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Why the UK doesn't have Sovereign Wealth Funds – and reasons why it should

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The UK Government's long-term rejection of proposals to invest to fund future expenditure is rooted in a strange combination of a simplistic approach to managing public finances, and an esoteric theory about its own financial power.

Both are wrong, and individually or in combination could be highly dangerous to financial stability, though this is not the focus of this chapter. What is more, the UK Government approach is denying the country the opportunity to improve public finances by over four per cent of GDP per year within a couple of decades, without raising taxes or cutting spending. This is roughly in line with what the Office for Budgetary Responsibility (OBR) has identified as the fiscal adjustment needed to meet future demands on public services over the coming generations.

Wealth funds – of two different types – are the key to exploiting this opportunity, and we will develop this point further below. But first we will look at the financial management framework that underpins current UK Government thinking, in order to identify what needs to change in order to unlock the public benefits that wealth funds can offer.

Why good accounting is essential for good financial management

Governments around the world insist that private sector organisations, and many public sector ones, produce regular, timely, comprehensive financial accounts. The larger, more complex the organisation, the more demanding the accounting requirements. Accounting is all-pervasive; management information systems provide the information on a day-to-day basis that is aggregated into formal financial accounts. Everyday actions are driven by, and aligned with, the basis on which the organisation's financial performance is judged.

However, with the exception of New Zealand, governments do not hold themselves to the accounting requirements that they impose on others, and neither do they use accounting information as the basis for decision-making.

Instead, most governments – and notably the UK and EU countries – rely on debt-based fiscal targets or rules. These comprise an in-year target or rule related to whether revenues are meeting expenditures, together with a target for total government borrowing. Both are usually expressed as a percentage of GDP.

Seen through an accounting lens, these rules are deeply flawed, for two reasons.

First, they ignore most of the balance sheet. On the liability side of the balance sheet, only debt liabilities are taken into account. Non-debt liabilities such as public sector pension obligations are ignored. In the UK, non-debt liabilities are somewhat larger than total government debt. Not to measure or control these seems like a very strange omission.

On the asset side, debt-based targets pay no attention to whether borrowing is used to fund long-term investment or near-term consumption. This is not to say that the

Government does not measure this – it does. But the debt target always dominates. As a result, the purchase of an asset which would deliver public benefits (financial or otherwise) for decades to come is treated in the same way as spending on current services that benefit only today's recipients. This can only distort decision-making and penalise investment. Moreover, as we shall see, there are strong reasons to believe that the value of government assets – especially property assets – is severely understated on government balance sheets, including in the UK.

Second, debt-based targets tell us very little about intergenerational fairness. As we have seen, if we only measure debt we pay no attention to whether the proceeds of debt issuance have been used to invest for the future, or simply to meet current needs. Neither do we know whether other liabilities are being stored up for the future.

The basic output of a company's – or government's – accounts is an assessment of Net Worth, which is the difference between total assets and total liabilities. If the accounting is done well, Net Worth therefore addresses both of the problems highlighted above, and allows regular assessments of the legacy that each cohort of taxpayers are leaving to their successors.

Unfortunately, the current position is pretty bleak; the latest UK Whole of Government Accounts (for the year 2020-21) put UK Government Net Worth at negative £3.3 trillion,[41] around 150 per cent of GDP, or a deficit of almost £50,000 per UK resident. Whilst there are reasons to believe that certain assets are undervalued and the true deficit smaller, these figures show a very poor return on 70-plus years of relative peace and prosperity, and represent a strong warning that something needs to change.

41 Whole of Government Accounts, 2020-21.

But not only does assessing government finances based on Net Worth make sense analytically, it also allows governments to act like other organisations and borrow to invest, and provides incentives throughout government for decision-makers to take into account, and manage, the value of the assets that they use and the liabilities that they incur in delivering government services.

This is essential if governments are to take advantage of the opportunities which wealth funds can offer.

Planning for the future – is the Government omnipotent or omniscient?

A proper balance sheet can tell us a lot about the current state of government finances, but says nothing about the future.

In fact, the outlook for government finances – especially in the most developed countries – is poor. As populations age and life expectancies increase, healthcare and retirement costs rise, and a smaller proportion of the population will be economically active and able to generate the surplus necessary to meet these rising costs. All this is on top of the known, high and growing liabilities already incorporated in the balance sheet, including financial debt and the rather larger commitments to public sector pensions and other future costs.

The UK OBR forecasts that in 50 years' time, assuming current trends and current tax and spending policies, UK Government debt will have risen to an 'unsustainable' 310 per cent of GDP.[42] A more complete analysis, including an assessment of other liabilities, might be even more alarming.

To keep debt at current levels relative to GDP, the OBR estimates that an immediate and permanent 'fiscal adjustment' – a reduction in spending or increase in revenue

42 OBR Fiscal sustainability report July 2023.

– of 4.4 per cent of GDP is required – that is, in excess of £100 billion per year in current terms.

Common sense would suggest that an organisation confronted with known future liabilities would take steps now to save and invest for the future. But the UK Government has not done that. Rather, over the course of the last generation it has increased its borrowing from around 20 per cent of GDP to around 100 per cent today.[43] And in sharp contrast to the rules it sets for other employers, the UK Government does not invest money to fund pension commitments that it makes to its employees – commitments which, as we have seen, fall outside the scope of its financial management framework.

The decision to leave the very large majority of non-debt liabilities unfunded is not just driven by short-term financial expediency. It also embodies a conscious long-term policy position that sits more with HM Treasury, as the UK's permanent institutional guardian of public finances, than with ephemeral political leaders.

In essence, the Treasury's position is that government has an asset that no other body has – the power to tax. As long as future needs are capable of being met within the Treasury's view of future tax capacity, there is no problem, and the Treasury will also take care of intergenerational fairness along the way, through unspecified means. In effect, the Treasury is relying on its power and wisdom, and assuring the outside world that they should rely on these too.

All this might work in a theoretical world, ruled by a benign dictator with perfect foresight. But we are privileged

43 Statista, *Public sector net debt expressed as a percentage of GDP in the United Kingdom from 1900/01 to 2028/29.* Available at: https://www.statista.com/statistics/282841/debt-as-gdp-uk/ (Accessed: 15 January 2024).

to live in a democracy, and a consequence is that political parties compete for electoral support based on policies that need to yield results within the four- to five-year life of a government. There is very little sign that the OBR's long-term concerns exert influence over near-term fiscal decisions; the expansion of debt in recent years, the Government's severe negative Net Worth position and the current (early 2024) political focus on foreswearing tax increases or even enacting tax cuts in the run-up to a mandatory 2024 General Election all suggest that the opposite is true.

The power to tax may be valuable and unique, but to use it requires the ongoing consent of the electorate, and at present this does not appear to be forthcoming on anything like the scale that the UK's long-term fiscal position requires. And indeed, the financial markets' reaction to the October 2022 Liz Truss/Kwasi Kwarteng mini-budget, and the sustained increase in the UK Government's cost of borrowing that has followed, suggests that belief in the Government's financial strength and wisdom has worn rather thin. So, Treasury orthodoxy – that the power to tax obviates the need to invest – appears to threaten both long-term solvency and intergenerational fairness.

How sovereign wealth funds can help fix long-term public finances

If we break away from Treasury doctrine and accept that governments – like other organisations – should manage their finances in relation to Net Worth, not Net Debt, and should be willing to invest to meet future needs, then we unlock the potential for sovereign wealth funds to make a major contribution to meeting the fiscal challenges of the coming decades.

The expression 'sovereign wealth fund' can be used to

cover a wide range of government-funded investment activity. Our focus is on two types of fund that address the challenges (and opportunities) on the two sides of the Government balance sheet.

The first – which we will refer to as SWFs – exist to invest public funds in a diversified portfolio of investment assets in order to meet future needs. These could be explicit liabilities like public sector pensions, or implicit liabilities, like expected healthcare and pension costs associated with an ageing population.

The second we will call PWFs (for 'public wealth funds'). In our terminology, these exist to manage existing public commercial assets – frequently property or infrastructure-related – in a way that will maximise financial value to the taxpayer.

The SWF opportunity

SWFs (as we describe them) have been around for many years, and typically have been set up to translate surpluses arising from natural resource exploitation or trade for the long-term benefit of the national population. A good example is Norway, which, at an early stage of its development of North Sea resources, resolved to invest the Government's oil and gas-related revenues. Singapore's Government Investment Corporation (GIC), China's China Investment Corporation (CIC) and State Administration of Foreign Exchange (SAFE) all invest foreign reserves generated through export activity.

The UK might be thought to have missed a trick by not following Norway's example and investing government oil revenues in a similar fund. But the scale of UK revenues was relatively modest relative to the UK economy – at its brief mid-1980s peak, only around three per cent of GDP per year,

and under one per cent of GDP each year since 1986-87.[44] So even if all revenues had been invested as received and had earned returns of three per cent above GDP growth, all of which were re-invested, the total value would have been around 80 per cent of GDP today,[45] in contrast to Norway's current SWF holdings of $1.5 trillion or 315 per cent of GDP.[46]

However, the UK has non-debt liabilities relating to pensions and other commitments which are effectively debt, even if they are not recognised in fiscal targets. If the UK were to borrow money to fund these liabilities (or alternatively, to divert other government revenues) and invest in a globally diversified portfolio, it would be highly likely, over time, to earn a significantly higher return than that incurred on the debt. Statistics suggest that an annual surplus of three per cent over the cost of funds might reasonably be expected, though a more precise estimate of expected return would depend upon the investment strategy selected. What is more, the UK would be acquiring an investment portfolio which in the event of a UK or £ crisis would provide a valuable source of financial resilience.

The following tables illustrate how this might work and the effects on government finances, assuming an initial Net Worth of -100 per cent (rather lower than the Whole of Government Accounts estimate), annual investment rate of five per cent of GDP (roughly in line with recent levels of government borrowing). There are two examples: in one case, 100 per cent of investment is assumed to be debt financed, in the other, 50 per cent. (In this case, the implied real cost of government borrowing is zero per cent; a higher real interest rate would increase the positive impact on government finances under these assumptions.)

44 Source: Institute for Fiscal Studies (IFS TaxLab).

45 Authors' estimate, using IFS TaxLab data.

46 Norges Bank Investment Management. Available at: https://www.nbim.no/ (Accessed: 15 January 2024).

Table 2.1. Assumptions

Initial Net Worth as % of GDP	(–100%)
Pension liabilities as % of GDP	100%
Annual funding as % of GDP	5%
Annual (real) return on investments vs borrowing costs	3%

Table 2.2. Results

Funding strategy	100% debt	50% debt 50% other
After 16 years:		
Funding status	Fully funded	Fully funded
Net worth	(–76%) [+24%]	(–34%) [+66%]
Annual revenue impact as % of GDP	+3%	+3%

This might look like a 'free lunch,' and in a sense it is; the Government balance sheet is currently being used very inefficiently for the reasons described above, and the SWF strategy would address this historic failure.

But there are some important points to note.

First, the ability to use government debt to fund an SWF will of course depend upon debt financing being readily available in the required quantities on reasonable terms. This is likely to depend heavily on the overall state of government finances – and in particular, that government credit is and remains strong and that UK Government sterling debt is seen as being of low risk. But a financial framework which targets Net Worth improvement (which is a pre-requisite for the SWF strategy to make sense) and so breaks away from a quarter century of borrowing to fund current expenditure is highly likely to be welcomed by capital markets, now and for the long-term; the SWF would enhance this strategy further through accelerating Net Worth improvement, generating a stronger revenue base

and creating a more resilient balance sheet.

Second, there might be concerns that this strategy would increase the Government's risk exposure. In our view, the risks are very limited. Even in a 100 per cent debt-funded strategy, the only incremental risk that is being incurred is the re-investment risk – the obligation to pay future pensions is already in place. Over a century of investment data provide a high level of confidence that a strategy of continually borrowing and investing over a sustained period of time will generate significantly higher returns than the cost of government debt.

Third, there is of course a need for a good deal of fine-tuning. The best asset mix for the SWF will depend upon a number of factors, not just expected return – liquidity, and correlation with other assets and liabilities to name but two. The rate of investment and the extent of debt versus tax financing will also need careful consideration. But the principle – that there is a very large, low-risk, high-return opportunity to improve government finances – seems undeniable.

Finally, this opportunity has been presented as a way of addressing the UK's public sector pension liabilities which total around 100 per cent of GDP and are likely to expand over time unless there are changes to public sector workers' retirement benefits. But there is no reason to stop when the pensions are funded; in principle it would make sense to keep on borrowing and investing to pre-fund longer term, less explicit liabilities such as expected future healthcare and retirement costs.

The PWF opportunity

Turning to the asset side of the balance sheet, the UK was an early adopter of privatisation for state-owned businesses and real estate since the early 1980s and has returned or

transferred to the private sector a wide range of industrial, transport, utility, infrastructure and property assets.

However, the UK still has a considerable portfolio of public commercial assets at all levels of government, most notably property holdings that are valued in the Whole of Government Accounts at £409 billion,[47] or rather, less than 20 per cent of GDP.

This seems likely to be a considerable underestimate, for two main reasons.

First, applicable accounting standards require most government-owned property to be valued on the basis either of its current use or its historic cost. Much may have changed over the decades or even centuries since the decisions that determine these properties' current use or book value were taken, and these accounting values might therefore vary radically from market values which would better reflect the opportunity cost of holding these assets. So, these accounting standards should be changed to enable the principles of accrual accounting to be properly applied to governments.

Second, and reflecting the accounting standards, comparisons of the market value of government property holdings with accounting values typically show large discrepancies. For example, in the City of Pittsburgh, market values of government-owned property were recently estimated at 70 times the accounting value.[48] In the UK, Transport for London (TfL) – the recipient of much central government funding for investment and for dealing with Covid-related costs – reports property holdings of around £19 billion. But this value appears to represent less

47 Whole of Government Accounts 2020-21.

48 Ball, J. Crompton, J. Detter, D. (2022) 'Mapping the unknown', *IMF F&D Magazine*, March 2022.

than 15 per cent of TfL's total holdings by number of individual properties; the full market value is likely to be closer to £100 billion.[49] Overall, it has been estimated that governments in developed countries typically own property valued at about 100 per cent of GDP, whether analysed on a local or national basis.[50]

Historically, if the Treasury identifies surplus property on a department's or other government's entity books, it tends to push for that property to be sold. This is of course consistent with debt-based fiscal targets or rules; if an asset is not required, it should be sold and debt reduced.

But this has two negative consequences. First, it provides an incentive for departments to conceal assets or to obscure their true values; admitting to owning a valuable asset might result in the requirement to sell it, and a corresponding reduction on central funding. This is bad for transparency and accountability, and is likely to lead to bad asset allocation. Second, the Government's experience of selling property assets is that prices received for often poorly-managed properties can greatly understate their long-term value.[51]

A PWF offers at least a partial solution to the first problem, and a full solution to the second one. A PWF exists to manage a portfolio of public commercial assets – property, but also potentially infrastructure or operating businesses. To ensure a commercial focus and insulation from political interference or from the commercial inexperience of political leaders, it should be operated on an arm's length basis, with an independent board, clear commercial goals and commercial terms of employment. PWFs can be organised

49 Ball, I., Crompton, J., and Detter, D. (2021) 'Tilted Balance Sheet: Making the most of public sector assets'. *Public Finance*, December 6, 2021.

50 Detter, D. and Folster, S. (2018)'Unlocking Public Wealth', *IMF F&D Magazine*, March 2018.

51 See for example, Bond, D. (2018) 'MoD loses up to £4bn in homes deal with UK private equity group'. *Financial Times*, January 30, 2018.

on a national or regional/local level; examples of the former include Temasek in Singapore, Khazanah in Malaysia, ADQ in Abu Dhabi and of the latter, Copenhagen By & Havn in Denmark, and Hamburg Hafen in Germany.

Birmingham City Council offers an excellent example of where a PWF could transform local authority finances. In September 2023, Birmingham issued a Section 114 notice that stated that it was, in effect, insolvent because of its liabilities under prior years' equal pay claims. The total sum involved was £760 million, of which several hundred million had already been anticipated; the extra cost was therefore not especially large for the UK's largest local authority, overseeing a region with 1.1 million residents[52] and a GDP of £32 billion[53] as of 2021.

Birmingham City Council's annual report[54] states that the authority holds non-residential property valued at £2.5 billion, together with residential property valued at £3.0 billion. These values are not market values, for the reasons described above. But separately, the council reports ownership of 26,000 acres (just over 10,000 hectares) of land,[55] representing just under 40 per cent of the total area under its jurisdiction.

If the actual value of Birmingham City Council's holdings is more in line with the 100 per cent GDP guesstimate referenced above, then a value of £30 billion would be expected. To use another metric, UK property values as a whole appear to be around four to five times GDP,[56]

52 Birmingham City Council website, referencing 2021 Census.
53 Birmingham City Council website, data are for 2021.
54 Birmingham City Council Draft Statement of Accounts 2021-22.
55 Birmingham City Council report, *Community Property Assets* 15 March 2022.
56 Authors' estimates, using data on residential and commercial property values from Statista.com. Other sources suggest similar magnitudes.

suggesting that the property within the council's area is worth £120-£150 billion. Birmingham City Council's 40 per cent share of the land area – which includes considerable holdings in central Birmingham – also suggests that there is a great deal of actual or potential value in its property portfolio.

By establishing a PWF – in this case an Urban Wealth Fund – Birmingham could set up an apparatus free from political interference which would manage its portfolio along commercial lines, ensuring best use of available assets and – of particular importance – developing under-utilised property to maximise value, most likely in conjunction with private sector partners. This could have a major positive effect on the council's long-term financial position, as profits could be distributed to it in the form of dividends. To provide an order of magnitude, if (say) the value of a developed property portfolio was £20 billion, a five per cent yield on this portfolio would yield Birmingham £1 billion per year – three to four times its current estimated operating deficit. Moreover, development of the portfolio should also benefit public policy goals in the areas of urban regeneration and housing provision.

Within the UK, PWFs have very broad potential application, especially in relation to property management and development, both at central and local government level. The sheer scale of the portfolio probably requires the use of multiple vehicles at central government level; local governments, by contrast, might need to pool property holdings to extract desirable economies of scale. At both levels of government, central leadership is required to establish the necessary institutional frameworks to enable these organisations to operate efficiently and safely within the public sector without sacrificing their commercial objectives.

In aggregate, the International Monetary Fund (IMF) estimates that public commercial assets on government hands produce returns that are 1.5 per cent below what should be expected. In the case of assets which are not properly identified on government balance sheets and which are severely undervalued and presumably undermanaged, this seems like a low number. But if we assume (in round numbers) that the true value of UK Government property is 100 per cent of GDP versus a reported 20 per cent, and that this represents the undermanaged part of the portfolio, then this suggests that commercial management could unlock value of the order of 0.8 x 1.5 per cent of GDP, or 1.2 per cent.

One final point. Despite the lack of good accounting for government property values, it is not difficult to derive a working estimate for actual or potential value that can provide a sound basis for developing a PWF strategy. Modern online mapping technology, used in combination with the UK Land Registry, allows usable working data for any given urban area to be generated in a few weeks, and at very modest cost. Lack of data is not an excuse for a failure to examine this valuable opportunity.

Summary and conclusions

We have argued in this chapter that the UK's long-established focus on debt-based fiscal rules and targets, in conjunction with some rather complex (and highly challengeable) financial management doctrines, has had the effect of preventing the UK Government from investing systematically to meet future needs. Moreover, the failure to put accrual accounting at the centre of government finances further obscures financial reality and intergenerational fairness. Given the challenges facing UK Government finances, now and for the future, it is high time to address these issues.

By switching to accounting-driven financial management and adopting Net Worth-based measures of the Government's financial position, the Government can open-up the opportunity to act as any other rational corporation or individual would do: invest and manage based upon long-term future needs.

On the liability side, this could mean recognising that non-debt liabilities are just as real as debt liabilities. Investing to meet these liabilities through a globally diversified SWF can strengthen balance sheet metrics and income flows and improve financial resilience. This is true even if the SWF is financed entirely through the proceeds of incremental government borrowing.

On the asset side, national and local government entities have very large property holdings whose values appear to be systematically and severely understated in government accounts. By establishing PWFs at a national and regional level, assets can be better managed and value extracted for the taxpayer without resorting to under-priced asset sales.

Taking these SWF and PWF initiatives together, there seems good reason to believe that within a couple of decades there is scope for a major improvement in government finances. Fully funding existing public sector pension liabilities via a globally-diversified SWF would increase government revenues by the equivalent of three per cent of GDP, whilst a conservative estimate of the value created by better management of property assets via PWFs is 1.2 per cent. The total of over four per cent is roughly what is needed to meet the long-term fiscal challenges caused by an ageing population and rising healthcare costs.

This chapter is based on a recently published book, 'Public Net Worth—Accounting, Government and Democracy', by Ian Ball, Willem Buiter, John Crompton, Dag Detter, and Jacob Soll (Palgrave MacMillan, 2024).