

# THE GOVERNANCE BRIEF

ISSUE 40 • 2020

## Public Commercial Assets

### The Hidden Goldmine

by Dag Detter<sup>1</sup>

This governance brief is intended for use by any government administration at the national, regional and local levels, as well as any government-owned enterprise (e.g., state-owned enterprises) interested in a funding tool to pay for infrastructure and other investments for the benefit of society as a whole. Professionally-managed public assets can help optimize services for society as well as increase revenues and strengthen balance sheets, without using taxes or fees. Public wealth is a well-proven tool to increase fiscal space, reduce risks, and improve the cost of capital for governments and government-owned enterprises around the world.

### I. Why Governments are Like IKEA and McDonald's

IKEA, Tesco, Walmart, and McDonald's are often seen only from the operational perspective—as suppliers of flat-pack furniture, groceries, and hamburgers. However, from a financial perspective, their value is to a large part derived from the fact that they have substantial real estate portfolios. If publicly listed, investors often attribute the lion's share of market capitalization to the real estate portfolio. The same could perhaps be claimed for governments, be it at the local or national level.

Effective use of a government balance sheet, especially public commercial assets (i.e., any government-owned asset that can generate an income, if professionally managed), has been a critical part of Singapore's strategy to move the economy from “barely managing to survive” to one of the

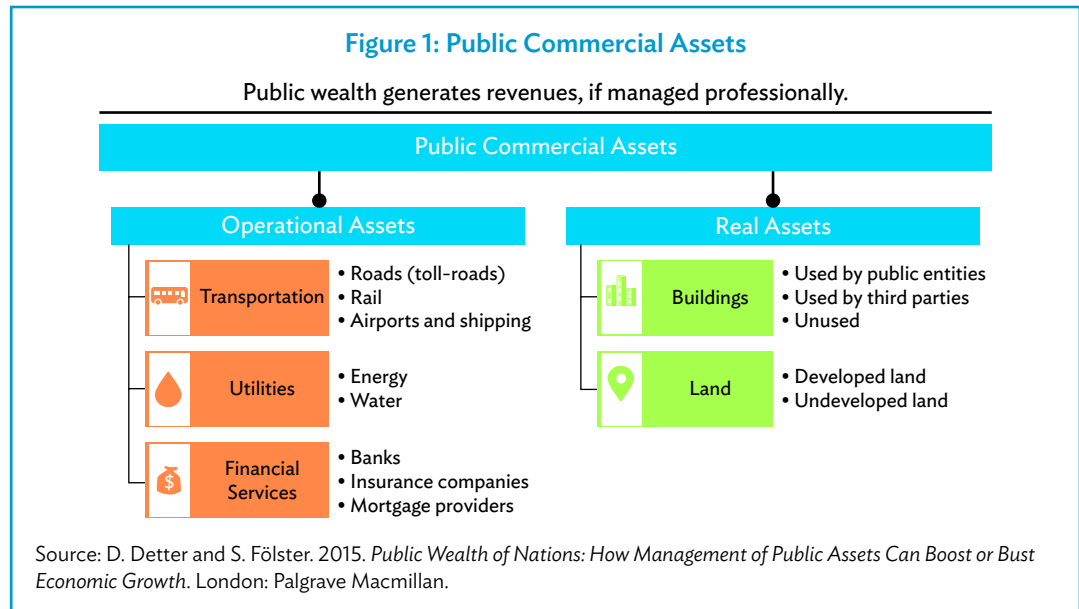
richest in a single generation. At a time when Asia was one of the world's poorest regions, the small island nation had few basic institutions, infrastructure, or resources when it gained independence from the British Empire some 50 years ago. Against all odds, it has thrived, thanks to innovative thinking, not the least with regard to the creation of successful economic institutions and productive use of public assets.

Singapore's founders recognized that a government has a balance sheet, just like a corporation, with both assets and liabilities that require active management. They introduced a separation of economic policy from the management of public commercial assets. Most other governments around the world kept managing their economies based on revenue and

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a stock of public debt. Instead, the innovative founders of Singapore incorporated portfolios of assets within public wealth funds and delegated the responsibility and accountability for managing public commercial assets (Figure 1) to professionals in holding companies.

Since then, the public wealth funds of Temasek and GIC (Government of Singapore Investment Corporation) have helped fund the economic development of the city state, while the Housing Development Board has provided an unparalleled almost four-fifths of its population with affordable and well-maintained public housing.

GIC is the vehicle that helped professionalize the management of foreign reserves as the sovereign wealth fund (SWF), which invests in financial assets outside of Singapore (Box 1).

A corporate holding company is the vehicle required to manage the portfolio of domestic operations (e.g., utilities, manufacturing, banks, telecommunication and transportation assets, and real estate). As in the private sector, it would come with internationally accepted corporate governance and accounting standards. In the public sector, the same professional management vehicle for commercial assets is called a national wealth fund (NWF). In Singapore, the NWF is Temasek (Box 2). There can be no professional management of commercial assets without such a vehicle.

The joint market value of GIC and Temasek significantly exceeds Singapore's public liabilities and is more than 1.7 times the annual gross domestic product (GDP) of the city state. It thereby helps improve the net worth of the government

### Box 1: Sovereign versus National Wealth Funds

**At the national level, there are typically two types of public wealth funds:**

- A **sovereign** wealth fund (SWF) is primarily concerned with managing reserve liquidity, typically investing in securities traded on major mature markets.  
SWFs are designed to optimize a portfolio by trading securities to achieve a balance between risk and returns.  
An example is GIC of Singapore.
- A **national** wealth fund (NWF) is an asset manager, concerned with managing a portfolio of operational assets.  
NWFs seek to maximize the portfolio value through active management including the development, restructuring, and monetization of individual assets.  
An example is Temasek of Singapore.

Source: D. Detter and S. Fölster. 2015. *Public Wealth of Nations: How Management of Public Assets Can Boost or Bust Economic Growth*. London: Palgrave Macmillan.

## Box 2: Temasek, Singapore's National Wealth Fund

Temasek was set up to enable the government to maximize long-term shareholder value by consolidating all commercial assets owned by the government. Total shareholder return, measured in Singapore dollars, has averaged 15% per year since Temasek's inception in 1974.

Previously existing monopolies and utilities that resided within the ministries were incorporated and subsequently transferred to Temasek. Many assets are now world-leading companies within their sector—including the telecom operator Singtel; DBS Bank, the largest bank in Southeast Asia; PSA International, one of the world's largest port operators; Singapore Airlines; ST Engineering, one of Asia's largest defense and engineering groups; and CapitaLand, one of Asia's largest real estate companies.

Transparency and clear objectives are strengthened by Temasek having an international credit rating. The board of Temasek, as well as those of its holdings, consists of independent nonexecutive directors recruited on merit, which reinforces independence. Almost half of both management and staff are non-Singaporeans. Furthermore, a world-class risk management system puts responsibility and accountability solidly with the board of each holding.

Source: Temasek. 2019. *Temasek Overview 2019*. <https://www.temasek.com.sg/content/dam/temasek-corporate/our-financials/investor-library/annual-review/EN-TR-PDF-2019/TO19-full.pdf>.

✓ **Greater net worth and stronger balance sheets also make countries more resilient to economic downturns**

balance sheet. As a result of this strong balance sheet, Singapore has consistently received the top credit rating AAA from the three main credit-rating agencies. Also, both funds deliver a significant surplus to the government.

According to the International Monetary Fund (IMF), countries with greater net worth have lower interest expenses and yields on sovereign debt and lower country risk premia. Greater net worth and stronger balance sheets also make countries more resilient to economic downturns. Five years after a recession, countries with stronger balance sheets are observed to be growing at three times the rate of those with weaker balance sheets.

## II. Professionalizing Public Financial Management

Most governments around the world have delegated the management of several core public financial operations to separate professional institutions, including government debt to a debt management office and the responsibility for setting interest rates to the central bank.

Similarly, some governments have delegated the management of excess revenue from exports to SWFs. These SWFs, often in resource-rich countries, have succeeded in generating wealth for society and future generations by investing surplus revenue in well-developed international stock markets or in real estate in stable developed markets. Authority is delegated to professionals for the very reason that they are thought to be neutral and can be easily held accountable against narrowly defined targets.

Governments around the world face pressure on their finances as well as a need to diversify

their economies, a situation not dissimilar to the pressure Singapore was under half a century ago. By reassessing the potential of the commercial assets on their balance sheet, most notably real estate, they have an opportunity to bring about transformative change. The best response would be to take a leaf from Singapore's book and reassess the potential of other commercial assets on the government balance sheet by setting up NWFs.

Public assets of most countries are larger than their public debt. In fact, the value of public assets is twice that of global stock markets and twice that of global GDP, according to estimates from the IMF (IMF 2018). Unlike listed equity assets, public wealth is unaudited, unsupervised, and often unregulated. Even worse, it is almost entirely unaccounted for. When developing their budgets, most governments largely ignore the assets they own and the value those assets could generate.

This is mainly due to the fact that the public sector has not adopted modern accounting standards similar to those used by private companies, which are based on accrual accounting as recommended by the International Public Sector Accounting Standards Board. Although most member countries of the Organisation for Economic Co-operation and Development are now reporting on an accrual basis and showing a balance sheet, the majority are still budgeting and appropriating on a cash basis. This means the balance sheet sits outside the budget process and is largely ignored and thereby made meaningless—something that would be unthinkable, if managing a large modern corporation.

The absence of a balance sheet that is fully integrated into the budget distorts incentives for politicians. Governments today still focus mainly on

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✓ **Improvement in global public wealth management would yield returns greater than the world's combined investment in infrastructure**

debt, without recognizing the value of their physical assets, using measures such as debt-to-GDP as key targets. This has led to wasteful short-term decisions, such as when privatizing water utilities because of the need for large-scale investments that would otherwise negatively impact misguided debt measures. This is like trying to manage a modern corporation using only the information available from the cash transactions recorded in the bank statements. Company accounting requires more complex information than this. This is equally true of governments.

For managing the financial affairs of a modern, highly complex government, the right tool is accrual accounting. A modern government needs a different mindset, a mindset that will recognize that managing public assets can generate revenues to pay for public services, fund infrastructure investments, and boost the economy—without raising taxes. As in the private sector, this means shifting the focus to net worth instead of focusing on cash and debt alone.

New Zealand is so far the only government that has introduced modern accounting and integrated its balance sheet with the budget, using it as a tool for its budgeting, appropriations, and financial reporting. This has led to New Zealand being one of the few countries in the world that has achieved and maintained significantly positive net worth, since their reforms in the 1980s. Most comparable governments like Australia and Canada, or larger economies such as the United Kingdom and the United States (US), have created a negative net worth, according to their financial statements (Ball 2019).

The governance of public wealth is one of the crucial institutional building blocks that separates well-run countries from failed states. However, the polarized debate between privatizers and nationalizers has missed the most important point: the quality of asset management.

An achievable improvement in global public wealth management would yield returns greater than the world's combined investment in infrastructure such as transport, power, water, and communications (Detter and Fölster 2015).

The cost of government services does not include the opportunity cost of publicly owned commercial assets. Real estate is generally the largest part of these, be it at the central or local level of government. These assets have been typically acquired in the past and depreciated accordingly, with book values that have no relation to their real value. A traditional approach to public sector assets fails to recognize their current market value;

moreover, it does not incentivize the maximization of value from these assets or their release for more beneficial uses such as residential redevelopment.

The cost associated with the original development of these assets is so historic that there is typically no perceived need to maximize return on the original capital investment. Government borrowing limits are in part a function of the size of the government's balance sheet—meaning, it is in the government's interest to accurately reflect the market value of publicly owned assets and pursue maximization of revenue from its portfolio.

With the right accounting, governments could focus on net worth, the measure used in the private sector, instead of on debt alone. With net worth as the official key target, an increase in debt to finance an investment is matched with an increase in assets. This would then incentivize investments in government-owned assets rather than encouraging wholesale privatization, which may be for the wrong reasons and at the wrong price.

A focus on debt alone has also led governments to embrace financial techniques such as a private finance initiative or public-private partnerships (PPPs), where the main advantage was keeping debt off the government's balance sheet. The concept has been criticized since it became popular in the early 1990s. The main criticism is the ability to take what is essentially government debt off the public sector balance sheet, while acquiring what may be more expensive obligations to the private sector.

Overall, the situation exacerbates the inadequacies of government accounting and the absence of an accurate balance sheet. Another problem with this type of financing is that it lays bare the challenge of a government bureaucracy to combine policy making and management of commercial risk. Due to this inherent commercial incapacity, the government may give away risk to a private sector partner. This results in a potentially larger profit for the private partner, while the public sector partner often is left with substantial financial risk should the project fail (Tang, Shen, and Cheng 2010).

History has shown that negotiating these contracts requires the commercial skills so often lacking in a political organization. This is why the results of such arrangements have been quite mixed and would ideally require the kind of professional organization that is represented by an independent holding company set up for the sole purpose of managing commercial assets while retaining public ownership. The needed professional organization is the public wealth fund.

Every penny generated with an increase in yield from public commercial assets is a penny less from budgetary cuts or increases in taxation. Any spending review should, in parallel, determine the extent to which additional yield can be generated from the government's own asset portfolio.

A focus on operational efficiency is not enough to extract value from these assets. Fully effective exploitation of public commercial assets should be transparent, and the implicit opportunity cost should be made visible in the budget review to the public services and government departments using these assets.

Yield may be maximized through a process whereby a fully integrated inventory of public assets would be established and maintained and the market value of each assessed asset takes into account its potential for alternative uses. This would allow for the design and development of a comprehensive business plan for all assets, an understanding of how to put each asset to its most productive use, and making visible the cost of using the asset in any suboptimal way.

### III. A Guide for Managing Public Wealth

A simple two-step process for professionalizing the management of public wealth starts with an understanding of the “size of the prize,” an indicative valuation, or an “asset map” of the portfolio of public commercial assets. This is followed by consolidating and institutionalizing a professional ownership of the assets inside one or several holding companies, also called public wealth funds.

#### 1. Preparing an Asset Map

To better understand the size of the total portfolio of public commercial assets at the national or local level, there must first be an assessment of the extent and value of the total portfolio of public assets through an indicative valuation or “asset map.”

Valuing operational assets is straightforward as they most often have financial accounts that can be analyzed and compared with publicly listed benchmarks. Real estate can be considerably more challenging.

In the absence of an electronic cadastre in the land registry office, a list of real estate assets is compiled by applying asset tracing techniques to identify property held directly or indirectly by various government entities (including affiliated corporate entities and authorities) across all jurisdictions.

Electronic data from geospatial analysis can be used to create a digitized inventory of all the properties. Historical data of real property transactions is applied to develop indicative values for portfolio holdings.

Indicative valuations of some US cities have recently shown that urban real estate, real estate already comprises land and buildings owned by the public sector, has a value equivalent to its GDP and represents a quarter of the total value of the real estate market (Detter and Fölster 2018). In addition, there are indications that the land value alone of Manhattan is larger than the GDP of Canada and the total value of urban land in the US is worth twice the national GDP. Government-owned real estate might be worth as much as global GDP, but we just do not know. Professionally managed, however, government-owned real estate could help increase housing supply as well as generate revenues to pay for public expenditures from education to infrastructure.

The reason governments do not know what they own in terms of real estate assets is partly because these are governed in a fragmented way and partly because many local governments do not have a consolidated list of their assets. It is also because the public sector does not use modern methods that account for the value of their assets. For example, the difference between book value and indicative value of the real estate owned by the City of Boston was shown to be almost 40 times and in Pittsburgh almost 70 times.

An indicative valuation is a financial prestudy carried out swiftly and discreetly in weeks rather than months. This provides a feasibility study of the potential for creating fiscal space and strengthening the public sector balance sheet. The value of the entire portfolio, the one single “large number,” is a useful tool to mobilize political support to introduce professional management of public commercial assets. Done professionally, better management of public commercial assets could generate extra revenue to the government equivalent to 3% of GDP each year, according to the IMF (Harris, Senhadji, and Tieman 2019).

Once the decision has been made to manage public commercial assets more professionally, it is time to consider how to structure the portfolio in one or several holding companies.

#### 2. Establishing Professional Ownership of Public Commercial Assets

The key to unlocking public wealth lies in the separation of governance of commercial assets from policy making.

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Fully embracing the term “commercial” in the phrase “public commercial assets” opens a whole new line of thinking. Such assets should be viewed as if they were privately owned, with value maximization as the sole objective of any decision making about them. The opposite—treating commercial assets as political instruments—distorts competition, investment, economic growth, and, ultimately, consumers’ interests. Misallocation of public capital inevitably leads to waste, corruption, and crony capitalism.

To improve productivity through deregulation and increased competition in a sector, it is important to create a level playing field, where the government is the owner of commercial assets as well as the regulator. This can be done by having a clear and reliable separation between regulation and ownership that can be trusted by all stakeholders. If this separation is sufficiently institutionalized and trusted, it will help encourage private sector investments and foreign direct investments.

Professional management of public commercial assets requires the ability to maximize the value of commercial assets in the most effective and economical manner. This is another reason why it is important for the government to separate ownership governance from any short-term political influence. A clear separation allows the use of private sector tools by consolidating and transferring assets into an independent corporate entity, such as a holding company, while still maintaining ownership.

Some real estate assets are not immediately understood as having a commercial value because they are the locus of activities related to public policy, such as schools or hospitals. Even if there is no intention of changing the function of a building,

there are still benefits from separating the value of real estate assets from the policy activity. The real estate, regarded independently, can be considered a commercial asset, with only a contractual relationship between the asset and its operation. An example is presented in Box 3.

These kinds of opportunities abound, but they are often not taken advantage of in a comprehensive way because political and administrative institutions are not geared toward exploring how public assets can generate greater value, nor do they have the information at hand that would enable such planning and professional asset management. That outcome requires a more systematic approach with professional engagement.

Based on a business plan, it would be possible to structure a portfolio accordingly and set up one or several holding companies. On the one hand, there is an argument for critical mass and economies that would allow for one large single holding company owning and managing both—i.e., all real estate and all operational assets. On the other hand, while it is almost always justified to consolidate all operational assets into one holding company, it can sometimes be tactical to consolidate real estate along the departmental lines of its current ownership.

In addition, it can be expedient to incorporate sizable brownfield opportunities. These exist in many shapes and forms, including former industrial or commercial facilities, harbour areas and other waterfronts, hospitals, railway stations, and the air rights above railway tracks that can be upgraded and developed. Creating a special-purpose holding company for such an opportunity has many advantages. The main benefit with this type of restricted urban wealth fund is the relative ease and speed with which the government can react to a

### Box 3: The Cost of Government and the Misuse of Public Assets

*Escola Municipal Cícero on Copacabana in Rio de Janeiro and the opportunity cost*

In Rio de Janeiro, Brazil, Escola Municipal Cícero Pena is a public school located on Avenida Atlântica, the famous stretch facing Copacabana Beach.

Surrounded by high-rise, five-star hotels on perhaps the most expensive land in the country, is suddenly this school, dwarfed by the surrounding real estate. This property is being used by an activity that, though socially important, could be located a couple of blocks away on much cheaper land in an environment perhaps more beneficial to students’ learning. Such relocation would release the property occupied by the school for use with the highest market value, while still being owned by the city.

Such a change would no doubt improve the general welfare because it would raise government income while affording the government the possibility to build an equivalent or better school with part of the revenue from developing the more valuable property.

Source: T. Prakash and V. Tanzi. 2000. *The Cost of Government and the Misuse of Public Assets*. IMF Working Paper No. 00/180. 1 November.

#### Box 4: MTR Corporation, Segmental Wealth Fund of Hong Kong, China

Hong Kong, China's fast-growing economy in the 1960s prompted the creation of MTR Corporation, essentially a segmental urban wealth fund that manages and owns an integrated rail transit system, the adjacent land, and much of the adjacent real estate.

Listed on the local stock market in 2000 with the government retaining the majority shareholding, MTR Corporation operates a predominantly rail-based transportation system that stretches more than 137 miles (220 kilometers).

It has funded and managed vast infrastructure investments and is a major property developer that helped to significantly increase the delivery of new residential homes in Hong Kong, China. Many of its stations are incorporated into large housing estates or shopping complexes. Residential and commercial projects have been built above existing stations and along new line extensions. The investment portfolio includes shopping malls and associated commercial services for the residents in and around the stations as a vital business for MTR Corporation, including the leasing of retail space, advertising space, automated teller facilities, and personal telecommunication services.

The property holdings generate almost 60% of the total operating profit for the domestic business in Hong Kong, China—including property development and rentals and property management—by developing for sale mainly residential properties in partnership with private sector property developers.

MTR pays a substantial dividend to the city, providing an income for the government that has been used to pay off existing debt and develop other assets. So far, it has developed the air rights over about half the system's 87 stations, amounting to 139 million square feet (13 million square meters) of floor area with another 38 million square feet planned (3.5 million square meters). Trains in Hong Kong, China carry more people, suffer fewer delays, and arrive on time more frequently than most of the world's other mass transit trains.

Purchasing power parity for fares shows that fares are marginally more expensive than Singapore, in line with New York, but almost a third the price of London. More than one-third of the revenue is spent on maintenance, renewals, and service improvements on the rail network. Half that amount is devoted to daily cleaning and inspection and the other half to capital expenditures such as routine replacement of cars and components.

Source: D. Detter and S. Fölster. 2017. *The Public Wealth of Cities: How to Unlock Hidden Assets to Boost Growth and Prosperity*. Washington, DC: Brookings Institution.

certain need or opportunity. The restricted scope means that only a limited number of stakeholders are affected, and this makes it easier to communicate and negotiate the benefits of a proposal.

Consolidating along departmental lines such as health care, where constant development of both technology and service models has changed the requirements for real estate, opens opportunities for converting unused parts of a hospital real estate portfolio into public housing and other mixed uses. International examples include Locum, the health care property company owned by Stockholm County in Sweden.

Transportation assets such as airports, postal systems, highways, ports, and subways all have abundant real estate assets that can generate substantial value and yields, if managed professionally through independent holding companies.

International examples would include Singapore and Dubai ports, now two of the world's largest port operators. In railways, one of the best examples is MTR Corporation in Hong Kong, China that has built one of the most efficient subway systems (the size of New York City), without using one tax dollar (Box 4). In the United Kingdom, London and Continental Railways has developed railway stations such as King's Cross in London and Stratford to help

pay for the Olympic Games. In Sweden, Jernhusen has developed the Stockholm City Terminal, paying for an almost doubling of the country's railway capacity.

Vasallen in Sweden is an example where the Ministry of Defence set up a property holding company to develop part of its property portfolio. BIG in Austria, Senate in Finland, ETAD in Greece, and Invimit in Italy are examples where central governments have established holding companies for their real estate. Similarly, Vasakronan in Sweden was set up as a central government property company and is now regarded as one of the most professional real estate developers in the country.

Urban areas would also benefit from consolidating assets into holding companies, as has been done in Copenhagen and Hamburg where their urban wealth funds developed public housing, offices, schools, kindergartens and universities, and hospitals without raising taxes. The yield from the Copenhagen urban wealth fund was also able to pay for the extension of the subway (Box 5).

In the end, the objective would be to capture as much value as possible from the portfolio under an institutional framework to generate the required fiscal space.

### Box 5: The Copenhagen Urban Wealth Fund

Copenhagen's "By og Havn" (City and Port) is a local government holding company and urban wealth fund established by the city of Copenhagen in 2007.

It is the largest urban wealth fund and urban development project in Europe and includes waterfront districts in the Copenhagen harbour area, as well as the land-locked Örestad District between the city center and Copenhagen's Kastrup Airport.

By developing a total area of 1,290 acres (5.2 square kilometers), the urban wealth fund will contribute more than 33,000 new residential housing units, 100,000 workspaces, and a new university for more than 20,000 students, as well as new parks and retail and cultural facilities.

It has been able to help fund part of the extension of the local metro system, as well as other infrastructure investments required by the developments and the city.

Source: D. Detter and S. Fölster. 2017. *The Public Wealth of Cities: How to Unlock Hidden Assets to Boost Growth and Prosperity*. Washington, DC: Brookings Institution.

For political reasons, the government often prefers to retain total ownership of a public wealth fund. The required participation from the private sector to develop the underlying real estate, thus realizing the full economic potential of the asset, is best done at the subsidiary level.

### 3. Setting Up the Holding Company

The initial setting up of a public wealth fund is most often a 6-month process, including the development of a business plan, recommendations for the structure and assets to be included, a fund strategy, an operating model, and governance (Figure 2).

To achieve this overall plan, four parallel workstreams coordinated by a project management office will help define, execute, and manage stakeholders under the leadership of a steering committee. This can be set up as a fully independent nonexecutive board of the actual holding company to delegate the appropriate responsibility and accountability during the entire process, from design to the launch of the finished holding company.

The **commercial** workstream would typically have the support of a management consultancy firm that would do an indicative valuation of all public commercial assets (e.g., real estate,

Figure 2: Process for Setting Up a Public Wealth Fund



IFRS = International Financial Reporting Standards.  
Source: Detter & Co. Public Wealth. <http://detterco.com/>.



operating businesses) at “current use.” Making some assumptions about the best use of the assets or segments of assets, it would be possible to formulate a value creation hypothesis and make a selection of the assets to be included and a business plan for a portfolio. This would help design a recommended operating model and organizational structure as well as the resource needs.

The **legal** workstream would be supported by a law firm that would carry out the legal due diligence, including an asset review, legal approvals, constraints, and requirements. The firm would also provide advice on the group legal structure and governance to be able to function as if it was a private sector holding company.

The **accounting** workstream, with the help of an international accounting firm, takes responsibility for the formal valuation of assets and the production of an initial set of accounts for the holding company using International Financial Reporting Standards.

The **financial** workstream involves rating advice by an international investment bank and their rating specialists that helps tailor all the above workstreams, with the purpose of obtaining the best possible rating to achieve the lowest possible cost of debt funding. Some of the working tools include a term sheet and, ultimately, a bond prospectus.

#### IV. Fundamental Governance Principles When Setting Up a Public Wealth Fund

In a market economy, the government acts as an independent referee to reduce monopoly profits and inefficiencies, lower prices for end users, increase investment and productivity, and encourage competition in the sector. This stance is irreconcilable with the government having direct involvement in commercial enterprises that risk crowding out private sector initiatives.

If the government does own commercial assets that compete with private sector initiatives, it needs to pay special attention to three fundamental principles to mitigate this contradiction and conflict of interest: transparency, a clear objective, and political independence.

- **Transparency.** Achieving the same standards of transparency for the holding company and its portfolio of holdings as for a listed holding company.
- **Clear objective.** Outsourcing policy objectives through a competitive procurement process paid

for directly by the government in order to achieve the sole objective of value maximization.

- **Political independence.** Institutionalizing the holding company and its governance structure in order to maintain its independence at arm’s length from short-term political influence.

As in a system of checks and balances, these three principles are interconnected. Like the spokes of a wheel, all must be equally strong for the wheel to turn smoothly and with speed. If not, the wheel will bend and, eventually, break.

Accountability is vested solely with the board, as a wheel is anchored at its hub. Any breach of accountability detected in one or all three spokes results in deteriorating financials and, sooner or later, a breakdown.

Political independence without transparency will create an unwieldy conglomerate so often seen with government companies. Political independence without a clear objective becomes a wrecking ball against fair competition and efficient capital allocation. Maintaining a clear objective is not possible without both transparency and political independence.

Each principle must be carefully reflected in the governance structure and continuously upgraded and refined over time to ensure the board is held accountable at all times. Any compromise in the governance structure will be reflected in the yield, as the correlation between the two is obvious.

The flip side of failing to ensure the three principles and, thereby, effectively assigning accountability with the board is that responsibility for any mismanagement or underperformance will immediately end up with the political leadership. There is often political will for having such technical responsibility delegated to professionals. Politicians are generally not keen to be measured and held accountable against narrowly defined targets.

#### V. Now to Work: Active Management and Development of the Portfolio

Standardized accounting is the prerequisite to maximizing value of both operational and real estate assets.

With operational assets, it is first important to benchmark the operational and financial efficiencies with private sector peers to better understand any performance gaps with the best-in-class.

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✓ **Government-owned operations tend to become unwieldy conglomerates with poor allocation of capital and overburdened by noncore assets**

Second, standardized accounting allows the government to optimize the capital structure and set up a dividend policy in line with its private sector competitors.

Third, through business development, it will maintain the focus on the core business and invest only when profitable.

This has proved to be an important strategy as government-owned operations tend to become unwieldy conglomerates with poor allocation of capital and overburdened by noncore assets.

The reason government-owned enterprises end up as hoarders of assets with poor returns on capital is partly because they can only raise additional equity through a painstaking political process in which their commercial requirements for additional capital will compete with the need for social spending and other public welfare requirements. Consequently, leaders of government-owned enterprises are incentivized to minimize earnings to avoid paying dividends altogether. An example is presented in Box 6.

There are numerous ways to show a loss and avoid paying dividends, including diversifying and making investments regardless of whether they will give a positive return or not, and then cross-subsidizing within the group. The result is that public enterprises often end up as ill-defined

and opaque operations with poor returns on capital and wasteful capital allocations.

In the context of publicly owned real estate, value maximization can be achieved through a similar process of making the best use of each asset and the portfolio, starting with commercialization and optimization, and concluding with a potential rationalization.

Commercialization requires a comprehensive business plan that provides an assessment of all assets, including those unused or used by third parties, as well as those directly used in the provision of public services, but which can either be (i) relocated to more cost effective or beneficial locations, or (ii) used to generate ancillary income (e.g., exploitation of publicly-owned intellectual property, and additional or alternative uses of real property).

Optimization requires economies of scale to be achieved across the entire portfolio directly used in the provision of public services and should be as much a priority as maximization of yield from each individual asset.

Rationalization involves determining assets that have reached a fair value and that would benefit from timely disposal rather than being further developed (surplus). Surplus estates should be disposed of at well-timed points in the market

### Box 6: The Swedish Experiment with Active Ownership, 1998–2001

Following the financial crisis in Sweden in the 1990s, a number of structural problems were revealed, including outsized public expenditures, laid-off workers absorbed by the public sector and vital sectors in need of restructuring, along with inefficiently regulated markets that led to poor industrial competitiveness.

The government set a goal of managing its commercial assets “as if owned by private shareholders,” instead of resorting to wholesale privatizations. This meant consolidating the portfolio under professional management, introducing private sector discipline, and an equity culture.

As a result, the portfolio value increased by 12%, while nearly one-third of the original portfolio was privatized—almost five times as much as when privatization was the main objective of the previous government. The value increase was almost twice that of the local stock market, which rose only by 6% over the same period.

This was the first attempt by a European government to systematically address the ownership and management of state-owned enterprises, and it quickly yielded significant returns and benefits. Given the portfolio’s 25% share in the economy, it helped boost economic growth over the period by improving returns from public corporations, intensifying market competition, increasing productivity and, ultimately, promoting disinflation. This contributed to a significant fall in prices in these sectors from the late 1990s into the early 2000s. The reforms meant the government broke with old-style policies, including regulations curbing competition, ineffective capital and labor use, inventory mismanagement, and lack of transparency.

The introduction of consolidated professional management of the portfolio included the restructuring of AssiDomän, one of Europe’s largest paper and packaging groups with significant holdings in forestry assets, by divesting or joint venturing portions of the industrial operations and returning capital to shareholders. Restructuring and the subsequent sale of Celsius, a large European defense group, involved finding suitable industrial partners for several of the company’s business areas. The state-owned rail monopoly SJ was transformed into one of the most profitable rail operators in Europe by streamlining operations and divesting all activities other than core passenger services.

Source: D. Detter and S. Fölster. 2015. *Public Wealth of Nations: How Management of Public Assets Can Boost or Bust Economic Growth*. London: Palgrave Macmillan.

cycle as part of the broader business plan for maximization of yield across the entire portfolio.

Monies generated from rationalization activities should be first made available as a source of funding for achievement of the business plan and can eventually be used to fund other government requirements such as infrastructure investments.

## VI. Impact on Sovereign Rating

Improved management of government assets may also have a positive impact on a nation's sovereign rating, which affects its cost of borrowing (Amin-Salem et al. 2019).

The monetization of public assets generates receipts that can be used to pay down existing debt, to reduce the need for new debt, or to build the government's financial buffers. Outcomes such as a reduction in the government debt stock or a slowdown in its pace of accumulation and an increase in government financial assets directly improve key metrics in the sovereign rating models of the three global rating agencies, thereby resulting in better ratings.

However, even without privatization, better management of government assets is likely to yield positive quantitative and qualitative impacts that eventually provide an uplift to the sovereign rating or provide a buffer against a downgrade.

To the extent that better management of public assets leads to improved delivery of public goods and services to the citizenry and is perceived by the rating agencies to enhance trust between the public and the government, this would further serve to improve their assessments of governance and institutional strength, which are components in their rating models.

The gains from a higher rating would likely be significant by lowering the cost of government borrowing as well as providing an attractive signal to foreign investors.

In addition to assisting sovereign credit ratings, more efficiently managed assets would contribute to a higher rate of real GDP growth, generate dividends or other cash flows for the government budget, and lower operating costs to the benefit of society.

*This governance brief was peer-reviewed by Bobir Gafurov and Cigdem Akin.*

✓ **More efficiently managed assets would contribute to a higher rate of real GDP growth**

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ISBN 978-92-9262-150-6 (print); 978-92-9262-151-3 (electronic)

[pubsmarketing@adb.org](mailto:pubsmarketing@adb.org)

ISSN 2520-6591 (print); 2520-6605 (electronic)

<https://www.adb.org/publications/series/governance-briefs>

Publication Stock No. BRF200110

DOI: <http://dx.doi.org/10.22617/BRF200110>