Montreal Economic Institute
Ideas for a More Prosperous Nation

ECONOMIC NOTE

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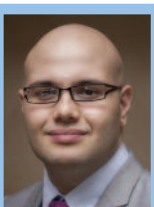
Canada Post: Opening Up to Competition

After months of unsuccessful negotiations and conciliation talks, Canada Post workers voted by a margin of 94.5% in favour of going on strike at the end of May if they do not reach a negotiated settlement with their employer. The time is right to evaluate the costs that a postal service monopoly imposes on consumers and on the economy as a whole. To determine which reforms might lead to the best postal service at the best price, we should study the experiences of other countries.

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The challenges faced by Canada Post

Canada Post is one of the country's largest companies: it posted $7.3 billion in revenue in 2009 and employed around 71,000 employees to deliver some 11 billion pieces of mail.[1] It also competes with firms like FedEx and UPS for parcel and express delivery. However, it enjoys a monopoly on the distribution of letters.[2]

Formerly operated as a government department, in 1981 it was transformed into a Crown corporation with the Government of Canada as its sole shareholder. Although it did not become fully independent, it did gain greater management flexibility. This structural change also meant that Canada Post would no longer receive subsidies to compensate for any operating shortfalls. The corporation can borrow funds from the federal government, but it has to repay them in full with interest. This new autonomy enabled Canada Post's management team to change some of the company's practices in order to generate profits and to be entirely self-sufficient financially since 1988.[3] Despite this improvement, Canada Post is still facing structural challenges from within and from without.

First of all, costs are growing faster than revenue for many postal operators all around world, due to the decreasing growth rate of mail volume.[4] Domestic mail volume in the countries of the European Union has not kept pace with economic growth since 1997, and has even declined in certain countries.[5] This volume is also down in the United States.[6] Canada Post's annual reports show that the number of pieces of mail handled per Canadian rose steadily from 1971 to 1996. However, in 1996, this trend stopped. The main reason for this reversal has been the rise of cheap and efficient alternatives like faxing, email, electronic billing and electronic funds transfers.

Second, Canada Post is afflicted with productivity problems related to its human resources management, and needs to modernize its infrastructure. In 2005, 16 days per fulltime employee were lost to absenteeism in delivery and mail processing

1. Canada Post, *Annual Report 2009*, pp. 95-97.
2. There are exceptions to this monopoly, including "letters of an urgent nature that are transmitted by a messenger for a fee at least equal to an amount that is three times the regular rate of postage payable for delivery in Canada of similarly addressed letters weighing 50 grams."
3. J. Gregory Sidak and Daniel F. Spulber, "Monopoly and the Mandate of Canada Post," *Yale Journal on Regulation*, Vol. 14, No. 1 (Winter 1997), p. 9.
4. Brian J. Moran and Andre Pharand, *Mail Mavens*, Accenture Consultants, October 2009, p. 2; Brian J. Moran and Vineet Narang, *Achieving High Performance in the Postal Industry*, Accenture Consultants, June 2009, p. 1.
5. Ita Consulting and Wik Consult, *The Evolution of the European Postal Market since 1997*, European Commission, August 2009, p. 36.
6. Boston Consulting Group, *Projecting U.S. Mail Volumes to 2020*, March 2010, p. 10.

operations. That figure is 60 percent higher than the Canadian average for manufacturing employees and 20 percent higher than the average for all unionized employees.[7] According to a study carried out in 2004, unionized Canada Post employees worked only 64 percent of their paid hours, which is 10 percent less than in other comparable unionized companies in Canada. This means that Canada Post needs to hire more workers than other companies in order to produce a given amount of work.

In addition to its low productivity, Canada Post must also deal with growing labour costs, which account for nearly two thirds of total costs.[8] High labour costs as a share of total costs indicates a low degree of automation of sorting processes and inefficient delivery techniques.

Moreover, Canada Post faces problems regarding its infrastructure (such as its mail processing centres), which is in need of significant maintenance and upgrading. According to a strategic review of the corporation, it is estimated that $4.4 billion will need to be invested over the next seven years for infrastructure maintenance and to catch up with current technology.[9]

Due to a combination of rising labour costs and the need to adapt to current technology, Canada Post is finding it difficult to control costs.

The same report pointed out that due to this combination of rising labour costs and the need to adapt to current technology, Canada Post is finding it difficult to control costs. This means that Canadian consumers could receive higher quality service at a lower cost if only these problems could be successfully tackled.

The authors of the report conclude that it will be difficult to improve Canada Post's performance without major structural changes. Due to its monopoly on the distribution of letters, which shields it from competition, Canada Post is tempted to raise its rates rather than curb its costs. This is the strategy it has adopted in the past, after all.[10] It continues along the same path now: it announced in 2009 that it would raise the rate for stamps from 54 cents to 65 cents by 2014,[11] a 20% increase in five years that consumers will have to be borne by consumers.

Alternative models for providing postal services

The monopoly on the distribution of letters, like the one enjoyed by Canada Post, is a model that has increasingly been abandoned in countries around the world, with governments deciding to open their postal markets to competition (liberalization) and also, in certain cases, to sell their publicly-owned postal operators to private shareholders (privatization). These alternative models use competition and pressure from private investors to encourage postal operators to become more innovative and to provide the best service at the lowest cost.

Liberalization means allowing competitors to enter the postal market so that the state-owned enterprise will be forced to innovate and become more efficient in order to retain its market share. Moreover, a privatized firm is under constant pressure from its shareholders, who push the management team to improve performance. In the case of Canada Post, the sole shareholder is the federal government, which has political interests that may not necessarily be aligned with the corporation's economic interests. It is unlikely that the government will allow Canada Post to go bankrupt, hence eliminating another source of pressure that would encourage it to improve its performance. Without such pressures, Canadian consumers – not the government – will bear the brunt of the problems caused by the government monopoly's underperformance, in the form of lower quality and higher prices. This is why privatization, meaning the transfer of ownership to private investors, has the potential to produce substantial benefits.[12]

Having had to surmount challenges similar to those now faced by Canada Post, many countries around the globe chose to liberalize and privatize their postal services. It is therefore useful to study the experiences of these countries in order to identify reform ideas that will allow us to improve the quality of our postal services while reducing costs.

In Europe, under the initiative of the European Commission, the postal market has been gradually liberalized since 1997. The postal monopolies of all member states must be abolished before January 1, 2013. Other countries around the world, like

7. Edward M. Iacobucci, Michael J. Trebilcock, and Tracey D. Epps, *Rerouting the Mail: Why Canada Post is Due for Reform*, C.D. Howe Institute, February 2007. p. 4.
8. Canada Post, *op. cit.*, footnote 1, p. 80.
9. Robert Campbell, Nicole Beaudoin, and Dan Bader, *Strategic Review of the Canada Post Corporation: Report of the Advisory Panel to the Minister*, Government of Canada, December 2008, p. 53. Note: the figure of $4.4 billion includes an annual cost of $200 million for infrastructure maintenance. The cost of modernization by itself is $3 billion.
10. Adminware Corporation, *Canadian Philately: Elizabethan-era Definitives*, http://www.adminware.ca/checklist/chk_rate.htm.
11. Michael Warren, "The Future of Canada Post," *Toronto Star*, August 9, 2010.
12. See: Aidan R. Vining and Anthony E. Boardman, "Ownership versus competition: Efficiency in public enterprise," *Public Choice*, Vol. 73 (1992), No. 2, pp. 205-239; Andrei Shleifer, "State versus Private Ownership," *Journal of Economic Perspectives*, Vol. 12, No. 4 (Fall 1998), pp. 133-150; Nandini Gupta, "Partial Privatization and Firm Performance," *Journal of Finance*, Vol. LX, No. 2 (April 2005), pp. 987-1015.

TABLE 1
Change in the price of a stamp
for sending a 20g letter ten years after the adoption of reforms in various countries

	Liberalization	Privatization	Stamp price*
Canada	✗	✗	+41%
Sweden	✓**	✗	+51%
New Zealand	✓	✗	-30%
Austria	✓	✓	-11%
Netherlands	✓	✓	-15%
Germany	✓	✓	-17%

* The increase in the price of a stamp was calculated in constant Euros, Swedish kronas, New Zealand dollars and Canadian dollars (OECD data).
** This analysis does not take into account rate reductions for bulk mail such as those observed in Sweden where they fell substantially. This table could therefore actually *underestimate* the benefits of liberalizing postal services.

Date of the start of reforms: Canada (1981, transformation into an independent corporation); Sweden (1993, liberalization); New Zealand (1990, liberalization); Austria (1998, liberalization); Netherlands (1994, privatization); Germany (1998, liberalization).

Sources: Canada Post, *Annual Reports*; Sedelmynt, *Brevporto 1855-2009*; New Zealand Ministry of Economic Development, *Postal services in New Zealand*; Ita Consulting and Wik Consult, *The Evolution of the European Postal Market since 1997: Annex*, European Commission, August 2009; Deutsche Post, *Letter Prices in Europe*, 2009 and 2010; TNT Post (correspondence); OECD StatExtracts.

New Zealand, also opted to liberalize. Unlike Austria, Germany and the Netherlands, however, New Zealand and Sweden have not privatized their postal operators, even though they have had fully liberalized postal markets for over a decade.

Having had to surmount challenges similar to those now faced by Canada Post, many countries around the globe chose to liberalize and privatize their postal services.

In 1988, New Zealand Post lost its government subsidies to cover operating shortfalls. During the 1990s, this country's postal market was progressively opened to competition. Faced with such challenges, the public corporation managed to reduce its workforce by 40%, mostly by attrition and by offering incentive packages for early retirement, while doubling its overall productivity[13] (revenue divided by number of employees). In the ten years following the reform, this improved performance allowed the corporation to pass on to consumers savings of 30 percent on the price of a stamp in real terms.

In Sweden, the government decided to promptly abolish the monopolistic privileges of its postal operator, Posten AB, in 1992. Following this opening up to competition, Posten AB's main competitor, Bring Citymail, captured a respectable share of the market and was able to deliver mail to just over half of Swedish households.[14] This fierce competition has pushed Posten AB to enact important reforms to lower its costs: it reduced its workforce by 30% and increased productivity by 32%.[15] Prices for bulk mail, (mail that is rated for postage partly by weight and partly by the number of pieces in the mailing), which constitute 73% of the total mail volume, have declined in real terms since liberalization, although the price for single-piece letters has increased. Nevertheless, "postal consumers found that the operators' quality was high and that they were willing to adjust to consumer demands more than before liberalization."[16]

As for Germany and the Netherlands, they opted to privatize their postal operators, in part or in full.[17] In the meantime, they opened their postal services markets to competitors, who were able to compete in several segments of the markets, even those believed to be the hardest to enter. Facing pressures both from increased competition and from shareholders, these two former monopolies were forced to enact important changes in order to keep their customers.

In Germany, Deutsche Post managed, mainly through attrition, gradually to reduce the size of the workforce by 38%.[18] After its privatization in 2000, the company continued to cut costs in its mail division, and by 2010, it had increased its productivity by 20%.[19] In the Netherlands, in the ten years following the first wave of privatization of PTT Post (today TNT Post), the company succeeded in limiting its labour costs, which fell from 55% of total costs in 1994 to 41% in 2004.[20] Over the same period, productivity increased by 16%.

13. Richard Geddes, "Policy Watch: Reform of the U.S. Postal Service," *Journal of Economic Perspectives*, Vol. 19, No. 3 (Summer 2005), p. 227.
14. Ita Consulting and Wik Consult, *The Evolution of the European Postal Market since 1997: Annex*, European Commission, August 2009, p. 146.
15. Peter Andersson, "Liberalization and market performance: towards higher efficiency in Sweden" in James Campbell, Michael Crew, and Paul Kleindorfer (ed.), *Handbook of Worldwide Postal Reforms*, Elgar Publishing, 2009, p. 308.
16. *Id.*, p. 306.
17. Ita Consulting and Wik Consult, *op. cit.*, footnote 14, pp. 51 and 104.
18. Richard Geddes, *op. cit.*, footnote 13, p. 229.
19. Deutsche Post World Net, *Annual Reports* 2000 and 2010.
20. TNT Group, *Annual Reports* 1997 and 2005. Privatization occurred in two steps: one block of shares was sold in 1994 and another in 1995.

In Austria, the government decided in 2006 to sell a minority stake in Österreichische Post AG to private investors.[21] Moreover, on January 1, 2011, the liberalization of the Austrian postal market that began in 1998 was fully completed. Österreichische Post AG shrunk its workforce by 25% in ten years, and investments in new equipment were made to improve both productivity and service quality. Over the same period, labour costs dropped from 64% of total expenditures to 50%.[22] As for productivity, it nearly doubled.[23]

Thanks to these cost-cutting approaches, significant savings have been passed on to customers. In the three countries examined which privatized their postal operator, prices for single-piece letters have fallen in real terms in the years following privatization (see Table 1).

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Toward a free postal service market

A plan for reforming Canada Post could start with an employee-share ownership program, as proposed by the strategic review of Canada Post,[24] after which a plan for progressive liberalization and further privatization would be announced. This first step would allow employees to benefit fully from productivity increases as shareholders and not only as workers. With the prospect of liberalization, the necessity of becoming more productive would be clear.

The issue of regional segmentation of postal services, which is often raised as a justification for keeping the monopoly in place, should not be an obstacle to reform. It is true that the costs of services are higher in sparsely populated outlying regions. But postal companies will deliver to all regions of the country as long as they can adapt their prices and frequency of service to reflect their greater costs.[25] In order to allow for true competition, it would thus be necessary to eliminate uniform pricing and allow companies to charge higher prices in certain regions.

Individuals who chose to live in rural regions – where housing prices are lower and where there is less traffic and air pollution – must also accept that there are downsides to this choice, such as higher prices and reduced access for some products and services. Even if we truly wish to ensure that every Canadian consumer has the same access to postal service, there is no need to subsidize it through regulation, which hides its real cost. Direct compensation to the individuals concerned would be more effective and less expensive. For example, since prices are higher in the northern regions, compensation could take the form of a more generous Northern Residents Tax Deduction.

To meet its modern challenges, the government should allow Canada Post to evolve into a modern postal operator. What should be front and center in reforming Canada Post is the pursuit of the best service at the best price for customers. In light of foreign experiments, the most effective way to attain this goal is to liberalize the postal service market and to consider the privatization of Canada Post.

21. Ita Consulting and Wik Consult, *op. cit.*, footnote 14, p. 8.
22. *Id.*, p. 8; Österreichische Post AG, *Annual Report* 2010, pp. 46 and 70.
23. Ita Consulting and Wik Consult, *op. cit.*, footnote 5, p. 86.
24. Robert Campbell, Nicole Beaudoin, and Dan Bader, *op. cit.*, footnote 9, p. 94.
25. Richard Geddes, *op. cit.*, footnote 13, p. 225.

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