NUS National University of Singapore

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Singapore is featured In the book as a model in the effective use of public assets and the creation of strong institutions, in particular, its sovereign and public wealth funds (GIC and Temasek Holdings). PHOTO: BT FILE

Public net worth – the measure of financial strength and success

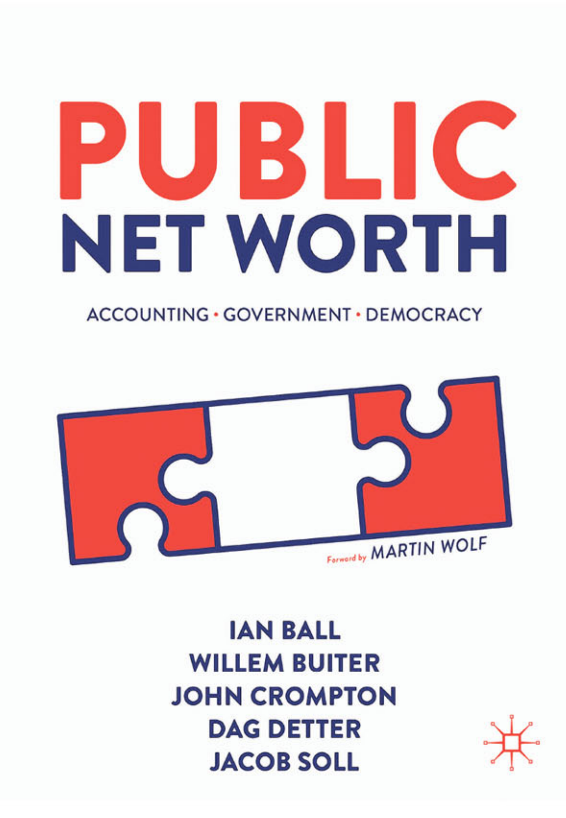
New book on government accounting advances ideas worth considering. **By Terence Ho**

PUBLIC Net Worth: Accounting – Government – Democracy (Palgrave Macmillan, London 2023) aims to do more than inform or educate. It is a book with a mission: to get governments to overhaul their approach to public finance and accounting.

The five authors draw on a wealth of professional experience in public finance across various jurisdictions to make the case that government accounting and budgeting should focus on "public net worth" – the sum of public sector assets and liabilities – rather than mere cashflow, public debt or deficits. This, they claim, holds the key to better decision-making, more effective government and stronger democracies.

Importance of the government balance sheet and "net worth"

The book makes a significant contribution by shining the spotlight on an important but often overlooked area of public finance: the government balance sheet. Preoccupation with the size of public debt means that other liabilities such as public pension obligations are often overlooked. As such liabilities could be larger than public debt in some countries, they are necessary for a complete picture of a government's financial position. Also critical are government assets, both financial and non-financial. Disregarding assets may lead to a fundamental misreading of a country's fiscal strength, as in the case of Singapore which has a relatively high public debt to GDP ratio but has assets considerably in excess of liabilities.



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The authors' sense of mission is evident throughout the book. They urge government adoption of accrual accounting not just for financial reporting, but also for budgeting and economic planning. This would make clear the impact of policy decisions on public net worth and enable citizens to better appreciate long-term policy tradeoffs.

Of particular interest is how policies may affect intergenerational equity, given that future generations will have to shoulder the costs of debt and obligations incurred today. Tracking the profile of liabilities is also critical for managing risks arising, for instance, from changes in interest and exchange rates.

Public Net Worth highlights the importance of distinguishing between spending for consumption and spending for investment. Under cash accounting, investments are treated like consumption, whereas spending to invest may in fact increase net worth.

Unsurprisingly, the book is critical of fiscal rules that impose limits on government debt and deficits. Besides disregarding non-debt liabilities, the authors believe that such rules disincentivise investment and asset creation, to the detriment of long-term net worth.

In a similar vein, it matters whether cash is earned from tax revenue or the sale of assets, as the latter may decrease net worth if assets are sold below market value.

International adoption of accrual accounting, however, has been slow. As of March this year, the OECD has only managed to compile consolidated balance sheet data for 24 economies up to 2020 or 2021. There is the further challenge of encouraging accrual-based budgeting, beyond just financial reporting. A 2016 OECD study found that while 82 per cent of advanced economy governments were reporting on an accrual basis, the majority of these continued to budget on a cash basis.

The comprehensive balance sheet and long-term prognosis for G7 economies

Where the book is in more speculative territory is in looking beyond the "conventional balance sheet" to include the present value of projected revenue and expenditure streams under what they call the "comprehensive balance sheet". Constrained by data, the authors limit their analysis to the G7 economies, justifying this on the basis of these countries' importance to the global economic and financial system.

The authors do in fact recognise that such projections are highly uncertain, and estimates of public net worth depend heavily on assumptions and the choice of discount rate. Long-term forecasts are therefore cast as "scenarios" in New Zealand and likewise as fiscal scenarios in Singapore. While Singapore publishes occasional papers on medium-term fiscal projections, the New Zealand Treasury is mandated to publish, once in four years, a statement of the country's long-term fiscal position with a time horizon of at least 40 years.

An insight that emerges from the book's review of government finances in Europe over

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Population ageing and increasing welfare benefits have seen liabilities expand in the advanced economies over the past three decades.
PHOTO: PIXABAY

the centuries is that whereas war financing was historically the main driver of public debt, population ageing and increasing welfare benefits have seen liabilities expand in the advanced economies over the past three decades. The 1970s were the first peacetime decade in which the UK's public sector net debt began to rise consistently, driven largely by higher spending on public services..

Examination of the long-term fiscal positions of the G7 economies yields sobering conclusions. According to the book, a multigenerational period of fiscal consolidation is needed: net taxes have to be increased significant upwards, or public service provision sharply scaled back. Otherwise, the cost of today's consumption may place an unfair burden on future generations.

Whether or not this is, in fact, fair hinges on how hopeful one is about the future. If future generations are likely be wealthier due to sustained real economic growth driven by technological advances, they may be well-placed to finance today's expenditure. However, the climate crisis, geopolitical fractures and even the downsides of technology itself may give us pause.

Managing assets well

A significant part of *Public Net Worth* is devoted to asset management. As a large proportion of any government's assets is held in buildings and infrastructure, failing to optimise these assets is akin to leaving money on the table.

The authors advocate accrual accounting as the basis for a strategic asset management plan, with better informed and well-considered decisions on the maintenance, replacement, deployment and sale of assets.

Failure to value assets properly may also result in the underpricing of public assets when they are sold or privatised. The book advocates the establishment of professionally-run public wealth funds to optimise asset management, and sovereign wealth funds to generate investment returns for the government.

The authors recognise that privatisation is not always the panacea that some make it out to be. They cite Thames Water, the UK's largest private water company which was plunged into financial crisis this year having racked up high debts without adequate investment in infrastructure.

Whether essential services are run by the public or private sector, the key is effective regulation to ensure timely maintenance and asset replacement, a lesson Singapore too learnt from MRT train disruptions in 2011.

Singapore's public sector governance is well aligned with the best practices advocated by the book. Major assets are monitored carefully, and in recent years more government agencies have taken up commercial leases as an alternative to owning office space. The Reserves Protection Framework requires state land and assets to be sold at fair market value, or the difference to be topped up from current reserves.

New Zealand and Singapore as exemplars

The book accords highest praise to New Zealand as the government which has "most fully integrated good accounting into its financial management processes and financial decision-making". Each year, the New Zealand government presents, alongside the Budget Policy Statement, a Fiscal Strategy Report setting out both long- and short-term fiscal policy objectives. The government also publishes forecasts of the balance sheet for the coming budget year and the three years that follow.

Singapore is featured as an exemplar in the effective use of public assets and the creation of strong institutions, in particular its sovereign and public wealth funds (GIC and Temasek Holdings). Although government ministries have not adopted accrual accounting, Singapore is said to have "instinctively focused on creating wealth intended and protected through the law to be preserved for future generations".

In concluding, the book makes the interesting observation that fiscal sustainability can in theory be addressed without changing accounting arrangements.

For instance, countries could adopt ultraconservative fiscal rules (such as requiring a consistently large annual budget surplus), although the authors suggest that this might be inefficient and would be extraordinarily difficult to sell to the public.

It could be argued that for several decades following independence, Singapore has been fiscally ultraconservative – made possible by rapid economic growth and rising living standards. Now that Singapore's expenditure needs have grown and we can no longer generate consistent budget surpluses, we need to weigh more carefully the impact of policy options on long-term fiscal sustainability. Greater awareness and discussion of policy tradeoffs, based on in-depth fiscal projections and scenarios, are essential.

While *Public Net Worth* is somewhat recursive in the flow of ideas it presents, this can be attributed to the interwoven nature of the topics covered. It is likely that different readers will take away different things from this book, but overall it is one that merits attention as an expert guide to enhancing public sector accounting and decision-making.

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