“Policy Pro-cyclicality”
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*Summary*

Whatever else fiscal policy does, it should not be pro-cyclical.

Let’s start with an international perspective: Which countries are fiscally counter-cyclical? During 1960-1999, Chile, like most developing countries, showed pro-cyclical spending, while Greece, like most advanced countries, was counter-cyclical. In 2000-2018, they switched places. Institutions can explain the difference – more specifically, institutions that block optimism-bias in official forecasts.

In developing countries, optimism bias takes the form of thinking that a commodity boom will go on forever. In euro countries, it takes the form of official forecasts that growth will bring the budget deficit back under 3% of GDP next year (the SGP rule). In one of the two US political parties, it takes the form of forecasts that tax cuts will pay for themselves.

A claim: US Republicans have been pro-cyclical in the policies they push for -- not only with respect to fiscal policy, but also with respect to financial regulation, and monetary policy. This is especially true at the current cyclical peak, but the historical pattern goes way back.

One question: Do I need to re-think this generalization, now that some Democrats have joined Republicans in supporting fiscal and monetary expansion even though unemployment is as low as 3 ½ %?