Telstra's travails will continue

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The T3 sale is a huge missed opportunity, argues Joshua Gans

By late 2006, the Federal government will lose its controlling interest in Telstra; perhaps to a 30 percent shareholding. In so doing, its hope was to remove the fog surrounding privatisation and perhaps sure up a flagging share price. The reality is so far from achieving that, it is tragic.

The key to getting the full economic benefits from privatisation is *commitment*. When the government owns and controls an asset, it can't help but direct its use towards its own interests. This can be good (weighing consumers above profits), ambiguous (engaging in cross-subsidies to suit social or electoral goals) or bad (if the politics and admitting mistakes makes it difficult to provide incentives to reward managers for efficiencies or otherwise fire them for incompetence).

Full privatisation would be a commitment for the government to stop doing these things: at least directly. The privatised firm will act in the interests of its shareholders but is also free to manage internal affairs free from specific government interference. Yes, the firm will act differently in terms of social goals but it will also potentially be more efficient and competitive.

That's the theory and it has also become reality. It is hard to remember now that CSL was a privatised entity previously set up to fund basic medical research. Now it does that and more.

For the better part of a decade, Telstra has been privatised in name but not as a commitment. The government has loomed ever present and has continued to exert on-going pressure.

And the result: without commitment, investors have been scared away. They simply do not know what the government's role in the future of Telstra would be and also, with the government having one eye on a pool of cash from a sale, the government faced an on-going conflict. Consequently, no clear statement on regulation has been forthcoming and uncertainty reigns.

In this light, last week's announcement does nothing to provide that commitment and, indeed, makes it all worse. The government will retain an ownership stake in Telstra through the Future Fund. While it is intended that 30 percent of the company will reside there, the number could be higher if investors do not want to pay the government's discounted selling price. That means that it will have an eye on Fund value in policy decisions and hence, no change from the present quagmire.

Moreover, while the Future Fund is supposedly arms-length and independent, the government appoints the managers. With this comes the temptation to direct them should Telstra stray and openly, say, re-direct investment away from regional Australia or consider sacking incompetent management. The Fund does not have the decades of independent reputation that institutions such as the RBA have built up. So if the government is hoping for some ‘privatisation dividend’ today or in the future, the fact that it is still a committed owner (or at least not a committed non-owner) is likely to thwart that realisation. For the MPs that voted earlier this year to allow government discretion on privatisation, this will be a sad loss (less money for marginal seats).

In the meantime, by losing its controlling interest, the government has thrown away options that would have allowed regulatory uncertainty to be removed forever. As I have said before, the need for regulation arises because Australian telecommunications hopelessly uncompetitive and doesn’t look like becoming more so where it really counts: competition in infrastructure investment. Thus, the Australian Competition and Consumer Commission will continue to have to manage Telstra’s marketing in order to protect consumers.

To get the regulator out of investment requires more firms. And to get more firms requires re-structuring Telstra. Any way of doing this from slicing of the cable network from the copper network, from dividing up country and city assets or from creating an independent mobile company presents an issue for current shareholders (who all vote). The government’s controlling interest was the big hope here because the government could bear the brunt of the financial burden on current investors. Control gave it the ability to ‘do a deal’ in the long-term interests of the industry rather than the firm.

Indeed, while its partial ownership looms, even the more wistful hope that Telstra itself might ‘do a deal’ to rid itself of on-going regulation in return for structural change lies dead. To achieve this, the coalition of shareholders – including the largest institutional investor of them all – would have to agree. If they didn’t want to do the right thing when it was easy and the political credit could be given, why would they do it when it is hard?

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