

There is large evidence that fiscal policy in many countries tends to pro-cyclicality. This phenomenon is often observed in emerging countries but might also be present in developed ones. It is unclear why so many countries follow apparently sub-optimal fiscal policy.

First part of this thesis reviews existing literature concerning pro-cyclical behavior of fiscal policy. It shows in which countries and under which circumstances pro-cyclicality has been present. Furthermore, models explaining pro-cyclicality of fiscal policy are introduced.

The remainder of this thesis surveys fiscal policy making in Europe. We show that after subtraction of automatic stabilizers from government budget and considering only discretionary part of fiscal policy, pro-cyclicality of fiscal policy is also present.