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1. Crown Assets

The Crown holds a large array of different assets, covering three broad portfolios:

- **Commercial Assets**
- **Financial Assets; and**
- **Social Assets**

For more information on these asset classes see the 2010 Investment Statement of the Government of New Zealand.

Discuss the principles you think the crown should apply in determining what assets it should own, what it should sell, and what it should invest more in, providing examples and the rationale for your conclusions.

<u>**Crown Assets**</u>

When determining what assets the crown should invest more in, sell or buy (whether they be commercial, financial or social assets) certain principles need to be considered. These include primary economic principles and secondary economic principles.

Primary economic principles are the broadest principles the Government needs to consider when buying selling or investing more in assets. There are two primary principles:

(i) Economic Return on an Asset

> This includes all explicit returns on an asset. Explicit returns tend to be confined to commercial assets and financial assets. Commercial assets for example pay dividends to the government (NZX, 2010) The Reserve Bank which manages financial assets has been known to make a return which it pays to the government (Crisis, 2010).

(ii) Social Return on an Asset

> Social returns include all implicit benefits derived from an asset including those enjoyed by a third party i.e. externalities (Principles of Microeconomics, 2006).
>
> The New Zealand government for examples manages the public health service. This leads to lower national rates of sickness, benefiting businesses (third parties) indirectly due to lower sick days. What's more, the government by managing such assets saves funds in the long term as early treatment of diseases prevents later hospitalization which is significantly more expensive(Inside Poverty In New Zealand, 2011).
>
> These benefits however are particularly difficult to measure. What's more, they tend to be mainly experienced by a third party as opposed to only the government. It's also important to note social return in this instance also encompasses employment and economic growth.

When the government purchases, sells or invests in a new asset they should measure the social and economic benefit derived from that asset. The combination of assets that provides the maximum utility/benefit is what the government should purchase.

Primary principles are influenced by secondary principles. Secondary principles are macroeconomic trends. These trends are continually changing and thus, the economic benefit and social benefit gained from these assets also changes. This in turn results in the combination of assets that offers the most utility also shifting.

Notable secondary principles include; fiscal trends, domestic and international economic activity, productivity of the potential asset, and the time period (short term, medium term, and long term).

<u>Fiscal Trends</u>

One of the key factors that influences how governments should manage their assets are fiscal trends. Mentioning an earlier point, social assets (e.g. public hospitals in the public healthcare industry) tend to have significant positive externalities but low if not any economic return to the owner. This results in the owner incurring an operating loss.

When the government is found to be continually operating budget deficits and is becoming increasingly indebted, then the purchasing of these assets should be avoided. The accumulation of these assets will only result in the increasing of the government's (Radio New Zealand, 2013) costs. This will result in either:

(i) International markets losing confidence in the government and avoiding purchasing bonds from that government unless they're sold at unsustainably high interest rates.
(ii) Alternatively, in the long run, the government will be unable to continue to invest in the asset to offset depreciation.

The Spanish economy is a particularly noteworthy example of a country experiencing these eventual outcomes for maintaining unsustainable expenditure on social assets (Bloomberg, 2013) It is incurring significant budget deficits in order to maintain these social assets.

When the fiscal situation is a negative one, the government should avoid investing in social assets and instead invest more in commercial assets and financial ones. This is due to the fact that they offer an economic return. It should also corporatize social assets into commercial ones where feasible. This has been previously done in New Zealand where the government converted the social asset New Zealand Post into the commercial asset Postbank in 1987(New Zealand Post, 2013).

That said when the position of the fiscal situation is a positive one, there should be a greater emphasis on the investing in existing social assets and purchasing new ones.

Domestic and International Economic Activity

Another important secondary principle that should be applied is what the state of the domestic and international economy is in.

The importance of the financial sector in recent times has increased. Given the reliance that New Zealand retail banks have on foreign capital, when global or domestic growth slumps, this can result in a capital flight. These capital flights can seriously threaten the financial sector and in turn the rest of the economy.

During slumps, the crown and more specifically the Reserve Bank of New Zealand should look more at investing in financial assets (rather than social and commercial assets). These assets include mortgage-backed securities. These expenditures are necessary in order to maintain liquidity and support retail banks. Alan Bollard, former governor of the Reserve Bank notes how during 2008

> *"A key scheme they devised involved residential mortgage-backed securities, where bank package up their housing mortgages in a way that allows the Reserve Bank to take them as security."* (Crisis, 2010)

There are also high social returns on these financial assets as they mitigate the effects of a potential capital flight or lack of funding for retail banks. In turn, they support more stable environments for employment and economic growth. What's more when the slump ends they can be sold back to a retail bank for a potential capital gain and thus an economic return.

Once again though, when economic activity is more buoyant there should be less emphasis on the purchasing of financial assets and more emphasis on commercial and social assets.

Productivity of the Asset

The operating costs of social assets for a Government can sometimes increase significantly. As a result of already incurring a negative economic return, the government may find if their finances are in a negative state or alternatively there are low social benefits relative to the negative economic return of the social asset, the government should corporatize the asset into a commercial asset to make it profitable. Alternatively they can outright privatize it.

Commercial assets can also become unprofitable. If they cannot be made profitable again and there is no prospect of such an outcome in the foreseeable future, they should be privatized so the crown no longer incurs the loss. The sale of the unprofitable state owned enterprise Petrocorp, in 1987, to Fletcher Challenge is a demonstration of one such instance (New Zealand Legislation, 1987).

The sale of the assets gives the government a pool of new funds to invest in assets that have higher social and economic returns.

Alternatively if an asset is:

(i) A social asset and has a high social return relative to the economic loss incurred via operation, then it should be invested in.

(ii) An economic asset that has a high economic return then greater investment should occur to increase revenue, profitability and thus the return to the crown.

Timeframe

The timeframe in some respects can be a secondary principle. There are three particular sub-principles of this secondary principle.

(i) Development in the Market in which the crown owns Assets

Occasionally the crown may buy or establish a commercial asset, which supplies a commodity to a market. In the short run, if the asset were to be sold to a private company, a monopoly would occur (as the asset can't be broken up) and consumers would be overcharged resulting in a low social return on the asset for an economic return to the private company. Hence the government may retain ownership of the asset in the short term.

In the long run however, the market for the commodity may grow so that more producers can exist in the market. In that case, the social effects of the government privatizing the asset would be mitigated, as other firms would enter the market. This allows the government to then sell that particular commercial asset and use the proceeds to invest in another commercial asset for social return. Max Bradford's reforms of 1998 were an attempt at breaking up and privatizing the government monopoly Electricity Corporation of New Zealand into a functional private market. (Radio New Zealand, 2013)

(ii) Predictions of Future Crown Operating Costs and Revenue

As mentioned in the fiscal trends section, some governments may find that in the short term the fiscal situation is positive (high budget surpluses and low debt) and will consequently invest in significant levels of social assets including roads, state highways and other infrastructure. This is theorized to be presently occurring in China. Tony Alexander amongst other economists have predicted that high depreciation is going to be incurred on these projects in the long run (Tony Alexander, 2012). Overall the government will not be able to maintain investment in these assets that exceeds the depreciation due to a lack of revenue.

Hence when buying or investing in social assets the government should investigate whether it will have the necessary funds to maintain sufficient investment to upkeep the asset. If not they should avoid the purchasing of that asset and allocate funds towards investing more in commercial assets.

iii) Influence on Macroeconomic Outlook

One of the key aims of the crown is to maximize economic growth and employment. The long term and short term effects that the purchasing (creation) of an asset has on employment and economic growth thus is important. The combination of social, financial, and commercial assets that maximizes these effects (has highest social return) in a fiscally stable manner (with highest economic return) in the short, long term and medium also needs to be considered. This feature is one of the most important given its political nature, and importance in the public sphere (Barry.A , 1997).

Conclusion

Overall, the Crown should invest in the combination of financial, commercial and social assets that delivers the highest combination of social and economic return. This combination though will always need to be investigated by analyzing and balancing the secondary principles. Secondary principles influence whether the crown should focus on assets that deliver an economic return or a social return. They also influence how large the economic or social return of an asset will be.

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