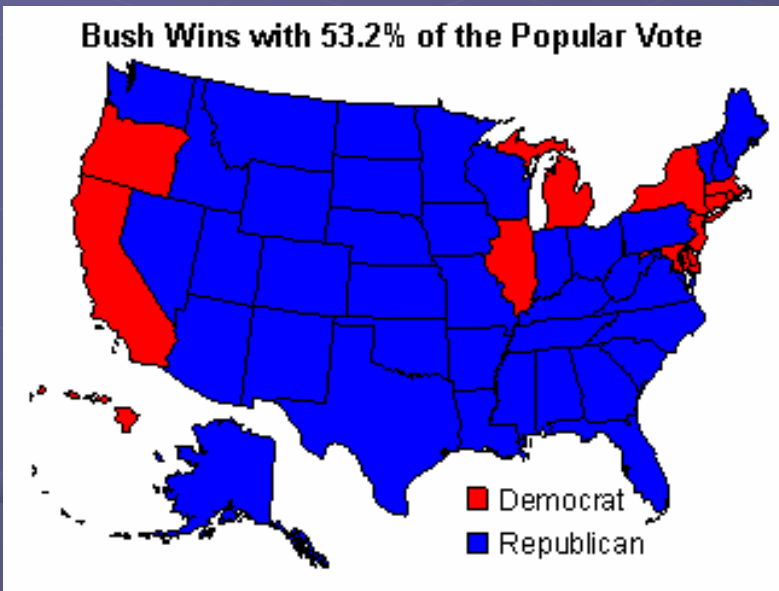
FLASH BACK! Just before the 2000 election, the Economy.com model was predicting a likely victory by V.P. Gore



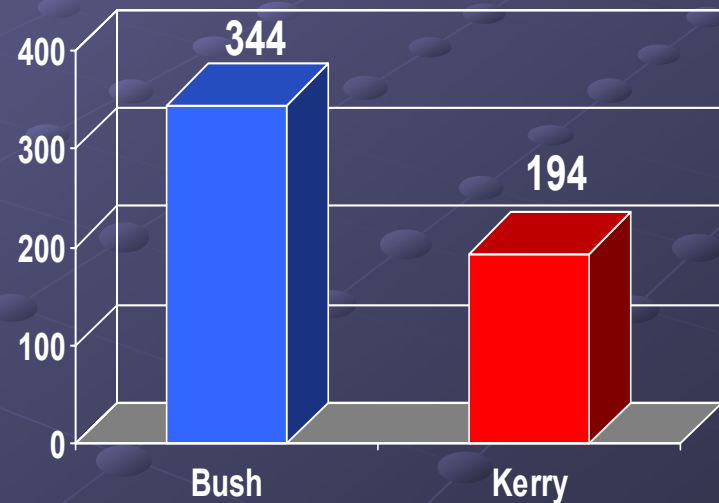
Projected Totals as of Sept. 25, 2000

FAST FORWARD TO 2004. The Economy.com model is now predicting a likely victory for President Bush

www.dismal.com



Electoral Votes Needed to Win: 270



■ Bush ■ Kerry

Projected Totals as of Oct. 18, 2004

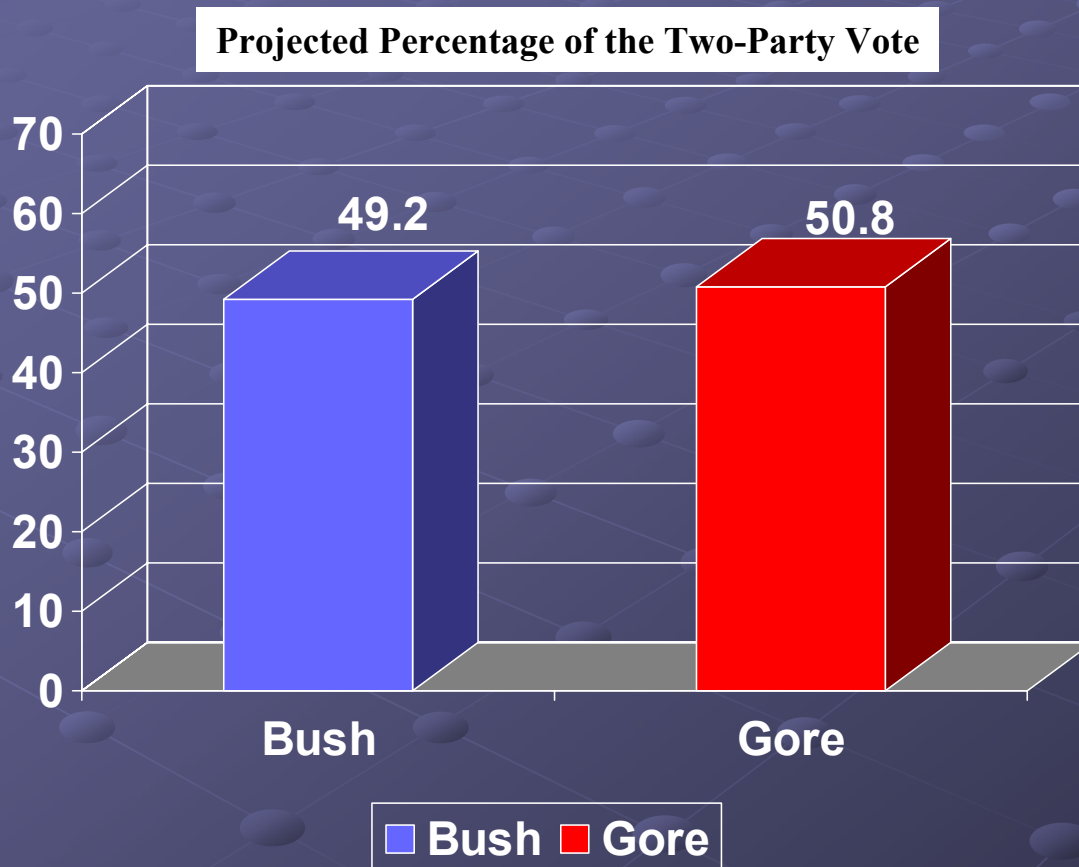
What Is Professor Ray Fair's Model Predicting?

- ▶ Unlike the Economy.com model, which uses state-by-state employment growth rates as a key ingredient, the Fair model, which was designed by Yale University Economics Professor Ray Fair, uses only U.S. aggregate-level economic data.
- ▶ The Fair Model predicts the incumbent's share of the popular vote; assumes a two-party race.
- ▶ The model also uses non-economic factors like the party that currently holds the Presidency, for how many terms, and if the candidate is an incumbent

What Is Professor Ray Fair's Model Predicting?

- ▶ Using historical data back to the 1916 election, Professor Fair's model showed that Republican incumbents are generally those with the largest advantage — as our earlier chart showed.
- ▶ The model is pretty accurate. It's average prediction error is relatively small, about 2.5 percentage points.

FLASH BACK! Just before the 2000 election, the Fair Model was also predicting a likely victory by V.P. Gore

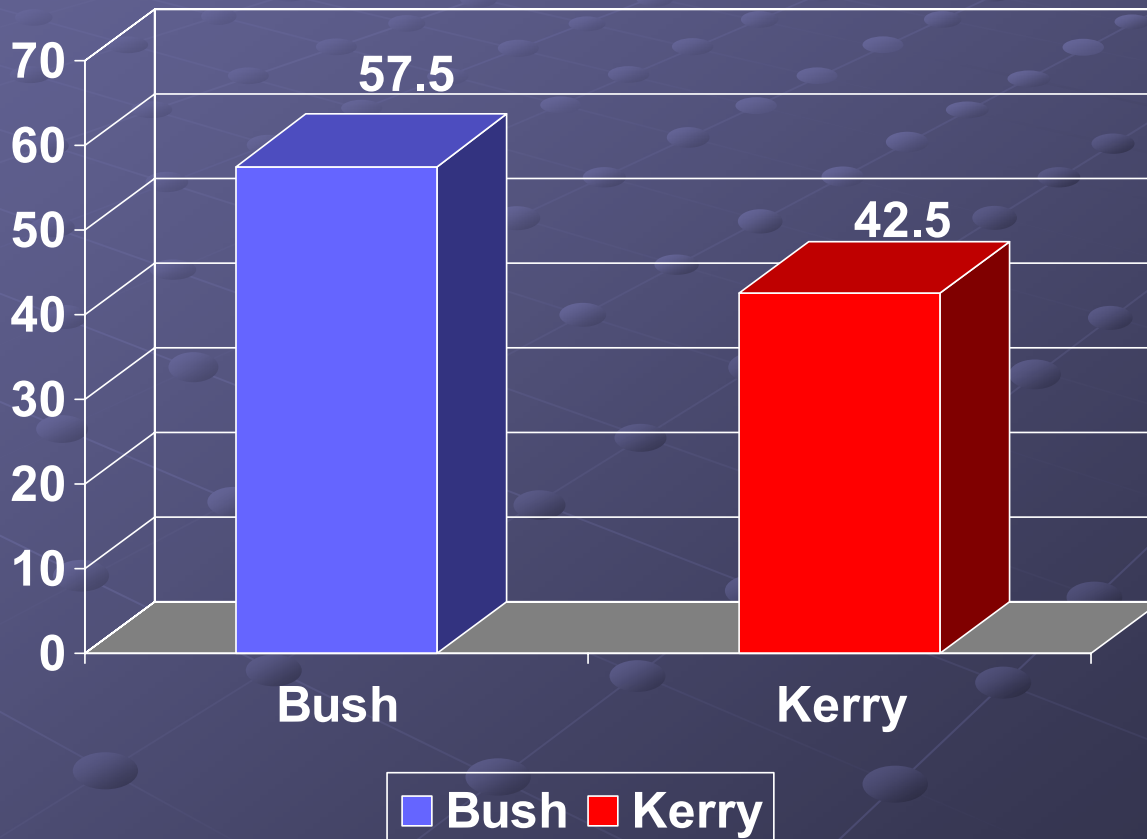


Projected Totals as of Oct. 27, 2000

“Given that the standard error of the equation is 2.15 percentage points, the election is essentially predicted to be too close to call. The equation will have done well if the election is close regardless of who wins. If either Bush or Gore wins by a fairly wide margin, say with 54 or 55 percent of the two party vote, the equation will have done poorly.”

What Is Professor Ray Fair's Model Currently Predicting?

Projected Percentage of the Two-Party Vote



Predicting Presidential Elections Using Economic Data: Some Caveats

- ▶ It is not entirely clear that a President can reliably influence economic growth over short periods of time. For example, every Administration is to some extent influenced by economic forces it has little or no control over:
 - Oil prices, droughts, hurricanes, wars, political or economic instabilities in important parts of the world
- ▶ **Often, candidates promise that they will create “X” number of jobs if they are elected. Usually, this belies the fact that the amount of jobs “created” depends importantly on the number of people created — that is, population growth.**

U.S. Labor Market Developments

	Nonfarm Employment	Civilian Population*
March 1991 (Thousands)	108,542	190,381
March 2001 (Thousands)	132,507	214,305
Change (Thousands)	23,965	23,924
Average Monthly Change, 1991-2001	199,700	199,400

*Population age 16 and older

Key Idea: Over time, job growth usually tracks population growth.

Are There Special Factors to Explain President Bush's Relatively Poor Economic Performance? Maybe.

“The performance of the U.S. economy has been most impressive in recent years in the face of staggering shocks that in years past would almost surely have been destabilizing.

Economic policies directed at increasing market flexibility have played a major role in that solid performance. Those policies, aided by major technological advances, fostered a globalization, which unleashed powerful new forces of competition, and an acceleration of productivity, which at least for a time has held down cost pressures.”

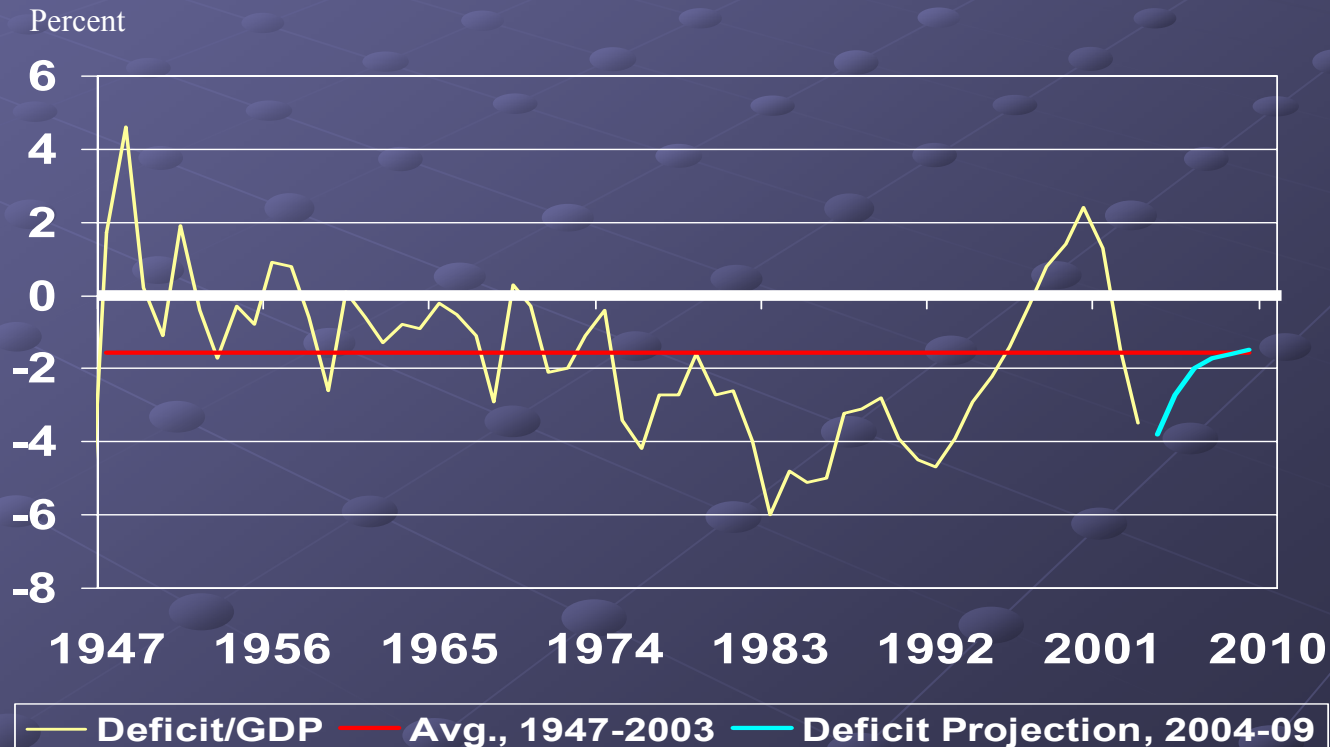
-- Federal Reserve Chairman Alan Greenspan, June 15, 2004

There are a Few Major Economic Issues Surrounding this Presidential Election Cycle

▶ Should we raise taxes and/or increase government spending on nondefense goods and services?

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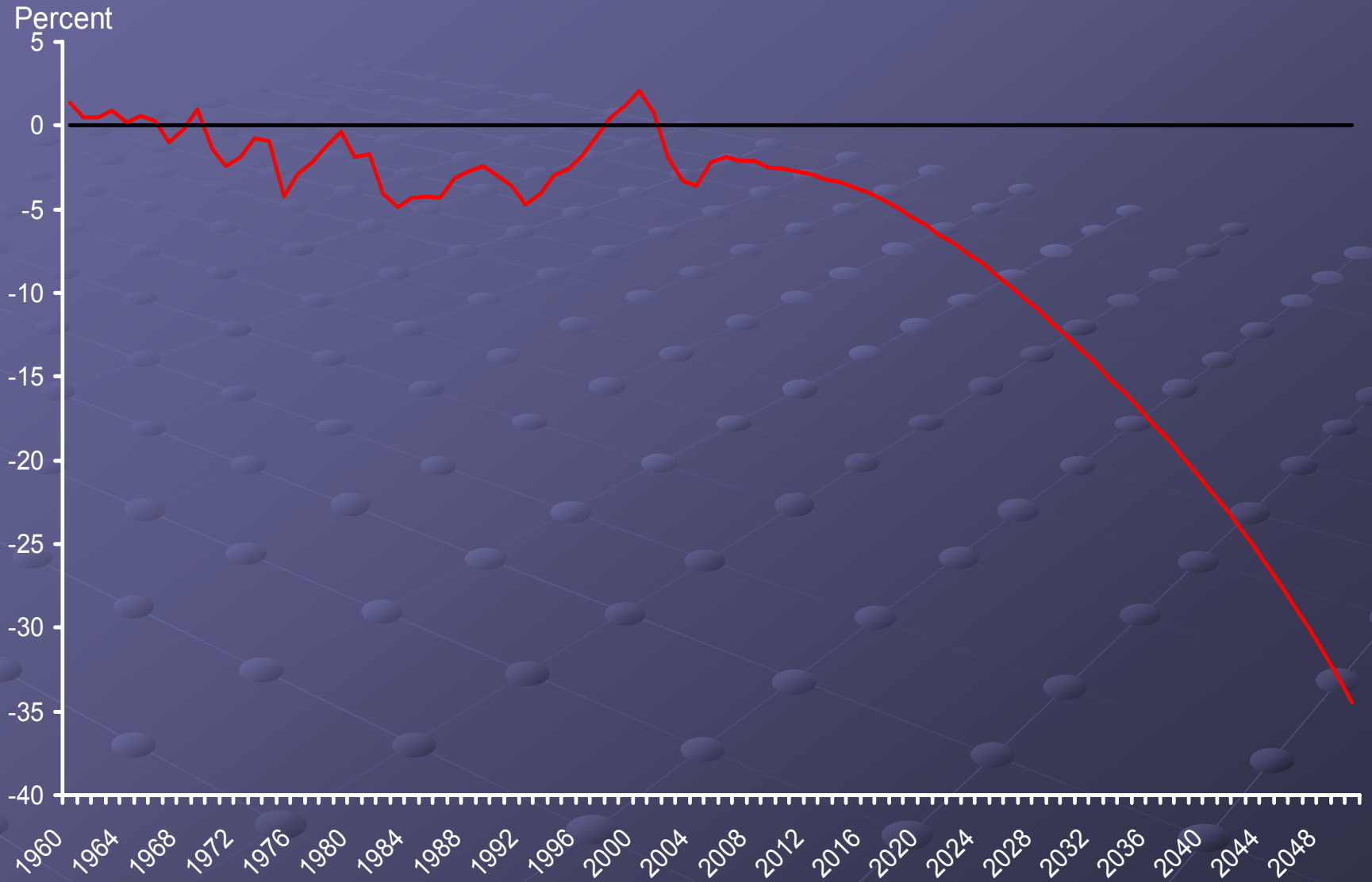


As in 2000, There are Three Major Economic Issues Surrounding this Presidential Election Cycle

- ▶ Should we reduce taxes and/or increase government spending?
- ▶ For your generation, the most important economic issue is how we should fix the long-term funding problem facing the Social Security and Medicare programs?

■ **By some estimates, the Federal Govt. promised Social Security and Medicare benefits to future retirees is \$51 Trillion more than the revenue it expects to receive from future taxes.**

U.S. Federal Surplus as a Percent of GDP, 1960 - 2050



Source: Congressional Budget Office

U.S. Medicare & Medicaid and Social Security Spending as a Percent of GDP, 1960 - 2050



Source: Congressional Budget Office

- **By some estimates, the Federal Govt. promised Social Security and Medicare benefits to future retirees is \$51 Trillion more than the revenue it expects to receive from future taxes.**
- **The funding problem will arise because there will be fewer and fewer workers supporting a greater and greater number of retirees — A retirement home on every corner!**
- **Closing this gap would require either:**
 - Raising federal income taxes 78%
 - Cutting Social Security and Medicare benefits by 51%
 - Eliminating more than 100% of federal discretionary spending (defense, homeland security, welfare programs, etc.)



QUESTIONS?