The Public Wealth of Nations

- How smart management of state commercial assets can drive economic growth

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In the aftermath of the latest financial crisis many countries remain heavily indebted and fettered by fiscal austerity in order to restore budget balance and regain economic growth. Policy choice is confined to saving more now or later. Structural reforms of labour markets and competition rules are also in the cards, but will take years to nudge growth and employment rates. Perhaps we should start asking what public assets can do for the economy?

The common description of the economic situation in many countries misses an essential point. Many countries, even the US and Greece, may be heavily indebted, but are also asset-rich. Southern European households are well known for having accumulated large savings, but most European countries also own vast portfolios of commercial assets, as do both the federal and local governments in the US. The value of these public portfolios may sometimes be larger than public debts, but governments rarely have detailed information on the extent of their own wealth.

Portfolios of commercial assets within the OECD-member states are not only vast in terms of value but also in importance to the economy. Knowledge about these vital assets is poor and sometimes even non-existent. Unlocking this wealth can significantly improve the balance sheet of many governments. Even more important, professional management of state owned assets can act as a catalyst for productivity enhancing structural change in many sectors of the economy. This potential tool could be essential to help solve the travails of Europe and the US, as well as unlocking structural change badly needed in developing and developed economies alike.

This underutilized opportunity, and how to go about exploiting it, is the subject of the recent cover story –'the USD9 trillion Sale' in the Economist[1]. The article highlights the size of these hidden assets and urges its immediate privatisation in order to create growth and restore the health of public finances. In the coming book 'The Public Wealth of Nations – how smart management of public commercial assets can drive growth' by Dag Detter, Stefan Fölster, and additional authors from Asia and the US, expected in the fall of 2014, it is demonstrated how these public assets can be a real engine for growth in many different corners of the global economy.

As described in the Economist story, governments all over the world do not have a clear picture of the extent of their wealth as these assets are hidden due to first of all poor accounting standards, but also to unclear and ill-defined economic statistics. Such statistics are limited to central governments and labelled with imprecise titles such as 'financial' and 'non-financial' assets, if at all existent. Policy analyses and statistics often focus solely on financial assets and the more visible listed companies held by central governments. So far very few attempts have been made to value non-financial assets. However, both of these

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[1] The Economist newspaper, 10 January, 2014

concepts comprise only selective assets held by the central government and almost always miss the ubiquitous portfolios of real estate. As with the iceberg, assets below the water level, in local and regional governments are never mentioned or included in this information.

In ‘The Public Wealth of Nations’ the concept of ‘Public Commercial Assets’ is introduced and defined as all publically owned assets, local and regional, working under market conditions and if monetised and managed efficiently would have an impact on the government finances. It excludes assets that have little chance of being monetised or playing a commercial role in the economy, such as national parks or historic buildings, as well as any other asset using public financing as its primary source of income or having a policy goal as its primary objective.

The most challenging feat required of state ownership is that government must ultimately be both player and referee, both market participant and regulator. This duality needs to be addressed head on through a legally clear separation between ownership and management. Ultimately it means that ministers will only be able to influence a sector and its participants through transparent and fair regulation. When government ministers act as referees alone we can claim to have achieved a level playing field for all participants.

Given that our common resources are limited, be it financial or real assets, it is imperative that we manage them in a sustainable way. Public commercial assets that remain hidden without a transparent economic value risk being misused without anyone paying much attention.. The book argues for increased transparency as a first step on the path to manage common resources in a more responsible fashion. An understanding of value is fundamental in order to develop a commercial asset and thereby making sure the real economy and all potential stakeholders, including customers, taxpayers and other investors can benefit and not just a few insiders. Transparency is also crucial for preventing waste, misuse and corruption of public assets. Monetising - managing these assets for value - means using both debt and equity as way of developing assets in a financially more efficient way to the benefit of the wider community.

Most, if not all, shortcomings in the governance of state assets stem from the way government exercises its ownership rights. The decentralised model of ownership in which line ministries both own assets and regulate a sector, is a left over from the days of central planning, when policy and commercial objectives were usually indistinguishable. This model is at odds with increasing efficiency in a sector by introducing competition. The introduction of competition combined with strengthening the regulatory clout has proven to deliver both sustainable profit and a better use of limited resources, as well as more attractive prices to the end users.

Within the OECD a consensus has emerged that a centralised and independent ownership vehicle is the most efficient way to manage public ownership of commercial assets. Centralisation enables not only a separation of inherent conflicts of interest between political and industrial imperatives, but also enables the introduction of commercial corporate governance skills. With a clear division of responsibility between ownership and holdings, the board of directors can held solely accountable for the running of a commercial operation and thereby making it less attractive with short-term political interference.

The commercial tool developed over centuries – the incorporated company - represents the most suitable governance structure for operational assets. In ‘The Hidden Wealth of Nations’ the concept of a ‘National Wealth Fund’ (‘NWF’) is introduced as an independent asset management company, or holding company at an arms-length distance from the policy function of a government. The NWF is different compared to a Sovereign Wealth Fund (‘SWF’). While the SWF is mainly a passive investor managing the public financial surplus invested in relatively liquid assets, the NWF is an active owner of operational assets. The management of a NWF would be well versed in management, development and potential restructuring of operational assets, rather than financial instruments.

By raising debt against such a commercial portfolio, credit ratings agencies are able to boost transparency that further encourages commercial discipline in the management of public assets.

Temasek of Singapore probably represents one of the most successful examples of a NWF. It has also a bond rating enabling it to raise money independently from the government balance sheet. Other examples of successful NWF acting as drivers of economic growth and structural development can be found in Korea and Malaysia

One pay-off from running state-owned commercial assets more like private sector businesses is that increased dividends flows become available to reduce budget deficits, thereby also helping to take some of the budgetary strain off much needed social spending. Also, enhanced performance by such a vital part of the economy will drive overall economic growth, while at the same time fostering competition within the individual sectors concerned. This is particularly important given that public commercial assets are generally concentrated in a few strategic industries of importance to many other sectors.

The current economic situation in Europe and the US as well as many other developed economies of the OECD requires extraordinary measures. Governments responsible for the ownership of commercial assets share the same challenge. None can ever be an ideal owner due to the inherent conflict of interest. Yet it should be incumbent on all decision makers, to allow for such assets to be managed professionally and do so in the interests of all citizens, however unpopular that may to be with some vested interests, inside and outside of a government and its public representative. In this sense, a public reform programme for commercial assets is a financial and social enterprise with global relevance.

The forthcoming book “The Public Wealth of Nations” provides an in-depth look at the economic arguments for managing Public Commercial Assets more effectively and the tools available to do so, including the importance of regulation. The book includes a head-to-head comparisons between successful developments and contrasting systems in Singapore, Korea, the UK and Sweden. Many examples of what has worked and what has not are provided. Interestingly, some Asian countries now manage state assets in ways that can provide lessons to European countries.