



— UNLOCKING — Public Wealth

Governments could do a better job managing their assets

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National and local governments own a potential gold mine of assets, mostly in the form of real estate and government-owned companies. With better governance, many of these assets—such as outdated buildings, undeveloped land, brownfield spaces, and air rights—could generate value and a revenue stream to fund government budgets, lower taxes, or pay for vital infrastructure. Unfortunately, most

opportunities for better public wealth governance have been lost in the debate over state ownership versus privatization.

Consider a city like Boston, which by its own accounting does not appear to be particularly wealthy. The city reported total assets worth \$3.8 billion in 2014, of which \$1.4 billion is in real estate. The city's liabilities of \$4.6 billion exceed its assets, but this valuation largely underestimates

the true value of the public assets. Using accounting conventions followed by most cities in the United States, Boston reports assets at book value, valued at historical costs. If it used the International Financial Reporting Standards, which require the use of market value, to assess the city's holdings, the assets' worth would be significantly higher than currently reported. In other words, the city is operating without fully leveraging its hidden wealth.

A recent independent estimate of the real property portfolio owned by the City of Boston, based on a consolidated list of publicly held real estate, gives an indicative valuation of the real estate alone of about \$55 billion. Boston's real estate portfolio includes holdings ranging from the Boston Housing Authority's \$4.7 billion worth of buildings and land to the Boston Public Market, valued at \$5.6 million. (The valuations are from work by one of the authors of this article and Tolemi, a company that provides data analysis to local governments.)

Accounting for the market value at current use is the first step toward quality asset management. The next step is to understand the return the city earns from revenue and rising market values on its assets. This is essential not only to compare its current use with the potential best use, but also to understand whether performance has been satisfactory and show stakeholders that their wealth is managed responsibly.

While Boston does earn revenue on some of its holdings, the city, by design or by default, does not report any return on its assets—that is, it does not make any connection between the value of the assets and their yield. Assuming, cautiously, that the city could earn a 3 percent yield on its commercial assets with more professional and politically independent management, such a yield on a portfolio worth \$55 billion would amount to an income of almost \$1.7 billion a year. That is about four times Boston's current capital plan of about \$400 million. In other words, even with a modest yield, Boston could quadruple its infrastructure investments.

For a glimpse at what's possible with better management of city-owned real estate, consider Copenhagen's By og Havn (City and Port) urban development project—the largest in Europe, with 1,290 acres in waterfront and inland districts. The successful development of these assets consolidated under a single independent institution and balance sheet will contribute to funding and managing the construction of more than 33,000 new housing

units, 100,000 work spaces, and a new university for more than 20,000 students, as well as new parks and retail and cultural facilities. Returns from City and Port have helped finance infrastructure investments, including expansion of the local metro system. Hamburg's 157-hectare (388 acre) HafenCity development is another example. This inner-city district of old harbor buildings is being transformed into more than 2 million square meters of space for offices, hotels, shops, and residential areas.

Missed opportunities

Many similar opportunities lie fallow. Our 2017 book, *The Public Wealth of Cities*, highlights one example in the Boston region. If Boston's Logan Airport were moved from prime waterfront real estate to cheaper inland property, it would stand to make a large windfall gain in real estate assets on the waterfront land that would probably well exceed the cost of building a new airport and infrastructure. Indirectly, GDP would also get a boost from ensuing investments. Living standards might rise since people appreciate waterfront views. But mainly it would represent a gain in wealth for state and city government, which could then be

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captured under a consolidated balance sheet and used, for example, for greatly needed infrastructure spending. As a bonus, the existing transportation to Logan would continue to take people to what could become a spectacular part of Boston.

When it comes to knowing their assets, many cities around the world have even less information to go on than Boston. For example, a 2017 inspector general's audit of Washington, D.C., found that the city's Department of General Services (DGS) "neither maintained a complete and accurate inventory of District-owned property, nor submitted annual reports detailing changes in this inventory to the D.C. Council as required by law. DGS lacked effective policies and procedures for maintaining inventory records; collecting and recording required data; and creating the



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necessary data fields in its database to record and update the inventory.”

Even some countries are not much better informed about the value of the assets they own.

Some “policy” assets funded by taxes—national parks or roads, for example—may not need a precise valuation. More worrisome is governments’ scant knowledge about public commercial assets that can render a revenue stream. These are government-owned enterprises; utilities; transportation assets such as airports and ports; and natural resources that can be commercialized, such as air rights, broadband spectrums, real estate, and toll-based infrastructure.

The IMF attempted to collect statistics on the book value of public commercial assets for 27 countries in a 2013 paper (IMF 2013). We added more countries in our 2015 book *The Public Wealth of Nations*. According to our estimates, public commercial assets are on the same order of magnitude as annual world GDP, which the IMF put at \$75 trillion in 2013, and comfortably higher than world public debt of \$54 trillion. At the city level, available valuation figures suggest the entire public portfolio of real estate within a city has the same value as the city’s GDP and represents a quarter of the total market value of real estate.

Although there are excellently run state-owned firms, such as Norway’s Statoil, these may be more of an exception. Studies by Bloom and van Reenen (2010), using detailed information on management methods, show that state-owned firms lag private firms considerably.

Comparison with some of the better professional institutions for governance of public commercial assets, such as Singapore’s Temasek, or pension funds managing similar assets suggests that much higher yields should be within reach. Consider,

conservatively, an additional annual yield of 3 percent worldwide: this would amount to \$2.7 trillion, more than current global spending on transportation, power, water, and communications infrastructure combined.

In addition there are democratic costs. Public wealth within easy reach of city administrations or national governments introduces incentives for abuse—for example, political favors in exchange for lucrative contracts or positions in state-owned firms; free access to federal land or water from public water companies in exchange for political support; union support if state-owned companies raise wages; and caving in to vocal minorities that oppose development projects. In all these ways democracy for the common good degenerates into clientelism or worse. Politicians who deftly buy support from various groups are rewarded, not those who enact reforms in the wider public interest.

A long-overdue revolution

With the invention of double-entry bookkeeping and accrual accounting some 700 years ago, the balance sheet was born. In contrast, the development of proper public sector accounting has just started. For the public sector, such a balance sheet would be able to quantify and publish specific fiscal risks, such as guarantees and other contingent liabilities, as outlined in the third pillar of the IMF’s fiscal transparency code. New Zealand and the United Kingdom are both regarded as pioneers in the use of accrual accounting—which records revenue and expenses when they are incurred—for public finances.

In the United Kingdom, the demand for better use of local government balance sheets is increasing, partly because of strong demand for public housing across the country. Moreover, local councils in the United Kingdom are diving headlong



into the commercial property market, borrowing at favorable government rates to purchase commercial real estate in pursuit of higher returns to fund gaps in their budgets after years of central government spending cuts. It is a role for which they are ill-suited, and the consequence is huge financial and fiscal risks.

As a result, the UK government is now making moves to improve balance sheet management. In the latest budget proposal, the UK government launched a balance sheet review to make more effective use of its public commercial assets, looking at areas such as improving the return on investments and reducing the cost of liabilities. The review will help release resources for further investment in public services and improve the sustainability of the public finances.

Toward effective governance

The holy grail of public commercial asset management is an institutional arrangement that detaches governance concerns from direct government responsibility. This can be accomplished through an independent balance sheet that encourages active long-term governance aimed at greater societal and financial value. Effective governance maximizes value in a transparent manner according to the highest international standards and independent of short-term political influence.

Some countries have made progress with a national wealth fund, similar to a private equity fund but wholly owned by the public sector, with active professional ownership to maximize long-term value. Such public wealth funds work under a government mandate while remaining fairly independent of short-term political influence, much like an independent central bank. This arrangement brings together the interests of the commercial management and the long-term life cycle of assets and supports the funding of maintenance, the bulk of the lifetime costs.

In Austria, for example, the ÖIAG (Österreichische Industrieholding AG) is a state holding company similar to Solidium in Finland that holds the government's listed companies. Another example is Singapore's Temasek, which has reported an average annual return of 15 percent over the 35 years since its inception.

A few cities have been very successful in setting up independent and professional holding companies or funds to manage their commercial wealth and help finance infrastructure investments—Copenhagen's City & Port Company and Hamburg's HafenCity, for example. MTR Corporation (originally, Mass Transit Railway Corporation), in Hong Kong SAR, funded and managed not only the vast investment in the city's rail infrastructure but also the large housing estates and shopping complexes incorporated into its stations. In addition, MTR pays a substantial dividend to the city, providing an income for the government that has been deployed to pay off existing debt and develop other assets.

Over the coming decades technological disruption and globalization will open many new opportunities for multiple uses of public assets. For example, self-driving cars may free public parking space that can be put to better use, and harbors, airports, and other transportation infrastructure will be revamped. Cities and countries are more likely to succeed with a transparent account of the assets they own and a government that promotes the creation of value. **FD**

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