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Government's Failures in Economic Policy Have Fuelled Financial Crisis, say Norman Lamont and Vito Tanzi in Politeia Message. The financial system must be tackled and Britain return to the sound economic policies pioneered in the 1980s

The new year has brought little comfort to the Government in its handling of the financial crisis. Despite the interventions of recent months, things seem to be getting worse. The Prime Minister contends that the UK's problems come from overseas: but should he be looking nearer home for the origins of the crisis and the solutions HMG should adopt?

Norman Lamont, the former Chancellor of the Exchequer, and Vito Tanzi, the influential economist who directed the IMF's fiscal affairs department, make clear that the crisis has its origins in the failings of government as well as those of the international system. Tanzi points the finger at the huge fiscal imbalances accumulating over the years, the fiscal accounts that ignored future liabilities and relied on tricks to hide growing problems, the failure of regulation in the financial system and the growing complexity of the markets, which were little understood and lacked transparency. Lamont highlights the downturn after the housing boom with its impact on the banking sector, low interest rates (one of the consequences of Gordon Brown's remit to the Bank of England when he gave it independence), and the growing complexity of the financial sector.

As for the package to meet the crisis, neither Lamont nor Tanzi is confident that the fiscal stimulus measures on which the Prime Minister and his Chancellor pin many hopes will work. Such packages have no record of success - having made the Great Depression 'great' and done little to help in Japan, where inefficiencies in the use of resources resulted in the 1990s. Instead what is needed is to strengthen the banks, restore the credit markets and ensure that the right regulation is introduced for transparency and to remove perverse incentives. Tanzi has also set out a clear programme for regulatory reform of the banks so the true position is transparent and all can understand the rules.

And, as the immediate crisis passes, the other problems must be tackled. The size of government must be cut, as well as its debt and borrowing. The problems we face do not, as some suggest, result from the failure of the market economy, but from the failure of those in charge to make the right policy, regulate effectively or act responsibly as referees.

*Lord Lamont of Lerwick was Chancellor of the Exchequer from 1990 to 1993.

*Vito Tanzi was Director of Fiscal Affairs at the IMF from 1981 to 2000. His publications include *Public Spending in the 20th Century: A Global Perspective* (Cambridge, 2000) with Ludger Schuknecht and *Regulating for the New Economic Order: The Good, the Bad and the Damaging* (Politeia, 2008).

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A Prosperous New Year? by Norman Lamont and Vito Tanzi is available online from Politeia (www.politeia.co.uk).

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