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Calculating the loss
Counting the true cost of an RBS fire sale
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How much money would the government lose by selling RBS? The answer depends on a number of different factors, but it is likely to be at least £13 billion and possibly as much as £26 billion depending on what costs we include and what assumptions we make.

Here is our guide to calculating the cost.

Step 1 – How much did our stake in RBS cost?

We use the Government's investment arm as the source of this figure. UK Financial Investments owns and manages our stake in the bailed out banks, and they quote the total investment in share of RBS as £45.5 billion (502p per share).

RBS is due to pay £1.5 billion back to the Government to allow it to start paying dividends again and also paid for £305million of fees incurred by the Government when it bought the shares. If we subtract both these repayments then, according to UKFI, our total net investment is £43.7 billion (482p per share). This is the figure that we use.

There are also suggestions that we should count fees paid to the government by RBS for the various forms of support given to it during financial crisis, such as cheap loan facilities and government guarantees. This would reduce the cost of the stake to £41.2 billion (455p per share). However, as the cost to the Government of providing these support schemes to RBS is not included, it is inconsistent to include the amounts received by the Government.

Finally, it has also been argued that the correct figure to use is the accounting figure on the Government's books for the cost of the shares. For technical reasons, this was entered at the average price that shares traded on the day of purchase, not the **actual priced paid** by the Government. Using this technical accounting figure gives a cost of 407p per share, with the difference between this and the actual price paid being effectively counted as a loss to the taxpayer **at the time**.

However, this is little more than technical accounting trickery. Most people would understand the cost of the shares as being the amount of cash you paid for them. They would not agree that just because we recognised some of the cost in the accounts in 2008 and 2009 we can now ignore these costs.

Furthermore, it is quite plausible to argue that the costs of paying interest on the Government debt incurred to fund the share purchases should also be included. The only reason we are paying these interest costs is because of the bail-out. If we add the cumulative interest on £43.7 billion to the cost of our stake, it rises by £7.8bn to £53.3bn.

Step 2 – How much are we likely to receive from privatising RBS?

The value of the Government's stake at the opening share price on 8 June of 355.8p per share was £32.2 billion. Share prices can fluctuate by several percent from day to day. One week earlier, on 1 June, the price was 341.4p (£30.9 billion). This is a difference of £1.3 billion just in a week.

To avoid the daily fluctuations of the stock market, we can use stockbrokers' estimates of what the shares are worth. The average of 11 stockbrokers' forecast price for RBS is 368p, which would give us a valuation of £33.4 billion for the Government stake.

However, the price that can be achieved for selling a large number of shares is bound to be lower, perhaps substantially, than the current market price. This is because the share price reflects the balance between buyers and sellers and the sale of a significant shareholding will require a discount to entice sufficient interest from new buyers.

A review of comparable share sales since 2008 included in the National Audit Office's more recent report shows that the discount required is in the region of 5%. This would give us a price of 337p or £30.6 billion.

However, these were for much smaller transactions – an average of £1.9 billion per sale excluding the two Lloyds share sales which were much bigger, but still only £3.2 billion and £4.2 billion. It is extremely unlikely that over £30billion of shares could be sold in this way, by selling directly to institutional investors on the stock market.

Any attempt to sell larger amounts, including by a large retail offering to ordinary investors, such as the large privatisations of the 1980s and 1990s, would almost certainly entail a larger discount to try to ensure that investors saw an instant profit on the value of their shares.

To illustrate, a discount of 15% to the current share price would value the Government's stake at £27.4 billion.

Step 3 – Counting the cost

As we have seen, there are a number of ways of calculating the cost of our stake in RBS, and any estimate of the likely proceeds of privatisation requires us to make some assumptions.

The worst case is to include the interest costs of funding our investment and assume that shares have to be sold at a 15% discount to the current share price. So a total cost of £53.3 billion less sale proceeds of £27.4 billion – a whopping £25.9 billion.

The best case is to ignore the interest costs, and for the sale price take the average stockbroker forecasts. So the total cost is £43.7 billion and the sale proceeds would be £33.4bn – a loss of "only" £10.3 billion.

Our central case is to use the total cost of £43.7 billion and assume that the shares can be sold at an average 5% discount to today's price – roughly in line with what has been achieved with the sale of Lloyds shares. This gives us a cost of £43.7 billion and sale proceeds of £30.6 billion – a loss of £13.1 billion or £13 billion to the nearest billion.

Step 4 – What does 'value for money' really mean?

All of these calculations above make a massive assumption – that privatising RBS is the most beneficial course of action for the economy as a whole. In our report 'Reforming RBS' we demonstrate that the economic benefits of turning RBS into a network of local stakeholder banks held in trust for the public benefit are likely to be far higher than the economic benefits of returning the bank to the stock market in its current form.

We cannot make any definitive statements about 'value for money' for the taxpayer without undertaking a broader economic cost/benefit analysis of all the alternatives for RBS, and it is essential that such an independent review is undertaken as soon as possible.

Step 5 – The sting in the tail: the fees payable to the City

Selling a majority Government stake in RBS worth over £30 billion will not come cheap. In our report we estimate that the total fees payable to City bankers, lawyers and other advisors to carry out the privatisation could be anywhere between £60 million and £480 million. Nice work if you can get it.

Key Sources

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UK Financial Investments Limited (UKFI) Annual Report and Accounts 2013/14, June 2014

Hargreaves Lansdown website – Broker Forecasts for RBS available at http://www.hl.co.uk/shares/shares-search-results/r/royal-bank-of-scotland-group-plc-ord-gbp1/broker-forecasts

New Economics Foundation (NEF), Reforming RBS, 2015, available at http://b.3cdn.net/nefoundation/141039750996d1298f_5km6y1sip.pdf