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Damaging Policies of Boom Years Must Be Reversed for Economic Recovery and Growth. Depth of recession owes much to government profligacy of last decade, says new Politeia study.

As Britain's leaders prepare to go to the electorate, the economy dominates the political battleground. How far were the financial crisis and the recession which followed caused or exacerbated by the policies of the boom years? How far must these policies be reversed for UK economic recovery? Politeia's new pamphlet, ***Booms, Busts and Fiscal Policy: Public finances in the future?*** by Dr Ludger Schuknecht,* considers what went wrong. It analyses the UK's position compared with other similar economies, the legacy of the boom years, and the steps now needed for sustainable recovery.

The pamphlet explains that the depth of the recession owes much to the policies of the boom years. Along with rising private debt and credit (associated with the housing boom), public spending and debt soared. Governments ignored the opportunity to restore sound public finances. Dr Schuknecht, a senior economist at the European Central Bank (ECB), explains that if 'the boom times had been used to bring public finances onto a sound footing with surpluses, low debt ... and low expenditure ratios, the fiscal burden of the bust and crisis would have been easier to absorb'.

Here the UK stands out and was particularly at fault. Having cut levels of public spending until the 1990s, Britain then changed direction. Public spending as a percentage of GDP rose by 15.7 per cent over the decade: from 36.8 per cent in 2000, to 44.0 per cent in 2007 and 52.4 per cent by 2010. These increases are far higher than those in similar economies such as France or Germany. The same is true of public sector employment which increased in the UK by 14 per cent, reversing, says the author, the sound public employment policies of the 1990s. Public debt too is rising: in only three years it is likely to increase by almost 40 per cent.

The pamphlet proposes that the priority must now be to restore sustainable public finances, on which economic recovery and growth depend. In particular:

- **Fiscal deficits and debts must be returned to a sustainable path.** Reducing deficits and debt is essential if debt is to stabilise and decline.
- **Public spending must be cut if deficits and debts are to be reduced and sound public finances restored.** The evidence is that tax rises have little chance of success.
- **Spending ratios should be brought back at least to pre-crisis levels** for growth and deficit and debt reduction. Public spending should be less than 40 per cent of GDP; countries should aim at 30-35 per cent - high enough for essential public goods and services and income growth.
- **Social policy reforms are needed to contain the costs of ageing populations e.g.** raising retirement age, introducing greater competition in healthcare or reforming labour and product markets.
- **Structural reforms, including in the fiscal area, are needed to reduce the likelihood of future booms and busts**. Though not predominant, they can play a role in reducing asset price cycles.

Booms, Busts and Fiscal Policy: Public finances in the future? is available online - please visit **www.politeia.co.uk/p112.pdf**
Hard copies are available to journalists on request from press@politeia.co.uk or to the general public from Politeia, 22 Charing Cross Rd, London WC2H 0QP.

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