Spot the difference

THE ONE issue which has consistently distinguished Labor from the Coalition in this election campaign,has been the question of whether or not to sell off Telstra. The Coalition came out fighting early, announcing its plan to sell a third of the national carrier and use the proceeds to pay off debt and eradicate weeds. To ensure majority control stays in Australia, John Howard said 65 per cent of the one third float would be for Australian investors only and that no single foreign investor could hold more than 5 per cent.

Labor responded with warnings that we'll have timed local calls before anyone can say 'universal service'. The leader of the Australian Democrats, Senator Cheryl Kernot declared that a Coalition attempt to sell off Telstra would meet a brick wall in the Senate (see page 9).

In this issue of *CU*, we have sought some expert views from industry, unions and community groups about the Telstra sell-off. We also commissioned some figures to determine how well off Australia would be now had Telecom been sold in 1993 (see story this page). New Zealand's less than overwhelming experience of privatised telecommunications is examined on pages 14-15 while the British regulator OFTEL, provides some insight into privatisation UK style on pages 16-17.

Also in this issue, the three major parties are lined up with their communications and arts platforms. On the Arts side, the Coalition appears to have decided since the 1993 election that it's best not to alienate the arts community. This time around, there are lots of morsels with dollars attached from both Labor and the Coalition on the Arts front.

Whatever the outcome on March 2, *CU* will be back to analyse the aftermath.

Privatising Telstra - losers and winners

What if we'd sold it off after the last election? *CU* asked **Trefor Jones** to do the numbers

A crucial issue in weighing up the benefits and costs of any privatisation of Telstra is its effect on the Commonwealth's budgetary position.

One way of assessing this is to look at where we'd be if Telstra had been privatised three years ago - if the Coalition had won the last election. This article employs a methodology developed by John Quggin (see page 4).(1)

First, estimate the value of Telstra and the amount that its full privatisation would have raised in 1993.

Assuming the Government used all the proceeds to retire government debt, it would save, each year, the interest that would have been paid on that debt, discounted for inflation. However, it would lose, each year, the profits from Telstra's operations.

The budget would show the Commonwealth losing the *dividend* Telstra paid, but the dividend paid is a product of politics and timing and other factors. *Profits* earned, even if not passed on to the government in the relevant year by way of dividends, provide the true measure of the value of the earnings of the asset. Thus foregone profits, rather than foregone dividends, represent the better measure of the loss to the Commonwealth, and hence the taxpayer, of selling Telstra.

A simplified scenario is set out in the table on page 3.

Under this scenario, other things being equal, the government would have been more than $1 billion dollars worse off (in 1993 prices) for having sold the asset, over the three year period, or around $360 million worse off if only a third of Telstra had been sold.

Using this method of calculation, the $24 billion for which it is claimed Telstra could be sold on the basis of 1994/95 earnings, would have saved the budget approximately $1.44 billion in public debt interest payments last year. This compares with Telstra's profit of $1.755 billion last year, which would have accrued to the company's new, private investors.

The reason for this result is that the government can generate higher returns given the current company structure because it pays less for access to capital (it can negotiate lower interest rates for itself) than private investors.

But other things aren't equal.

The effects of privatisation would not be so bad if there was any expectation of real growth in Telstra's profits at the time of the sale. This seems quite likely, given the sharp increase in profits from 1992/93 to 1993/94. Such expectations would have increased the value of Telstra and hence increased the implicit interest cost of the Commonwealth's ownership of it. This would narrow, or reverse, the gap between interest saved and earnings foregone.

The situation would however be worse if, as proposed by the Opposition, the asset was sold off slowly (in 'tranches'). This would incur high transactions costs (advertising, brokering, underwriting etc) and probably involve significant underpricing of the asset, as happened with the sale of the first tranche of the Commonwealth Bank and British Telecom. According to Dumberger,(2), such underpricing in privatisations typically averages 20 per cent, and has been as high as 35 per cent. This underpricing reflects the difficulty in valuing the asset and the political desire to avoid the embarrassment of the float not being fully subscribed, or the shares trading after issue at lower than their issue price.

A critical factor which this simplified approach does not take into account is potential improvements in Telstra's efficiency as a result of privatisation.

A privatised organisation would see management and workers subjected to pressures to increase productivity to stave off bankruptcy, and a profitable direction necessarily imposed on the company through the mechanism of the share market, rather than through the clumsy mechanism of a Government minister whose agenda may not include running a successful business.

Thus the figures set out below do not necessarily imply that the country as a whole would be worse off as a result of privatisation.

This would be a comprehensive inquiry beyond the scope of this article. ❑

Impact of Telstra Sell-Off on Commonwealth Finances

Year	Profit (1)	Total Value(2)	Real Bond Rate (%)	Public Debt Interest Saved	Net Impact for Commonwealth
1993	904 (301)	16,272	6.35	1033 (344)	129 (43)
1994	1704 (568)	16,272(3)	7.85	1277 (426)	-427 (-142)
1995	1755 (585)	16,272(3)	6.00	976 (325)	-779 (-260)

All figures in A$million except real bond rate (%)

Figures in brackets are one third of the totals - the impact if a third of Telstra had been sold, as now proposed by the Coalition

(1) Telecom/Telstra Annual Reports
(2) Assumes 18 times profit - refer Brown, A.(3)
(3) Assuming full sale in 1993

(1) Quggin, J., 1995, 'Does Privatisation Pay', *Australian Economic Review*, Second Quarter; pp26-41.

(2) Domberger, S., 'What does Privatisation Achieve - A Comment on Quggin', *Australian Economic Review*, Second Quarter; pp 43-47.

(3) Brown, A., 1995, 'Should Telstra be Privatised', Paper for presentation at The 24th Conference of Economists, Adelaide, 24-27 September 1995.

Legal implications for a privatised Telstra

TELSTRA DERIVES its current status from the Telstra Corporation Act 1991 and by that Act is already exposed to the operation of the Corporations Law. Telstra directors are therefore subject to the same duties and obligations as their counterparts in privately held companies.

Partial privatisation's most significant consequence will flow from Telstra's listing on the Australian Stock Exchange (ASX) which will result in the imposition of more stringent ASX reporting requirements. Particularly, it will be interesting to see the level of disclosure in the prospectus that must be issued for any float which will give the public a more detailed insight into the operation of the company than has been possible to date.

A privatised Telstra will be subject to continuous reporting obligations which will require the company to notify the ASX of any information a reasonable person would expect to have a material effect on the price or value of Telstra's shares. Also, with Telstra shares being traded on the market, the Corporations Law insider trading provisions will become relevant particularly for the directors and higher level managers who are privy to confidential information.

With privatisation, the dynamics in the board room will shift significantly as a result of the change in ownership of the company. If only a partial privatisation is undertaken, government appointed directors will need to be mindful of minority board nominees and the shareholders they represent. Government policy initiatives and universal service obligations will have to be tightly legislated to avoid board room clashes over loss making activities. In this regard the Government will lose a degree of control over the organisation.

Richard Stowe, Corrs, Chambers, Westgarth