Stock Markets' Power to Explain Electoral Outcomes: Evidence from Four Countries

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Several studies on economic voting outline the effects of economic variables such as economic growth, inflation, unemployment on election outcomes at individual and country levels. Development and trends in stock markets can also be instructive about the performance of a country's economy and can be influential on voting decisions. Despite many studies on stock markets' movement with respect to political events and in particular elections attempt to explain stock market performance on vote outcomes for incumbent parties are fairly rare. Economic voting theory (Lewis-Beck 1988, Lewis-Beck and Stegmaier 2000) in political science firmly establishes the link between economic indicators and vote. However, except a small number of recent papers the economic indicators they use does not include stock market data (for exceptions see Fauvelle-Aymar and Stegmaier 2013). Under political business cycles literature a considerable number of studies investigate stock markets-elections relationship (Vuchelen 2003). Mostly based on US presidential elections they investigate political effects on stock market performance and volatility in periods immediate to election times, not the effects of stock market performance on election outcomes as a macroeconomic variable. Only exception to this is Gleisner (1992). Expanding on Fair(1978)'s model that builds the nexus between US election results and average GDP per capita growth Gleisner (1992)'s expanded model argues Dow Jones stock market index is a better explanatory variable explaining incumbent vote in the US presidential elections trumping GDP per capita growth. However, these results need re-testing with an expanded dataset because they only depend on one country with a limited number of elections.

This study attempts to test whether the developments in stock markets explain the electoral fortunes of incumbents under different political settings. We are interested in two major questions: 1) Does stock market performance between two elections explain vote shares of incumbents in upcoming elections like other economic variables such as GDP, inflation etc.? 2) If yes, does this effect the same across different countries? That is do we see the same explanatory effect in different countries
other than the US? To this end, we analyze elections and stock markets from four countries that have long established stock markets with high trade volume but employ different political and electoral institutions; the US (presidential), the UK (parliamentary-majoritarian), the Netherlands (parliamentary-proportional representation) and Germany (parliamentary-mixed). We believe this comparative empirical analysis would yield new insights on electoral systems, economic voting theory and financial decision making. The paper proceeds as follows: In the next section we survey economic voting and political business cycles literatures in general and in relations to stock markets. Following that we motivate the reasoning to use stock market data to explain vote share of incumbents and introduce our data. Empirical section consists of two basic models; First model is mostly inspired from Fair (1978) model with stock market index change and volatility as an explanatory variable and using expanded dataset of four countries. The second model uses stock market variables to explain whether they increase or decrease vote shares of re-elected incumbents to explain vote share changes of incumbents between two elections. The last section concludes with a discussion of results.

**Literature Review**

Economic voting has been studied extensively and the relationship between economic variables and vote/popularity functions is well established. A review study in 2007 finds more than 400 studies on economic voting in developed democracies (Lewis-Beck and Stegmaier 2008). It is safe to assume this number has increased considerably since. The gist of the theory suggests that economic conditions affect electoral fortunes of incumbents (and hence opposition candidates). The better the economy the higher the chance of better performance for incumbents in the elections. In the literature two distinctions are made regarding the nature of “economic voting”. First distinction is whether the voters are retrospective or prospective in their evaluations of economy while voting. Key (1966) and Fiorina (1981) argue voters evaluate past economic performance of the government while Downs (1957) postulates there is a prospective element in voters' reasoning. They act and
vote on the promise political candidates' good economic outcomes (Batool and Sieg 2009). Second
distinction is whether the voters value the state of the economy in general or their own economic
conditions in their vote calculations. In the US presidential elections literature it has been
established that voters are more responsive to general economic developments (called sociotropic)
rather than their owns pockets (called pocketbook) (Lewis-Beck 1988; Lewis-Beck and Steigmaier
2008). Put together, in the US context, economic voting is retrospective and sociotropic (Lewis-
Beck and Nadeau 2011). However there are also studies contesting this postulation. According to
Hibbs (2000, 2008) pocketbook is more important than sociotropic concerns. Batool and Sieg
(2009) find the same results for Germany. German voters are retrospective yet they care more about
their own finances than the German economy as a whole.

Economic voting models are either constructed as vote or popularity functions. In vote models
economic variables are used to predict incumbent vote whereas in popularity functions approval
rate of the incumbent is defined as the dependent variable. Economic variables utilized in these
models include classical measures like growth, inflation, unemployment as well as “disposable
income, wages, tax burden, consumer confidence, military expenditures and salience of the
economy” (Fauvelle-Aymar and Stegmaier 2013). According to Jones (2002), among many others,
election year GDP growth is the single biggest predictor of incumbent vote share. According to Fair
(1978) growth rate of real per capita income in the election year and inflation are most important
variables explaining democratic vote share in US presidential elections. Hibbs (1977, 2000) found
that average per capita GDP growth for the whole legislative term is the most important predictor of
vote in US elections. Batool and Sieg (2009) find the same effect for Germany albeit with a much
smaller magnitude. Nannestad and Paldam (1994) singled out inflation and unemployment as most
important economic variables. Chrystal and Peel (1986) on the other hand argue the link between
election results and economic indicators like inflation or unemployment are neither theoretically nor
empirically robust (Prechter et al. 2012).
The relationship between stock markets and elections has also been extensively studied. Almost all of these studies investigate the effects of elections on stock market performance and they are based on extending political business cycles assumptions to include financial indicators (Döpke and Pierdzioch 2006, Santa-Clara and Valkanov 2003, Vuchelen 2003). Political business cycles theory takes root from the idea that governments tweak macroeconomic policies before elections in order to improve economic conditions in the run up to elections (Alesina 1987, Nordhaus 1975). Since their electoral fortunes are tied strongly to good economy politicians would not mind taking palliative measures to improve economic indicators in the short term even though these measures would have detrimental effects to the economy after elections. In terms of economic voting voters are retrospective and sociotropic according to political business cycles theorem. Drazen (2008) in his review of political business cycle literature calls this “opportunistic political business cycles”. The main economic indicators in this analysis are inflation, economic output and unemployment. It is opportunistic because governments opportunistically chose to increase economic growth and employment near elections just to give voters a false sense of economic security only to face them with economic hardships after elections. According to Drazen's (2008) review the evidence is mixed there is little evidence pointing to opportunistic political business cycles in the developed world economies. In the US, inflation increased after elections until 1979 but not later. Economic output is higher during the first part of Democratic administrations in the US than Republicans, however there is no evidence of pre-election increase.

Second type of business cycles is called “partisan political business cycles” by Drazen (2008). According to partisan theory of Hibbs (1977) economic policies of the government affect economic growth directly and since left and right parties have different economic policies their economic performance in government would be different from each other. This in turn inevitably effects electoral fortunes of incumbents. Left parties would pursue economic policies stimulating more growth, less unemployment and higher inflation than right parties. Alesina (1987) extends this theory by arguing that being aware of this policy difference between parties voters would adjust
their expectations according to winning chances of the parties. That is why only unexpected election outcomes would affect economic performance but it would even out once the uncertainty surrounding the elections is gone (Fowler 2006). In terms of total output economic activity has been markedly higher in Democratic administrations than Republicans (Drazen 2008). Alesina et al (1997) only find supporting evidence for some countries but not all. Apart from the US (Fair 1978) in developed countries output growth seems to be insignificant in explaining vote. Brender and Drazen (2005) found that GDP growth does not explain vote in developed countries but in less developed countries it does.

A natural extension to political business cycles analysis is stock markets. Forecasting financial market returns is an important area of analysis and given the consequential effects of political events on financial markets it is not unexpected that the relationship between elections and stock markets is analyzed widely (Fama and French 1988, 1989, Leblang and Mukherjee 2005). The questions analyzed closely followed the ones posed in political business cycles literature: Does stock market performance show volatility around elections due to political manipulation or increased uncertainty? Does stock market performance show consistent differences according to ideological composition of governments, i.e between left and right governments?

Different from political business cycles theory, most of the financial literature point to uncertainty caused by elections and its effects on stock markets rather than conscious manipulation of the economy and stock markets by the government. Niederhoffer et al. (1970) is among the first to study stock market behavior around election times in the US. Pantztalis et al. (2000) investigated stock market behavior before elections in 33 countries and found positive abnormal returns before two weeks to elections in many countries. According to Pasquariello and Zafeiridou (2014) uncertainty related with elections affect stock markets through market quality, i.e trading volume and liquidity. On the other hand numerous studies verified partisan political business cycle expectations in the US (Allvine and O’Neil 1980, Herbst and Slinkman 1984, Hobbs and Riley
1984, Huang 1985, Gartner and Wellershoff 1995). Johnson et al. (1999) and Santa-Clara and Valkanov (2003) also suggest in the US stock market performance is markedly different and positive during Democratic administrations compared to Republican administrations. Cross country analyses, on the other hand, fail to verify partisan business cycles in other developed countries. Döpke and Pierdzioch (2006) could not find support for partisan cycles in German economy. Bialkowski et al. (2008) report that there are no statistically significant differences in stock market returns between left wing and right wing executives. Vuchelen (2003) brings electoral institutions into play. According to his argument in countries with proportional representation elections tend to create higher uncertainty, which in turn affects stock market performance badly. Also his analysis based on Belgium reveals ideological composition of the government is important for stock market performance. In Vuchelen's (2003) calculations a right wing government in Belgium increases stock market 20% more compared to a coalition government consisting of left and right wing parties.

Until now we set out that in economic voting in political science and political business cycles in economics literatures provide the theoretical basis for studies linking elections and economic variables. Our variable of interest stock market indicators are more used in economics than political science literature. In these models stock market related indicators, like stock market growth, volatility, trading volume, are used as dependent variables and election related variables are expected to explain, at least partly, the movements in stock markets. There are only a handful of exceptions, as far as we can find in our literature review. Gleisner (1992) and Haynes and Stone (1994) include 10 month performance of Dow Jones Industrial Index before election time to their models and report that each percentage increase in the stock market leads to a 0.4 to 0.7 point increase in US presidential elections. Batool and Stieg (2009) like Fair (1978) and Hibbs (2000) find increase in disposable per capita income as the only and most effective economic predictor of incumbent vote. They report that, together with a number of other economic indicators, stock market change does not have an impact on incumbent vote in German elections. In political science literature as far as our search go, we could only find one article that includes stock market
performance to vote function. Prechter, Jr. et al. (2012) argue that stock markets are an indicator of what they call “social mood” and this mood is the main determinant of vote. Their analysis reveals that stock market performance during the term of the president is the biggest predictor of vote margin between incumbent and his competitor in the elections. A recent article by Fauvelle-Aymar and Stegmaier (2013) investigates the relationship between stock markets and presidential popularity in conventional ways. They argue it is not only the changes in stock market leading to change in presidential popularity but the speed of the change that matters much. Apart from stock market change inflation seems to be effective on popularity but not economic growth or unemployment. Chong et al. (2011) before them look at the impact of stock market volatility on presidential approval. Dicle and Dicle (2011) look at the impact of “high frequency variables” including not only Dow Jones but a number of world stock markets, price of crude oil, gold and international currencies on presidential approval rates. They show high frequency financial indicators have causality relationship with presidential approval.

Stock market performance as an explanatory variable

Stock market prices carry valuable information about the state of the country's economy in the eyes of institutional investors and ordinary public alike. Prices are reported daily and widely discussed in the media, they are important indicators of the functioning of the economy even in the eyes of people who does not invest in stocks or securities (Döpke and Pierdzioch 2006). According to efficient markets hypothesis (Fama 1970) all kinds of news and political events are interpreted by the markets and their impact is immediately reflected in the market movements. Markets collectively are expected to absorb financial, economic and political developments that might be influential on economy more efficiently and objectively than other actors (Dicle and Dicle 2011). In terms of economic voting's retrospective vs. prospective and egotropic vs. sociotropic distinctions stock market index can be regarded as an interim measure which taps both sides of both of these
distinctions. It is true that rising stock market means a growing, vibrant economy. This taps sociotropic side. But also at the same time rising stock market means personal finances of stockholders is increasing. If we take into account almost half of the US households are holding stocks today we can see how important the stock market is for pocketbook of voters. Even in other countries where stock ownership is not that high a positive economic outlook should definitely reflect on the pockets of voters.

Coming to retrospective vs prospective dimensions; it is mostly argued that stock markets reflect investors' future expectations (Fair 1994). However current stock market levels not only depends on future expectations but maybe more so on the current fundamentals and growth potential of the economy. In this sense it if voters are taking stock markets into account in their voting decisions this features both retrospective and prospective components (Fauvelle-Aymar and Stegmaier 2013). Last but not least, recent studies begin to investigate relationship between stock ownership and voting behavior and they find positive results. According to Nadeau et al. (2010) stock ownership leads a voter to support right parties more. According to Barabas (2006) social security privatization support in the US is highly correlated with stock market changes. When stock market rises support for privatization increases and it declines when the stock market declines. These examples show that voters do actually care about stock markets and they shape both attitudes about specific policy proposals and general voting decisions according to it. These theoretical arguments lead us to believe stock market change can be a meaningful explanatory variable in explaining vote. How meaningful it is with respect to other classical economic variables and how it fares in different countries remains to be seen in the analysis.

**Data and Empirics**

As we discussed in the previous section there are a handful of studies that use stock market as an
explanatory variable in a vote or popularity function and all these studies are based on US presidential elections with one exception. That exceptional study (Batool and Sieg 2009) find no effect of stock market increase on vote in Germany. All these studies are single country studies. This definitely poses a generalizability problem. Also in vote function models number of cases (elections) are few. This means small degrees of freedom and hence less reliable statistical models. Fair (1978) and Gleisner (1992) themselves admit to this problem. In order to increase the number of cases we employed data from four countries. In order to account for conflicting results in the US and German cases we select countries with distinct political systems. This also allows us to generalize our results should we found statistically significant results. In order to ensure generalizability we chose four different developed economies which employ different electoral systems. The US has presidential system and first past the post electoral system. As a corollary it has a two party political system. The UK is a parliamentary democracy but first past the post electoral rule leads to a two party system like the US. Germany is another parliamentary democracy but it employs a mixed electoral system in which a portion of the MPs are elected from single seat constituencies and the remaining portion is distributed proportionally to the votes cast for parties. There are multiple parties in the parliament and two party coalitions are frequent. Finally the Dutch employs proportional electoral system with a very low threshold. There are numerous parties and multi-party coalitions are the rule.

For the US we included 16 presidential elections from 1954 to 2012; for the Netherlands 7 presidential elections from 1994 until 2012; for Germany 6 federal parliamentary elections from 1994 until 2013 and for the UK 13 parliamentary elections from 1964 until 2010. Total number of elections is 42. The number of elections included is limited by our ability to gather the stock market data. Stock markets included are S&P 500 for the US; DAX 40 for Germany; Amsterdam Stock Exchange AEX for the Netherlands and FTSE All Share Index for the UK. All stock market data is acquired from Bloomberg and Yahoo Finance.
Table 1: List of Elections (N=42)

<table>
<thead>
<tr>
<th></th>
<th>United States</th>
<th>United Kingdom</th>
<th>Netherlands</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>November 04, 1952</td>
<td>October 15, 1964</td>
<td>May 03, 1994</td>
<td>October 16, 1994</td>
</tr>
<tr>
<td>3</td>
<td>November 08, 1960</td>
<td>June 18, 1970</td>
<td>May 15, 2002</td>
<td>September 22, 2002</td>
</tr>
<tr>
<td>4</td>
<td>November 03, 1964</td>
<td>February 28, 1974</td>
<td>January 22, 2003</td>
<td>September 18, 2005</td>
</tr>
<tr>
<td>5</td>
<td>November 05, 1968</td>
<td>October 10, 1974</td>
<td>November 22, 2006</td>
<td>September 27, 2009</td>
</tr>
<tr>
<td>6</td>
<td>November 07, 1972</td>
<td>May 03, 1979</td>
<td>June 09, 2010</td>
<td>September 22, 2013</td>
</tr>
<tr>
<td>7</td>
<td>November 02, 1976</td>
<td>June 09, 1983</td>
<td>September 12, 2012</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>November 04, 1980</td>
<td>June 11, 1987</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>November 06, 1984</td>
<td>April 09, 1992</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>November 08, 1988</td>
<td>May 01, 1997</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>November 03, 1992</td>
<td>June 07, 2001</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>November 05, 1996</td>
<td>May 05, 2005</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>November 07, 2000</td>
<td>May 06, 2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>November 02, 2004</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>November 04, 2008</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>November 06, 2012</td>
<td></td>
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</tbody>
</table>

In our first set of models, we aimed to explain the incumbents vote share in a given election using measures of economic performance. We estimate an unbalanced panel data model based on the popular vote shares of incumbent parties, economic growth, and stock market performance measures. We hypothesize that incumbent party’s popular vote share in a given election is a function of economic performance and stock market conditions within the four countries, namely the U.S., UK, Germany, and the Netherlands.

*Incumbent's vote share = f (real GDP growth, stock market index return, stock market index volatility)*

We have defined vote shares as the dependent variable in our model and it accounts for the incumbent party’s share of popular vote in the current election. In our sample, elections in the U.S., UK, and Germany provided bi-partisan outcomes in terms of the election results. The list of bi-partisan election results for those countries is as Democrat vs. Republican, Conservative vs. Labour, CDU/CSU vs. SPD, respectively. Studies based on the U.S. (Fair 1978, Fair 1994, Gleisner 1992)
has naturally utilized bi-partisan setting in their analysis of election outcomes using economic measures as well.

$$v_{it} = x_{it}' \beta + \alpha_i + \epsilon_{it}$$

where $v_{it}$ is the incumbent party’s popular vote share in the $i^{th}$ election at year $t$, $x_{it}$ embodies regressors in the model without a constant term, $\alpha_i$ is the group specific constant term, and $\epsilon_{it}$ is the error term. In its simplest form, model includes annualized quarter-on-quarter GDP growth rate of the election economy for two quarters preceding the quarter in which the election takes place. This essentially represents the growth for the last quarters while the economy heads to an election. Although macroeconomic measures provide abundant application opportunities to capture the variations in the incumbents’ vote share, we introduce annualized monthly stock market index return and volatility of each country for the six months preceding the election month in our model.

The estimation procedure primarily employs annualized GDP growth rate for the last quarters before the election as the explanatory variable, in line with Gleisner (1992) and Fair (1994). Fixed effect estimation is a conditional analysis where we estimate that GDP provides .74 points to the incumbents’ respective shares of popular vote. The next step is the addition of annualized monthly stock market index return for the six months preceding each election month. However, this addition yields no explanatory power as the coefficient for returns is insignificant and the GDP coefficient remains at the same level. Table 2 summarizes the results.

While taking stock market developments into consideration, volatility of market index return would also yield additional information on explaining the incumbent vote share. Fauvelle-Aymar and Stegmaier (2013) proposed a model where US presidential popularity is a function of change in the stock market index among other economic variables. They performed a second differencing for stock market index in their analysis. In that regard, we checked for possible effects of market
volatility on the incumbent vote share along with economic growth and market return. Basically, volatility is calculated as standard deviations of month-on-month market returns for the six months preceding each election and we introduce market volatility to the second model as an additional explanatory but to no avail.

Table 2: Model Estimations - I

<table>
<thead>
<tr>
<th></th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
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<tbody>
<tr>
<td></td>
<td>Adj. R²=.73</td>
<td>Adj. R²=.72</td>
<td>Adj. R²=.72</td>
</tr>
<tr>
<td>Constant-term</td>
<td>38.65***</td>
<td>38.71***</td>
<td>36.2***</td>
</tr>
<tr>
<td></td>
<td>(1.15)</td>
<td>(1.18)</td>
<td>(3.09)</td>
</tr>
<tr>
<td>GDP real growth rate</td>
<td>0.74**</td>
<td>0.74**</td>
<td>0.84**</td>
</tr>
<tr>
<td>(annualized quarterly growth for the preceding 2 quarters)</td>
<td>(0.35)</td>
<td>(0.36)</td>
<td>(0.38)</td>
</tr>
<tr>
<td>Return on stock market index</td>
<td>-0.01</td>
<td>0.01</td>
<td></td>
</tr>
<tr>
<td>(annualized monthly return for the preceding 6 months)</td>
<td>(0.03)</td>
<td>(0.04)</td>
<td></td>
</tr>
<tr>
<td>Volatility of the return on stock market index (annualized monthly volatility for the preceding 6 months)</td>
<td>0.14</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.16)</td>
<td></td>
<td></td>
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</table>

Values in parantheses () are standard errors. ***, **, * represent 1%, 5%, 10% significance levels, respectively.

Going a step further we wondered the effects of stock market variables, return and volatility, in the case of incumbent parties winning the current election. In the second set of models, models from 4 to 6, we investigated the effects of stock market variables on vote share of re-elected incumbents. A dummy variable representing re-election of the incumbent party would yield further information for better explanation of incumbent vote share. In a given election, if the incumbent is the leading party, this variable takes the value 1, and 0 otherwise. When we introduce the dummy term and its interaction with the GDP growth, the results in Table 3 suggest that the interaction term, that is GDP growth rate times the re-election dummy variable, shows a positive contribution from the recent economic growth toward incumbent vote share when the incumbent wins the election. However, same reasoning fails to apply while GDP growth rate is replaced with stock market...
return. As a further attempt, we test the same setting using the market index volatility variable. Results are available in the fourth column of Table 3. The interaction term tells about the effect of market index volatility preceding an election on the incumbent vote share as expected. Although the election itself would be a partial source of uncertainty while the economy is heading to an election, increase in the volatility of market return has a negative impact on the incumbent’s share of popular vote. Here, the negative sign of the interaction term is of greater importance than its magnitude. However, this reasoning should be carefully evaluated as we rely on annualized monthly volatility calculations, which essentially smooth the information incorporated in the price within each month. A further analysis focusing on more recently held elections where higher frequency market data is available would be more appropriate.

Table 3: Model Estimations - II

<table>
<thead>
<tr>
<th></th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Adj. R²=.85</td>
<td>Adj. R²=.84</td>
<td>Adj. R²=.84</td>
</tr>
<tr>
<td>Constant-term</td>
<td>35.97***</td>
<td>35.73***</td>
<td>32.13***</td>
</tr>
<tr>
<td></td>
<td>(1.49)</td>
<td>(1.21)</td>
<td>(2.07)</td>
</tr>
<tr>
<td>GDP real growth rate (annualized quarterly growth for the preceding 2 quarters)</td>
<td>-0.09</td>
<td>-0.09</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.48)</td>
<td>(0.48)</td>
<td></td>
</tr>
<tr>
<td>Return on stock market index (annualized monthly return for the preceding 6 months)</td>
<td>-0.04</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.03)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Volatility of the return on stock market index (annualized monthly volatility for the preceding 6 months)</td>
<td>0.22**</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.09)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Re-election dummy variable</td>
<td>5.67***</td>
<td>7.98***</td>
<td>11.31***</td>
</tr>
<tr>
<td></td>
<td>(1.69)</td>
<td>(1.39)</td>
<td>(2.20)</td>
</tr>
<tr>
<td>GDP*Re-election</td>
<td>0.88*</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.51)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return*Re-election</td>
<td>0.04</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.04)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Volatility*Re-election</td>
<td>-0.20*</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.10)</td>
<td></td>
<td></td>
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</tbody>
</table>
Values in parantheses ( ) are standard errors. ***, **, * represent 1%, 5%, 10% significance levels, respectively.

Discussion

In this paper we aim to test whether stock market return and volatility are good measures explaining electoral fortunes of incumbents. Despite use of other macroeconomic indicators stock market performance has rarely been used to explain electoral support for incumbents. Different from these limited number of studies we use data from four different countries in order to increase number of elections in the statistical model and to ensure generalizability. Results of our base model is not encouraging. Our results from fixed effects models verify previously found dominant effect of GDP growth on votes however our stock market return and volatility variables fail to make statistically significant explanatory contribution to the models. The most straightforward explanation would be the special place of stock markets in the US economy. Fauvelle-Aymar and Stegmaier (2013) reports half of the households in the US have stock ownership. This degree of penetration is not achieved in any other country. Despite stock markets dominate the daily debate in the media it is possible that voters in other countries does not base their voting decisions on stock markets. Methodologically we might be suffering from omitted variable bias. Our models does not include inflation and unemployment. Also, despite our efforts, still not too high number of cases might peril econometric analysis. A way to overcome this is including stock market data from all developed economies. In the second set of models we find that re-elected incumbents suffer from increased volatility before elections. This is in line with our expectations. Again the number of cases is not high and these results need to be replicated with expanded datasets. However, if they hold, these results offer an opportunity. Sources of market volatility, how different sources of volatility affect incumbent votes and what incumbents can do to limit stock market volatility can be a fruitful line of research.
Bibliography


