UK PLC

Britain's debt time bomb

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BRIEFING PAPER

EXECUTIVE SUMMARY

- This Paper addresses the Big Numbers in the Whole of Government Accounts (WGA) – in effect, the UK Government PLC - which were recently issued for the 2013/14 fiscal year. The size of some of the declared liabilities is truly staggering.

- The rationale behind the WGA is to create greater financial transparency, by adopting accounting policies replicating those of the largest PLCs. In some areas, the WGA's methodology still falls short, leading to the WGA's figures being qualified by the Comptroller and Auditor General.

- In the equivalent to the Profit and Loss Account, the 2013/14 figures show a massive deficit of £213 billion, which mirrors the vast – and ongoing - public sector net deficit for the year.

- The WGA Balance Sheet equivalent reveals a net liability of an astonishing £1,852 billion, caused mainly by the £1,302 billion public sector pension liability - 93% of which is unfunded. Aside from the recent contribution and benefit changes that will impact in 2017, far more radical measures are needed to cut this vast public liability, especially by cutting the level of Defined Benefit (DB) pension membership.

- The WGA also reveal some very large figures on other fronts. The notional loss on the 79% (now 73%) RBS shareholding is now £22 billion, whilst recent international accountancy changes have loaded an additional – and unwelcome - £38 billion of Network Rail debt onto the public sector balance sheet.

- Nuclear decommissioning liabilities, over two-thirds of which are related to the Sellafield/Drigg facilities, exceed £77 billion, whilst the student loans programme – almost unbelievably - has a non-payment expectation rate of up to 45%.

- As a matter of real urgency, the new Government should vigorously cut these excessive public sector liabilities, which – for varying reasons – continue to grow rather than contract.

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Central to the rationale behind the compilation of the Whole Government Accounts (WGA) is the quest to achieve a more transparent view of the public finances, which go well beyond the limitations of the long-established National Accounts – and especially in terms of quantifying unfunded public sector pension liabilities.

The latest set of WGA, covering the period 2013/4, is the fifth that has been published. The data in the WGA is compiled from the returns submitted from 4,000 public organisations, including Local Authorities. Undoubtedly, the task of consolidating this mass of data is a daunting one.

Importantly, the quality of the data is improving from year-to-year: material anomalies, though, still remain. In fact, the accountancy principles adopted are very close to those used by typical PLCs, which - in recent years - have been required to make appropriate provisions for future pension liabilities. Consequently, actuarially-driven pension fund adjustments are made periodically, both to reflect changes in the actual level of unfunded liabilities but also to reflect up-to-date discount rates.

Such well-known companies as British Telecom and British Airways (now ICAG) inter alia have struggled for years to prevent excessive deficits accruing from their long-term pension fund liabilities – to the clear detriment of their on-going share price rating.

The WGA also adopt the technical criteria prescribed by the International Financial Reporting Standards (IFRS) on accounting policies.

Significantly, too, far more scrutiny is now being accorded to sovereign debt levels – and the accounts that underpin them - as EU governments continue to run ever-higher levels of borrowing. Consequently, they need to sell even more bonds than previously to finance them. Indeed, buyers of bonds need to be increasingly aware of the detailed liabilities of the sovereign body to whom they are lending, which directly impact the prevailing bond yields of individual countries. The stark plight of the Greek financial system, as well as that of Spain, Portugal and Ireland, underlines this point. Their respective bond yields have fluctuated enormously in recent years, despite very low – and stable - EU interest rates.

Whilst by historic standards UK gilt yields have remained very low, especially in nominal terms, the level of borrowing following the start of the financial crisis in 2008 has been colossal. Public Sector Net Debt (PSND) has risen from £633 billion in 2008/09 to a current figure of almost £1,600 billion. This scenario is partly reflected in the WGA for 2013/14, which shows a net liabilities figure of £1,852 billion; even so, gilt yields, both short-term and long-term, still remain very low.

Table 1 (overleaf) shows the headline data.

TABLE 1: KEY DATA, WGA OF 2013/14[1]

ITEM	£BN
Operating Revenue	649
Operating Expenditure	718
Net Financing Costs	79
Net Expenditure	149
Total Assets	1,337
Total Liabilities	3,189
Net Liabilities	1,852

NATIONAL ACCOUNTS RECONCILIATION

In comparing the long-standing National Accounts with the WGA, there are many salient differences. In short, the WGA represent the adoption of modern-day accounting principles in a way that the National Accounts – first drawn up shortly after the end of World War II, albeit heavily amended subsequently - cannot do.

The most obvious numerical difference is the inclusion of long-term public sector pension liabilities, which were valued at £1,302 billion at March 2014, a figure that equates to over 85% of the 2014/15 PSND out-turn. By adopting standard PLC accounting principles, this liability is now counted as such in the WGA and is mainly responsible for the net liability of £1,852 billion. Inevitably, this figure is a broad estimate at a particular point in time, heavily influenced by the discount rate adopted in assessing its value. With very low gilt returns, a low discount rate is used. In 2013/14, the discount rate was cut from 2.4% to 1.8%, which was the main factor in raising public sector pension liabilities by £130 billion compared with 2012/13.

Inclusion of Local Authority assets in the WGA is distorted by the historic cost accounting principles that are widely used in local government, especially in valuing school building assets. This practice is in the process of change so that it can become more consistent with central government accounting policy which uses replacement cost principles - with appropriate depreciation charges to assess net asset book value.

Similar principles apply to the current book valuation of public highways, which are based predominantly on historic cost, rather than depreciated replacement cost, valuations. More specifically, within the WGA, various judgements have had to be made to reflect the ownership of various financial, commercial and industrial assets, including the 79% (now 73%) share-holding in Royal Bank of Scotland (RBS) and the 25% (now 10%) share-holding in Lloyds.

Similar adjustments will also be needed in the 2014/15 WGA to reflect the change in status of the not-for-profit Network Rail, which has gross assets of over £50

1 Source: WGA 2013/14.

billion; . Network Rail is now fully incorporated within the public sector and its net debt of £34 billion – as at March 2014 – is now part of the PSND; previously, it was not.

Very substantial provisions have also been made in the WGA for future nuclear decommissioning liabilities, principally at the controversial Sellafield plant in Cumbria; total nuclear-related provisions at March 2014 exceeded £77 billion.

Unlike the National Accounts, the WGA also treats off-balance sheet items more rigorously by adopting current accounting principles.

PROFIT AND LOSS ACCOUNT

The Profit and Loss account for UK Government PLC seeks to replicate that of a commercial PLC; there are, though, various material differences, which impact the bottom-line numbers.

Table 2 below highlights the substantial 2013/14 deficit, with expenditure, including debt interest, exceeding revenues by £149 billion – a 17% reduction on the 2012/13 figure.

TABLE 2: CONSOLIDATED STATEMENT OF REVENUE AND EXPENDITURE[2]

	2012/13 (£BN)	2013/14 (£BN)
Taxation Revenue from Direct Taxes	(289.1)	(308.9)
Taxation Revenue from Indirect Taxes	(179.4)	(194.1)
Taxation Revenue from Local Taxes	(55.9)	(52.8)
Revenue from Sales of Goods and Services	(42.7)	(39.0)
Other Revenue	(53.6)	(53.7)
Total Revenue	*(620.7)*	*(648.5)*
Social Security Benefits	215.0	213.4
Staff Costs	183.6	185.8
Purchase of Goods and Services	182.3	189.8
Cost of Grants and Subsidies	56.3	59.8
Depreciation and Impairment Charge	51.1	49.5
Provision Expense	29.0	19.7
Total Expenditure	*717.3*	*718.0*

2 Source: WGA 2013/14

Net Expenditure before Financing Costs	*96.6*	*69.5*
Investment Revenue	(4.8)	(7.0)
Net Finance Costs	36.3	36.7
Interest on Pension Scheme Liabilities	47.9	49.1
Net Financing Costs	*79.4*	*78.8*
Revaluation of Financial Assets and Liabilities	(0.6)	4.6
Net Loss on Disposal of Assets	3.3	(4.3)
Net Expenditure for the Year	*178.7*	*148.6*
Other Comprehensive Income		
Net Gain on Revaluation of Property, Plant and Equipment	(7.1)	(13.0)
Net Gain on Revaluation of Intangible Assets	0.0	2.2
Net Loss/(Gain) on Revaluation of Financial Assets for Sale	(5.6)	(8.7)
Actuarial Gain/(Loss) on Pension Liabilities	97.4	83.5
Net Other Comprehensive Income	*84.7*	*64.0*
Total Comprehensive Expenditure/(Income)	*263.4*	*212.6*

BALANCE SHEET

The balance sheet of UK Government PLC has been compiled on similar - though not identical - principles to that of a major PLC. Whilst there are material differences in assessing both the assets and liabilities, the basic principles remain the same. However, the bottom-line 2013/14 net liabilities figure of £1,852 billion in Table 3 below is, of course, unprecedented for any UK organisation; it reflects the barely credible levels of borrowing since the onset of the financial crisis in 2008.

TABLE 3: CONSOLIDATED STATEMENT OF FINANCIAL POSITION[3]

	2012/13 (£BN)	2013/14 (£BN)
Non-Current Assets		
Property, Plant and Equipment	746.8	762.6
Investment Property	12.4	13.0
Intangible Assets	34.5	35.9
Trade and Other Receivables	16.6	18.1
Equity Investment in the Public Sector Banks	40.0	43.0
Other Financial Assets	158.6	154.6
Total Non-Current Assets	*1,008.9*	*1,023.2*
Current Assets		
Inventories	12.1	12.0
Trade and Other Receivables	122.3	131.0
Cash and Cash Equivalents	24.5	25.5
Gold Holdings	10.5	7.7
Assets Held for Sale	1.6	1.7
Other Financial Assets	117.6	136.2
Total Current Assets	*288.6*	*314.1*
Total Assets	***1,297.5***	***1,337.3***
Current Liabilities		
Trade and Other Payables	(98.3)	(102.0)
Government Borrowing and Financing	(214.3)	(212.4)
Provisions for Liabilities and Charges	(13.4)	(13.0)
Other Financial Liabilities	(408.4)	(429.6)
Total Current Liabilities	*(734.4)*	*(757.0)*
Net Current Liabilities	*(445.8)*	*(442.9)*
Total Assets less Current Liabilities	*563.1*	*580.3*
Non-Current Liabilities		
Trade and Other Liabilities	(55.2)	(56.7)
Government Borrowing and Financing	(781.9)	(883.7)
Provisions for Liabilities and Charges	(117.6)	(128.8)
Net Public Service Pension Liability	(1,171.9)	(1,301.9)

3 Source: WGA 2013/14

Other Financial Liabilities	(64.4)	(61.0)
Total Non-Current Liabilities	*(2,191.0)*	*(2,432.1)*
Net Liabilities	***(1,627.9)***	***(1,851.8)***
Financed by Taxpayers' Equity:		
Liabilities to be Funded by Future Revenues		
General Reserve	1,876.6	2,111.7
Revaluation Reserve	(245.0)	(256.6)
Other Reserves	(3.7)	(3.3)
Total Liabilities to be Funded by Future Revenues	***1,627.9***	***1,851.8***

At the heart of the Balance Sheet are the current and non-current assets, which amounted to £1,337 billion at March 2014.

In fact, as Table 4 indicates, there have been relatively modest changes in the total asset valuation over the three years preceding 2013/14. The major movements have been on the liabilities side of the Balance Sheet and specifically the impact of accounting for public sector pension fund liabilities.

TABLE 4: ASSETS[4]

	2010/11 (£bn)	2011/12 (£bn)	2012/13 (£bn)	2013/14 (£bn)
Property, Plant and Equipment	714	745	747	763
Gold, Cash and Other Financial Assets	255	282	311	324
Trade Receivables	145	142	139	149
Equity in Public Sector Banks	60	41	40	43
Intangible Assets	35	35	35	32
Other Assets	26	26	26	27
Total	*1,234*	*1,271*	*1,298*	*1,337*

The relatively flat profile of the property, plant and equipment elements of the asset base is partly attributable to the convention of Local Authorities of valuing their assets on a historic – rather than a depreciated replacement – cost basis. In particular, the valuation of the schools' estate is depressed by such treatment, especially since many schools were built several decades ago – and often on land with a valuable development potential today.

As part of the WGA process, it is planned to re-value Local Authority assets on the basis of replacement cost, which should raise the asset base significantly; according to the Comptroller and Auditor General, the impact of such an uplift could exceed £232 billion. Significantly, too, gold, cash and other financial assets were valued at £324 billion for the period ending March 2014.

4 Source: WGA 2013/14.

There are major differences between the long-established PSND figure, which measures the Government's direct borrowings, and the total net liabilities as confirmed by the WGA. The two most notable differences are the public sector net pension liability and the inclusion of public assets, albeit under inconsistent accounting valuation policies, within the WGA.

These items are shown in Table 5 below, revealing a deficit for 2013/14 of £1,402 billion, although property assets were valued at £763 billion. Certainly, in terms of assessing sovereign risk and financial viability, these are big – and important - numbers.

TABLE 5: PUBLIC SECTOR NET DEBT[5]

	2011/12 (£BN)	2012/13 (£BN)	2013/14 (£BN)
Net Liabilities (WGA)	1,347	1,628	1,852
Net Public Service Pensions Liabilities	(1,006)	(1,172)	(1,302)
Provisions	(113)	(131)	(142)
PFI Contracts	(31)	(32)	(33)
Unamortised Premium/Discount on Gilts	(23)	(31)	(29)
Property, Plant and Equipment	745	747	763
Investment Property	13	12	13
Intangible Assets	35	35	32
UKAR Net Impact on Net Debt	83	83	74
Trade and Other Payables	(50)	(48)	(47)
Accruals and Deferred Income	(41)	(39)	(44)
Net Taxation and Duties Due	3	3	6
Inventories	11	12	12
Trade and Other Receivables	35	35	39
Prepayments and Accrued Income	81	77	80
Investments	17	27	23
Network Rail	0	34	34
Asset Purchasing Facility	0	44	45
Other	0	15	26
Public Sector Net Debt (National Accounts)	*1,106*	*1,299*	*1,402*

Comment: The 2016 Budget indicated that the PSND would continue its remorseless upward trend, albeit at a lower rate than in recent years; it may well reach a staggering £1,700 billion within the next three years

Of course, these figures are well above previous forecasts as the Government has been unduly optimistic in its PSND reduction projections. Its efforts to cut public

5 Source: WGA 2013/14.

expenditure have been insufficiently robust whilst there has also been a generally unexpected shortfall in the yield from Income Tax.

In terms of the WGA net liability figure, the pronounced negative position is expected to remain until the PSND falls markedly, the discount rate for the public sector pension liability is raised significantly and/or the asset base, primarily Local Authority Network Rail property, is substantially re-valued upwards.

TAXATION YIELD

The yield from taxation underpins the public finances. Overall, tax currently accounts for around 86% of total public sector income, with the remainder financed from other sources.

As Table 6 shows, slightly less than 50% of total operating revenue arises from direct taxes, predominantly Income Tax. The contribution of indirect taxes continues to rise, driven in part by the increase in 2011 of the VAT rate to 20%. Local taxes are essentially the Council Tax and Non-Domestic Rates.

TABLE 6: PUBLIC SECTOR REVENUE

	2012/13 (£bn)	2013/14 (£bn)
Direct Taxes	289	309
Indirect Taxes	179	194
Local Taxes	56	53
Revenue from Sales of Goods and Services	43	39
Other Revenue	54	54
Total Operating Revenue	*621*	*649*

Whereas overall tax revenues in 2012/13 were virtually flat compared with 2011/12, the 2013/14 figures show a marked recovery in tax proceeds – up by £31 billion. Nonetheless, the shortfall in tax revenues over recent years, especially from direct taxes, has been very significant and unexpected – all the more so with employment at record levels. In effect, this pronounced shortfall has been a major constraint on reducing the vast level of public borrowing – the PSND for 2014/15 was £1,486 billion.

Table 7 (overleaf) provides a breakdown of the main taxes that are levied and how much they raised in 2013/14 and in the preceding year.

TABLE 7: TAXATION REVENUE[6]

	2012/13 (£BN)	2013/14 (£BN)
Income Tax	150.9	162.1
Social Security and National Insurance Contributions	90.7	97.3
Corporation Tax	38.9	39.6
Capital Gains Tax	3.9	3.9
Inheritance Tax	3.1	3.8
Bank Levy	1.6	2.2
Taxation Revenue from Direct Taxes	289.1	308.9
Value Added Tax	99.1	108.2
Hydrocarbon Oils Duty	26.5	26.9
Excise Duties	26.6	26.8
Stamp Duties	9.5	12.9
TV Licence Fee Income	3.2	3.1
Insurance Premium Tax	3.0	3.0
Air Passenger Duty	2.8	3.0
Betting and Gaming Duties	1.8	2.3
Lottery Income	2.0	1.6
Landfill Tax	1.2	1.2
Climate Change Levy	0.6	1.2
Petroleum Revenue Tax	1.8	1.1
Other Indirect Taxes	1.4	2.8
Taxation Revenue from Indirect Taxes	179.4	194.1
Council Tax	30.4	28.5
National Non-Domestic Rates	25.5	24.3
Taxation Revenue from Local Taxes	55.9	52.8
Total Taxation Revenues	*524.4*	*555.8*

Comment: In terms of tax yield, it is noticeable how both Income Tax and VAT predominate; they contribute almost one-half of total tax revenues and, if National Insurance Contributions are also added in, the percentage figure rises to around two-thirds. By contrast, comparatively little revenue is raised by capital taxes, such as Inheritance Tax and Capital Gains Tax. Both are strong candidates to be abolished.

6 Source: WGA 2013/14.

For many years, the social security programme has been the largest departmental budget – the gap between it and other spending departments continues to grow. In effect, there are two very different elements within the overall budget, namely the state retirement pension and various welfare programmes. Despite well-publicised efforts to curb the seemingly relentless growth of the social security budget, especially by limiting certain welfare entitlements, such as Housing Benefit, it continues to grow.

Importantly, despite the political imperative of protecting the state retirement pension, its formidable future costs are not included in the WGA as a liability because it is considered to have the status of a benefit payment. That is totally different from the treatment of accrued public sector pension liabilities, which are considered to be contractual obligations.

Undoubtedly, however, the 'triple-lock' state retirement pension pledge is pivotal in driving up the cost of providing such pensions, especially since many pensioners are now living far longer than their predecessors. Under the 'triple-lock' pledge, which has been firmly endorsed by the leading political parties, the state retirement pension is guaranteed to grow each year by whichever is the highest of the increase in RPI, the increase in average earnings or 2.5%. Given the current low inflation environment and minimal increases in average earnings, the 2.5% figure has come increasingly into play – the state retirement pension was raised by this amount for 2015/16.

There is no doubt that, because of their significantly higher voting turn-out record, retired people are particularly favoured by political parties – this trend partly explains the widespread political support for the 'triple-lock' pledge.

Nonetheless, the rising cost of providing state retirement pensions is clearly illustrated in Table 8 (overleaf).

TABLE 8: SOCIAL SECURITY BENEFITS[7]

	2012/13 (£BN)	2013/14 (£BN)
State Retirement Pension	83.8	85.0
Local Government Housing and Other Benefits	28.5	27.3
Tax Credits	30.8	30.9
Disability Living Allowance	15.5	15.6
Child Benefit	12.2	11.5
Jobseeker's Allowance	5.4	4.5
Employment Support Allowance	6.7	10.9
State Pension Credit	7.9	7.3
Income Support	5.7	4.0
Attendance Allowance	5.4	5.5
Incapacity Benefit	3.5	1.3
Carer's Allowance	2.0	2.2
Other Benefits	7.6	7.4
Total Cost of Benefits	*215.0*	*213.4*

In the two preceding years of 2011/12 and 2010/11, the total cost of benefits was £210 billion and £204 billion respectively. Hence, despite the much-vaunted claims of deep cuts to the social security budget, the reality is that social security expenditure is falling very slightly, once the upward impact of the 'triple-lock' protected state retirement pension is stripped out.

Comment: The 'triple-lock' pledge effectively protects state retirement pensions, although the length of this pledge is less clear; nonetheless, given the high propensity of pensioners to vote, it would be brave politics for any governing party to end it.

Tighter eligibility criteria for the various welfare programmes have at least curtailed the annual increases in costs, although material reductions in real terms have so far proved elusive. However, if the Universal Credit programme is fully operational nationwide - and administered efficiently - there is a real prospect that the cost of the welfare element of the social security budget will be sharply reduced.

PUBLIC SECTOR EMPLOYMENT AND PENSIONS

Despite repeated efforts to make the public sector more efficient and to cut back its overall employment level, the total number of permanent staff still exceeds 4

7 Source: WGA 2013/14.

million: the overall figure for 2013/14 did, though, show a material reduction on that of 2012/13. Table 9 below shows the overall levels of public sector employment.

TABLE 9: AVERAGE NUMBER OF PERSONS EMPLOYED[8]

ITEM	PERMANENT STAFF	OTHERS	2012/13 TOTAL	2013/14 TOTAL
Central Government (including Health)	2,340,829	190,828	2,459,033	2,531,657
Local Government	1,751,341	65,805	1,921,147	1,817,146
Non-Financial Public Corporations	84,357	18,844	233,106	103,201
Financial Public Corporations	2,451	-	2,173	2,451
Total	*4,178,978*	*275,477*	*4,615,459*	*4,454,455*

However, in financial terms, it is the cost of accrued public service pensions - rather than current wages - which constitute the major part of the Government's overall liabilities. The total net public sector pension liability was a massive £1,302 billion as at March 2014: the re-stated March 2012 figure was £1,006 billion, which illustrates how much this liability has increased in recent years.

Currently, there are a number of Defined Benefit (DB) - funded and unfunded - pension schemes for past and present public servants. Importantly, the vast majority of the DB liabilities are currently unfunded, whilst the funded liabilities mainly cover Direct Contribution (DC) pension schemes. Crucially, the main public service pension schemes, with the exception of the local government schemes, remain unfunded. For these unfunded schemes, expenditure on pension payments has to be met from general taxation.

As employees retire and draw their pensions, the liability will be discharged over time. Table 10 below shows net public sector pension liabilities, as represented by the main pension schemes currently in operation. Around half of the overall public sector pension liability is accounted for by pension rights accrued by teachers and nurses.

8 Source: WGA 2013/14.

TABLE 10: UK NET PENSION LIABILITIES AT MARCH 2014[9]

UNFUNDED LIABILITIES (GROSS)	MARCH 2013 £BN	MARCH 2014 £BN
Teachers (UK)	258.5	288.1
NHS (UK)	325.1	391.6
Civil Service	176.5	193.2
Armed Forces	118.1	129.6
Police	118.0	123.0
Fire	22.9	25.5
Other Unfunded	53.2	54.8
Total Unfunded	*1072.3*	*1,205.8*
Funded Schemes (net)		
Local Government	90.5	85.6
Other Funded	8.8	10.5
Restatements	0.3	0.0
Total Funded	*99.6*	*96.1*
Total Net Pension Liability	*1,171.9*	*1,301.9*

The Government's public sector pension liability is heavily influenced by the way in which public service pension schemes are actually managed. As such, the total pension figure reflects the net present value of the total liability owed to:

- Current pensioners;
- Deferred pensioners, who are no longer employed but who are waiting to receive a pension when they reach retirement age;
- Existing employees who will receive a pension on retirement.

In calculating this pension liability, allowance is made for salaries projected to retirement or an earlier leaving date; importantly, it reflects only the number of years of pensionable service to date. The liability does not include the pension that may be paid to current employees for future years of service to retirement or to future employees.

Comment: Successive Governments have failed to tackle the relentless increase in unfunded public sector pension liabilities, primarily for political reasons. Indeed, had leading PLCs, such as British Telecom, acted similarly in letting their already massive liabilities accumulate further, they would have been pilloried.

It should be noted, though, that the WGA-calculated pension fund liability of £1,302 billion has been inflated by the long period of low interest rates which has lowered the discount factor that has been applied; when interest rates eventually rise again, this process should be reversed.

9 Source: WGA 2013/14.

Whilst some changes relating to contributions levels and benefit entitlements have recently been announced – they will be introduced in 2017 – a more radical approach is needed.

- Cutting very substantially the number of members of public sector Defined Benefit schemes;
- Levying significantly higher contributions from current public sector employees;
- Reducing the various benefits that such accrued pensions can earn;
- Extending the eligibility period before which pensions can be drawn.

BANK SHAREHOLDINGS

With the sudden advent of the financial crisis in 2008, the Government felt compelled to provide massive financial support to both Royal Bank of Scotland (RBS) and Lloyds. Irrespective of the vast amount of credit that was injected into the UK banking system to prevent its systemic collapse, an almost unbelievable £66 billion of new equity capital was invested in RBS and in Lloyds. In the case of RBS, its share of the new equity was a colossal £45.5 billion: an Asset Protection Scheme (APS) was also established to ring-fence a vast portfolio of high-risk assets.

More than seven years after the financial rescue of RBS, the Government's original shareholding of 79% (now 73%) has barely changed. Furthermore, based on the current share price of 234p (following the 10/1 split), the Government is still sitting on a paper loss of £22 billion. The approximate entry price for the Government's majority stake in RBS was just over 50p (now 500p) once various complex share valuation adjustments have been made.

Importantly, the Government's stake in RBS is not consolidated in the WGA, partly because of its vast size - especially in terms of gross assets and liabilities - which would otherwise seriously distort the WGA. Instead, given the Government's declared aim to sell off its majority stake, its RBS share-holding is treated in the WGA as an available-for-sale asset.

The public sector equity investment in Lloyds is currently worth far less since the Government has sold most of its original stake. Following the selling of several tranches in recent years, the public sector share-holding in Lloyds now lies at 10%. In common with the RBS stake, it has not been consolidated within the WGA; it is also treated as an available-for-sale asset.

Unlike the RBS and Lloyds' stakes, the residual Bradford and Bingley net assets, along with those of the collapsed Northern Rock, are included within the WGA – these mortgage-based assets are being progressively run down.

Comment: In time, the Government still plans to sell down its RBS and Lloyds' stakes, especially with the former's more risky investment bank division being heavily cut back. With a share price of 234p (following the 10/1 split), its current 73% stake is worth £20 billion.

Unless there is a sharp down-turn in equity prices or specific problems adversely impacting Lloyds, the Government should complete the full disposal of its 14% stake within the next two years. Based on a share price of 68p, its Lloyds stake is currently valued by the market at £5 billion.

NETWORK RAIL

The Government's accountancy treatment of the not-for-profit Network Rail is being changed. Previously, it had not been included in the WGA. However, following the recent inclusion of its net debt in the PSND, Network Rail will be included - for the first time - in the 2014/15 WGA. Given the considerable size of its net debt, which was £38 billion at March 2015, this accounting change will inevitably have a material impact on the overall PSND. In time, the Government may decide to sell part or all of Network Rail, despite the notorious financial collapse of its predecessor, Railtrack, back in 2001.

Comment: There is undoubted financial appetite from institutions - seeking secure and durable returns to meet long-term pension-related liabilities - for such investments as recent sales have demonstrated, notably the Government's 40% Eurostar disposal. They recognise, too, that there is major scope for cost savings within Network Rail.

Hence, the ideal scenario would be a Government sale of an initial 49.9% stake in Network Rail, which would be expected to raise £8 billion of proceeds. To achieve such a sum, considerable financial restructuring would be needed, which would provide the headroom for Network Rail to pay a decent dividend.

NUCLEAR DECOMMISSIONING LIABILITIES

The financial legacy from nuclear weapon research in the 1950s and 1960s at Sellafield in Cumbria is immense. Nuclear decommissioning liabilities from these activities and from more recent civil nuclear generation operations are vast – and they keep on rising on a year-to-year basis.

Most of the £77 billion of liabilities relate to the Sellafield complex, where the world's first commercial nuclear power station at nearby Calder Hall was opened in 1956. Very considerable work is needed to clean up the site, which was used for nuclear weapon development purposes during the post-war period. Quite remarkably, the Government has indicated that it may not be until 2137 before the clean-up process is complete.

Table 11 below provides a breakdown of the Government's nuclear decommissioning liabilities, two-thirds of which are centred on Sellafield and the neighbouring Drigg low-level nuclear waste disposal site.

TABLE 11: NUCLEAR DECOMMISSIONING LIABILITIES

ITEM	2012/13 (£BN)	2013/14 (£BN)
Sellafield	42.8	47.9
Low Level Waste Repository	4.2	4.4
Repository/Geological/Disposal Facilities Research Sites	3.3	3.7
Fuel Manufacturing	8.6	8.0
Ministry of Defence	3.7	3.6
British Energy/EdF	5.4	7.2
Other	1.9	2.6
Total	*69.9*	*77.4*

Comment: Detailed questions need to be asked about the troubled clean-up programme at the Sellafield complex - which the Nuclear Decommissioning Authority (NDA) costed at £79 billion (on an undiscounted basis) at March 2014 - and whether all the proposed work really needs to be carried out at such an immense cost. After all, it is difficult to envisage that the former nuclear site will ever become a housing estate - and a suitable home to young families. Whilst some of the planned decommissioning work is undoubtedly vital, it is far from clear that seeking to return the Sellafield site to something close to normality is imperative, although there will clearly be many relevant legal issues.

In any event, a further in-depth analysis is called for to ensure that the financial costs of the comprehensive clean-up there are not running out of control – as is widely believed.

STUDENT LOANS

In the WGA, the student loan book was valued at £39 billion at March 2014. Subsequently, the figure should have risen as more students continue their path through higher education.

Nonetheless, serious concerns remain about the loan write-off rate. Many students become lost to the repayment system, especially those based overseas. Others simply do not earn enough from their job to trigger the pay-back arrangements. As such, the loan write-off rate is set to rise very appreciably from previous expectations. Recent figure from the Department of Business, Innovation and Skills (BIS) indicate an expected write-off ratio of up to 45%.

Comment: If the shockingly high write-off figure being suggested by BIS is anywhere near accurate, it can only mean that the financing of higher education is in total disrepute. In effect, it would mean that almost half of those in higher education, to whom such loans were extended, actually received large grants, irrespective of their means.

A radical overhaul of higher education, and its financing, is needed. It should focus on first making the UK's higher education system far more efficient, with many more high-quality two-year courses being offered. Secondly, reducing the burgeoning costs of higher education, through greater efficiency, and raising academic standards amongst the participants - and especially of under-performing students - are obvious priorities.

QUALIFICATIONS TO WGA

For a PLC to have its accounts qualified is a serious issue – such an event is likely to have a substantially adverse impact on its share price rating. And whilst the accounts of the European Union have been qualified – quite disgracefully - for almost 20 years in succession, such a status in the UK is very unusual. Nonetheless, in respect of the WGA, the Comptroller and Auditor General has raised serious concerns which have led him to qualify the accounts on several counts – some of which are directly related to the relatively short period during which the WGA have been compiled.

In particular, the Comptroller and Auditor General has identified the following issues:

- The exclusion, due to the vast size of their gross assets and gross liabilities, of the Government's (then) 79% share-holding in RBS and its (then) 25% share-holding in Lloyds from the ongoing WGA;
- The inconsistency with Local Authority assets, especially with respect to schools, being generally valued on an historic - rather than a depreciated replacement cost - basis as is the case with central Government assets;
- The recognition of the £22.5 billion proceeds from the 3G mobile telecoms auction in 2000 and of the £2.5 billion for the 4G spectrum auction in 2013 as revenues in the first year of the respective licence periods rather than being spread over their 20-year duration;
- The omission of the state-controlled Network Rail from the WGA - this apparent anomaly is now being rectified for the 2014/15 WGA;
- The inconsistent valuation polices as they apply to public highways, many of which are owned by Local Authorities, who generally use historic cost accounting principles;
- Various issues relating to the accounts of the Ministry of Defence, whose financial controls have been widely questioned for years, especially on the procurement side.

CONCLUSION

Whilst the WGA are far from perfect, they represent a major improvement on what preceded them. To that extent, they shine a much-needed light on seemingly obscure aspects of the public sector accounts - but which nevertheless involve some extremely large numbers.

It is incumbent now on politicians to respond to the various issues thrown up by the annual publication of the WGA. In particular, they should seek to rein back the soaring public sector pension deficit, which – even allowing for the application of a higher discount rate once interest rates rise again – represents a very large financial liability for present and future generations.

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He is a regular features writer for Utility Week and Cleantech magazines and frequently contributes to the financial media. In addition, he undertakes various research projects on energy, water and economic policies for Westminster-based Think Tanks.

For the Adam Smith Institute, where he is a Senior Fellow, he has written several previous publications:

- Privatization – Reviving the Momentum;
- Re-energizing Britain (UK Electricity);
- Ten Economic Priorities;
- The Party is Over – A Blueprint for Fiscal Stability;
- Privatisation Revisited;
- High Speed Fail – The Case for HS2;
- Cash in the Attic
- Utility Gains.

Prior to joining the City, he worked for six years in politics, including three years as Political Correspondence Secretary to Lady Thatcher at 10 Downing Street. In 1987, he stood in the general election as Conservative Party candidate in Sedgefield against Tony Blair.

He was awarded a degree in law, economics and politics from the University of Buckingham and subsequently qualified as an Associate of the Institute of Chartered Secretaries and Administrators (ACIS), whilst working as Export Sales Manager for Marlow Ropes, Hailsham, East Sussex.

N.B. Although every effort has been made to ensure that the data in this paper is accurate, neither the author nor the Adam Smith Institute accepts legal liability for any errors that may have arisen.