

6. ICAEW: public sector assets

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Key findings

- **HM Treasury is conducting a Balance Sheet Review that is due to report alongside the 2018 Autumn Budget. This provides an opportunity to develop a comprehensive investment and asset management strategy**, going beyond ad hoc initiatives such as the recent establishment of the Government Property Agency to improve the management of offices and other general-purpose central government property.
- **Public sector assets are less than half the size of public sector liabilities.** At 31 March 2017, the government reported assets of £1.9 trillion (94% of national income), compared with total liabilities of £4.3 trillion (214% of national income). Most public sector assets are not readily saleable and could not easily be used to settle liabilities, although the public sector's most significant resource – the ability to levy taxes – is excluded.
- **Capital investment is a relatively small component of public spending and has declined since 2009–10, although the government plans to increase investment next year and the year after.** Capital expenditure in 2016–17 of £55 billion (2.8% of national income) was less than 7% of non-capital expenditure of £819 billion (41.2% of national income) and 9% lower in real terms than in 2009–10. Net additions to fixed assets after depreciation and disposals were just £18 billion (0.9% of national income).
- **The government is reliant on future tax revenues to fund its financial commitments, with public debt currently standing at close to £2 trillion.** There are no social security or social care funds. No money has been set aside for £1.9 trillion in unfunded public service pensions, nuclear decommissioning or clinical negligence liabilities.
- **Labour party proposals for nationalisation would add to public sector assets, but the borrowing required would add considerably to liabilities. Higher revenues would follow, but there is a risk of underinvestment in the future without a change in capital allocation approach.** Nationalising utilities, train operations, the Royal Mail and PFI contracts could potentially increase public debt by more than £200 billion.

This chapter complements our chapter on liabilities in last year's Green Budget.¹

¹ <https://www.ifs.org.uk/uploads/publications/budgets/gb2017/gb2017ch4.pdf>.

6.1 Introduction

Public assets are integral to both the government's balance sheet and the functioning of the UK. Some of these assets, such as schools and hospitals, are essential in delivering public services. Others, such as the road network, are part of the economic, social and legal infrastructure that supports economic activity and hence the tax revenues needed to pay for public services.

As illustrated in Figure 6.1, total public sector assets at 31 March 2017 of £1.9 trillion were reported, equivalent to 94% of GDP or approximately £28,500 per person living in the UK. These were more than offset by liabilities of £4.3 trillion at the same date, equivalent to 214% of GDP or £65,500 per person.

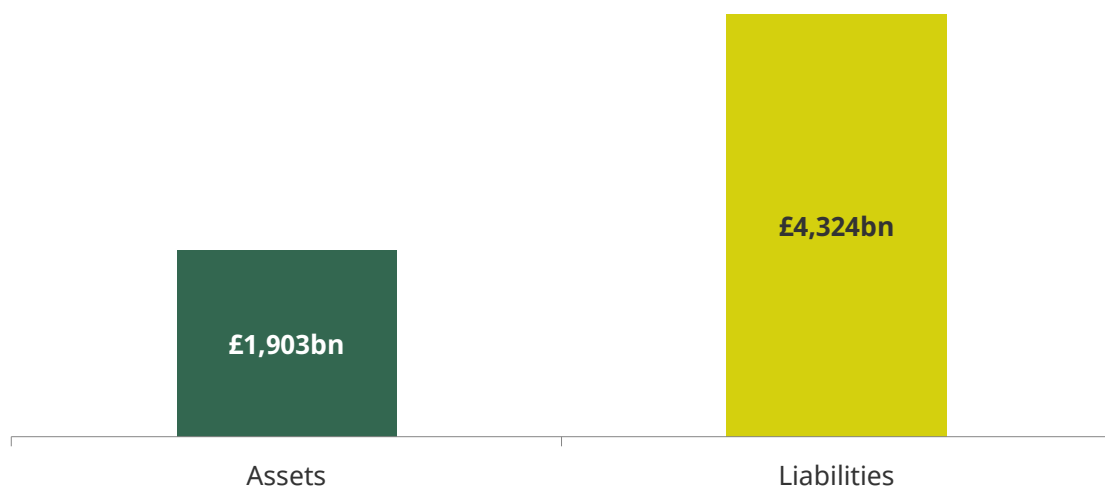
As a consequence, net liabilities were £2.4 trillion – 120% of GDP and an increase of £435 billion from 31 March 2016.

The government is undertaking a Balance Sheet Review, considering how it can use public assets in the most effective way to advance its policy priorities, and how it manages its liabilities and other financial commitments. A progress report is expected with the 2018 Autumn Budget.

The review provides an opportunity for the government to develop a comprehensive investment and asset management strategy, going beyond ad hoc initiatives such as the recent establishment of the Government Property Agency to improve the management of general-purpose central government property.

Section 0 provides an overview of the assets recorded in the public balance sheet at 31 March 2017 and compares them with those of other nations. Section 6.3 examines fixed assets in more detail, including infrastructure, land and buildings, and equipment, while Section 6.4 looks at capital expenditure. Section 6.5 looks at other assets, including

Figure 6.1. Public sector assets and liabilities at 31 March 2017



Source: HM Treasury, *Whole of Government Accounts 2016–17*.

investments, receivables, inventories and financial assets, and Section 6.6 discusses how the Balance Sheet Review can be used to improve the utilisation of public assets and the prospects for a comprehensive investment and asset management strategy. Section 6.7 concludes.

Box 6.1. What is an asset?

Accounting standards define an asset as a resource that has arisen from a current or past event and from which future economic benefits are expected to flow.

The definition includes cash, contractual rights that will turn into cash, and resources that can be exchanged for cash or other assets. It also includes tangible and intangible resources that can be used to generate value, which in the case of government includes providing public services.

Assets are initially recorded at fair or market value, in most cases cost or transaction amount. Their value in later periods depends on the type of asset. Fixed assets are reduced by depreciation each year, although an accounting policy to revalue them can be adopted (see Box 6.2 later).

Most investments and financial assets are updated to current market values, though loans are generally recorded at the amount lent plus accrued interest (less provisions for non-repayment). Most other assets are not revalued, unless they need to be written off or impaired.

Assets include resources that are controlled but not owned, such as NHS hospitals under the Private Finance Initiative that are legally the property of private companies.

Not all rights to receive income in the future are recognised as assets. For example, the right to levy tax revenues is not considered to be an asset as it does not arise from a past event. (This is similar to the accounting definition of a liability, which does not include all future payments; for example, commitments to pay the state pension and welfare benefits in the future are not counted as liabilities.)

Some assets may not be sufficiently certain to recognise in the balance sheet – for example, legal claims where there is possibility that money may be received in the future, or a guarantee or indemnity that will only be triggered in certain circumstances. These are known as contingent assets and are disclosed in the notes to the financial statements.

6.2 Assets in the Whole of Government Accounts

The 2016–17 Whole of Government Accounts (WGA) can be summarised as shown in Table 6.1.

The accounting loss of £98 billion was higher than the reported fiscal deficit of £45 billion for 2016–17. This was principally because of the inclusion of long-term liabilities, including those for public sector pensions, nuclear decommissioning and clinical negligence, all of which increased between March 2016 and March 2017.

Total assets were recorded at book values adding up to £1,903 billion. Although this is not necessarily the same as their market or potential sales value (as explained in Section 6.3), book values do provide an indication of the level of resources being deployed by the state in providing public services, enabling the financial position of public bodies to be monitored and analysed.

Assets can be categorised as fixed assets, investments, financial assets or working capital assets. Fixed assets are used in production or are needed to support the delivery of services, while investments are generally held with the intention of generating an income and/or capital growth.

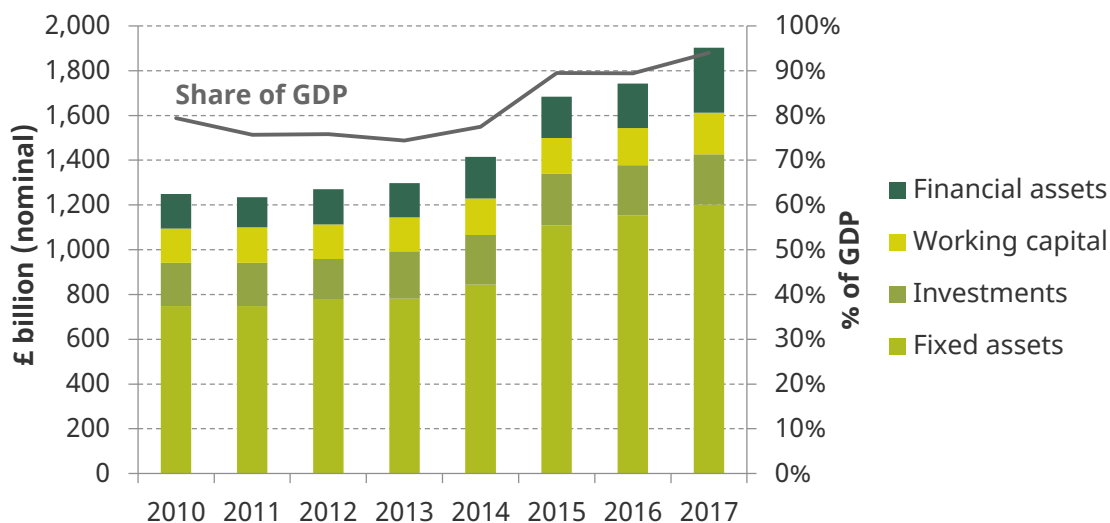
Financial assets include cash and bank deposits that can be used to acquire other assets or to meet liabilities as they fall due, as well as short-term loan receivables, gold holdings and financial derivatives. Working capital assets arise as a consequence of operational activities and include receivables and inventories.

Table 6.1. Summarised Whole of Government Accounts 2016–17 (£ billion)

Balance sheet		Revenue and expenditure	
Assets	1,903	Revenue	721
Liabilities	(4,324)	Expenditure	(819)
Net liabilities	(2,421)	Accounting (loss) for the year	(98)
Cash flows		Change in financial position	
Operating cash inflow	70	Accounting (loss) for the year	(98)
Investing cash outflow	(53)	Pension revaluations	(361)
Interest and similar outflows	(33)	Asset revaluations	40
Financing cash inflow	19	Other movements	(16)
Change in cash balances	2	Change in financial position	(435)

Note: In this table, positive numbers are used for revenue, other gains, cash inflows and assets, while (in parentheses) negative numbers are used for expenditure, losses, cash outflows and liabilities.

Source: HM Treasury, *Whole of Government Accounts 2016–17*. These, and those for earlier years, can be downloaded from <http://www.gov.uk/government/collections/whole-of-government-accounts>.

Figure 6.2. Total assets, March 2010 to March 2017 (£ billion and % of GDP)

Source: HM Treasury, *Whole of Government Accounts 2016–17* and earlier years.

This increase looks more significant than it is.

As illustrated in Figure 6.2, the value of recorded assets increased by more than 50% between March 2010 and March 2017. As a share of national income, assets grew by 15 percentage points.

As summarised in Table 6.2, half of the increase between 2010 and 2017 arises from the incorporation of additional public bodies into the WGA, principally Network Rail in 2014 and 2015.

A further £83 billion is from revaluations net of impairments.

Net additions included £103 billion (£15 billion a year) added to fixed assets, as discussed in more detail in Section 6.3, and £112 billion more in financial assets, as discussed in Section 6.5.

Table 6.2. Change in total assets over the seven years to 31 March 2017 (£ billion)

	Fixed assets	Investments	Working capital	Financial assets	Total
31 March 2010	749	192	153	155	1,249
More public bodies ^a	282	12	1	24	319
Net revaluations ^b	68	-	15	-	83
Net additions	103	20	17	112	252
31 March 2017	1,202	224	186	291	1,903

^a Network Rail £306 billion and other public bodies of £13 billion.

^b Revaluations of £145 billion less impairments and write-downs of £62 billion.

Source: HM Treasury, *Whole of Government Accounts 2016–17* and earlier years; ICAEW calculations.

International comparison

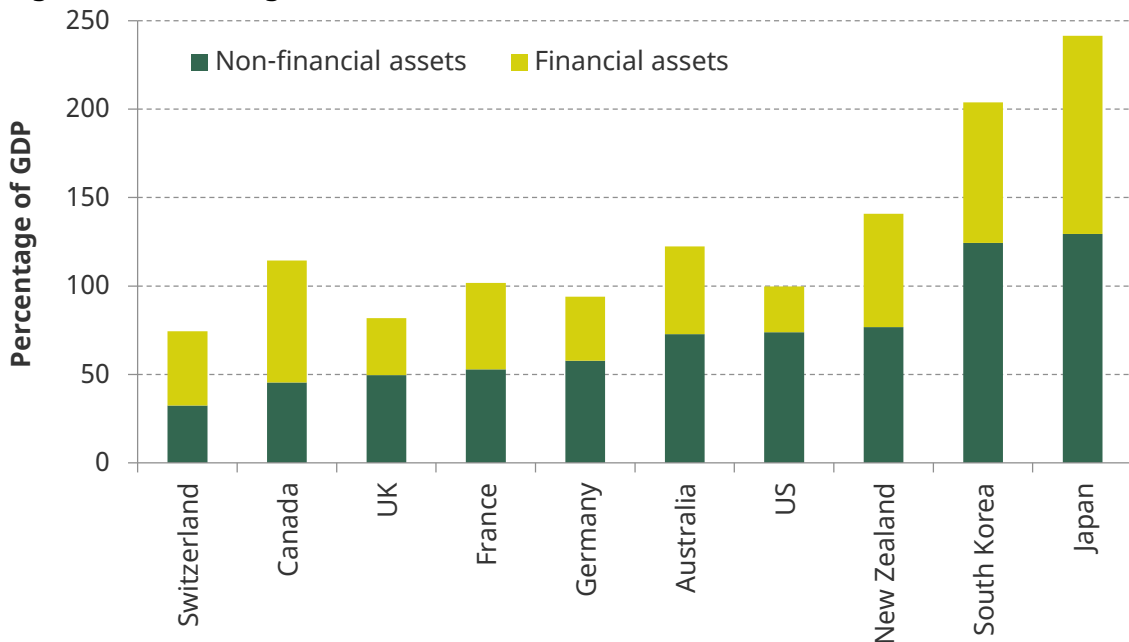
Figure 6.3 compares the assets held by general government (comprising central government, state/provincial government and local authorities) of several countries in proportion to the size of their respective economies.

The amounts are based on National Accounts statistical returns, as the UK is the only country that produces integrated financial statements like the WGA that encompass the entire public sector.

Financial assets can vary significantly depending on each country's fiscal position and financial investment strategy.

The UK's non-financial assets are similar to those of Canada, France and Germany at around 50% of GDP. However, countries such as the US and Australia hold non-financial assets worth 75% of their national income, while Japan and South Korea have non-financial asset holdings that exceed the UK's total assets as a share of the economy.

Figure 6.3. General government assets at 31 December 2016 (% of GDP)



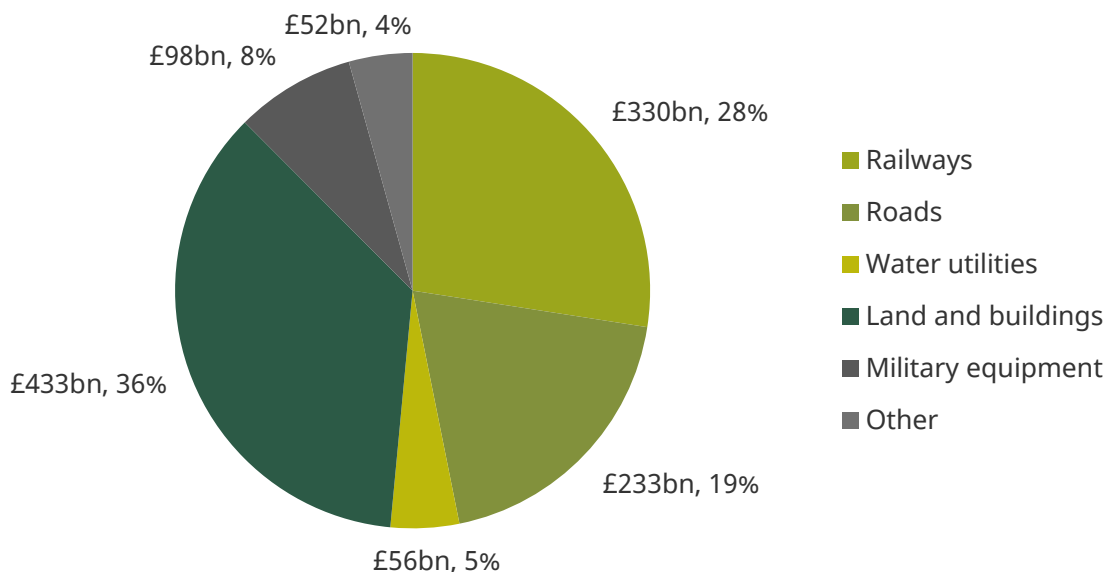
Note: Non-financial assets here comprise fixed assets, inventories and non-financial investments. Financial assets include receivables and financial investments in addition to cash. The UK's general government assets of 82% of GDP at 31 December 2016 are different from assets in the WGA of 94% of GDP at 31 March 2017 due to the exclusion of public corporations from the former and differences in land valuation.

Source: IMF, *Government Financial Statistics 31 August 2018*; Federal Statistics Office of Germany; Japan Cabinet Office.

6.3 Fixed assets

At 31 March 2017, the public sector reported tangible and intangible fixed assets with a book value of £1,202 billion, equivalent to 59% of GDP.

Figure 6.4. Fixed assets at 31 March 2017 (£ billion and % of fixed assets)



Note: Railways includes Transport for London infrastructure of £19 billion.

Source: HM Treasury, *Whole of Government Accounts 2016–17*; accounts of government departments.

As illustrated by Figure 6.4, just under half of these relate to transport infrastructure such as the road and railway networks, while a further third or so are in the form of land and buildings.

The strategic road network and local roads not only enable people to get around, but also are essential to economic activity. Land and buildings include schools and hospitals needed to deliver education and health services and social housing for 4.5 million people, as well as central and local government offices and facilities. Military equipment includes tanks, ships, aircraft, missiles and other military systems to support the defence of the realm, while publicly owned water utilities provide water and sewerage services to Scottish and Northern Irish households.

Public sector bodies are estimated to own approximately 2 million hectares out of the 24 million hectares that make up the UK, including 450,000 hectares of forest, 220,000 hectares owned by the Ministry of Defence (MoD) and 140,000 hectares owned by the Crown Estate.

As part of its Balance Sheet Review, the government intends to evaluate its stock of fixed assets, the income they generate, and whether they are being used efficiently and in line with policy priorities. It states: ‘The government’s Balance Sheet Review is intended to help release resources for further investment in public services and improve the sustainability of the public finances’.²

Assets can be used to support policy priorities directly. For example, the government has been keen to identify land to build new housing, with the Ministry of Housing,

² Government Actuary’s Department, ‘Autumn Budget 2017: a GAD technical bulletin’, 2017, <https://www.gov.uk/government/publications/autumn-budget-2017-a-gad-technical-bulletin>.

Communities and Local Government in England aiming to release land for 160,000 new homes over the five years to 2020. Managing the government's estates to free up land in the more promising sites would have a clear impact on this target, and play a part in helping halt the decline in homeownership rates among the young (see Chapter 9).

Government assets can also be deployed indirectly to support a range of policy priorities. Some assets could be sold and the cash used to pay for other programmes. Proceeds might also be used to invest in other assets or to settle or fund liabilities.

In practice, the majority of public assets are integral to the delivery of public services and so are difficult to sell. Even in the case of assets that are not essential to public service delivery, sales are not always straightforward. Many 'non-core' assets are in the form of forest, open spaces, heritage buildings and government-owned art and museum collections, and proposed sales can generate substantial political opposition. For example, a proposal in 2011 to raise £350 million by selling half of the publicly owned forests in England was reversed in the face of strong public opposition.

Even where assets are surplus to requirements, there can be practical difficulties in establishing ownership before they can be sold. Many public assets are on sites that were originally donated or are subject to restrictive covenants. In particular, many state schools are built on land owned by religious institutions.

In other cases, the ownership of assets may be uncertain or disputed. An example is the St Bartholomew's Hospital site in the City of London – although the main hospital was closed in the 1990s, most of the site it occupied could not be sold and so continues to be used for public purposes.

It is important to understand that the book values at which fixed assets are recorded in the WGA are not necessarily the same as the amount they could be sold for. For most other organisations preparing accounts, market values of fixed assets are usually higher than the depreciated historical cost book values at which they are usually recorded if for no other reason than inflation.

The government's approach of revaluing land to an estimate of current market value avoids this issue for land, which in theory should be capable of being sold for a similar price to its recorded book value.

However, the government's use of an unusual accounting policy – depreciated replacement cost – for infrastructure, equipment and other fixed assets can result in the opposite problem. Many fixed assets are recorded in the books at more than they could be sold for, one of the drivers behind the £62 billion of impairments and write-downs recorded in the WGA over the seven years to 31 March 2017.

This accounting approach is discussed further in Box 6.2.

Box 6.2. Revaluing fixed assets

Most preparers of financial statements carry fixed assets at **depreciated historical cost**, which is the amount incurred on the original acquisition or construction, less accumulated depreciation to reflect age and usage. It is not adjusted for inflation.

The government instead chooses to revalue its fixed assets each year. Land is updated to estimated market values, with external valuations carried out every five years. Most other fixed assets (including buildings and equipment) are uplifted to an estimate of the cost of replacing them at current prices, adjusted for depreciation.

The latter approach is known as **depreciated replacement cost** and it enables assets acquired or constructed a long time ago to be reported at a current value. It also has the benefit of aligning the accounting book values with the amounts recorded in National Accounts statistical returns, while requiring government departments to assess the value of their fixed asset portfolios each year, potentially providing useful information that can be used in managing those assets.

However, there are some significant disadvantages.

Replacement costs can be difficult to estimate and so are inherently less certain than the original cost of acquiring an asset. While the depreciated historical cost approach tends to value assets at less than they could be sold for, depreciated replacement cost is more likely to overvalue assets, leading to write-offs rather than gains when assets are disposed of. Some transport network enhancements have to be impaired immediately, because their individual cost is greater than the value they add to the overall network. Where an asset has been the subject of an upward revaluation, the depreciation charges recorded over the life of an asset will exceed the original cost of buying it.

One rationale for using depreciated replacement cost is that it can act as a proxy for market value. Unfortunately, this is not the case for most fixed assets owned by government – either because a ready market does not exist or because a rational purchaser would not pay that amount. For example, it would not be possible to sell the national railway network for its £289 billion book value based on the financial returns available from operating it.

Another issue is that local authorities continue to use depreciated historical cost for road infrastructure, causing a mismatch within the WGA. The Treasury estimates that local roads would be recorded at least £53 billion higher if depreciated replacement cost were used.^a

Using depreciated replacement cost creates unnecessary complexity in government accounting. A substantial proportion of the value of fixed assets relates to the land on which assets are built, so as long as land is updated to its current value, using depreciated historical cost for other fixed assets would be simpler and would enable more transparency and accountability. For example, impairments that deserve proper scrutiny – actual losses compared with the original cost – would no longer be obscured by technical impairments resulting from this choice of accounting policy.

^a Page 152 of HM Treasury, *Whole of Government Accounts 2016–17*.

Infrastructure, land and buildings

Table 6.3 sets out the main components of economic infrastructure, land and buildings.

Economic infrastructure on the public balance sheet almost entirely relates to transport infrastructure, with the exception of publicly owned water and sewerage utilities in Scotland and Northern Ireland.

The remainder of the UK's economic infrastructure – electricity, gas, water and telecommunications networks and most air transport infrastructure – is in the private sector, albeit subject to government regulation.

The valuation of the railway network illustrates how the choice of accounting policies can make a significant difference to the values at which assets are recorded. Network Rail itself records the rail network at £56 billion, on a value-in-use basis, reflecting the track access fees it can charge. This contrasts with the £289 billion book value in the WGA, which is the estimated current value of rebuilding the network, less depreciation to reflect the age and usage of the assets concerned. It could be argued that the market value of the railway network is actually negative, as without public subsidies, in the order of £7 billion a year, it would make significant losses. However, the government is able to take account of the value of the railways to the overall economy in justifying the carrying value it uses in the WGA.

Land and buildings include 1.9 million homes owned by local authorities in Great Britain, with a value of approximately £88 billion or around £46,000 per dwelling. This includes

Table 6.3. Economic infrastructure, land and buildings as at 31 March 2017 (£ billion)

Economic infrastructure		Land and buildings	
National railway network ^a	292	Local government ^d	220
Strategic road network	148	Whitehall departments	48
Local roads ^b	124	Academy schools	46
Water utilities ^c	59	Department of Health	43
Transport for London	19	Ministry of Defence	32
Other public transport	7	Scottish and Welsh governments ^e	10
Understatement ^b	(53)	Public corporations and other	21
Economic infrastructure	596	Land and buildings	420

^a Network Rail £289 billion and High Speed 1 £3 billion.

^b Northern Ireland strategic and local roads £26 billion and England, Scotland and Wales local roads £98 billion at estimated depreciated replacement cost; the latter are recorded at depreciated historical cost of £45 billion, a £53 billion understatement.

^c Scottish Water £56 billion and Northern Ireland Water £3 billion.

^d Includes social housing and local authority schools in addition to local government offices and other facilities.

^e Includes NHS Scotland and NHS Wales assets of £4 billion.

Source: HM Treasury, *Whole of Government Accounts 2016–17* and other public accounts for 2016–17.

1.6 million homes in England, for which the average rent is £380 per month, at an average gross rental yield of 10%.

Whitehall departments own land and buildings with a recorded value of £48 billion. Many of these properties will be transferring over time to a new executive agency set up to manage general-purpose property. This new body, known as the Government Property Agency, came into existence on 1 April 2018 with the intention of managing the property portfolio more commercially. This includes a strategy to co-locate government departments together in 'hubs' comprising modern office buildings in cities around the UK. It is envisioned this will reduce the space required per public employee and free up spare capacity to be sold or leased out to the private sector.

A significant change within the public balance sheet has been the transfer of schools from local government to central government as they have converted to academy status. Unfortunately, poor financial controls at the Department for Education have meant that it has been unable to report a reliable value for academy schools transferred during 2016–17. The WGA included academies as at 31 August 2016, which means schools that transferred out of local authorities between September 2016 and March 2017 have been temporarily 'lost' from the balance sheet. This is not material to the government's overall financial position, but it represents a significant failure of financial control. It has resulted in the Comptroller and Auditor General qualifying his audit opinion.³

Land and building used for health purposes include hospitals, GP surgeries and ambulance stations across the country, including £11 billion through the Private Finance Initiative (PFI) and £1 billion in 'donated assets'.

Government has sought to encourage departments to identify surplus property that either could be sold to generate cash to reinvest in public services or could be used for new housing, a policy priority. Only a very small element of departmental assets have been identified so far – for example, the Department of Health has identified £23 million or 0.05% of its fixed assets as surplus to requirements, while the Ministry of Defence has identified £26 million or 0.08% of its fixed assets as surplus. There are more opportunities with assets owned by local government, with British local authorities reporting £2 billion or approximately 1% of their fixed assets as potentially surplus to requirements.⁴

Other fixed assets and assets under construction

Other fixed assets and assets under construction are set out in Table 6.4. This includes military assets of £98 billion (in addition to £32 billion of MoD properties above in Table 6.3). These are discussed in more detail in Chapter 7. Most other fixed assets relate to the delivery of public services, including IT equipment, systems and software, vehicles, and office furniture and fittings across central and local government.

Assets under construction included £10 billion for the Elizabeth Line (Crossrail) in London at 31 March 2017. This is two-thirds of the budgeted cost of £15 billion forecast to be incurred by the originally scheduled opening of the Elizabeth Line in December 2018. Costs incurred on the estimated £55 billion High Speed 2 project were still less than £1 billion at this point.

³ Page 155 of HM Treasury, *Whole of Government Accounts 2016–17*.

⁴ CIPFA, *Local Authority Asset Statistics 2017*.

Table 6.4. Other fixed assets and assets under construction (£ billion)

Other fixed assets	Book value	Assets under construction	Book value
Defence equipment and systems ^a	71	Ministry of Defence	27
Other equipment and vehicles	19	Transport for London	19
Furniture, fittings and other	17	Other transport projects	10
Software and other intangibles	11	Schools, hospitals and other	13
Other fixed assets	118	Assets under construction	69

^a Military equipment £33 billion, transport equipment £11 billion, plant, machinery and IT equipment £4 billion, and systems, software and technological designs £23 billion.

Source: HM Treasury, *Whole of Government Accounts 2016–17* and other public sector accounts for 2016–17.

Other fixed assets include £34 billion in intangible assets, such as software and other non-hardware elements of developing computer systems and technological designs. The majority of these intangible assets relate to military equipment, as discussed in Chapter 7.

Fixed assets include £45 billion of leased assets not owned by the government, but which it has the right to use under leases or that are embedded within long-term contracts. The latter include schools, hospitals, service housing, military equipment and other assets constructed under PFI. These assets (and the related obligations⁵) are gradually declining as the government now enters into few new PFI contracts. Between 1997 and 2010, on average 55 contracts were signed a year. Since May 2010, 84 contracts have been signed, an average of 12 a year.⁶

Off-balance-sheet resources

The government is also able to benefit from resources that are not recorded on the balance sheet. These include a number of off-balance-sheet assets as described in Box 6.3, but these are relatively small in comparison with the unmeasured value of resources that generate value for the government in the form of future tax revenues.

Examples of the latter include the benefits a stable legal system has for economic activity; the contracts the government has with suppliers that enable it to deliver public services; the financial benefits that treaties such as the WTO, NATO and the EU bring to the UK economy (and hence tax revenues); the government's rights to regulate certain businesses such as utilities; its rights to grant planning permissions for development; and the right to compulsory purchase of property for public purposes.

The most important group of these intangibles can be collectively described as the productive power of the UK economy that supports tax revenues. This is akin to goodwill

⁵ Obligations under finance lease and PFI contract liabilities amounted to £192 billion at 31 March 2017, with £43 billion in liabilities relating to the assets and £149 billion in service charges and future interest.

⁶ <https://www.gov.uk/government/publications/private-finance-initiative-and-private-finance-2-projects-2017-summary-data>.

in a commercial context: it is the difference between the total value of individual assets and the value of the overall enterprise – in this case ‘UK plc’.

In practice, the government is restricted in its ability to control or utilise many of these intangible resources as it is limited by legal, political and other constraints. Entering into a particular treaty might benefit tax revenues, but other factors could offset any gain. Planning decisions can be challenged in the courts, while compulsory purchase powers are subject to restrictions on their use and political considerations.

Box 6.3. Off-balance-sheet assets

Certain assets are excluded from the balance sheet, even though they meet the accounting definition of an asset.

Leased assets of £18 billion are not recorded because of an exemption under current accounting standards, which treat ‘operating leases’ differently from other assets. These are leases where the majority of the financial risks and rewards of an asset accrue to the legal owner rather than to the user of the asset. This inconsistency in the accounting rules will cease in 2019, and these assets will be brought onto the WGA balance sheet, together with the associated lease liabilities.

The government does not record some assets in the WGA that it should do under accounting standards. It excludes housing association properties in the order of £70 billion, further education colleges of £12 billion and trust ports of £5 billion, together with an unquantified amount of assets used by the armed forces embedded inside contracts between the MoD and the defence industry.

The exclusion of housing associations was based on planned changes in the law that reduce the level of government influence over them, made specifically to change their status from being part of the public sector to being in the private sector. Further education colleges and trust ports have not been included in order to minimise differences with public sector assets reported in the statistics-based National Accounts.

The government also excludes the Royal Bank of Scotland (RBS) from the WGA on the grounds that incorporating the operations of a large commercial bank would distort the financial picture presented.

Neither accounting nor statistical definitions of assets include the assets of universities, charities or other bodies that are used to deliver public services, even where these bodies are almost entirely reliant on public funding. Generally, this is because although the government has significant influence over how these assets are used, this is not the same as the level of control that would require them to be consolidated within the WGA or count as public bodies in the National Accounts.

6.4 Capital investment

Capital expenditure and net additions to fixed assets are summarised in Table 6.5.

Capital expenditure of £55 billion in 2016–17 was equivalent to 2.8% of GDP. This is less than 7% of non-capital expenditure of £819 billion for the same period. Set against this was depreciation of £33 billion and disposals of £4 billion, leaving net additions at £18 billion.

Investment in transport infrastructure of £17 billion included £6 billion invested in the strategic road network and £4 billion in local roads. Of the £7 billion invested in railway and Tube projects, £4 billion went into the national railway network, with £2 billion on the Crossrail project in London and £1 billion on High Speed 2.

Net additions of £8 billion to transport assets (after depreciation and disposals) accounted for almost half of net capital additions. However, these additions are worth just over 1% of the £589 billion value of the government's portfolio of transport assets, reflecting the incremental amounts being invested in roads and railways in the UK.

Investment in social housing, schools, hospitals and general-purpose central and local government property, including offices, was offset by depreciation and disposals.

Although capital expenditure (including Network Rail) was similar in 2009–10 and 2016–17 – at £54 billion and £55 billion respectively – this corresponds to a real-terms cut of 9%.

Capital expenditure in the WGA can be reconciled with the public sector investment measures reported in the National Accounts, as shown in Table 6.6.

Table 6.5. Capital expenditure in 2016–17 (£ billion and % of GDP)

	Capital expenditure	Depreciation	Disposals	Net additions	% of GDP
Transport infrastructure	17	(9)	-	8	0.4%
Land and buildings ^a	14	(11)	(3)	-	0.0%
Defence equipment	10	(4)	-	6	0.3%
Other tangible assets	10	(6)	(1)	3	0.2%
Software and other intangibles	4	(3)	-	1	0.0%
Additions during year	55	(33)	(4)	18	0.9%
% of GDP	2.8%	(1.7%)	(0.2%)	0.9%	

^a Includes £3 billion on new social housing, £2 billion in capital works on existing social houses and £4 billion on schools and hospitals.

Source: HM Treasury, *Whole of Government Accounts 2016–17* and other public sector accounts for 2016–17.

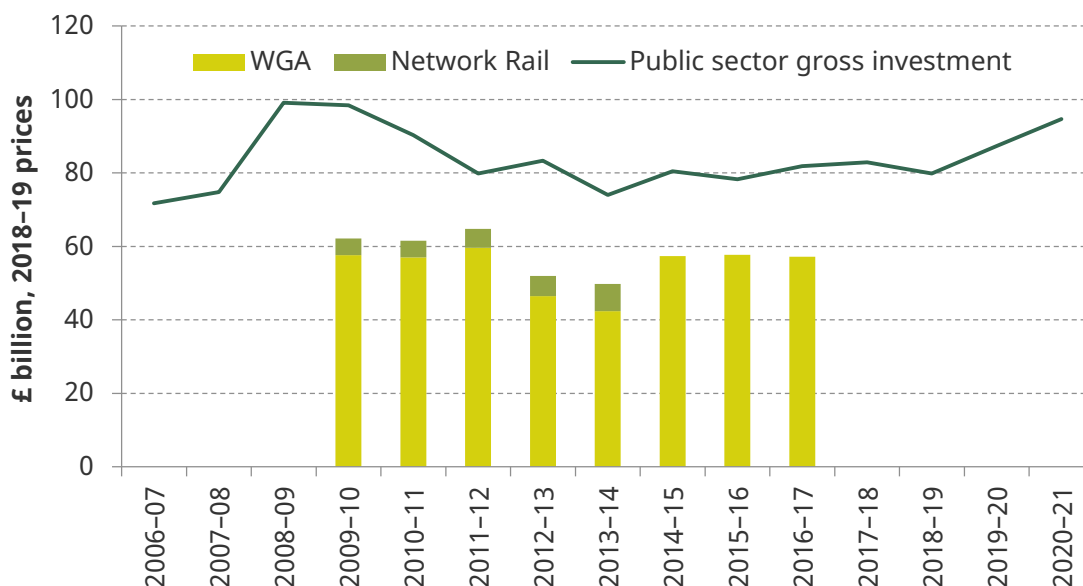
Table 6.6. WGA capital expenditure and public sector investment in 2016–17

	£ billion
Capital expenditure in WGA	55
Student loans	11
Capital grants ^a	9
Housing associations (excl. £3 billion in capital grants)	6
Research and development	3
Less: fixed asset disposals	(5)
Public sector gross investment	79
Less: depreciation in the National Accounts	(41)
Public sector net investment	38

^a Capital grants included £3 billion to housing associations, £1 billion to universities and research institutions, £2 billion to other UK recipients and £3 billion in official development assistance.

Source: HM Treasury, *Whole of Government Accounts 2016–17*; Office for Budget Responsibility, *Economic and Fiscal Outlook: March 2016*; Office for National Statistics, *Public Spending Statistics*, July 2017.

The principal differences relate to student loans (discussed in Section 6.5) and capital grants. Housing associations have subsequently been returned to the private sector. Amounts for disposals and depreciation are also different between the WGA and the National Accounts.

Figure 6.5. Capital expenditure and investment since 2006–07 (in 2018–19 £ billion)

Note: Capital expenditure on a WGA basis is not available prior to 2009–10.

Source: HM Treasury, *Whole of Government Accounts*, 2009–10 through 2016–17 (Network Rail financial statements for periods before its capital expenditure was included in the WGA); Office for Budget Responsibility, *Public Finances Databank*, 3 September 2018.

Figure 6.5 provides an analysis of both public sector gross investment (since 2006–07 and forecasts to 2020–21) and capital expenditure (between 2009–10 and 2016–17).

These illustrate slightly different patterns for the period in which we have data for both. Public sector gross investment increased in response to the financial crisis, but then fell – initially as a result of non-capital expenditure elements, with lower capital expenditure following in 2012–13 and 2013–14.

Forecasts for the next four years are for the government to increase investment by £13 billion between 2016–17 and 2020–21 in 2018–19 prices, a real-terms increase of 16% in public sector gross investment over that period (although still below the level seen in 2009–10).

Only £3 billion of the additional investment planned for 2020–21 has been allocated to spending departments so far, mostly to the Department for Transport to cover planned investment in the High Speed 2 railway link between London and Birmingham.

Some £7 billion is included in a ‘National Productivity Investment Fund’ controlled by the Treasury. This is a budgetary heading rather than a fund, which for 2020–21 includes £3.4 billion in additional funding for housing, £2.0 billion extra for research and development, £1.3 billion more for transport and £0.3 billion for digital infrastructure.

There is a significant risk that not all of planned capital investment will be made, especially as much of the additional plans have yet to appear in the National Infrastructure Pipeline. Underspensing has been an issue in the past, as researchers from IFS have reported.⁷

More important is the question of whether all of this investment will provide high value for money, a particular issue for large complex infrastructure and defence projects that involve significant risk.⁸

6.5 Investments, financial assets and working capital

Financial and other assets in the WGA amounted to £701 billion at 31 March 2017, just over a third of the total assets in the balance sheet. Investments amounted to £224 billion, there was £291 billion in cash and other current financial assets, and £186 billion in receivables and other working capital assets.

The majority of investments and financial assets have arisen from the delivery of public policy objectives. These include student loans used to support students undertaking higher education in England and Wales, loans and cash advances provided by the Bank of England to support the financial sector, foreign reserves used to support sterling, and stakes in the International Monetary Fund and other international organisations.

The main exceptions are the pension fund investments of local authorities and some other public bodies (which are not included in assets as they are instead netted against

⁷ R. Crawford, P. Johnson and B. Zaranko, *The Planning and Control of UK Public Expenditure, 1993–2015*, IFS Report R147, 2018, <https://www.ifs.org.uk/publications/13155>.

⁸ Department for Transport, ‘Annual update on Crossrail’, Written Statement to Parliament, 24 July 2018, <https://www.gov.uk/government/speeches/annual-update-on-crossrail-2018>.

liabilities), the assets of the Pension Protection Fund, and investment properties owned by the Crown Estate, Network Rail and local authorities. These behave more like traditional investments, held by government with the aim of generating financial gain or in order to provide an income stream to match liabilities or future financial commitments.

Table 6.7 sets out the principal elements of investments and financial assets at 31 March 2017.

Table 6.7. Investments and financial assets at 31 March 2017 (£ billion)

Investments		Financial assets	
Student loans	67	Foreign reserves	104
Long-term loans and deposits	32	Short-term loans and deposits	69
Equity investments ^a	53	Repurchase agreements	51
Derivatives and other	32	Derivatives and other	29
International Monetary Fund	22	Cash and cash equivalents	28
Investment property	18	Gold holdings	10
Investments	224	Financial assets	291

^a RBS £20 billion, Lloyds £1 billion, European Investment Bank £10 billion, Pension Protection Fund £23 billion.

Source: HM Treasury, *Whole of Government Accounts 2016–17*.

One financial asset that has attracted significant attention is the government's student loan book, as described in Box 6.4.

Loans and deposits include £20 billion of mortgages advanced by Bradford & Bingley, Northern Rock and other nationalised banks and retained in a 'bad bank' after the financial crisis. These are gradually being sold off, with £16 billion disposed of during 2016–17.

There is also £55 billion in low-cost loans provided to high-street lenders through the Bank of England's Term Funding Scheme; these are due to be repaid by 2020–21.⁹

Equity investments include a £20 billion investment in RBS, a bank that the government rescued during the financial crisis. The initial loss on this investment was £19 billion, a consequence of the decision to bail out RBS to avoid contagion in the banking sector. Subsequently, once this risk was confidently deemed to be past, the government should have sold off the shares in an orderly, gradual process – regardless of whether the price at that moment in time was higher or lower than it had originally paid. Instead, the government has held the investment in the hopes that the share price would recover. However, so far this has not come to pass; instead, the market value has fallen by £6.5 billion since 31 March 2012, a 24% reduction over five years.

⁹ A further £72 billion was lent out in 2017–18, which is due to be repaid by 2021–22.

Box 6.4. Student loans

Unlike with most other loans, student loan repayments are linked to graduates' earnings and the system is explicitly designed to insure graduates against low earnings. Most graduates – around 80% – will not subsequently earn enough to repay their debt in full.^a To reflect this, student loans with a face value of £97 billion have been impaired by £30 billion to allow for loans that are expected not to be repaid, together with implicit subsidies in some older loans. New student loans issued during 2016–17 amounted to some £14 billion, but were immediately impaired by £4 billion.^b

The student loan system is similar in economic effect to a graduate tax, but the government was able to meet the accounting and statistical criteria for student loans to be presented as assets in the WGA and as investment spending in the National Accounts.

The government intends to sell part of the student loan book in order to reduce public sector net debt. In the first part of this sale, in December 2017, the government sold student loans with a face value of £3.5 billion for proceeds of £1.7 billion. This was a 50% discount to face value that resulted in an accounting loss of £0.9 billion,^c although the National Audit Office estimates that the economic loss was lower – £0.6 billion – when using a different model for calculating expected repayments than that used for accounting purposes.^d

If future sales result in similar losses, then the government would achieve a £12 billion reduction in public sector net debt at a net cost of £4 billion. This is not a sensible use of public money: if the asset is worth more when held by the public sector than when held by the private sector, then the public sector should continue to hold it. In the case of student loans, there are good reasons to think that these are best retained by government: much of the difference between the government's valuation and the lower sale price is driven by the lower cost of borrowing enjoyed by the government, which is helped even more by the current low-interest-rate environment.

^a C. Belfield, J. Britton and L. van der Erve, 'New higher loan repayment threshold is a big (and expensive) giveaway to graduates', IFS Press Release, 3 October 2017, <https://www.ifs.org.uk/publications/9965>.

^b This was an impairment to face value of 29%. These loans have subsequently been impaired to 45% of their face value, principally because of an increase in the repayment threshold.

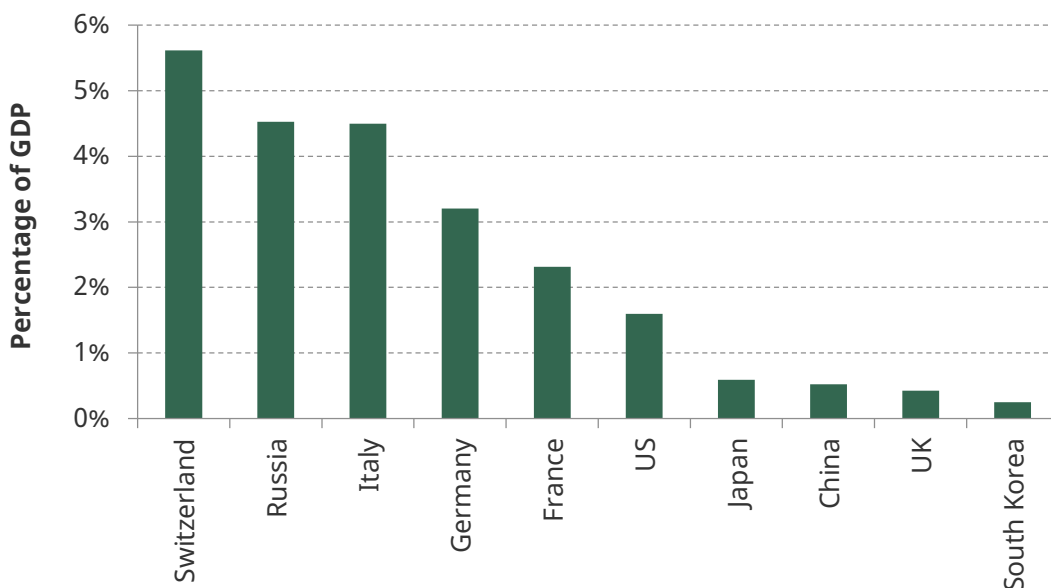
^c These loans had previously been impaired by 26% to £2.6 billion.

^d National Audit Office, *The Sale of Student Loans*, 2018, <https://www.nao.org.uk/report/the-sale-of-student-loans/>.

The government is expecting to record a write-down in 2018–19 in its investment in the European Investment Bank. Although this is valued at £10 billion in the WGA at 31 March 2017, the UK has subsequently agreed with the EU – as part of the 'divorce settlement' – that it will only recover its original £3 billion investment and will not receive its share of profits accumulated while the UK has been a shareholder.¹⁰

¹⁰ ICAEW, 'Analysing the EU exit charge – an update', July 2018, <https://www.icaew.com/technical/economy/brexit/analysing-the-eu-exit-charge>.

Figure 6.6. Gold holdings (30 June 2018 holdings as % of GDP)



Note: US (8,133 tonnes), Germany (3,370), Italy (2,452), France (2,436), Russia (1,944), China (1,843), Switzerland (1,040), Japan (765), UK (310), South Korea (104). Not shown: IMF (2,814 tonnes), European Central Bank (505 tonnes), Netherlands (613), other EU countries (1,854).

Source: World Gold Council, Reserves Statistics, 2018 Q2; IMF, World Economic Outlook Database, April 2018.

Foreign reserves comprise interest-bearing government securities issued by the US, Japan and other major economies, principally in the EU. The UK has been increasing its level of foreign reserves over the last few years, while the fall in the pound following the EU referendum has also increased their reported value when translated back into sterling. There is a risk to holding these securities from movements in bond prices and exchange rates, although some of these exposures are hedged using derivative financial instruments. On the other hand, these assets could also be used to hedge government purchases denominated in foreign currencies; Chapter 7 discusses this in the case of the Ministry of Defence.

Although London has the largest stores of gold of any city in the world, very little of this is owned by the UK government. No longer needed to back sterling, successive administrations have reduced gold holdings, culminating in Gordon Brown’s decision in 1999 to sell 415 tonnes of the 715 tonnes then owned. The UK currently owns 310 tonnes of gold, worth £10 billion at 31 March 2017. This is equivalent to 0.4% of GDP, less than for other countries, as illustrated by Figure 6.6.

Working capital assets

Working capital assets at 31 March 2017 amounted to £186 billion, comprising £122 billion in taxes owed and accrued, £52 billion in trade and other receivables, £9 billion in inventories and £3 billion in assets held for sale. These were net of £11 billion in bad debt provisions for taxes owed or accrued and £10 billion in provisions against trade and other receivables.

Working capital assets are necessary to the operation of any organisation. However, they often involve an opportunity cost as many do not earn any financial return. Because of

this, most businesses seek to reduce their investment in working capital to the minimum necessary to operate effectively. Governments are no different in principle – every amount unnecessarily tied up in working capital assets could be better used elsewhere.

Although taxes owed and accrued for UK central and local government of £122 billion do not appear unreasonable at 2.3 months of total tax revenues, it should be possible to reduce this further. The government continues to look at ways to accelerate payments further where it can, with electronic filing (Making Tax Digital), improved compliance, and plans to accelerate the payment of corporation tax.

There are also opportunities to accelerate the collection of trade and other receivables, such as making it easier to collect court fines or to pay for local services.

Public sector pension schemes

The balance sheet includes £319 billion in pension fund assets of local government and other public sector funded pension schemes. Thanks to strong investment returns, these had grown by £53 billion or 20% over the 2016–17 financial year.

These ring-fenced investments are not included on the asset side of the balance sheet, but are instead netted against the £457 billion of obligations that they are set aside to cover. They represent 70% of the related liabilities, reducing the net obligation to £138 billion.

By contrast, central government pension schemes for workers including civil servants, health workers, armed forces, teachers and former Royal Mail workers are unfunded, with no assets set aside to meet the estimated £1,697 billion of accumulated pension entitlements. Instead, the payment of these pensions will come from the future contributions of employees and future tax revenues.

When combined with public debt and other unfunded government liabilities, this represents a significant transfer of value between generations.

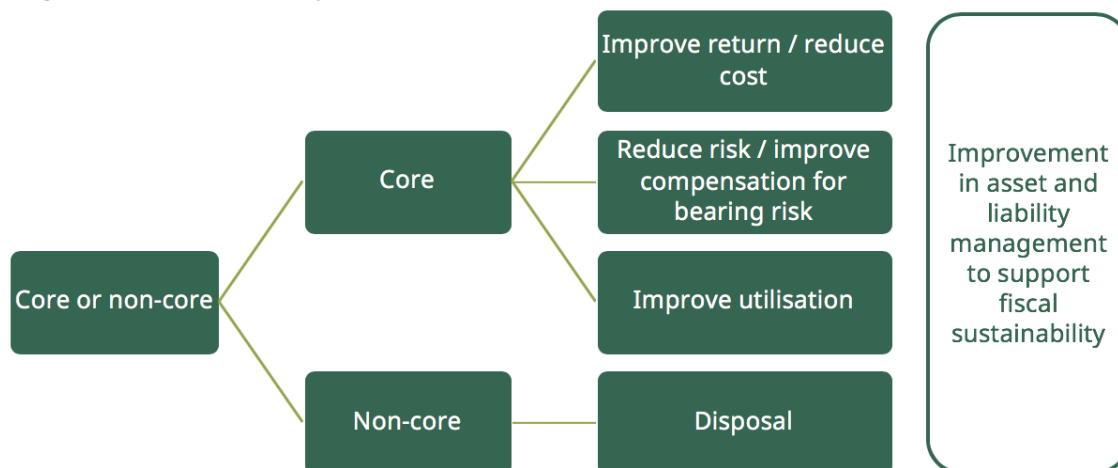
6.6 The Balance Sheet Review and the potential for a public investment and asset management strategy

There has been an increased focus on how to track and manage public assets more effectively over the last couple of decades.

Government departments have compiled registers of the assets they own, and local authorities have followed suit in the past couple of years. The advent of the WGA in 2012 has helped the government to understand better the resources that are available to public bodies to achieve policy objectives.

These developments mean that it is now possible to go further, and the government initiated a Balance Sheet Review last year to look at how it can manage public assets and liabilities more effectively. The government intends to deliver a progress report on this review alongside this year's Autumn Budget.

Figure 6.7. HM Treasury Balance Sheet Review



Source: HM Treasury, 'Balance Sheet Review', 2018, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/718021/FR_AB_132_05 - 03 Balance Sheet Review presentation.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/718021/FR_AB_132_05_-_03_Balance_Sheet_Review_presentation.pdf).

As part of this review, the government plans to take stock of the assets that it holds and how these could be used to generate greater value, whether from more efficient utilisation, generating commercial income or selling off non-core assets.

The Balance Sheet Review provides an opportunity for the government to consider its overall strategy around public assets. Should government be in the business of owning certain assets, or would they be better situated in the private or third sector? Is it investing enough in its assets, and in the right places? Should it be investing for financial returns and not just for public service delivery? Is it better to pay off public debt or establish funds earmarked for specific liabilities that continue to grow?

In the past, these questions have been considered only on a piecemeal basis, when at all. For example, the decision to transfer inland waterway assets to a charitable trust came out of a review of government organisation, rather than as part of a more comprehensive review of public assets and liabilities.

Figure 6.7 illustrates the review’s approach to evaluating assets.

Assets held to achieve a policy or financial purpose (core assets) are being assessed to determine whether they are meeting policy objectives and providing adequate returns (either financial or non-financial). This includes assessing whether assets could be better used – for example, by being more efficient in the use of office space or by obtaining better financial returns from commercial property or financial investments.

Assets surplus to requirements (non-core assets) will be sold.

The government has already made progress with general-purpose central government property assets – the ‘Government Estate’. The Government Property Agency (GPA) came into existence on 1 April 2018, with a plan to expand its scope from an initial 80 properties to over 1,000. Ownership of the property assets will transfer to the GPA, which will in effect

compete with private landlords to provide cost-effective office space to central government departments. Properties surplus to requirements will be sold.

Initially, the GPA is working with HMRC to create 12 'government hubs' to consolidate government office space in cities across the UK. The aim is to save £1 billion over 10 years by reducing average space per employee from 8 to 6 square metres – for example, by promoting new working practices such as hot-desking. The Cabinet Office already claims £38 million in new income from letting out vacant space freed up as a result of this work.

General-purpose central government property does not include operational assets, such as schools, hospitals and defence properties. Optimising these assets will remain the responsibility of the relevant government departments in England and the devolved administrations in Scotland, Wales and Northern Ireland, although the Balance Sheet Review is likely to look at whether there is a case for establishing health, schools and defence estates within their respective departments to complement the Government Estate and the Crown Estate in managing public sector property holdings effectively.

Similarly, regional and local government could be asked to consider whether (for example) a Yorkshire Estate or a Greater Manchester Estate might provide a better and more effective way of managing and generating value from general-purpose and commercial property in these areas.

The review should provide greater transparency on the government's portfolio of assets and comparative performance in delivering economic, social and financial returns.

Investment and asset management strategy

Currently, central government departments, devolved administrations and local authorities have been left to develop their own approaches to investing in and managing public assets, albeit supported by some centrally established investment principles. These principles are set out in government guidance, in particular the *Managing Public Money* and *Green Book* manuals as described in Box 6.5.

The Balance Sheet Review provides an opportunity for the Treasury to develop an explicit strategy for investment and managing public assets. Some of the building blocks for such a public-sector-wide strategy are already being developed.

The government has been working on its strategy for investing in infrastructure, with the establishment of the National Infrastructure Commission and the National Infrastructure Plan. This involves central government departments, local authorities and the private sector working together to improve economic and social infrastructure across the country – for example, on the 'Northern Powerhouse' initiative in the north of England.

The government has also been working to develop a new approach to investing in social infrastructure, in particular social housing, where the government wants to increase construction from current levels.

Box 6.5. Managing Public Money and the Green Book

The government sets out principles for managing public assets in *Managing Public Money* and the *Green Book*. The Balance Sheet Review provides an opportunity to build on these principles and develop them further as part of an investment and asset management strategy.

Managing Public Money is a government handbook that summarises the fiduciary duties of ministers and departments in overseeing public funds. It sets out how parliament grants the right to raise, commit and spend resources in order to implement government policies and deliver public services.

It provides guidance on all aspects of financial management by central government departments and the public bodies they control. This includes maintaining asset registers, developing a department-level asset management strategy and encouraging the commercial exploitation of assets that are not fully used. It also provides for clawback provisions on capital grants to ensure assets created are used as intended.

The Green Book provides guidance and methods for appraising and evaluating financial decisions. These range from the need for a cost-benefit analysis before approving spending requests or making changes to the tax or social security system, through to the need for comprehensive project appraisals before investing in infrastructure assets and ensuring that alternatives are properly considered.

Business cases need to assess social, environmental and economic costs and benefits of a proposal as well as the financial costs and any financial returns available to the government itself. This is encompassed by the five-case model: strategic, economic, commercial, financial and management. These five cases summarise the key criteria to be considered in making a financial decision: the economic and social value generated, how risks will be managed and who will bear them, the implications for the public finances, and the ability to deliver as planned.

The Green Book includes specific guidance on assessing residual asset values and on when and how to generate value from asset sales, and criteria to be considered before entering into public-private partnerships.

Better information and analysis are needed

The ability of the public sector to improve its management of assets is dependent on the information available and the analysis that is possible as a result. Historical practice has been to focus on income and expenditures, with little analysis about the value of the resources used to support public services.

The Balance Sheet Review provides a chance for government to consider these longer-term issues more deliberately and comprehensively. However, this is only a first step: this type of assessment should not be limited to one-off reviews, but should be embedded into financial management in government.

Government departments need to do more to analyse how assets are being deployed and how they could be used more effectively. Resource allocation decisions need to look at more than just the cash expended.

An example of where analysis could be improved is the Ministry of Housing, Communities & Local Government's annual release of statistics on English social housing.¹¹ This exercise fails to include data on land or house values reported in local authority financial statements. This limits the ability of the department to have a full picture of the resources being deployed in the provision of social housing, the financial returns being made on existing houses or the returns that might be available from investing in new housing.

Funding liabilities and financial commitments

A public investment and asset management strategy needs to consider more than just the delivery of public policy objectives. It should also address the role that assets can play in the management and settlement of liabilities, financial obligations and other financial commitments.

An underlying presumption of the government's current approach is that surplus resources should generally be used to repay public debt. This default principle means that generally no consideration is given to settling or funding other liabilities or financial commitments, even where this might be more effective in reducing future cash outflows or in reducing risk.

The establishment of pension funds by local authorities and a number of other public bodies illustrates how net liabilities can be reduced by taking an alternative approach. Although there would be additional interest on the public debt needed to establish such funds, this could be more than offset by the higher returns over the decades over which pension promises build up. This approach might also encourage government to manage public expenditure more effectively, by reflecting the cost of pension promises made into its fiscal measures that currently count cash payments but do not count the debts owed to public sector employees.

The Crown Estate, a monarchical legacy that has continued into the present day, and the Pension Protection Fund have also seen strong investment growth in recent years, which in the latter case means that it is possible that lost pension entitlements may be partially restored.

The decision to establish the Pension Protection Fund in 2005 arose because of the growth of liabilities in the Financial Assistance Scheme, which covered members of defined benefit occupational pension schemes that failed between 1997 and 2005. This cashed in the investments of failed schemes, resulting in a then-growing liability to be paid for out of central government budgets.

This contrasts with the approach adopted by the Department for Health and Social Care clinical negligence claims. These are increasing at around £6 billion a year, as summarised in Table 6.8, but no money is being set aside to match these liabilities.

¹¹ The latest release is Ministry of Housing, Communities & Local Government, 'Local authority housing statistics: year ending March 2017', 2018, <https://www.gov.uk/government/statistics/local-authority-housing-statistics-year-ending-march-2017>.

Table 6.8. Examples of financial assets to fund liabilities or commitments (£ billion)

	Invested assets	Liability or commitment	Comments
Financial Assistance Scheme	0	7	Schemes no longer being added since advent of the Pension Protection Fund.
Pension Protection Fund	29	23	Investment performance has exceeded growth in liabilities.
Clinical negligence claims	0	67	Liability increasing by £6 billion a year (£8 billion new claims – £2 billion paid).

Source: HM Treasury, *Whole of Government Accounts 2016–17*.

Paying clinical negligence claims over time will save money compared with the previous practice of making one-off financial settlements, as well as being fairer to claimants.¹² However, it has flattered health budgets in fiscal terms, with the full cost of claims not scoring against the budget deficit.

A more commercial approach might involve risk-based premiums being levied on hospitals and GP practices and the proceeds being invested to create a fund to pay for claims which in some cases can extend for decades into the future. This might have other advantages, such as providing a financial incentive for clinicians to invest in safer practices and more generally the true cost of different activities being considered.

Financial pressures on the public finances are unlikely to permit a significant amount of resources to be put into setting up funds for clinical negligence claims or for other liabilities such as nuclear decommissioning or currently unfunded pension obligations. However, even relatively small investments made now could have the benefit of substantially improving the financial position in several decades' time, through investment growth (admittedly with some risk). This would also ensure that the costs of claims are fully recognised in the fiscal measures when incurred.

A wider debate is also underway about how to address the costs associated with an ageing population. For example, funding greater levels of adult social care might benefit from establishing investment portfolios to support the cost. A pot of money that can be added to over time, whether or not funded through premiums or additional taxes, might be more sustainable than the current approach of waiting for the bill to fall due, and the consequential pressure that places on other public services.

Such an approach might also provide a vehicle for reducing risks to personal finances through an insurance mechanism similar to that proposed in the Dilnot Review.¹³

¹² As ongoing claims can be adjusted to reflect actual needs, rather than needing to re-litigate settlements.

¹³ Commission on Funding of Care and Support, *Fairer Care Funding*, 2011, <http://webarchive.nationalarchives.gov.uk/20130221121534/http://www.dilnotcommission.dh.gov.uk/our-report/>.

The potential for nationalising utilities and service providers

One question that is likely to be outside the scope of the current review is the potential for acquiring private businesses, such as those proposed in the Labour party's 2017 general election manifesto and currently being developed further. Proposals potentially include the nationalisation of electricity, gas and water utilities in England and Wales, the Royal Mail and PFI contracts and to return train operating companies to the public sector as their franchises expire.

The consequence would be to increase assets in the public balance sheet, with liabilities increasing both from the debt used to fund each acquisition and from existing liabilities acquired with the nationalised companies. Any profits of the utilities and other businesses acquired in this way could be used to help fund the increased interest payments in respect of the higher debt, although profits may be reduced given that Labour have also indicated that they would like to see lower charges to consumers and improved pay and conditions for workers.

Nationalising utilities, train operations, the Royal Mail and PFI contracts could potentially increase public debt by more than £200 billion, depending on the particular businesses and assets acquired and the price paid. For example, nationalising the water industry could cost between £80 billion and £90 billion.¹⁴

These acquisitions would increase the level of risk in the public finances, potentially affecting the perception of investors in UK gilts. With public debt already in excess of £1.8 trillion and likely above £2.0 trillion if this programme of renationalisation occurred, higher borrowing costs could add significantly to government expenditures.

Although Labour indicate that they will target a fiscal measure for the deficit that excludes borrowing to fund capital investment, there is the potential that capital investment could be constrained to meet their target to reduce public debt as a share of national income. Politically, it can be easier to cut investment than to reduce spending on public services or welfare.

While the stated purpose of nationalisation might be to increase investment, experience suggests that nationalised industries compete with other government priorities for spending, and investment within the public sector can in fact be lower than in the private sector. That risks a deterioration in economic infrastructure on which economic growth depends.

6.7 Conclusion

With a reported value of £1.9 trillion or 94% of GDP, the government's assets are not insubstantial. They are, however, less than half the reported liabilities of £4.3 trillion or 214% of GDP.

Of course, the public sector retains the right to raise taxes, perhaps the most valuable resource available to government. But, as the Office for Budget Responsibility has shown,

¹⁴ Social Market Foundation, *The Cost of Nationalising the Water Industry in England*, 2018, <http://www.smf.co.uk/publications/water-nationalisation/>.

taxes will have to be raised from current levels if the public finances are to be put on a sustainable footing – and this may be politically challenging to achieve.

The Balance Sheet Review, due to report in the Autumn Budget, is expected to identify opportunities to improve the utilisation of public assets, generate some additional income and release value by disposing of surplus assets or redeploying them – for example, to provide land for social housing. The Government Property Agency provides a model that could be used to improve asset management in other parts of the public sector if it proves successful. However, care should be taken to avoid suboptimal financial decisions, such as continuing to sell student loans at a loss.

Consideration is needed not only of the assets that are there, but of those that are not.

This extends beyond identifying infrastructure that is necessary to support greater economic growth, critical though that is. There are no social security or social care funds. No money has been invested to provide for £1.9 trillion in unfunded pensions, clinical negligence or nuclear decommissioning liabilities.

Consideration should be given as to whether it might make sense to put money aside to fund certain liabilities or financial commitments now rather than waiting until the bills fall due, even if this means assuming some investment risk. For example, establishing a clinical negligence fund might help reduce the pressure on future health budgets.

The government remains dependent on its ability to continue borrowing at an affordable rate of interest, especially as it remains politically difficult to increase taxes. As our chapter on public debt in the 2017 Green Budget makes clear, in these circumstances the most important thing is maintaining the confidence of investors.

Maintaining that confidence, and that of the British public, would be made easier by an investment and asset management strategy that sets out how the government plans to improve the resilience of the public finances through a stronger balance sheet and better utilisation of public assets.