

# Partisan Conflict and Uncertainties Spillover in the United States

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## ABSTRACT

Given the increasing political polarization in the United States, especially on cogent issues of climate change, health policy, immigration, and recently the handling of the Coronavirus pandemic, the current study divulged further on the link between policy divides and partisan conflict. In the context, we employed the Diebold and Yilmaz index model to examine the potential spillover effect among partisan conflict (PC), economic policy uncertainty (EPU), fiscal policy (FP), and monetary policy (MP) over the period from January 1996 to June 2020 for the case of the United States. Importantly, the result posits a total spillover index (interconnectedness) of 30.04% among the examined variables, thus showing that shock transmission exists among these variables. In addition, the EPU transmits the largest share of shock (56.78%) to PC, FP, and MP, thus illustrating that the EPU is the only net giver of potential shock but with a net spillover of (+) 12.325%. Moreover, with the largest spillover index of 84.569%, PC directly contributes the largest shock to the EPU (6.691%), which is followed by a direct 4.608% to fiscal policy and a lower shock of 0.526% to monetary policy. Apart from making a significant contribution to the existing literature on partisan conflict in the United States, this study further highlighted the grey area to pursuing more inclusive democratic discourse and dialogue among the country's social, cultural, and political representations.

**Keywords:** *partisan conflict, monetary policy, fiscal policy, economic policy uncertainty, spillover Index, United States*

**JEL Classification:** E51, E52, H30

## INTRODUCTION

Partisan conflict refers to the discord or disagreement between political parties or factions within a political system. This conflict can manifest in various forms, including differences in policy preferences, ideological positions, and strategies for governance. Partisan conflict often arises from competing interests and values held by different political groups, leading to disagreements over issues such as taxation, healthcare, immigration, and social welfare policies. In democratic systems, partisan conflict is inherent to the political process, as it reflects the diversity of perspectives and interests within society. However, excessive or polarized partisan conflict can impede effective governance, hinder policymaking, and contribute to gridlock or

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dysfunction in political institutions. Moreover, heightened partisan conflict may erode public trust in government and undermine social cohesion (Akadiri & Alola, 2022; Akadiri, 2018; Balcilar et al., 2017).

Partisan conflict can occur at various levels of government, including the national, state, and local levels, and may involve different branches of government, such as the executive, legislative, and judicial branches. Additionally, partisan conflict can be exacerbated by factors such as electoral competition, media polarization, and socioeconomic divisions within society. Efforts to address partisan conflict often involve fostering dialogue, compromise, and consensus-building among political actors. Strategies for mitigating partisan conflict may include promoting bipartisanship, encouraging civil discourse, and enhancing transparency and accountability in the political process. Ultimately, managing partisan conflict is essential for maintaining a functioning democracy and advancing the common good (Akadiri & Alola, 2022; Balcilar et al., 2019).

Considering the growing political polarization among Republicans and Democrats in the United States, there has been an increasing concern regarding the economic policy uncertainties associated with fiscal and monetary policy imbalances. As the world integrates into one global village, the interconnectedness among economies creates changes in economic and political outlooks, which in one way or another also create tension (either directly or indirectly) and a perception of economic and political instabilities. Thus, increasing economic policy uncertainties and heightened partisan conflict trigger fiscal (Azzimonti, 2018a, b) and monetary (see Balcilar, Demirer, Gupta and Eyden, 2017) imbalances resulting in reduced investment (see Azzimonti (2018b), and impacting both money and financial markets (Pastor and Veronesi, 2012; Gupta et al 2018), respectively. It is believed that economic policy uncertainty in the United States, China, and the United Kingdom, among others, coupled with monetary policy, fiscal policy and other forms of government regulations, immensely influence the world economic and financial downturn and the steady recovery that followed.

Economic policy uncertainties, if not properly managed, could influence investment decisions negatively and increase financial market volatility, while heightened partisan conflict, on the other hand, would halt investment decisions (fiscal policy), lead to increased economic policy uncertainty and lower financial volatility (monetary policy). This argument is in line with the findings of Gupta et al. (2018), where they concluded that, heightened partisan conflict lowers stock market volatility in the United States. Pastor and Veronesi's (2012) study resonates with this result that lower economic policy uncertainty reduces financial market volatility and vice versa. Furthermore, Bechtel and Fuss (2008) reveal that political polarization reduces policy uncertainties by reducing the possibility of any policy variations. In addition, Azzimonti (2018b) is of the opinion that heightened partisan conflict reduces policy uncertainty. According to Azzimonti (2018b), a reduction in economic policy uncertainty can be achieved if and only if such an economic situation or condition remains stable, a consequence of polarization among political parties. Thus, the interactions between economic policy uncertainty and partisan conflict have significant impacts on both the fiscal and monetary policies of any nation, most especially in the United States.

This study aims to examine the interactions and interconnectedness in terms of spillover impacts among economic policy uncertainty, monetary policy, fiscal policy, and partisan conflict in the United States over the periods January 1996 to June 2020 (a constraint on data availability) in the United States by employing the Diebold and Yilmaz (2012) approach. The choice of the United States for the current study is based on the fact that, over time, the nation has been experiencing heightened political polarization, thus exerting a grievous impact on the overall well-being of the nation (see Balcilar et al. 2019; Azzimonti, 2018b). In turn, the situation creates uncertainty in the country's economic policy, thus eroding and delaying immediate responses to fiscal and monetary policy issues. Policy suggestions from this study would assist the government and policymakers (especially economies with high partisan conflicts and economic policy

uncertainty) in coming up with workable policies that would facilitate social, political and economic stability for all-inclusive economic growth.

The contribution of this study is as follows (i), this study appears to be the first empirical study that focuses on the interconnectedness between economic policy, partisan conflict, and monetary and fiscal policy, especially for the United States, as most of the study rather focuses on the interaction between the variables under investigate and other macroeconomic variables (see Boushey & McGrath, 2020; Balcilar et al 2017; Balcilar, Saint, Gupta and Miller, 2019; Saint Akadiri & Alola, 2019; Cheng, Chiu, Hankins & Stone, 2018) (ii), Results show an aggregate spillover of 30.04%, with the highest shock coming from the EPU (a net giver of spillover shock). Also, the uncertainty resulting from monetary policy, fiscal policy and partisan conflict is received from the spillover effect from the EPU, thus making monetary policy, fiscal policy, and partisan conflict net receivers of spillover shocks. Importantly, with the largest spillover effect of 84.569%, the uncertainty resulting from partisan conflict directly contributes the largest shock of 6.691% to EPU, followed by a 4.608% direct shock contribution to fiscal policy and a lower shock of 0.526% to monetary policy. From a policy standpoint, we are of the opinion that the government of the United States will have to deliberately do more to douse the lingering trend of democratic polarization in the country. Thus, a new approach, such as the adoption of a more inclusive dialogue among political and social representations, could effectively moderate or pacify the current political atmosphere in the United States, resulting from the deep political dichotomy between the Democratic and Republican parties.

The study outline is scheduled as follows: Section two discusses the data and methodology adopted for empirical analysis. Section three presents and discusses results, while section 4 concludes the study with attendant policy suggestions.

## DATA AND METHOD

### Data

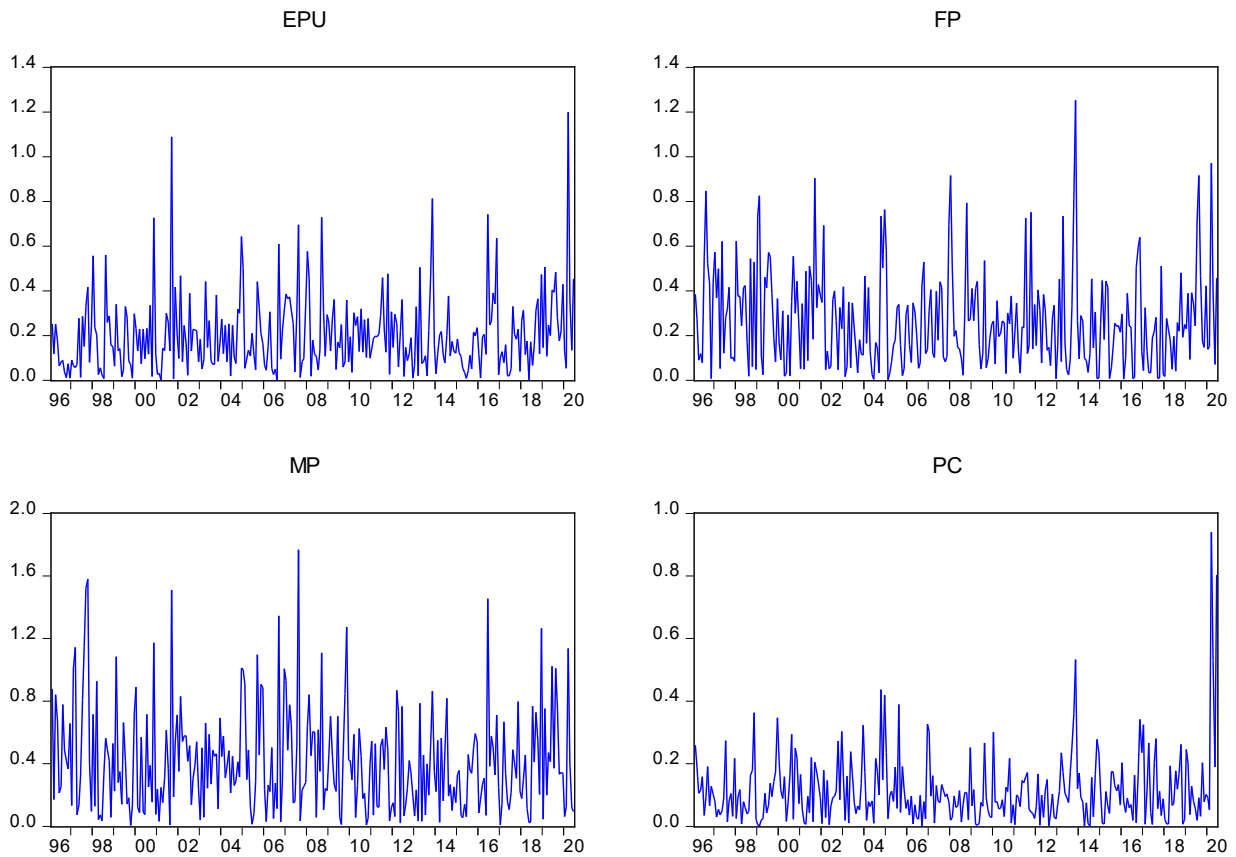
This study uses the United States' categorical data (that include the economic policy uncertainty (EPU), monetary policy (MP), and fiscal policy (FP)) from the economic policy uncertainty (2019). The index of partisan conflict (PC) was retrieved from the Federal Reserve Bank of Philadelphia (2020). In addition, the monthly dataset employed covers the period from January 1996 to June 2020. Following Wang et al. (2016) and Antonakakis et al. (2018), we define the volatility as the absolute return  $V_t = |\ln PC_t - \ln PC_{t-1}|$ . In addition to the graphical presentation of the examined series (see Figure 1), the statistical property of each series is presented in Table 1,

**Table 1.** Volatility summary statistics

	EPU	FP	MP	PC
Mean	0.202	0.268	0.414	0.115
Median	0.158	0.235	0.348	0.091
Maximum	1.198	1.252	1.767	0.939
Minimum	0.0009	0.001	0.004	0.0002
Std. deviation	0.172	0.214	0.329	0.112
Skewness	1.926	1.174	1.211	2.867
Kurtosis	9.111	4.681	4.592	17.186
Jarque-Bera	637.308*	101.944*	102.616*	2858.640*
ADF	-16.583*	-14.297*	-16.345*	-6.402*

Notes: \* denotes significance at the 1% level.

The ADF statistics reported in the last row of Table 1 show that the series under investigation are integrated of order 1, and none of the series are of order II. The coefficients are greater than 2, implying statistical significance at 0.01 percent.



**Figure 1.** Variables volatilities (absolute returns).

## Methodology

By considering the appropriateness of the Diebold and Yilmaz (2012) methodology in this study, we consider a stationary VAR (p) model:

$$Y_t = \sum_{i=1}^p \Phi_i Y_{t-i} + \varepsilon_t \quad (1)$$

where  $Y_t$  is a vector of size  $N$  and  $\varepsilon_t$  is a vector of independently and identically distributed disturbances. Then,  $Y_t$  can be expressed as a moving average representation VMA ( $\infty$ ):

$$Y_t = \sum_{i=0}^{\infty} \Theta_i \varepsilon_{t-i} \quad (2)$$

where  $\Theta_i$  is a coefficient matrix of size  $N \times N$ . In this line, the  $h$ -step ahead forecast error variance decompositions are defined as:

$$\Psi_{ij}(h) = \frac{\sigma_{ij}^{-1} \sum_{h=0}^{h-1} (e_i' \Theta_h \Sigma e_j)^2}{\sum_{h=0}^{h-1} (e_i' \Theta_h \Sigma \Theta_h' e_j)} \quad (3)$$

where  $\sigma_{ij}$  is the standard derivation of the error term for the  $j$ th equation,  $\Sigma$  is the variance matrix for the error vector  $\varepsilon$  and,  $e_i$  and  $e_j$  are the selection vectors with one for the  $i$ th and  $j$ th elements, respectively, and zeros otherwise.

To calculate the spillover index, Diebold and Yilmaz (2012) normalize each entry of the variance decomposition matrix by the row sum:

$$\tilde{\Psi}_{ij}(h) = \frac{\Psi_{ij}(h)}{\sum_{j=1}^N \Psi_{ij}(h)} \quad (4)$$

In addition, they introduced the **total volatility spillover** index to measure the contribution of the spillovers of the volatility on the system's forecast error variance.

$$S(h) = \frac{\sum_{i \neq j}^N \tilde{\Psi}_{ij}(h)}{N} \quad (5)$$

However, the **directional volatility spillovers** received by market  $i$  from all other markets  $j$  is measured by:

$$S_i(h) = \frac{\sum_{j=1}^N \tilde{\Psi}_{ij}(h)}{N} \quad (6)$$

Similarly, the **directional volatility spillovers** transmitted by market  $i$  to all other markets  $j$  is measured by:

$$S_{.i}(h) = \frac{\sum_{j=1}^N \tilde{\Psi}_{ji}(h)}{N} \quad (7)$$

Consequently, the **net volatility spillover** from market  $i$  to all other markets  $j$  is defined by:

$$S_i(h) = S_{.i}(h) - S_i(h) \quad (8)$$

Finally, the **net pairwise volatility** spillover between market  $i$  and market  $j$  is defined by:

$$S_{ij}(h) = \frac{\tilde{\Psi}_{ji}(h) - \tilde{\Psi}_{ij}(h)}{N} \quad (9)$$

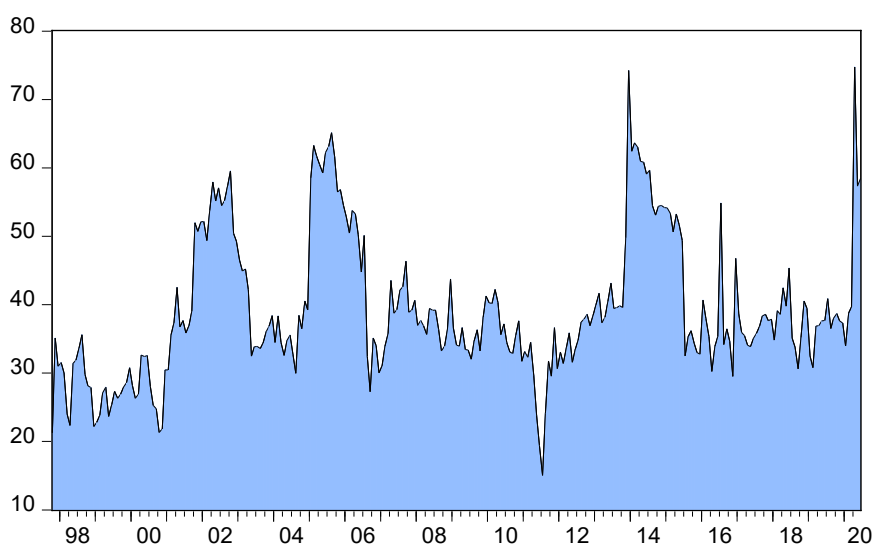
## RESULT AND DISCUSSION

By employing the Diebold and Yilmaz (2012) approach to examine the volatility spillover effect among the United States' partisan conflict (resulting from the intrigues associated with American politics), fiscal policy, monetary policy, and economic policy uncertainties, the implied result is indicated in Table 2. Importantly, the study revealed that the total spillover, which explains the extent of interconnectedness among the examined variables, is 30.04%. This value is significant enough to show that shock transmission exists among these variables, as further indicated in Figure 2. In specific, it is revealed that EPU transmits the largest share of shock (56.78%) to other variables, thus suggesting that EPU is the only net giver of potential shock, with a net spillover of (+) 12.325%. While fiscal policy, monetary policy, and partisan conflict are vulnerable to receiving a share of shock from EPU, partisan conflict received the second largest (-3.607%) after monetary policy.

**Table 2.** Volatility Spillover Result

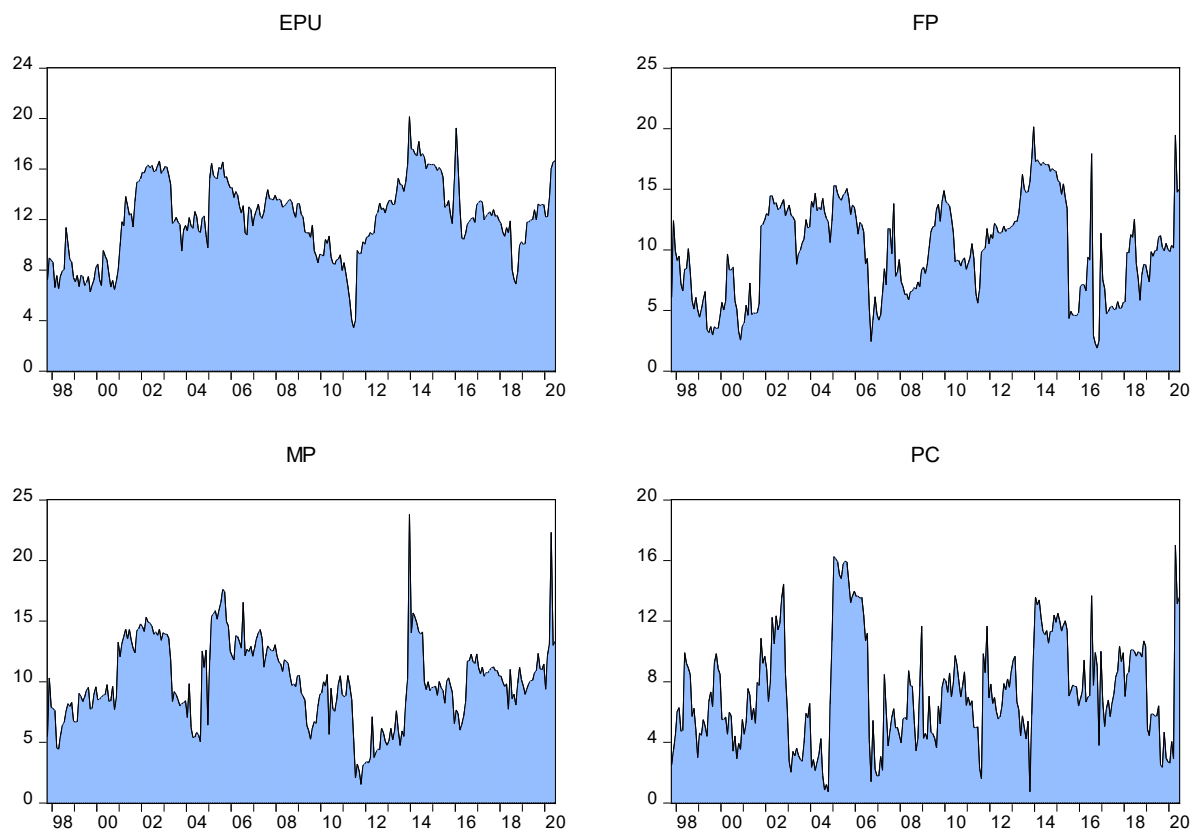
	<b>EPU</b>	<b>FP</b>	<b>MP</b>	<b>PC</b>	<b>From others</b>
EPU	<b>55.546</b>	18.255	19.508	6.691	44.454
FP	22.496	<b>69.225</b>	3.671	4.608	30.775
MP	24.626	4.352	<b>70.497</b>	0.526	29.503
PC	9.658	5.311	0.462	<b>84.569</b>	15.431
Contribution To others	56.780	27.918	23.642	11.825	120.164
Directional including own	112.325	97.143	94.138	96.393	Total spillover index
Net spillovers	12.325	-2.857	-5.862	-3.607	(30.041%)

**Note:** EPU, FP, MP and PC are, respectively, the economic policy uncertainty, fiscal policy, monetary policy, and partisan conflict. While the bold indicate

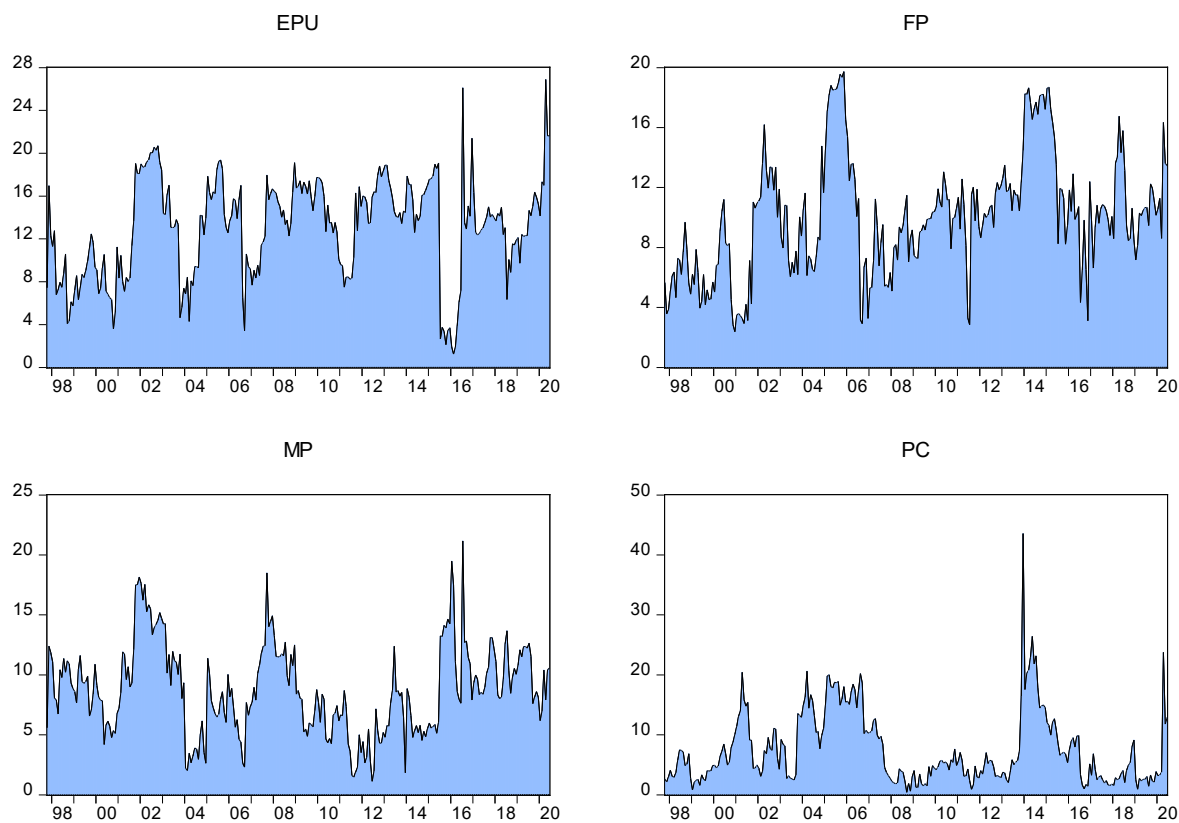
**Figure 2.** Total volatility spillovers.

Considering that partisan conflict is a net receiver of shock with the largest spillover effect (84.569%) in this context, PC directly contributes the largest shock to the EPU (6.691%), followed by 4.608% directly to fiscal policy and a lower shock of 0.526% to monetary policy. The implication is that the United States' economic policy and fiscal policy are quite vulnerable to a shock that arises from the volatility of the country's democratic polarity vis-à-vis the increasing trend of political partisanship. This new evidence affirms the position of Azzimonti (2018, 2019), who found a negative relationship between the PC and investment (as a fiscal policy) in the United States. In regard to the nexus of PC, EPU, and monetary policy, a related study by Cheng et al. (2018) found that political uncertainty shocks (arising from partisanship) lower financial market volatility and also exert an asymmetric effect on aggregate corporate cash holdings vis-à-vis monetary policy.

Moreover, Figures 3-6 further provided diagnostic evidence in support of the results. For instance, PC exhibits the least volume of directional spillover volatility from and to others, as obviously reflected in the depletion associated with the volume/size of PC in Figures 3 and 4. Similarly, evidence of the net spillover effect and pairwise spillover connected are respectively indicated in Figures 5 and 6. In addition to the contribution of Gupta et al. (2019) on the nexus of political uncertainty (partisan conflict), fiscal policy and asset prices, PC has increasingly been linked with related dynamics (Cheng et al., 2016; Balcilar et al., 2019; Boushey & McGrath, 2020; Saint Akadiri & Alola, 2020).



**Figure 3.** Directional volatility spillovers from others.



**Figure 4.** Directional volatility spillovers to others.

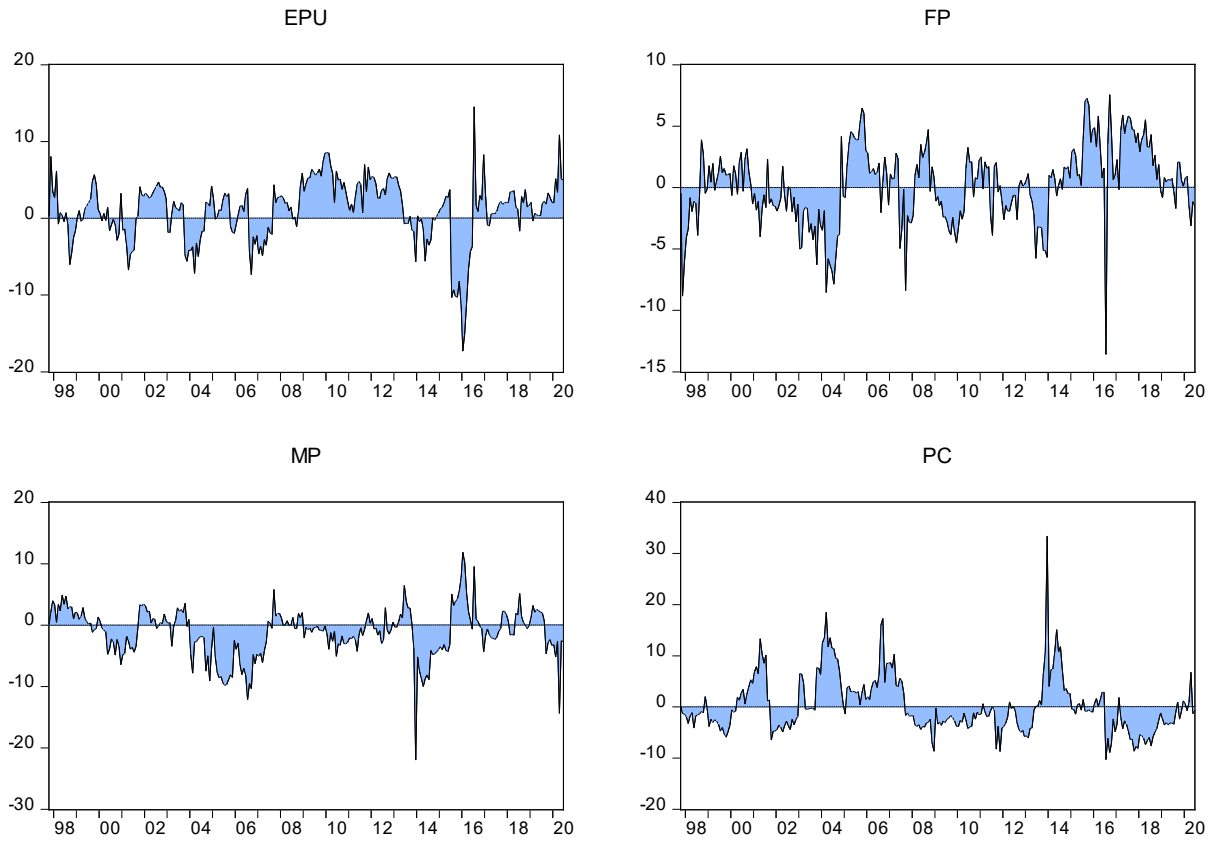
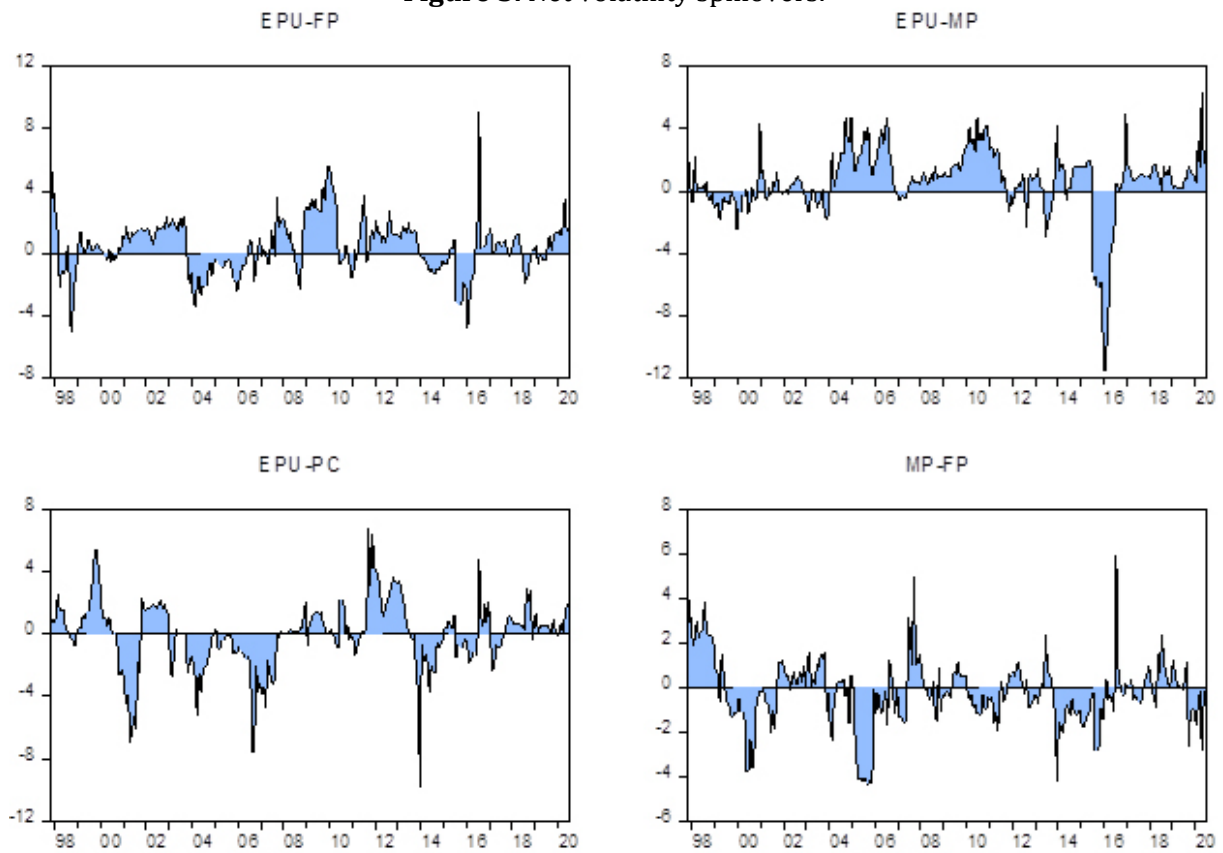
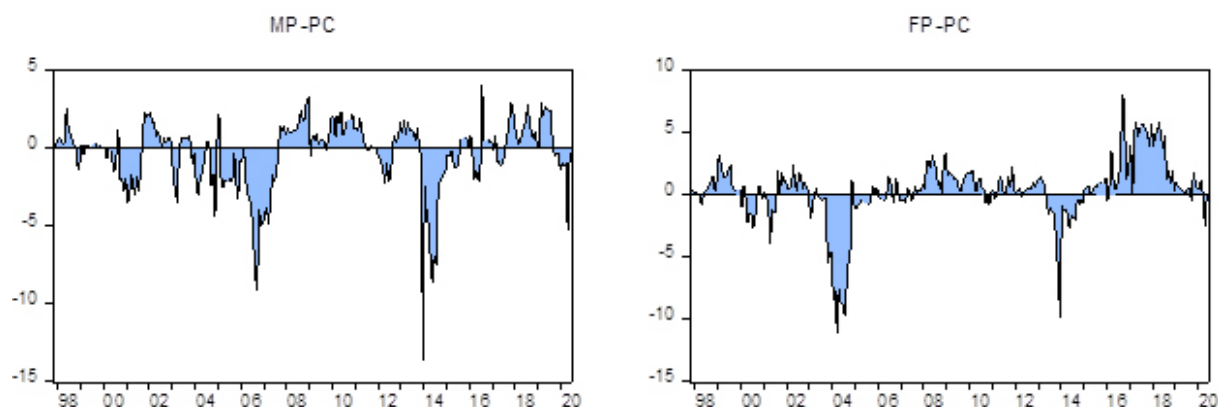


Figure 5. Net volatility spillovers.







**Figure 6.** Net pairwise volatility spillovers.

## CONCLUSION/POLICY SUGGESTION

In recent times, the polarization of the democratic process in the United States has consistently heightened the trend of partisanship in the country, thus affecting a broad range of socioeconomic and financial forces. This study employed the Diebold and Yilmaz (2012) approach to examine the interconnectedness among economic policy uncertainty, monetary policy, fiscal policy, and partisan conflict in the United States over the period of January 1996 to June 2020. In this context, the study revealed a total spillover of 30.04%, with the highest shock coming from the EPU (a net giver of spillover shock). In addition, the uncertainty resulting from monetary policy, fiscal policy and partisan conflict are received from the spillover effect from the EPU, thus making monetary policy, fiscal policy, and partisan conflict net receivers of spillover shocks. Importantly, with the largest spillover effect of 84.569%, the uncertainty resulting from partisan conflict directly contributes the largest shock of 6.691% to EPU, followed by a 4.608% direct shock contribution to fiscal policy and a lower shock of 0.526% to monetary policy.

Based on policy inference, the government of the United States will have to deliberately do more to douse the lingering trend of democratic polarization in the country. Thus, a new approach, such as the adoption of a more inclusive dialogue among political and social representations, could effectively moderate or pacify the current political atmosphere in the United States, resulting from the deep political dichotomy between the Democratic and Republican parties. Given the significant impact of partisan conflict on economic policy uncertainty, policymakers should prioritize efforts to reduce polarization and foster more inclusive dialogue among political and social representatives. This could involve initiatives to bridge divides between political parties, encourage bipartisan cooperation, and engage diverse stakeholders in the policymaking process. Policymakers should also focus on addressing the underlying factors driving partisan conflict, such as ideological polarization, electoral competition, and institutional dysfunction. This may require reforms aimed at promoting transparency, accountability, and fairness in the political system, as well as efforts to counteract media polarization and mitigate the influence of special interests.

Considering the interconnectedness among economic policy uncertainty, monetary policy, fiscal policy, and partisan conflict, policymakers should prioritize efforts to enhance coordination and coherence across these policy domains. This could involve adopting a more integrated approach to policymaking, improving communication and collaboration between relevant government agencies, and ensuring consistency and alignment in policy objectives and strategies. Policymakers should also focus on building resilience to economic policy uncertainty and mitigating its adverse effects on the economy. This may involve implementing measures to enhance transparency and predictability in policy decision-making, providing clear guidance to

businesses and households, and strengthening institutions and mechanisms for managing and responding to economic shocks.

One potential limitation of this study is its focus on the United States, which may limit the generalizability of its findings to other countries or contexts with different political systems, institutions, and dynamics of partisan conflict. Reliance on data from January 1996 to June 2020 may also present limitations in capturing more recent developments or changes in the political landscape that could impact the relationship between economic policy uncertainty, monetary policy, fiscal policy, and partisan conflict. Additionally, while the study provides valuable insights into the interconnectedness among these variables and their implications for policy, it may overlook other factors that could influence partisan conflict and its effects on economic policy uncertainty. For example, the study does not take into consideration the underlying causes of partisan conflict or consider potential interactions with broader societal trends, such as media polarization, social movements, or demographic shifts. Furthermore, reliance on the Diebold and Yilmaz (2012) approach for analyzing spillover effects may have limitations in capturing the full complexity of the relationships among the variables under investigation.

Future research could explore alternative methodologies or incorporate additional variables to provide a more comprehensive understanding of the dynamics of partisan conflict and its implications for economic policy. Additionally, studies could explore the role of non-governmental actors, such as interest groups, grassroots organizations, and civil society, in shaping partisan dynamics and influencing economic policy outcomes. Moreover, comparative studies across different countries or regions could provide insights into the factors driving variation in partisan conflict and its consequences for economic policymaking.

**Competing interests:** There is no conflict of interests reported by the authors.

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