

# U.K. Had Record Deficit in August as Tax Revenue Fell

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By Thomas Penny

Sept. 18 (Bloomberg) -- Britain posted the biggest budget deficit for any August since modern records began in 1993 as the recession destroyed tax revenue and welfare costs soared.

The 16.1 billion-pound (\$26.3 billion) shortfall compared with a deficit of 9.9 billion pounds a year earlier, the Office for National Statistics said in London today. The median of 16 forecasts in a Bloomberg News survey was 17.6 billion pounds.

Britain will have to cut spending at the fastest pace since the 1970s to repair the damage the slump has inflicted on the public finances, economists warned this week. The International Monetary Fund expects the budget deficit to exceed 13 percent of gross domestic product next year, the most in the Group of 20.

"We have a huge underlying deficit caused by a collapse in tax revenues," said Richard Snook, senior economist at the Centre for Economics and Business Research. "There is an enormous black hole in the public finances which only major spending cuts can fill."

The scale of the budget deficit has ignited a political dispute over spending that is set to dominate the next general election, which Prime Minister Gordon Brown must hold by June.

Conservative leader David Cameron this week accused Brown of misleading Parliament after leaked Treasury documents showed that in April the Labour government was forecasting it would have to cut departmental budgets by 9.3 percent in real terms by 2014 because of soaring welfare and debt-interest costs.

## 'Shocking Figures'

Until this week, Brown had refused to publicly acknowledge the need for spending restraint. Instead, he accused the Conservatives of planning 10 percent cuts across departments that would hit the poor and jeopardize the nascent recovery.

Chancellor of the Exchequer Alistair Darling is now holding meetings with Cabinet ministers to determine possible targets for cuts, Brown's spokesman, Simon Lewis, told reporters in London today.

"We used to worry about borrowing 16 billion pounds in an entire year. Now Labour have done it in just one month," said Philip Hammond, who speaks on Treasury matters for the Conservatives. "These shocking figures show the depth of Gordon Brown's debt crisis and just how irresponsible he was to pretend that spending cuts weren't necessary."

Standard & Poor's warned in May that Britain may lose its AAA credit rating after the Treasury said debt would reach 1.4 trillion pounds by 2014, the current value of the economy.

## Debt Burden

Including the liabilities of banks now controlled by the government, such as Bradford & Bingley Plc and Northern Rock Plc, Britain had 804.8 billion pounds of debt in August, or 57.5 percent of GDP. That's the biggest debt burden since at least 1975.

The scale of the tightening in the public finances required may allow the Bank of England to leave interest rates near a record low for some time, according to Jonathan Loynes of Capital Economics Ltd., a London-based consultant.

"With the main political parties now openly discussing plans to cut public spending more sharply than current plans allow, a severe fiscal squeeze is on the way which will necessitate the maintenance of very loose monetary policy for a prolonged period," Loynes said.

The pound fell for a second day against the dollar amid concern that continuing turmoil in Britain's banks will delay the recovery. Against the U.S. currency, the pound fell 0.5 percent to \$1.6367 as of 12:11 p.m. in London.

## Spending Squeeze

The Institute for Fiscal Studies, a non-partisan research group, said the leaked Treasury projections imply departmental spending falling by 2.9 percent a year between 2011 and 2014, the sharpest squeeze since James Callaghan's Labour government was negotiating its budget plans

with the IMF in 1976.

In April, the [Treasury](#) forecast a deficit of 175 billion pounds in the fiscal year through March 2010, or 12.4 percent of GDP. In the first five months, the shortfall was 65.3 billion pounds compared with 26.1 billion pounds a year earlier.

"If the rate of deterioration continues at this pace, the government is likely to overshoot its spending projection for the current fiscal year," said [Hetal Mehta](#), senior adviser to Ernst & Young's Item Club, which makes forecasts using the Treasury's economic model.

Government receipts dropped 9.2 percent in August from a year earlier, with taxes from corporate profits falling 49 percent, value-added tax declining 13 percent and income tax dropping 12.5 percent.

#### Jobless Benefits

Spending rose 2.9 percent, with net spending on social benefits increasing 7.4 percent as [unemployment climbed](#) to a 14- year high. Net investment rose 54 percent to 3.3 billion pounds as the government brought forward projects to help the economy.

A cash method of accounting, known as the [public sector net cash requirement](#), showed the deficit doubling to 10.4 billion pounds in August, the largest shortfall for the month since records started in 1984. Economists had expected a 14.5 billion- pound deficit.

The figures are in line with the forecasts made in the [April budget](#), a Treasury spokesman said. "They reflect the impact of the global financial crisis on tax receipts as well as the action we are taking to support the economy right now and invest to benefit from the recovery," the spokesman said.

The government plans to reduce the deficit to 5.5 percent of GDP by 2014, a target Cameron this week dismissed as "not that impressive" as he reiterated his undertaking to make faster progress than [Labour](#) on tackling debt.

#### Conservative Options

If the [Conservatives](#) honored their pledges to protect spending on health and overseas aid, spending at other departments would have to be cut by 14 percent unless the party increased taxes, according to the IFS.

That's the equivalent of 54 billion pounds today -- almost as much as the defense and transport budgets combined -- and deeper cuts would be needed if the Conservatives want to step up the pace of deficit reduction.

Both Brown and Cameron have promised to give priority to frontline services by focusing on cutting costs.

The Conservatives led Labour by as much as 16 points in [opinion polls](#) carried out this month, putting the party on course to win the next election, political analysts say.

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*Last Updated: September 18, 2009 07:58 EDT*

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