

## EXECUTIVE SUMMARY

Public sector balance sheets provide the most comprehensive picture of public wealth. They bring together all the accumulated assets and liabilities that the government controls, including public corporations, natural resources, and pension liabilities. They thus account for the entirety of what the state owns and owes, offering a broader fiscal picture beyond debt and deficits. Most governments do not provide such transparency, thereby avoiding the additional scrutiny it brings. Better balance sheet management enables countries to increase revenues, reduce risks, and improve fiscal policymaking. There is some empirical evidence that financial markets are increasingly paying attention to the entire government balance sheet and that strong balance sheets enhance economic resilience. This issue of the *Fiscal Monitor* presents a new database that shows comprehensive estimates of public sector assets and liabilities for a broad sample of 31 countries, covering 61 percent of the global economy, and provides tools to analyze and manage public wealth.

Estimates of public wealth reveal the full scale of public assets and liabilities. Assets are worth US\$101 trillion or 219 percent of GDP in the sample. This includes 120 percent of GDP in public corporation assets. Also included are natural resources that average 110 percent of GDP among the large natural-resource-producing countries. Recognizing these assets does not negate the vulnerabilities associated with the standard measure of general government public debt, comprising 94 percent of GDP for these countries. This is only half of total public sector liabilities of 198 percent of GDP, which also includes 46 percent of GDP in already accrued pension liabilities.

Net worth—the difference between assets and liabilities—is positive on average, although about one-third of the countries in the sample are in negative territory, including most of the G7. But net worth does not account for the state's ability to tax in the future, which is why intertemporal balance sheet analysis—which combines current wealth with future revenue and expenditure—is important. Still, balance sheet strength is not an end in itself, but rather a tool

to support the objectives of public policy. Because balance sheet estimates can involve various data quality issues, with challenges in measuring and valuing many assets and liabilities, improving public sector accounting standards is important.

The scars from the global financial crisis are still evident on public wealth a decade later. Even though deficits have shrunk, at least in the advanced economies most affected by the crisis, net financial worth across the 17 sampled countries with time series data remains US\$11 trillion (28 percentage points of GDP) lower than it was before the crisis. The balance sheet approach reveals a more nuanced picture than what deficits and debt alone show. It recognizes that public investment creates assets, and accounts for valuation effects, which are particularly large on the asset side. The scars from the crisis reemphasize the importance of governments rebuilding their balance sheets, by reducing debt and investing in high-quality assets.

This report introduces tools that can be used to comprehensively analyze the resilience of public finances. These tools allow governments to examine both sides of the balance sheet to identify imbalances or mismatches and use fiscal stress tests to gauge the resilience of public finances against tail-risk shocks such as the global financial crisis. These tests should ideally be done on the full public sector balance sheet, where data are available. By identifying risks in the balance sheet, governments can act to manage or mitigate those risks early, rather than dealing with the consequences after problems occur.

Once governments understand the size and nature of public assets, they can start managing them more effectively. Potential gains from better asset management are considerable. Revenue gains from nonfinancial public corporations and government financial assets alone could be as high as 3 percent of GDP a year, equivalent to annual corporate tax collections across advanced economies. In addition, considerable gains could be realized from government nonfinancial assets. Practical experience from Australia, New Zealand, the United Kingdom, and Uruguay can guide countries on how to increase the effectiveness and

returns on assets, while reducing risk across both sides of the balance sheet.

While there are considerable challenges in compiling reliable balance sheets, the benefits of basic balance sheet analysis are within reach of many countries, not just advanced economies with high-quality data. Only a handful of countries currently undertake a public sector balance sheet approach. Yet, balance sheet estimates can be developed even in data-constrained environments like The Gambia or complex emerging economies like Indonesia. The estimates should be treated with some caution, as the application of accounting and statistical standards varies widely. Once governments produce these estimates, analyzing, assessing, and projecting the balance sheet forward is relatively simple, relying on easy-to-use frameworks.

This report analyzes balance sheets through a range of case studies, in a first step of an ongoing research agenda. The following are some of the findings:

- Applying the same stress test that the Federal Reserve applies to banks would reduce US public sector net worth by 26 percent of GDP, with balance sheet losses to pension funds and nonfinancial assets responsible for the bulk of the decline.
- New estimates suggest that China's general government net financial worth has deteriorated to about 8 percent of GDP, largely because of subnational borrowing and underperforming public corporations. Off-budget debt and the weak performance of public corporations both entail risks for the future.
- In Indonesia, an increase in public investment financed by a surge in revenue is estimated to boost public wealth. The combination of new infrastructure assets and future revenue from higher output could result in a 6½ percent of GDP increase in public wealth, and potentially even larger gains with strengthened infrastructure investment efficiency.
- Although Norway's fiscal position is very strong, long-term spending pressures significantly reduce its intertemporal net worth relative to its vast asset position. In contrast, Finland's recent and planned reforms mean that future primary balances are posi-

tive despite an aging population, adding to intertemporal net worth.

- The Gambia's balance sheet reveals large cross holdings of fragile assets across the public sector that could cause cascading losses and result in unsustainable government financing needs in the event of a natural disaster.
- Balance sheet effects cushioned the impact of the halving of oil prices in 2014 in resource-rich Kazakhstan. This was due in part to persistent positive exchange rate effects on its oil revenue savings that are held in liquid foreign currency assets. These savings also allowed the government to undertake a large stimulus package.

These case studies distill some lessons that apply more broadly. First, both sides of the balance sheet are important. Governments should consider the effect of policies on assets and nondebt liabilities, in addition to debt. This also applies to risk management, where valuation changes can have large wealth effects. Second, considerable fiscal activity occurs outside the general government. Including public corporations in fiscal analysis is necessary to assess and manage fiscal risk more effectively. Third, comparing current levels of public wealth with long-term projections reveals how well placed governments are to meet building demographic pressures, in the face of rapidly aging societies.

Over and above these insights, balance sheet analysis enriches the policy debate by focusing on the full extent of public wealth. Public assets are a significant resource, and how governments use and report on them matters, not just for financial reasons, but also in terms of improving service delivery and preventing the misuse of resources that often results from a lack of transparency. Recent parliamentary debates in New Zealand, as well as the UK government's response to the fiscal risk report, illustrate this point. They show that publishing balance sheet information can raise the tenor of policy debate, asking how public wealth can be better used to meet society's economic and social goals.