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THE PUBLIC WEALTH OF NATIONS

Unlocking the value of global public assets

[Citi GPS: Global Perspectives & Solutions](#)

June 2015



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Dag Detter is the co-founder and partner of Whetstone Solutions, advising investors in Europe and Asia, specialized in identifying underperforming high potential assets and advising in the acquisition/disposal process for private and public institutions. Dag has served as Non-Executive Director on a range of boards of private and public companies. As President of Stattum, the Swedish government holding company, and a Director at the Ministry of Industry, he led the first deep-rooted transformation of state commercial assets. He has worked extensively as an investment banker and advisor within the corporate, real estate and financial sector in China and Europe.



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THE PUBLIC WEALTH OF NATIONS

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In his foreword to the book *The Public Wealth of Nations*, Adrian Wooldridge, Management Editor of *The Economist*, suggests that Dag Detter and Stefan Fölster have proposed a new idea in the public policy arena which not only identifies a problem that few people had realized existed, but suggests a relatively pain-free way to tackle it while at the same time boosting the size of the global economy.

The idea rests on the observation that governments around the world have an estimated \$75 trillion of dollars of public assets, ranging from corporations to forests, which are often badly managed and frequently not even accounted for on their balance sheets. Over recent decades, policy makers have focused almost solely on managing debt while largely ignoring the question of public wealth. Given that in most countries public wealth is larger than public debt, just managing it better could help to solve the debt problem while also providing the material for future economic growth. A higher return of just 1% on global public assets would add some \$750 billion to public revenues. Poor management not only throws money down the drain, but also forecloses opportunities. As an example, the fracking revolution, which is making the US self-sufficient in oil, has taken place almost entirely on private land.

In this Citi GPS report and as a preview to their upcoming book, Dag Detter and Stefan Fölster present their thesis that the governance of public wealth is one of the crucial institutional building blocks that divides well-run countries from failed states. They argue that the polarized debate between privatizers and nationalizers has missed the point — what really matters is the quality of asset management, and the focus when it comes to public wealth should be on yield rather than ownership. They calculate that improvements in public wealth management could yield returns greater than the world's combined investment in infrastructure such as transport, power, water and communications. They also note that improvements in public wealth management could help to win the war against corruption as assets are moved at an arm's length from politicians. They thus address at a single stroke two of the great problems of our age: the shortage of infrastructure investment thanks to the overhang of the public debt and the halt in the advance of democracy thanks to the prevalence of poor government.

Improving the quality of asset management starts with transparency. Back in 1983, Chief Economist Willem Buiter argued that governments needed to have a clearer picture of their total balance sheet and should construct a “comprehensive balance sheet” including all assets and liabilities of the state, including commercial and non-commercial assets as well as central bank assets. He notes that even partial success — and the recognition of what information is still missing and preventing the completion of the comprehensive balance sheet — can inform policy debate and improve the accountability of the state and its agents.

Finally, the authors argue that the best way to foster good management and democracy is to consolidate public assets under a single institution — a national wealth fund — which is removed from direct government influence. This structure maximizes economic value consistent with the principles of corporate governance. It can also be a vehicle for improving access or the cost of borrowing on the international capital markets for financing infrastructure projects or other commercial ventures or assets.



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Introduction

Willem Buiter

Citi Chief Economist

Dag Detter and Stefan Fölster have written a remarkable book, 'The Public Wealth of Nations', which Citi is privileged to be able to preview in this GPS report. In it they demonstrate that, remarkably at first blush, governments across the world are either ignorant of the true value (at times the existence) of some of their most important assets, or have actively tried to hide these assets and have been highly successful in doing so. The hidden public assets are the real commercial assets of the state, or perhaps more accurately the real commercial *or* real *potentially* commercial assets of the state. Many of these assets have not been managed effectively, let alone commercially — to the detriment of the citizens. A large part of these assets is land and real estate, including ports, airports, canals, bridges and other infrastructure, but it also includes publicly owned corporations. Although valuing these assets is often extremely difficult, the likelihood is high that in many countries a fair valuation would price them at more than 100% of annual GDP.

Without transparency, openness and clarity to assets of the state there can be no accountability

Most of these assets are poorly accounted for. Some don't occur in any accounts. Even proper ownership registers are sometimes lacking: Greece still does not have an integrated national land registry or cadaster. The word 'account' has the same root as 'accountability': without transparency, openness and clarity (including the proper application of International Public Sector Accounting Standards (IPSAS) to these real commercial assets of the state), there can be no accountability of the proximate beneficial owners (the government) and its agents to the ultimate beneficial owners – the often sadly uninformed and disenfranchised citizens.¹

Better information on these assets should lead to better monetization through paths such as intelligent securitization

With better information, the monetization of these under-exploited real commercial state assets will likely require considerable innovation in capital markets and investment banking. Liquid, tradable financial claims on the future income streams from these often illiquid and non-traded (or even non-tradable) real public assets will have to be developed. Intelligent securitization is likely to be essential – an opportunity to restore some kudos and respect to an asset class whose reputation got damaged badly by the subprime mortgage securitization debacle.

We are all familiar with governments trying to understate the true magnitude of their indebtedness. Even if we restrict ourselves to contractual commitments and omit political commitments like social security retirement benefits or Medicare benefits that are political promises, hopes, expectations or aspirations rather than legally enforceable contractual arrangements, a wide range of off-balance sheet vehicles has been used to hide government liabilities. According to the (often severely defective) public sector accounting conventions currently in widespread use, contingent liabilities like guarantees or the exposure created by a government-backed deposit insurance scheme are often not included among what counts as government debt for the purpose of meeting constitutional, legal or other gross or net debt ceilings. Public-private partnerships (PPPs) often are no more than an arrangement for deferring the recognition of the financial consequences of commitments undertaken by central, state, provincial and local governments, even if the projects in question, by design, have no hope of ever yielding a positive cash flow. Examples included PPPs for the construction of non-fee-paying, not-for-profit schools in countries where there is also no education voucher-style mechanism for making public money follow pupils to schools, or PPPs for non-profit prisons. If there is a realistic prospect of capital and operating costs being recovered out of fees, other charges or access pricing, PPPs can of course make sense.

¹ On IPSAS see <http://www.ifac.org/public-sector>

The Comprehensive Balance Sheet of the State

A “comprehensive balance sheet” should be compiled including all assets and liabilities of the state

To obtain a truly informative picture of the fiscal/financial health of the state, all present and anticipated or contingent future cash flows of the state must be allowed for, including non-contractual commitments to future payments by the state, such as Social Security or Medicare benefits. Before we can determine what decisions about public spending and taxation are desirable or optimal, we have to determine what is feasible. What is feasible — the present and future fiscal space — can only be determined by constructing the most comprehensive set of accounts of the state — what in 1983 I called the “comprehensive balance sheet” — which includes all assets and (contingent) liabilities of the state, valued as the present discounted value (NPV) of their uncertain future cash flows.² The assets and liabilities of the two (US federal) government-sponsored enterprises (GSEs), Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation), are definitely part of the federal government’s comprehensive balance sheet (and of the comprehensive balance sheet of the general government — the consolidated federal, state and local government sector). Although the practical implementation of such a comprehensive balance sheet (or inter-temporal budget constraint) of the government can be a bit of a nightmare — assigning probabilities to highly uncertain future cash flows and applying the appropriate (stochastic) discount factors to these uncertain future cash flows is a rather daunting task — countries like New Zealand have had a serious go at it for decades.³ Even partial success — and the recognition of what information is still missing and preventing the completion of the comprehensive balance sheet — can inform policy debate and improve the accountability of the state and its agents.

Which Real Assets Should Be Included and How Should They Be Valued?

All real assets for which the state either is the beneficial owner or has fiduciary responsibility should be included, and both commercial and non-commercial assets should be considered in continuum

Strictly speaking, to construct the comprehensive balance sheet of the state, all real assets for which the state (central/federal, state/regional/provincial or local/municipal) either is the beneficial owner (has a claim on the residual income or profits) or has fiduciary responsibility should be included. The distinction between commercial assets (e.g. forests or other land that can be exploited and developed commercially without restrictions other than those that apply to privately owned forests or land) and non-commercial assets (e.g. national or state parks) where commercial exploitation is restricted or impossible is not a binary but a continuous one. A national park in the US is likely to present the US federal government with a negative cash flow — the costs of managing, policing, protecting and maintaining the national park. The value (the financial value, given by the discounted future cash flows) of the national park is therefore most likely negative. This negative value as a commercial asset can, of course, be justified by the social returns yielded by the national park, now and in the future. Now consider the case where there is a chance that, at some future date, there could be some commercial exploitation of the national park (drilling for gas and oil or fracking might, for instance, be permitted, or the construction of residential or commercial real estate). In that case, the commercial value of the national park would be boosted by the NPV of the future cash revenues from these commercial activities. These uncertain future cash flows would be discounted at the appropriate stochastic discount rates that reflect both the likelihood of commercial exploitation occurring at various future dates and the likely revenues that would be appropriated by the federal government should commercial exploitation take place. Of course, a higher valuation of the national park as a commercial asset would likely be at the cost of a reduction in its non-

² Buiter (1983)

³ New Zealand Treasury (2014)

pecuniary social value as an amenity for rest and recreation and as a reservoir of environmental treasures. We are not advocating strip mining Yellowstone National Park, only outlining the way in which the federal government's guardianship of Yellowstone National Park ought to be reflected in the federal government's comprehensive balance sheet. Only that way can a well-informed cost-benefit analysis be conducted to determine the socially optimal use of this public asset.

Calculating or estimating the pecuniary value of a government real asset by discounting its uncertain future cash flows, positive and/or negative, is therefore not a sneaky way to open the door to turning the Acropolis into a bowling alley, casino or parking lot. But even a real public asset that is a jewel in the crown of the nation or all of humanity and whose non-pecuniary value is immeasurably vast will have a financial footprint that will have to be recognized, estimated and entered into the comprehensive public sector balance sheet if informed social choices are to be made.

Central banks are an additional asset that should be added to the comprehensive balance sheet

Again going beyond the scope of the 'commercial' government assets of the state that are the focus of Detter and Fölster analysis, I would like to draw attention here to another state asset that tends to be left out of the government's accounts. The Treasury or Ministry of Finance of the central or federal government is the beneficial owner of the central bank. Some countries make this very clear. In the UK, for instance, the Bank of England is formally a joint stock company all of whose stock is owned (since 1946) by HM Treasury. In other countries this fundamental beneficial ownership structure under which the Treasury/Ministry of Finance is the claimant to the residual income of the central bank is obscured by legacy pseudo-private ownership structures (Italy, Japan and the regional Reserve Banks in the US, for instance) or by hiding the beneficial ownership structure in a vague independent government agency construction, as with the Board of Governors of the Federal Reserve System. In recent years, the Federal Reserve System has contributed around \$80 billion annually to the US Treasury. With the massive increase in the size of the Federal Reserve System's balance sheet since the beginning of the Great Financial Crisis in 2007 (from 6% of GDP to 24% of GDP), seigniorage profits are likely to remain massive for the foreseeable future, especially if interest rates return to less abjectly low levels and normal spreads between interest rates on the Fed's liabilities (even its interest-bearing ones, like excess reserves) and on its assets are restored.

Not only should the conventional balance sheet of the Federal Reserve System be consolidated with that of the general government (which for reasons unknown excludes the central bank), the invisible, off-balance sheet asset of the central bank (the NPV of its future net interest income) has to be entered into the comprehensive balance sheet of the state. We are talking trillions of US dollars in the case of the Fed (see Buiter (2013)).

A stylized version of the comprehensive balance sheet of the consolidated general government and central bank (taken from Buiter (2014)) is shown in Figure 1 below.

Figure 1. Comprehensive Balance Sheet of the State (consolidated General Government and Central Bank)

Assets		Liabilities	
K	Value of real assets, equity in public enterprises and other financial assets	Base money	M
$V(\{T\})$	NPV of taxes, levies and social security contributions	Non-monetary liabilities of central bank	N
$V(\{I\})$	NPV of future interest saved through the issuance of base money and other net interest income	State debt held by the public	B
$V(M_{\infty})$	NPV of the terminal (long-run) stock of base money	NPV of state primary current expenditure	$V(\{G\})$
		State comprehensive net worth	W^+

Source: Buiter (2014)

If we were to restrict ourselves to the consideration of financial and tangible real assets and liabilities only, omitting the net present values (NPVs) of the future revenues and outlays entered in Figure 1, we would end up with the complete conventional balance sheet in Figure 2.

Figure 2. Complete Conventional Balance Sheet of the State (consolidated General Government and Central Bank)

Assets		Liabilities	
K	Value of real assets, equity in public enterprises and other financial assets	Base money	M
		Non-monetary liabilities of central bank	N
		State debt held by the public	B
		State complete conventional net worth	W

Source: Buiter (2014)

The way the government's accounts are typically presented is 1) to omit the consolidation of the general government and the central bank and instead present the general government accounts by themselves, and 2) to omit the value of the real assets of the government.⁴ Only a subset of the financial assets of the government is included. For simplicity I assume that the second omission amounts to not allowing for K in Figure 2.

What we end up with is the incomplete conventional balance sheet of the general government. The general government debt held by the public and the central bank should be net, although many debt norms imposed on governments are specified in terms of gross debt.

⁴ In the US it is bizarrely difficult to get timely and detailed general government accounts. Federal, state and local government accounts are readily available, but the consolidation at the general government level is sadly deficient.

Figure 3. Incomplete Conventional Balance Sheet of the General Government

Assets		Liabilities	
		General government debt held by the public and the central bank	B^g
		General government incomplete conventional net worth	W^-

Source: Buiter (2014)

Figure 3 is a sad travesty of Figure 1 and even of Figure 2. Detter and Fölster put the K back into Figure 3. With central bank consolidation, they get us to Figure 2. It is an important step forward.

Why Would a Government Hide Its Assets?

Lack of transparency on government assets leads to inadequate accountability

Why would governments want to hide these assets? The sad but simple political economy answer is that hidden assets, that is, hidden actual or potential wealth, grants the owner and the agents who manage these assets the power to appropriate rents and to distribute these rents among beneficiaries selected by the owner and/or the managers. Lack of information about the existence and the key economic and commercial characteristics of these real government assets, and a failure of openness and transparency as regards the way in which these assets are managed and their returns distributed, mean there is inadequate accountability of the government for these assets. Even though, from a social perspective, the assets may be poorly managed and yield returns far worse than could be achieved with first-best management, from the perspective of the incumbent government and its agents, these inadequate social returns include 'private' returns (to the government, its agents and its beneficiaries) that may well be higher than the 'private' returns they can hope to extract under open, transparent and accountable management.

NWFs would put public assets at arms' length from political leadership in a transparent and accountable manner

Detter and Fölster propose putting all central government commercial real assets into a single national wealth fund (NWF), which would act as a gigantic publicly owned private equity fund (or public equity fund). This would be managed at arm's length from the political leadership of the country, and in a transparent, accountable manner using suitable modified private sector accounting and management practices.

I agree that putting all commercial real assets in a single fund would help accountability and transparency. If the assets are very heterogeneous, however, it may not be possible to manage all of them with just one management team — we are talking of assets worth well over 100% of annual GDP in some countries. Diseconomies of scale, scope and span of control may dictate splitting up the NWF either along regional, industrial or other categorical lines. But these are minor quibbles. Detter and Fölster are leading the way toward the realization of value for real public sector assets. Not before time.