

PRIVATE

Thoughts

The partial sale of the Commonwealth Bank and the airlines is now assured. The Chifley legacy has faded from view. But should privatisation be the key issue for the Left? And what is the best role for the public assets at stake? We assembled a round-table discussion to look beyond the privatisation battlelines.

Peter Botsman is director of the Evatt Research Centre. Kerry Schott is an economist for Bankers Trust, and is a director of Australian Airlines. Tony Aspromourgos teaches economics at Sydney University. The discussion was chaired by David Burchell.

Ot's obvious now that a number of government business enterprises are going to be partly or wholly sold as a result of the events of the last few weeks. This is clearly a significant defeat for the opponents of privatisation. It is also clear that this fairly dramatic turn of events is the result of a political victory by Paul Keating rather than a victory by virtue of economic argument. However it does seem that these events have had the effect of breaking the impasse which the privatisation debate had created. There is no doubt that there has been a defeat for one side in the debate. Yet in an odd way it seems that defeat may have opened questions that weren't being asked and issues that weren't being raised as a result of that impasse. The most obvious of these is Brian Howe's recent proposal that the proceeds of assets sales be invested in infrastructure. This

seemed an attempt to reorientate the debate away from the defence of the actual public sector to the most efficient and useful ways of allocating the government's portfolio of assets as a whole.

Peter: It remains to be seen whether the Labor movement can make something positive out of this, or whether we're going to be dealing with a series of negatives in terms of economics and traditional policy. To talk about the positive side for a moment; since 1988 the Labor Party has developed a debate that is unique in Australian public policy and politics. Not only has it invigorated the government public policy debate, it has even invigorated academic research.

Over the last few years the public finance field has been moribund, and that's one reason why the debate over privatisation has been so one-sided. If something positive comes out of this, it will be a revitalised theory of public enterprises, and a new perspective on public infrastructure. However, we would be taking a very big punt to think that Brian Howe's proposals about what would happen



Photos: Jamie Dunbar

Kerry Schott, Peter Botsman and Tony Aspromourgos

after the privatisation of Australian Airlines, Qantas and the opening up of telecommunications competition will carry the day. There is still great opposition to public borrowing in Treasury and the Department of Finance, and we've got a long way to go before that agenda shifts.

Kerry: Any sale of the public sector assets is going to have some benefit. Say the money is used to pay off more debt. The interest savings achieved through that could be \$500 million a year, and that puts less pressure on cuts in other areas of the public sector budget. So it's hard to see it as all negative.

Even if public sector assets aren't sold, the debate has had the effect of putting a lot of pressure on public sector enterprises to perform efficiently. People in those enterprises are now much more aware of performance measures and the like.

Tony: The thinking Right in the Labor Party sees the role of government providing a welfare safety net - so there is no systematic role for public enterprise, apart perhaps from areas in market failure. The view of the thinking Labor Left is that the role of government is to provide a safety net, plus a belief that public enterprise can also play a strategic economic and industrial role. On that view it's fairly obvious that the Right would opt to get out of areas where there is no real social function to perform. It is plausible to argue that anything that the Commonwealth Bank is doing as a government bank could be done by way of regulation

without any public ownership at all, and similarly with Australian Airlines and maybe with Qantas.

On the other hand, the view of the thinking Labor Left is that our stock of public assets is the result of historical circumstances that have changed. So even if you accept the current level of asset ownership by the government it is plausible that if you sell some at appropriate prices you can use the proceeds to better pursue strategic industrial and economic objectives such as those suggested by Peter Baldwin in *ALR* recently. I don't think this latter viewpoint is privatisation at all. The identification of privatisation with assets sales pure and simple is far too crude, because any enterprise, government or private sector, must be continuously reshuffling its assets to target its objectives adequately. The only sensible definition of privatisation is a reduction in the net worth of the sector. So, as long as you've done it sensibly, assets sales aren't necessarily a curse.

There's another question: whether it is more appropriate to retire debt or to invest in other assets. A further question is: if you sell essentially commercial assets, do you invest in other commercial assets or non-commercial assets, like public infrastructure that isn't self financing. I have concern on both these counts. I don't believe that, given the current position of the federal government, there is any imperative to retire debt. Given the sorts of Commonwealth government surpluses we've seen, and the level of outstanding Commonwealth liabilities, I would prefer to



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see other assets purchased. I have misgivings too about using those assets sales for non-commercial purposes because there would be a contraction in the commercial public enterprise sector, and I happen to believe that government has a role to play in commercial enterprise.

Peter: The original purposes and functions of enterprises like Telecom and the airlines have now changed completely. There's a need to reorganise and reorientate those enterprises so that they do provide a socially useful and commercial purpose in the future. Perhaps we should be looking at amalgamating Australian Airlines and Qantas - and we shouldn't be considering privatisation at all. There's another question about what the telecommunications network is going to look like in the future and whether Australia is going to have a stake in it. Whatever happens, there have to be radical changes in all the public trading enterprises.

Kerry: I agree that some of the proceeds of assets sales ought to be used on some public infrastructure projects, but big infrastructure projects must be funded over a number of years. An asset sale gives you an immediate gain, but you're not going to spend all that money in the first year on an infrastructure development. If it is used to retire debt then the interest that is saved could be put aside for further public infrastructure, like rail, water and sewage treatment, or electricity grid development, things that are true capital investments. We have to be careful not to sell

capital and then spend it on consumption items. It really must be kept in the public investment sphere and in areas that are going to increase the efficiency of the country.

Tony: With regard to Kerry's comments, one of the problems we have is the shifting boundaries between commercial and non-commercial assets. There are some areas where investment is clearly required, which aren't strictly speaking commercial operations within the public sector but which should be. Rail freight is one of them. We should be moving, like they are in NSW, to the commercialisation of rail freight. There's no rationale to do otherwise. With regard to Peter's comments, there is a big difference between the arguments that are now surfacing about Australian Airlines, Qantas and the Commonwealth Bank, and those which apply to Telecom. In the former cases, which are essentially commercial enterprises, I'd be surprised if anyone would argue that the efficiency of those assets will significantly improve if they are sold to the private sector. The argument is essentially about whether under the current circumstances it is worth the public sector's while to own these assets given alternative possibilities. Telecom is primarily an argument about competition and technical efficiency and allocative efficiency in terms of pricing structures. There are two very different sets of issues.

Peter: But I still think there is a link in that the debate has focused on the efficiency of public sector trading enterprises. They've made great strides at Australian Airlines, for instance. In 1983 they got their first capital injection in decades, and the management has improved out of sight...

Kerry: It was also corporatised and that's helped improve management.

Peter: The labour movement has moved very reluctantly from a position where they felt very suspicious about commercialisation and corporatisation. People now understand the issues. I'd like to see Australian Airlines and Qantas retained with a corporate board that had complete commercial freedom to borrow. I'd like to see Telecom run by a board with very little government involvement except for setting the corporate charter and the policy objectives. They wouldn't get mucked about when there is a change of government, they wouldn't go through the policy circus we've seen in telecommunications. They would simply get about their business.

Kerry: But the problem with the airlines has been that equity has not been put in when it was needed. The government restricts the amount of money the airlines can borrow. But even if debt wasn't restricted you'd still need an equity injection because there are times when you need to buy new aircraft and you just can't finance them out of the cashflows with debt finance. I think the government is in a difficult situation; often it isn't a very good shareholder for an airline, because it's got other agendas. Rather than give Australian Airlines \$300 or \$400 million for new aeroplanes, it would prefer - quite rightly - to spend that money on other social objectives. In my view if it can't behave like a normal shareholder it ought to get out.

There have been at least three very different sorts of arguments advanced in favour of the privatisation of the airlines and the banks. The first is the question of the debt retirement imperative. The second is the question of capital funding which Kerry just raised. And the third - which it may be unfair to lump with the others - is the alleged efficiency gains to be achieved by a transfer to private ownership per se.

Kerry: The third argument is rubbish. With a change of ownership there may be a little bit of efficiency gain, because things which have become sleepy come under scrutiny and changes are made. But in most cases it's not the change of ownership which causes efficiency; economic studies indicate it's competition which causes efficiency. If you haven't got competition you're not going to get efficiency, regardless of who owns the enterprise.

Peter: That's why the federal Opposition's position on these questions is so weak. If you listen to someone like Neil Brown speaking on telecommunications, he assumes still all the early Thatcherist rhetoric which says that you get great efficiency gains simply by shifting from public to private ownership.

Tony: On your first point, David, I don't think there is an imperative to debt retirement. In fact the strange situation that the government finds itself in is largely an unintended consequence of its concern with the overall savings and investment balance, and how that might influence the current account. As it turns out, with the sort of surpluses we're running now, and the level of outstanding Commonwealth debts, the government could find itself of having no outstanding Commonwealth debts left to retire in as little as five years.

In terms of savings and investment balance, the essence of the matter is this. If an economy invests more than it saves, it can only do so by drawing in imports from the rest of the world. This suggests that to correct a trade deficit requires a correction of the imbalance between savings and investment. The government looks at the problem like this. Private saving is bugged and there's not much they can do about it. Private investment, on the other hand, has been surging in the last couple of years and might actually help our longer term problems. They don't want to restrict that unduly. So the federal government has been moving into increased net saving - that is, running big surpluses - to try to make space for private investment without having the current account deteriorate too much. That's the real imperative.

What does this mean for public enterprises? As long as the capital requirements of public enterprise can be entirely met from borrowings I don't think this creates any problems. For commercial self-financing public enterprises there is no reason for their borrowing requirements to be collapsed into the macro-economic indicator of the public sector borrowing requirement [PSBR] for general government. It's simply a foolish accounting convention which lumps together the purely commercial requirements of public enterprises with the balances of the general government sector. Problems only arise for govern-



*The Telecom debate
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competition not
ownership
- Kerry*

ment fiscal balance if the gearing ratio of a commercial public enterprise is so affected by borrowings that it inhibits the competitive ability of that enterprise. Then you need a capital injection - not just borrowings - and that capital injection must draw away from the net saving being undertaken by the public sector. And unless government is prepared to do that you're going to screw the enterprises, as Kerry said.

Peter: That's true. But we know there's no set gearing ratio that's acceptable even in the private sector, so it comes down to simply being able to service your debt.

Kerry: But there are several problems here for the public enterprise. It may want to buy some new aeroplanes, for instance. It knows it's going to make money out of them but it has to put money on the table up front, and its shareholder won't give it money up front. Furthermore its shareholder - for reasons that completely escape me - won't even let it exercise the lines of credit it has. So the enterprise gets stymied all round. A commercial board won't go out and borrow money if there's no way to repay it because it is then in contravention of the law.

Tony: Like Peter, I'm somewhat sceptical of the significance of gearing ratios for public enterprise. The least one can say is that a relatively greater reliance on debt does introduce a financial inflexibility to public enterprise compared to its competitors. Thus there are real problems. How serious

they are must be determined case by case. Some managements of public enterprises may actually want to be privatised and will make the problem look worse than it is. But I think we have to accept that the owners do have a responsibility to provide equity for capital expansion. If the owners are not prepared to do so, the competitive position of the enterprise may be fatally compromised.

Peter: But if they can't run these companies properly by giving them the appropriate equity injections when they're needed, how will they go managing other commercial enterprises? Peter Baldwin was arguing in his *ALR* article for taking money from Australian Airlines and putting it into the AIDC. I can't see the higher purpose in taking money from Australian Airlines, which has great significance for our tourism and service industries - a highly fragile and tenuous international and domestic transport arena - and putting it into the AIDC, which has acted like any other commercial company. It hasn't made strategic investments in manufacturing as far as I can see; it's made a series of very safe investments.

Kerry: The matter Baldwin was raising - quite rightly I think - was that the government should be putting its money into things that the private sector won't do. So, for instance, the airlines are going to continue on their merry way whoever owns them. But the AIDC, if it were really to generate extra venture capital and encourage high tech industries and the like, would be doing things that no-one in the market would otherwise do, and hence should certainly be given some government money. The Commonwealth Bank has some community service operations, unlike the airlines, because it does an enormous amount of transactions for social security beneficiaries; it has a lot of very low income accounts which are very expensive to run. If the Commonwealth Bank were to change hands, the government ought to pay some bank to do that job. This raises the question of what do these enterprises do that a private sector company wouldn't do in the same situation.

That raises another interesting question. Given that some public sector enterprises do have a certain social equity role, must this social role be maintained through public ownership? Is that a sufficient argument for public ownership of such enterprises? Are there other ways of protecting community service obligations - for instance, by regulation?

Peter: The answer must be that there are a multitude of ways of meeting those community service obligations [CSOs] - not only through outside public ownership, but also through different management and regulatory techniques. Here I'm thinking about STD phone calls. We could use an array of techniques to get the cost of STD phone calls down, which would retain Telecom in public ownership but also involve competitive pressures on Telecom in those areas. We could, for instance, take away CSOs from Telecom and take them instead out of federal tax concessions and budgetary outlays to people in remote areas. It really is a question of figuring out the optimal methods of providing social goals - ones that are economically and politically viable. I can see the benefits of using an enterprise like Telecom to deliver CSOs but also accept that

there is now a greater need for regulatory pressure on something like the Sydney-to-Melbourne telecommunications route. We have to be more creative in all those areas.

Kerry: If you're a member of the Labor Party, it is absolutely clear that CSOs have to be met. The argument is how best to meet them. In the case of Telecom delivering telephone services to remote areas are largely met by charging the hell out of people phoning between Sydney and Melbourne. That may not be the most sensible way to cover their cost of the CSOs. It might be better to tax everybody in the country a few bucks and drop the cost of calls between Sydney and Melbourne.

Tony: If community service obligations are strictly reducible to money terms, there's no real reason why public ownership is necessary to maintain them - presumably a government can always pay for them as a transfer from general revenue. As Kerry said, there may be better ways of providing them. For those cross subsidies which are purely pecuniary, I would prefer, as a political democrat, to see transparency introduced, because I think taxpayers have a right as users of government services to know whose paying for what. Even the most starry-eyed supporter of the role of the Australian public sector would have to allow that many of these labyrinthine cross subsidies have in fact been part of a history of pork-barrelling. If they were made transparent, we would discover in some cases that there is no social justice justification for them that would appeal to anyone in the labour movement.

Kerry: One of the major CSOs that the Commonwealth Bank and state banks provide is an agency service in times of natural disaster like earthquakes and floods. If the government wants to distribute money or some other assistance it has a natural distribution network that can be used quickly. Such costs are carried on their books, and they aren't easy to quantify.

Peter: Telecom has tried to come up with accounting techniques that really show the costs of their cross- subsidies. The big problem is that, particularly given competition, Telecom is never going to tell you how much it actually costs them to put a phone call from Sydney to Melbourne for commercial reasons. The government's role with Telecom should be to place pressure on the regulatory body and to impose some acceptable amount of transparency about the CSOs that they're supposed to deliver.

Tony: I don't think I agree. If you're going to open Telecom to any kind of systematic competition, then the doctrine of the level playing field requires you to impose the same CSOs on all of them or on none of them.

Kerry: Or else Telecom is paid for providing them. You mustn't allow cream-skimming; you mustn't allow a competitor in on an unlevel footing.

A lot of the Telecom debate has revolved around the question of whether Telecom is a good enough performer to be left relatively intact. Yet many of the assessments that have been made of Telecom are extremely subjective.

The British, American and New Zealand experiences have been used by people of all persuasions to prove quite contrary things. How do we measure the efficiency of an enterprise like Telecom?

Peter: The recent OECD report has argued that Telecom is a pretty good performer by OECD standards. That confounds a lot of the nonsense that is being peddled by Henry Ergas and others about the comparative cost of phone calls. The OECD report has its biases, but at least you can see exactly where their information comes from. In much of the Australian debate we haven't been able to see that. We have people arguing that Telecom is the greatest thing since sliced bread and we have other people saying we're one of the worst performers. As a result it's very difficult to make head or tail of the real issues.

I think Telecom does pretty well, though that's not to say that it is a perfect enterprise or that it can't improve. In customer service it has been very poor. After all, like a lot of public enterprises Telecom started off with a purely engineering function. It was like Chifley's goal of getting a light in every farmhouse - to get a phone in every house. As a result Telecom's been very slow on the consumer side: on service standards, on performance reporting and so on. Constant pressure needs to be applied. They haven't come out of this debate very well because they aren't very good at doing these things. Customer performance is just one dimension of their whole corporate performance, but their customer relations record has a way of slanting the whole debate.

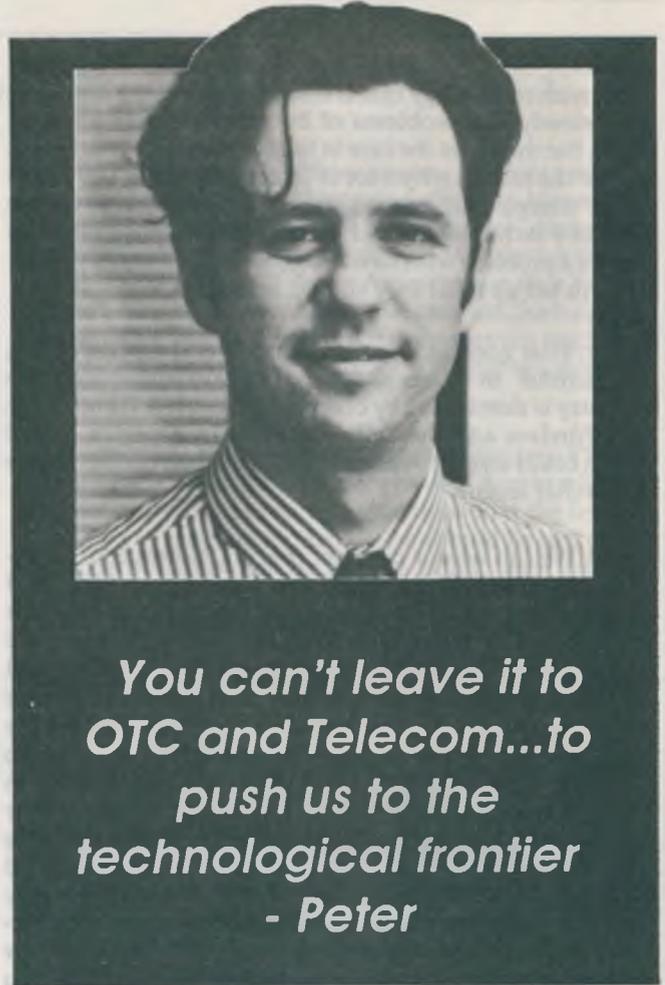
Kerry: Everyone has their favourite Telecom story about five people turning up to fix a phone one day who only work outside the door, while tomorrow another five turn up who only work inside. Whether or not Telecom fares well in international comparisons is not the main issue. The main point is to make Telecom more efficient. That's a separate issue, it seems to me, from who owns it. Over recent years, Telecom has had to face more competition at its edges, and it's around those edges that it has greatly improved its performance. The debate should really be about how much more competition it should face rather than about the ownership issue.

Another question is: what is the appropriate form of competition? A large part of the controversy has been about the integrity or otherwise of the basic network.

Peter: The problem here is: what is the basic network? It's changing rapidly.

Kerry: Technology is changing so quickly I'm frightened that we could get the whole thing very wrong indeed. There's a good case for sitting still and letting competition nibble around the edges, apart from fixing up Aussat's obvious problems. We might benefit from seeing what happens technologically over the next two or three years.

Peter: The change in satellites alone is bewildering. Satellites have been launched in America that will provide a worldwide mobile telephone service. We don't know whether fibre optics or satellites is the way to go; there's



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micro-wave technology; there's a whole range of different options that could fundamentally change the face of telecommunications technology. It could be that cable networks become obsolete overnight.

One thing against standing still is that we've got to situate ourselves to take the opportunities these changes offer. The bigger your markets, the more powerful your competitive position. So Telecom's corporate line of building a globally strong telecommunications company is a pretty valid one. The question is what form will it take. In that sense standing still might not be the formula.

Kerry: I'm a bit sceptical about 'big is beautiful' as a basis for any business. I think businesses grow because they're run well. In Australia we've had to cope with enormous distances and we've done that with great skill. As a result we're very strong on optical fibre technology, among other things. And industry size hasn't been the major factor there.

Tony: I'm quite equivocal on Telecom. I think it's a very complex question and the tendency of economists to explain every industry by the same model just doesn't work too well here. But it does point to a particular problem. It seems to me that many of the regimes we've had for commercial public enterprise have really not been very good. But public enterprises with bad institutional and incentive structures undoubtedly work worst in the most

technologically dynamic areas. Where public enterprises work with technology that is essentially stable or changing very slowly, the problems of bureaucratisation are least acute. But that's not the case in telecommunications. I think part of the reason why a lot of us are scratching our heads about telecommunications is because Telecom is on the edge of a technologically dynamic industry. And it seems there's a problem with its management. And we can't trust them to tell us what they should be doing.

Kerry: That goes back to the problems of the belief in 'big is beautiful' in a world where the telecommunications industry is dominated by companies like AT&T, and Cable and Wireless and the Bell companies in America - all of which could swamp Australia's GDP in their output. We're not in that league.

Peter: We can accept or reject the 'big is beautiful' argument, and accept or reject the merging of OTC and Telecom. But we all have to accept that you can't leave it to OTC and Telecom to develop the processes which are going to push us to the technological frontier. That will require appropriate joint ventures with a range of private sector companies, and we have to accept that they are the ones that will do the pushing. What are the best ways to do that? The industry development arrangements in telecommunications, which have tended to favour Ericsson, are due to be phased out in 1993. Should we be abolishing those industry development arrangements and moving to a market-based solution? If you accept Henry Ergas' arguments, those industry development arrangements mean that we're paying some 40% more for our components through those protected industries. If you accept the Left's arguments, on the other hand, those arrangements are putting us in a position to have our own indigenous manufacturing capacity in telecommunications and to have dynamic private companies on the edges of Telecom developing out of that. It seems to me that we've got to be much more creative with those kinds of interventionist arrangements and we have to be much more encouraging of innovation among the private suppliers of the public companies.

Kerry: We've got to concentrate on what we're good at. I think we could be world leaders in optical fibre cables, with an appropriate joint venture partner. In the area of equipment supply, however, we probably never will be, because we won't get the economies of scale. Australians are quite good at service-related things, but historically we haven't been good at equipment making. We're good at things where our big distances and relatively small population are actually working to our advantage rather than against us and that could be a big bonus for the communications industry.

One final question. There have been several suggestions to get around the perceived problem of capital funding of public enterprises. The two most prominent have been quasi-equity funding - which was very popular a few months ago - and the use of superannuation funds as capital injections for public enterprises. First, what about the super option?

Kerry: People who pay superannuation to invest for their old age ought to have that money put where it's going to yield the largest return. You might put some of that money into venture capital, and you might put a small part of it into infrastructure investments which are going to assist the nation. But what you absolutely mustn't do is put workers' money into industries that aren't going to earn a reasonable rate of return for their retirement income.

Peter: Workers who take up superannuation funds usually are given an option. They can go for the riskier investments and hope for a better return or they can go for blue-chip investments. It seems to me that there is a lot of room, particularly for employees in particular public enterprises, to build a superannuation base for investments that help those public enterprise companies. If workers could opt to have their superannuation funds invested in the company they work for with a particular return guaranteed by government, I think that might solve some of their equity problems.

Kerry: But that's just like the workers lending the company money. And if the company goes broke, the government's got to keep paying that guaranteed rate of return.

Getting back to Kerry's point, the Victorian experience suggests that people have expectations of the security of government investments which they don't have of the private sector. Taking risks with superannuation funds could be political dynamite in that sense.

Tony: I don't have a fixed view on the superannuation option, but it seems to me that governments have to avoid funny money stuff: there's got to be transparency in the use of public funds. Hidden subsidies to private industry can be very dangerous.

Kerry: If you're going to favour some industry by throwing money at it, throw some rich person's money at it, not the workers' money.

The other funding option, proposed quite a while ago, was for quasi-equity capital, or non-voting shares.

Kerry: You can do either of two things with quasi-equity capital. You can structure it so it's very close to debt, and give it a government guarantee. But once you've protected an investor's return like that it's exactly like a loan. You might as well have saved yourself all the effort and all the arm-twisting you have to do to get people to accept it. Or you can structure so it's very close to equity, in which case nobody's going to be very interested in it, because they won't have voting rights. So it's a bit like trying to reinvent the wheel.

Tony: As someone said recently: it looks like debt, it smells like debt, it feels like debt, let's call it quasi-equity. It's just a cosmetic operation produced by the obsession with the public sector borrowing requirement - we don't want to call things debt because it's got a bad aura about it, so we call it something else.