THE PRIVATISATION OF CSL

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Summary

CSL Ltd, formerly the Commonwealth Serum Laboratories, is the sole manufacturer of blood products in Australia. It also has a substantial pharmaceuticals business. Although one of the most profitable of the Commonwealth’s business enterprises, CSL was privatised in 1994. This paper analyses the fiscal impact on the Commonwealth of the sale of CSL and relates this impact to the market environment in which CSL operates. It raises serious concerns about the returns to tax-payers from the sale.

CSL was sold as a bundle of assets, rights and obligations. The company has a 10-year contract to manufacture blood products for the Commonwealth. The new owners have been indemnified against claims arising from the use of some blood products manufactured by CSL in the past. This was important to the sale because CSL is subject to compensation claims arising from previous practices, including claims relating to AIDS-related illnesses, hepatitis, CJD and pertussis vaccine intolerances.

It is often argued that one of the benefits of privatisations is that it improves the ability of government to reduce budget deficits or fund other programs. Reducing the budget deficit brings about savings in public debt interest payments. In general, the sale of a public asset increases the net worth of the public sector if the interest savings exceed the stream of profits foregone. In practice, the appropriate test is to ask whether the rate of return on the enterprise (measured by current profits divided by the value of assets determined in the sale process) exceeds the real interest rate on government bonds (about 5 per cent). The sale is fiscally advantageous if the rate of return is less than the real bond rate.

However, when all of the relevant financial details are taken into account, it is shown that the sale of CSL will result in an additional annual expenditure by the Commonwealth of $45 million. The proceeds of the sale, $292.4 million, will thus be foregone soon after the first six years after sale and each year thereafter taxpayers will be $45 million worse off as a result of the sale. The loss to the taxpayers can be capitalised at around $607 million. The fiscal impact of the sale is the same as if the Government were to borrow $607 million, commit itself to paying interest on that sum for eternity, and simply dissipate the funds. From a taxpayers viewpoint, the privatisation of CSL was a disastrous transaction.

The loss to the Commonwealth from the sale of CSL does not necessarily translate into a boon for private share-holders. The reasons for this lie in the structure of the markets for blood products and, to a lesser extent, pharmaceuticals. The risk taken on by the private owners is considerably greater than the risk avoided by the Commonwealth. In addition, it is well established that equity holders demand a higher rate of return than bond holders, especially for risky investments.
The nature of the blood products market allows very little scope for the operation of market forces and the efficiencies they can bring about. There is no commercial market for blood in Australia and the Commonwealth is virtually the monopoly purchaser of blood products and pharmaceuticals. In addition, the manufacturing operations of CSL are necessarily subject to stringent regulation.

Thus with respect to both the provision of inputs and supply of outputs, the market conditions facing CSL are determined almost entirely by the Government. Since the profits of CSL depend heavily on the regulatory and purchasing decisions of government, investors have a reasonable concern that the market environment may change in ways that reduce their returns. It seems likely then that investors perceive CSL to be carrying a large degree of sovereign risk.

The impact of the privatisation of CSL on provision of its community service obligations (CSOs) has not been incorporated into the financial analysis of this paper. The principal CSOs previously provided by CSL were research into and production of antivenoms, research into blood products, and development of flu vaccines. It is likely that, from the public’s viewpoint, taking account of CSOs would make the sale appear worse than the financial analysis already indicates.

The analysis of this paper could have been carried out by the Commonwealth prior to sale. It would have been apparent that the privatisation of CSL would be very detrimental to tax-payers. The analysis of the sale of CSL casts doubt on the desirability of other sales of public assets, in particular the airports.

Summary

CSL Ltd, formerly the Commonwealth Serum Laboratories, is the sole manufacturer of blood products in Australia. It also has a substantial pharmaceuticals business. Although one of the most profitable of the Commonwealth’s business enterprises, CSL was privatised in 1994. This paper analyses the fiscal impact on the Commonwealth of the sale of CSL and relates this impact to the market environment in which CSL operates. It raises serious concerns about the returns to tax-payers from the sale.

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to tax-payers. The analysis of the sale of CSL casts doubt on the desirability of other sales of public assets, in particular the airports.
1 Introduction

In 1994 CSL Limited, formerly the Commonwealth Serum Laboratories, was sold to private investors for $299 million. CSL has been Australia’s principal supplier of vaccines and antivenoms since 1916 and the sole manufacturer of blood products. CSL has been responsible for a number of research breakthroughs, most notably the development of a range of antivenoms and improved flu vaccines.

The backbone of CSL’s operations has been the production of a range of blood products processed from blood provided free by the Australian public to the Red Cross. CSL processes blood for the Red Cross for a fee paid by the Commonwealth. The Commonwealth thus pays CSL for manufacturing a range of products derived from blood plasma (coagulants, immunoglobins and albumins) for use in Australian hospitals and by clinicians. A state-of-the-art plasma fractionation facility at Broadmeadows was commissioned in 1994. Construction of the facility cost $209 million, of which $150 million was met by the Commonwealth. The new facility, along with a 10-year contract with the Commonwealth to finance the fractionation of blood products, was a major selling point in the privatisation process. The annual blood processing capacity of the new facility can be expanded from 250,000 litres to 500,000 litres for an additional investment of just $11 million (CSL 1994, p. 20).

CSL was one of the best-performing Commonwealth business enterprises, second only to the former OTC. CSL’s strong financial performance occurred despite the low revenues generated by very low blood products prices and the obligation to provide unprofitable community service obligations for which no subsidy was provided. The privatisation of CSL raises serious issues about the returns to the community of the sale of public assets and the provision of health care services. The case of CSL exemplifies some of the more questionable aspects of the Federal Government’s privatisation program, including the claim that sales of public assets are a useful means of reducing public debt.

To investigate these issues, this paper is arranged as follows. Section II evaluates the fiscal implications for the Commonwealth from the sale of CSL. Section III examines the market environment for blood products and pharmaceuticals in which CSL now operates. Section IV discusses some important aspects of the sale process itself and Section V makes some observations on the effects of privatisation on the community service obligations previously provided by CSL. The final section draws some conclusions.

2 The fiscal effects of privatisation

The 130 million shares in CSL Ltd were sold by the Commonwealth through a public tendering process in May 1994, culminating in the listing of CSL on the Australian Stock Exchange on 30th May 1994. The shares were sold at $2.30 each, yielding $299 million less fees and commissions of $6.6 million (CSL 1994, p. 94). CSL had net assets valued
at $310.2 million, of which the Broadmeadows fractionation facility formed by far the largest portion. The new owners of CSL were indemnified against claims arising from the use of some (but not all) products manufactured by CSL up to the date of sale, including claims arising from AIDS-related illnesses, hepatitis, CJD and pertussis vaccine intolerances. The indemnities do not cover all products manufactured prior to the sale or all claims arising from products indemnified, in particular, liabilities arising from ‘a deliberate or reckless failure by CSL to satisfy required standards of care’ (CSL 1994, p. 92).

Quiggin (1994) examines in detail the fiscal effects of privatisation and assesses the returns to the public from a number of actual and proposed privatisations. It is argued that privatisations of public assets increase the net worth of the public sector only if the proceeds of the sale, when used to pay off debt, yield sufficient savings in interest to offset the loss of the stream of profits the asset would have yielded in continued public ownership. In most cases, the appropriate test is whether the rate of return obtained by taking the ratio of the current profits of the enterprise to the sale price is less than or greater than the real interest rate on government bonds (about 5 per cent). That is, the sale is fiscally advantageous if

\[
\frac{\text{current profits}}{\text{sale price}} < \text{real bond rate.}
\]

At first sight, the privatisation of CSL appears to pass this test. Annual profits prior to privatisation were in the range of $15 million to $20 million (and are projected to rise to $25 million), so the sale price of $292.4 million ($299 million less fees of $6.6 million) implies a rate of return of around 5 to 7 per cent. Hence it would appear that the privatisation was fiscally neutral.

However, a closer examination of the sale contradicts this conclusion. The $299 million sale price represents a payment not for CSL as it existed prior to privatisation but for a set of assets and rights at the time of sale. Thus there are several additional aspects that need to be taken into account in a full assessment of the fiscal impact of the sale of CSL.

Firstly, CSL has recently acquired a sophisticated blood fractionation facility at a construction cost of $209 million, of which $150 million was provided by the Commonwealth (CSL 1994, p. 19). In addition, over the three years prior to the sale the

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1 Recent allegations that CSL mixed foreign with Australian blood may give rise to claims against CSL for which CSL is not indemnified. The indemnities cover blood products derived from blood donated by ‘people in Australia’ (CSL 1994, p. 92).

2 The decision to build the Broadmeadows facility was taken in 1988, prior to corporatisation of CSL and well before consideration of privatisation. The company itself did not have the financial capacity to pay for
Commonwealth spent an additional $42 million on, in the words of the prospectus, ‘costs associated with commissioning, validating and transferring the new production facility’. (The amount of $42 million can be deduced from an examination of Appropriation Acts Nos 1 and 2, 1991-92 to 1993-94). Prior to the sale, the Commonwealth transferred to CSL the Broadmeadows site and facility in exchange for almost 51 million shares.

Secondly, CSL signed a contract with the Commonwealth to supply blood products for 10 years (extendable to 15) at prices far higher than were previously paid by the Commonwealth. These prices are secret. Although there are no competing firms for blood products the prices are described in the prospectus as ‘commercially sensitive’ (CSL 1994, p. 96). Nevertheless, it is easy to obtain an accurate indication of the price rises from the following sources. Firstly, the Commonwealth Gazette gives details of the Plasma Fractionation Contract under which CSL is obliged to provide a minimum volume of blood products for a contract price of $800 million ($80 million annually). Secondly, fees for fractionating blood products (all provided to the Commonwealth) from CSL’s Bioplasma Division are projected to rise from $29.9 million in 1992-93 to $82.9 million in 1994-95 (CSL 1994, p. 20).³ Thirdly, several sources claim that the old prices were about 30 per cent of world prices while the new prices are about 70 per cent of world prices (Business Review Weekly 26 November 1993; Beauchamp 1994, p. 319; official close to the sale, pers. comm.). These figures indicate that over the next 10 years the Commonwealth will pay for blood products up to $500 million ($50 million per annum) more than it would have if CSL had not been sold.⁴

However, if CSL had remained in public hands then the Commonwealth would most likely have continued to lease the new fractionation facility to CSL. If the prices for blood products had remained the same then the Commonwealth would have had to make an additional grant of around $20 million per annum to CSL to cover the leasing costs. Alternatively, the lease costs could have been waived. In addition, the Commonwealth would have had to provide around $5 million per annum for maintenance costs of the facility. Combined with the additional cost of blood, this implies that the Commonwealth will be paying out an additional $25 million ($50 million less $25 million) per year for at least 10 years.

There is a third aspect that needs to be accounted for. It seems likely that the future profitability of CSL will be significantly higher than it has been in recent years due to higher profits in the Pharmaceuticals Division and potential growth in fees for

the new facility, in part because of the low prices paid by the Commonwealth for the manufacture of blood products.

³ Projected sales for 1993-94 were $52.6 million reflecting the increased prices under the new contract for the half year from 1 January 1994.

⁴ The costs of providing blood products to hospitals should include the costs of funding blood collection by the Red Cross, currently around $100 million of which 40 per cent is funded by the Commonwealth and 60 per cent by the States.
fractionation of overseas blood products (made possible by the ease with which the capacity of the fractionation plant can be doubled). The prospectus (which was for institutional and individual buyers the principal, and in some cases the only, source of information on the company) thus seems to give a conservative picture of future profitability. A source close to the CSL sale suggested that additional profits of $10 million would be a reasonable forecast, taking annual profits to around $30 to $35 million. For the purposes of the analysis below we will conservatively assume a profit level of $25 million.

Thus in estimating the fiscal implications of continued public ownership of CSL, the expected profits (of $25 million) would have been offset by lease payments and maintenance costs of the fractionation facility implying that, in the absence of privatisation, CSL would break even (i.e. its profits would have been matched by Commonwealth grants). If the lease payments were set at a level just sufficient to offset depreciation on the facility then the Commonwealth, as owner of the facility, would also have broken even.

The profit estimates and estimates of depreciation made here are conservative, that is, profits may well be higher and depreciation lower than estimated. The net financial return to the Commonwealth from continued ownership of CSL and the fractionation plant would probably be positive. However, for the purposes of the present analysis the conservative estimates indicate a zero return from continued public ownership. On the other hand, the expected loss associated with the privatisation package is represented by increased payments by the Commonwealth for blood products, less tax payments by the privatised CSL. Together these yield a total loss of $45 million. The situation is summarised in Table 1.

5 See the interviews with institutional investors in Beauchamp 1994, pp. 337-38.

6 Note that profits for the privatised CSL are expected to be taxed at the rate of approximately 20 per cent since the company plans to take advantage of the 150 per cent research and development allowance (CSL 1994, p. 40).
Table 1  Annual fiscal impact on the public sector of CSL privatisation  
($ million/annum)

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<th>Item</th>
<th>Fiscal impact with privatisation</th>
<th>Fiscal impact without privatisation</th>
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<tr>
<td>Expected profits (after tax)</td>
<td>0</td>
<td>+20</td>
</tr>
<tr>
<td>Tax payments</td>
<td>+5</td>
<td>+5</td>
</tr>
<tr>
<td>Additional cost of blood products</td>
<td>-50</td>
<td>0</td>
</tr>
<tr>
<td>Grants to cover lease &amp; maintenance costs of fractionation facility</td>
<td>0</td>
<td>-25</td>
</tr>
<tr>
<td>TOTAL</td>
<td>-45</td>
<td>0</td>
</tr>
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It is apparent that the sale of CSL will result in an additional annual expenditure by the Commonwealth of $45 million. Thus the net proceeds from the sale, $292.4 million, will be forfeited soon after the first six years of private ownership, and each year thereafter taxpayers will be $45 million worse off as a result of the privatisation. The net loss to the taxpayer from the sale of CSL, after taking account of the sale proceeds, can be capitalised at around $607 million. The fiscal impact of the sale of CSL is the same as if the Government were to borrow $607 million, commit itself to paying interest on that sum for eternity, and simply dissipate the funds.

By any accounting method, the sale of CSL has been a disastrous transaction for taxpayers. The implied real rate of return of keeping CSL in public ownership is 15.4 per cent, compared to the public cost of funds of around 5 per cent. In the case of the sale of British Telecom, the worst of all of the privatisations examined by Quiggin (1994), the rate of return implied by the sale price was less than 20 per cent, so the sale of CSL is comparable to that case.

A key question is why CSL share prices, at the time of sale and subsequently, have not reflected the loss to the public. In other words, why has a large loss to the Commonwealth not been a large gain for the private owners? The answer is that, because of the market environment in which CSL operates, the risk taken on by the private owners is considerably greater than the risk avoided by the Commonwealth. In addition, it is well established that equity holders demand a higher rate of return than bond holders, especially for risky investments. Thus the fact that private investors demand a rate of return three times the Commonwealth bond rate -- or, equivalently, value the asset at one-third of the present value of the additional payments by the Commonwealth -- is
unsurprising. What is surprising is that the Commonwealth decided to sell a valuable public asset under circumstances that would lead to continuing large losses to the taxpayer. The market environment of the privatised CSL, which gives rise to this situation, is discussed in the next section.

3 CSL’s market environment

Along with vaccines and antibiotics, the core activity of CSL is the production of blood products for use in Australian hospitals and by clinicians. Although the company’s prospectus represents this as a commercial activity that is suitable for privatisation, it would be difficult to imagine a market in which there was less scope for the play of market forces. With respect both to the provision of inputs and the supply of outputs, market conditions for CSL blood products are determined entirely by government policies. In addition, CSL’s own operations are necessarily the subject of strict regulation. We examine these three aspects of the market environment in more detail.

At present, there is no commercial market for blood in Australia; the sale of blood is prohibited by law. Instead, blood is collected by the Red Cross Society from voluntary contributions by the public. Although the Red Cross is nominally a non-government organisation, its activities in this respect are those of an agent of the government. Indeed, the $100 million required each year to run the blood collection service are provided by government -- 40 per cent from the Federal and 60 per cent from State governments. Moreover, it is clear that the Commonwealth and the States stand behind the Red Cross Society in the event of mishaps such as the accidental transmission of diseases through donated blood. These arrangements are particularly important when assessing the market conditions facing CSL.

The case for a voluntary donation system, as opposed to the purchase of blood from individuals motivated by financial need, is well-known and need not be rehearsed here. The key point is that the supply of freely donated blood, in which even the costs of collection are met by taxpayers, represents a massive cost saving for CSL. It has been this subsidy, rather than superior efficiency, that has been the primary factor in allowing the publicly-owned CSL to supply blood products at around 30 per cent of world prices. Furthermore, due to public health concerns, there is no prospect of blood being imported for fractionation and use in Australian hospitals. The continued commercial viability of CSL thus depends heavily on the continuation of the existing regime governing the supply of blood. This regime ensures that there is almost no likelihood of significant competition for CSL in the supply of most blood products.

Turning to the output of blood products, apart from some foreign sales of products derived from imported blood (about 20 per cent of plasma processed in 1994), CSL’s sole customer for blood products is the Australian hospital system supplied by the Commonwealth through its contract with CSL. In addition, approximately 80 per cent of the prescription pharmaceuticals market in Australia is ‘determined by the
Commonwealth’ (CSL 1994a, p. 23). The hospital system itself is funded almost entirely by Federal and State governments. In addition, while there is some scope for expanding exports of blood products through the fractionation of imported blood, there is no foreign market for Australian-sourced blood products. Nothing could be better designed to destroy the voluntary donation system than the export of freely-donated Australian blood for the financial benefit of CSL shareholders.

This market structure for blood products means that the market cannot exercise its discipline on the efficiency of CSL’s blood products operations. Since competitors cannot enter the market to supply blood products to Australian hospitals, the market is not contestable. The supply of blood products is critical to the health system, and the liquidation of CSL, the ultimate market discipline for inefficient firms, could not be contemplated except in the most extreme circumstances. Thus, no matter how internally inefficient the company may become, it is guaranteed that output prices will be set at levels that yield positive returns to the capital. As we have seen, the Plasma Fractionation Contract that sets prices for the next 10 years provides an assured generous return.

On the other hand, the desire to rein in health expenditures is one of the great constants of Australian budgetary policy. An excessively profitable CSL may be a target for future cost-cutting measures through renegotiation of the contract between CSL and the Commonwealth. Thus if large internal efficiencies were realised by CSL, it is possible that a substantial share of the benefits would be creamed off by the Commonwealth. These two forces are likely to keep CSL’s profitability within a fairly narrow band.

In summary, in the long term the profitability of CSL’s blood products business depends primarily on government policy and hardly at all on the competence and diligence of its management. The supply of its principal input is determined by a collection system funded and backed by government, and the market for its products is provided by government contracts.

The discussion thus far has concerned pricing policy. The Government must be equally concerned with the safety of blood products supplied to the public. The examples of AIDS and CJD suggest that it is impossible to guarantee complete safety. Furthermore, the regulatory issues are exceedingly complex, as is the issue of compensation when infected products are supplied. To take just one example, an unregulated blood products supplier could reduce the risk of infectious diseases being transmitted through blood supplies (by an extent difficult to determine) if individuals with multiple sex partners were not permitted to donate blood. On the other hand, such a restriction would involve grave issues of privacy. This is properly an issue for government. Nevertheless, an individual who was infected with a serious disease as a result of the failure to impose such restrictions could reasonably argue that CSL as a commercial enterprise had a duty of care to ensure the safety of their products, whether or not the government imposed regulation.

Similar issues in relation to pricing and safety arise with many of CSL’s other products, although none of them face the same severe market constraints as blood products. Thus
the production and sale of vaccines and antibiotics by CSL’s Pharmaceuticals Division is heavily influenced by the Commonwealth’s Pharmaceutical Benefits Scheme which, according to CSL’s Prospectus:

places the Commonwealth in a position as the virtual monopoly buyer and price setter. For example, approximately 80 per cent of the ethical (prescription pharmaceuticals) market and 58 per cent of the total market for pharmaceuticals in Australia is determined by the Commonwealth. (CSL 1994, p. 23)

Thus the Government is simultaneously one of CSL’s principal suppliers, its principal customer and its regulator. Despite its commercial facade, the privatised CSL remains for most practical purposes a regulated monopoly, with the rate of returned being determined by the Commonwealth Government. This means that the profitability of the company will depend on the vicissitudes of the relationship between CSL management, the Therapeutic Goods Administration (of the Commonwealth Health Department) and the Government.

All of this has serious implications for the impact of privatisation on both private investors and the Government. Since the company’s profitability is contingent on the regulatory and purchasing decisions of government, investors have a reasonable concern that regulations will be changed after privatisation in a way that reduces their returns. This fear is heightened when the regulatory framework appeared to be in a state of flux right up to the time of announcement of privatisation. In addition, the Commonwealth has announced that it will in future call for tenders for vaccines, which could have a major impact on sales of CSL’s Pharmaceuticals Division (CSL 1994a, p. 25). As the Chanticleer columnist of the Australian Financial Review observed: “Nothing leads investors to lower their bids more than the uneasy feeling of standing on regulatory quicksand” (AFR, 5 April 1994).

On the other hand, the opportunities for CSL to expand into new markets will be circumscribed by the regulatory framework, including the blood supply institutions. This is perhaps the reason behind the comment by a corporate analyst from one of the big institutional investors when he dismissed CSL as a “boring company” (Beauchamp 1994, p. 338).

When faced with these circumstances, two responses are available to governments when privatising public assets. One is to attempt to buoy up the sale price by giving iron-clad (and potentially very costly) guarantees to the buyers to the effect that regulatory outcomes will be favourable. The other is to accept a greatly reduced price for the assets being sold. In the CSL case, the outcome has reflected some of both. As we have seen, the Commonwealth signed a 10-year contract with CSL guaranteeing much higher payments for blood products than had hitherto prevailed. The Commonwealth under agreement with CSL also provided a series of indemnities against existing or potential claims arising from infected blood products, including indemnities against claims associated with AIDS, hepatitis and CJD and injuries due to the use of the pertussis
vaccine. Despite these various guarantees, it seems likely that investors perceive CSL as still carrying a large degree of sovereign risk.

The type of problem discussed above has received extensive attention from economists as one of a class of issues referred to as principal-agent problems (see, for instance, Laffont 1989). A general implication of this literature is that where the informational problems associated with the form of the principal-agent relationship are severe, as in the CSL case, alternative organisational forms involving more direct control are preferred. For example, firms are likely to manage relationships of this kind using hierarchical command structures rather than contracting out.

The difficulties of privatisation in an environment where subsequent close regulation is required have been extensively studied. Although some advocates of privatisation, such as Littlechild (1983), argue that regulatory problems can be resolved, others, such as Zeckhauser and Horn (1989), acknowledge the severity of the problem and recommend alternative organisational forms.

4 The sale process

The difficulties with the float of the Commonwealth Bank may have been uppermost in the minds of the public servants on the task force in charge of the privatisation of CSL, in particular the fact that the second tranche of the float did not sell well. This meant that CSL shares would be offered at a price that was assured of attracting an excess of buyers. Indeed, the float was substantially over-subscribed, especially by overseas buyers.

The CSL offer was over-subscribed despite an obvious difficulty with the privatisation -- the low apparent rate of return. As we saw, profits prior to privatisation were around 5-7 per cent of the proposed sale price. This is well below the level that would normally be expected by buyers of equity. It seems likely that buyers were persuaded by the prospectus and associated promotion of the shares, that the company was in a good position to increase its profitability substantially. Thus the buyers likely to consider participating in the float were those aware of the generous terms that were being offered, including the recent $192 million public capital injection, the lucrative contract with the Commonwealth for supply of blood products, and the apparently generous indemnities agreed. Due both to the secrecy associated with some of these terms and to the natural reluctance of politicians promoting privatisation of public assets to boast of the generosity of the terms of sale, ordinary investors were not well-informed about the attractiveness of the shares. The result was that well-informed insiders were in a good position to make profitable purchasers.

Some criticism was levelled by market analysts at the privatisation task force for its decision not to underwrite the float. This criticism appeared to be borne out when interest rates rose and share prices fell so that the Government was faced with the prospect of unsold shares that would otherwise have been taken up by the underwriters. However,
this criticism cannot be sustained. Underwriting is essentially a form of insurance, often costing 2-3 per cent of the proceeds of a float. The fact that underwriting is a profitable activity means that on average the amount paid out by underwriters is less than the fees they charge. People and organisations take out insurance to cover the possibility of being unable to cover losses. The Commonwealth has a huge revenue base and is at least as well placed as commercial underwriters to meet the costs of any shortfall in demand for a share issue. Just as the Commonwealth does not insure its vehicles against accident, it would make no sense to take out costly forms of insurance such as underwriting.

5 CSL’s community service obligations

In addition to their commercial role, many government business enterprises have broader goals, often written into their charters or establishment acts. These goals are referred to in the literature as community service obligations (CSOs). The existence of CSOs has frequently been used to justify relatively low levels of profitability and non-commercial pricing policies. Australia Post’s uniform charge for a standard letter is a good example. Advocates of microeconomic reform have often argued that CSOs should be explicitly costed and, where possible, the costs should be compared to the benefits people derive from provision of CSOs.

In the case of CSL, the principal CSOs that it has provided have been research and development of antivenoms, the National Bloodgroup Reference Laboratories and the WHO Influenza Research Centre. Depending on how one defines CSOs, the provision of highly subsidised blood products through the hospital system may be regarded as the primary CSO provided by CSL.

The issue of CSOs is particularly important when privatisation is being considered, especially in the cases of enterprises that were originally established to provide community services that private firms would not offer. In the absence of explicit legislative requirements to the contrary, it may be assumed that privatisation will result in the abandonment of all CSOs provided by the enterprise while under public ownership. This has several implications.

First, responsible public policy generally requires that decisions to abandon CSOs should be made, and preferably implemented, prior to privatisation. This ensures that privatisation is not employed as a political device to avoid debate on decisions that are necessarily social. Secondly, where CSOs are to continue to be provided and are contrary to the financial interests of the firm, the methods by which the services will be provided need to be specified in legislation or contracts of sale. Thirdly, in assessing the benefits of privatisation, cost savings associated with the abandonment of CSOs should be excluded from consideration unless the lost benefits can also be netted out. In the financial analysis carried out in Section II above, no account was taken of the possible costs to the community from loss of CSOs.
In the case of CSL’s antivenom research and production, there is no practicable way of recovering the costs of the research and production from the consumers of antivenoms. It would be contrary to standards of fair play to demand payment from a snake-bite victim before administration of antivenom. As part of the CSL sale process, the Commonwealth hived off CSL’s antivenom research and provided funds for the principal researchers to carry on their work at the University of Melbourne.

6 Conclusions

While it operated under public ownership, the objective of CSL was to provide health services to the Australian community, especially blood products, antivenoms and vaccines. The privatisation of CSL has caused its objective to change. The Chief Executive of CSL has stated: “All our business activities will continue to be consistent with CSL’s key objective -- the growth of shareholder wealth” (CSL 1994b, p. 6). The continued provision of high quality health products to the Australian community will now depend on whether it is consistent with the maximisation of the wealth of private shareholders. The analysis of this paper has demonstrated that the privatisation of CSL was not consistent with the maximisation of the wealth of its previous public owners.

The analysis above of CSL’s market environment suggests that it would be difficult to find a government business enterprise less suited to privatisation than CSL. The structure of the blood products market, and to a lesser extent the pharmaceuticals market, do not lend themselves to the efficiency benefits said to arise from exposure to private sector incentives.

In deciding to sell off CSL, the Federal Government appears to have been motivated by ideological conviction rather than any analysis of the costs and benefits to the community. Indeed, there appears to have been no assessment at all by the Commonwealth of the comparative returns to the tax-payer of retaining or selling CSL. While in some cases following ideology may lead to net benefits to the community, in the CSL case it clearly did not. Even from the constrained viewpoint of the fiscal impact of privatisation, a simple review of the financial implications would have shown that the selling of CSL would result in a huge financial loss to taxpayers.

The results of this analysis suggest that there must be grave doubts about the benefits to the community from selling other government enterprises that operate in market environments that are necessarily characterised by restrictions on competition or which provide important community service obligations. In this regard, the most serious questions hang over the proposed privatisation of Australia’s airports since the airports, despite hopeful comments to the contrary, will remain a regulated monopoly. On the basis of the CSL experience, we should expect the sale of the airports to result in a large loss to taxpayers.
References


CSL 1994a, *Prospectus* Commonwealth of Australia: Canberra


