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How Ottawa Can Deliver A Reformed Canada Post

by
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- Canada Post is at a critical juncture: facing large current – and larger looming – financial losses, it must undergo reforms in order to contain costs and stem losses.
- However, the federal government, as the owner of Canada Post, will also face pressure to maintain the same price for mail services across Canada, keep open rural and isolated facilities, and maintain or improve delivery performance.
- The federal government should consider further contracting out some postal services, gradually reducing the scope of the government monopoly, while avoiding large-scale layoffs of Canada Post employees. The government should also consider direct subsidization of services in remote areas, rather than cross-subsidizing them via revenues generated from urban consumers.

Canada Post, a Crown corporation facing large and looming financial losses, is examining cost-saving measures (Stewart-Patterson et al. 2013). The national discussion so far has avoided discussing fundamental changes to the way mail is delivered in Canada.

Around the world, the response of governments to changing demand for mail services has been to alter the ownership structure of those services, and create competition for both collection and delivery. In this sense, Canada is lagging major countries that have ended the monopoly status of their national postal services, with regard to letter mail.

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Many countries now have fully privatized mail services, which is one option among the many reform models Canada could consider.[1] The UK, for example, started incremental reforms 10 years ago, and is now privatizing the remaining government postal corporation mail services.[2] Ottawa should enact similar, incremental reforms that take into account domestic realities that require a made-in-Canada postal reform agenda. These realities range from the details of collective bargaining agreements, to public demands to maintain uniform prices across Canada, and pressure to limit outlet closures.

A possible made-in-Canada reform approach would not entail full, immediate privatization of postal services, but rather the gradual introduction of contracting arrangements for more Canada Post services. Most important is the observation that arranging contracts for various operations could be effected without compromising coast-to-coast uniform service standards and pricing, or existing jobs. Because maintaining rural services and common service standards, or forbidding outlets from closing, are political objectives, public attention to the costs of these political objectives may help the policy reform process. Direct government subsidization, rather than requiring Canada Post to subsidize loss-making postal services through higher prices for other customers, would be a better approach.

Canada Post Today: Financial and Operational Stresses

The federal government owns, but provides significant autonomy to, Canada Post. Under the *Canada Post Corporation Act*, the government has made Canada Post the only organization that can collect or deliver letter mail, but has tasked the corporation with the obligation to serve all addresses, known as the universal service obligation.[3] Despite having been a profitable corporation in past years, Canada Post faces a number of potential challenges, many of which were long foreseen (see Strategic Review of the Canada Post Corporation 2008, for example).

Changing business models: Domestic mail is forecast to decline by 27 percent from 2012 through 2020 (Stewart-Patterson et al. 2013).[4] Other Canada Post revenue streams – such as magazine delivery, advertising mail, and other services – are being increasingly supplanted by online services.

The cost of door-to-door and rural service: The two most expensive means of delivering mail are door-to-door service and rural mailboxes. Canada Post serves one-third of the total addresses in Canada with door-to-door service, at an average annual cost of $269 per address. This compares to $182 per rural group mailbox and about $120 for centralized points (such as in apartment buildings) and community mailboxes. With a rise, due to population increase, in the number of addresses that Canada Post must serve – combined with lower mail volumes – the Crown will face higher costs in future, while earning less revenue.

1 See Iacobucci et al. (2007) for a summary of international reforms, from which I draw examples.

2 For information on the Royal Mail's coming privatization, see http://www.economist.com/news/britain/21581732-royal-mail-faces-privatisationand-then-struggle-afterwards-going-postal.

3 Canada Post has the exclusive right to collect and deliver letters less than 500 grams. This is subject to a number of exclusions, such as for premium price delivery and periodicals.

4 However, other areas, such as domestic parcels, are forecast to grow over this period.

Pension obligations: As of the end of 2011, Canada Post had a pension solvency deficit of $4.7 billion (Stewart-Patterson et al. 2013) which grew by 26 percent to $5.9 billion in 2012.[5] Under pension solvency rules, Canada Post would have been required to pay an aggregate $2.4 billion in special payments by 2013 to cover the solvency deficit, but received special federal permission to pay only pay $63 million and $219 million in 2011 and 2012.

Labour: The 2011 labour disruption was perhaps the most high-profile reminder of labour issues at Canada Post. However, chronic labour issues exist. Labour accounted for 71 percent of Canada Post's costs in 2011, up from 67 percent in 2004. Regular absenteeism is also a major concern. Wages and benefits for replacement workers amounted to $310 million in additional costs to Canada Post in 2007 (Canada Post 2007).

Canada Post is bound by collective agreements that make layoffs relatively difficult. The collective agreements for the majority of employees are separated into rural/suburban and urban postal employee units, with indoor and outdoor groups within the two employee units. Under the current rules, full-time employees as of October 2012 cannot be laid off without cause.[6] However, Canada Post can move them to other jobs within 40 kilometres of their current postal location.[7] Employees must first be displaced to jobs within their employee group, and can only be displaced to positions in other groups if there are no positions available within their current group.

The future of Canada Post without reforms: The corporation's expenses exceeded revenues of approximately $7.5 billion by $188 million in 2011. Further, Canada Post has not provided its owner – the federal government – a dividend since 2008. The bottom line: Canada Post is forecast to have an annual operating deficit of $1 billion by 2020 if does not enact any new reforms (Stewart-Patterson et al. 2013).

How to Reform Canada Post

The primary objective of Canada Post is to provide a universal service at the same price to consumers across the country.[8] Canada Post uses profits from urban routes to sustain unprofitable rural routes to fulfil the obligation to service all areas of Canada. However, Canada Post could achieve its primary objective through other delivery and financing models, such as contracting arrangements and direct government subsidies.

Principles of Reform – the Economics of Postal Networks

Postal services are network economies: that is, they are most efficient when a single network connects all the points (mailboxes and addresses) within the system. A postal system may be a natural monopoly, and the

5 The financial position of Canada Post's pensions may be different based on different assumptions regarding expected rates of return for the corporation's pension plan, a topic I do not discuss here.

6 Similarly, employees hired after October 2012 cannot be laid off once they have five years of continuous employment. (See Article 53 of Canada Post's collective agreement for Urban Postal Operations.) Otherwise, employees may be terminated for just, reasonable and sufficient cause after having received written notice of termination for disciplinary reasons.

7 Workers in Toronto and Montreal can be displaced to other jobs within the urban area, rather than only to positions within 40 kilometres from their current position.

8 This objective is a summary of the first three points of the *Canadian Postal Service Charter*, as set by the federal government. (See Iacobucci and Trebilcock 2012.)

economic benefits – and potential commensurate costs – of natural monopolies have been a major argument for keeping postal services in public, rather than private, hands.

Although the network as a whole may be a natural monopoly, individual parts of the service may not be. Operating centralized sorting facilities or maintaining a registry of addresses and postal codes may be most efficiently done by a single operator.[9] If an unregulated private company operated a natural monopoly, there would be a risk that it would charge higher prices than those expected in a competitive environment for access to its facilities or information. However, other parts of the service – such as the final delivery and collection of mail, or the operation of individual stores – are standalone services that are not natural monopolies.

Implementing Reform

Any reform of Canada Post must address the extent of government monopoly, the requirement for universal service, and the labour and pension concerns of existing Canada Post employees.

Government monopoly: There are two general approaches to encouraging multiple firms to provide postal services. The first approach, similar to that of Sweden and Finland, is to eliminate the government monopoly on letter pickup and delivery. When governments do so completely, they often set the terms of service for new entrants, such as prices and access terms for postal infrastructure.

A second option is to gradually eliminate the government monopoly. This could be done through contracting arrangements, whereby the government auctions the right to operate specific parts of postal services, such as mail delivery and pick up.[10] In such an auction – in which current Canada Post employees could bid for the work – the bidder that offers to accept the lowest payment per unit of mail for delivery or pick up would win the right to provide the service. Canada Post could pay contractors out of revenues from stamp sales or other income streams. New entrants could be guaranteed access to Canada Post's remaining services and facilities.[11] Unlike full privatization, contracting delivery and pick up services would mean little noticeable change for customers unless the government chose to enforce performance standards different from current practices.

Contracting arrangements for delivery and pick up services would be a continuation of the existing practice of contracting out the operation of postal outlets, customer care centres and air and long distance transportation.[12]

9 The existence of multiple competing parcel delivery services in Canada suggests that the argument that delivery networks are most efficient when operated by a single provider may no longer be valid, especially for higher-priced parcel services.

10 In practice, contracting specific postal service would be similar to contracting of other government services, such as bus transportation or waste collection. See Dachis (2010) for a summary of the general principles of contracting and contract design. The government can set the terms on items ranging from: the length of the contract, the service area of the contract, bonuses or penalties for meeting or falling short of performance standards, contingency plans for labour disruptions, contract enforcement and monitoring, and other criteria. Governments may also place limits on the number of contracts that any one firm may hold in a specific area in order to encourage future competition.

11 However, if companies that win contracts for specific delivery routes also chose to operate a competing national distribution network, rather than using the existing Canada Post distribution network, the federal government should allow this as well.

12 According to Stewart-Patterson et al. (2013), contracted postal outlets have a one-third lower cost than facilities owned by Canada Post. Of 6,400 retail posts across Canada 2,500 are operated by private dealers (Canada Post 2013).

Previous estimates have found that, without closing any outlets, contract arrangements for all remaining postal outlets could reduce Canada Post's costs by $100 million per year by 2020 (Stewart-Patterson et al. 2013). The potential cost savings from eventually contracting out all of Canada Post's services – if they are of a similar magnitude to international reforms – could be larger than the savings from reduced services identified by Stewart-Patterson et al. (2013).[13]

Contracting out, on its own, will not solve crucial policy questions for Canada Post such as delivery standards, pricing policies or other policy mandates. The corporation could set general contract terms for bidders – such as maintaining a certain share of postal outlets in a region, or a certain density of postal service per resident. The winners could then experiment to find the most innovative or least costs ways of meeting the contract terms. New entrants would be able to pair mail delivery with complementary non-mail services such as parcel delivery or other delivery networks that Canada Post does not currently offer.

The universal service obligation: The economic merits of maintaining common prices and service levels across Canada are dubious. The cost of service is higher in rural areas than in urban areas, and cross-subsidizing mail services in rural areas results in higher costs for urban customers. Nevertheless, political influences over short-term postal reform make scrapping the notion of universal service unlikely. But rather than imposing the cost of maintaining rural service on other postal customers, government could provide general subsidies, which would be the most efficient and transparent way to meet the policy goal of preserving equal urban and rural prices.

Under a subsidized contracting model, service providers would require the largest subsidy to service high-cost areas. If the cost per item sent or delivered in remote areas is not covered by the set stamp price, the difference would be made up by a payment from general government revenues.[14] Paying for an explicit policy goal through a general government subsidy would be similar to the current policy of maintaining free delivery in some circumstances, such as letters to and from Members of Parliament, which cost $22 million per year (Canada Post 2012). Direct government payments to maintain rural services would be transparent and, once the cost became evident, allow for a debate over whether equal pricing was worth the expense.

Addressing labour and pension challenges: The collective bargaining agreement between Canada Post and workers that forbids layoffs of most current full-time employees will be one of the main short-term constraints on the extent to which Canada Post can hand off services to contractors. However, the section of the collective agreement that allows workers to be displaced only to other Canada Post groups – for example, from an outside group to an inside group – within a specific area gives Canada Post the ability to offer contracts for a portion of routes across the country. With nearly half of Canada Post's workforce set to retire by 2021, or an average of 3,000 people per year (Canada Post 2012), the organization could gradually increase the share of services it contracts out without relying on layoffs. Offering contracts to provide some services, but retaining a core Canada

13 For example, New Zealand Post cut total expenses by one-third. Although a precise estimate of the potential savings from contracting out mail delivery and pick up services is outside the scope of this E-Brief, applied to Canada Post's expenses, that would result in savings of $1.9 billion. The largest savings that Stewart-Patterson et al. (2013) identify is a potential $576 million per year reduction in costs from eliminating door-to-door delivery.

14 An alternative approach, first attempted in Finland, is to tax all postal operators to cover the expenses of the universal service provider. However, this approach resulted in fewer potential entrants, and this tax on operators was eliminated in Finland's 2011 reforms to the *Act on Postal Services*.

Post, would also allow Canada Post to gradually shrink the size of its pension liabilities for current and recently retired employees.

Contracting arrangements would create a strong incentive for contracted employers and their employees to maximize their productivity. Firms with relatively low-productivity employees would either lose contracts or be less profitable than otherwise. Employees, recognizing that labour disruptions, low productivity or excess wage demands could result in their firm losing contracts, likely would perform better than current Canada Post employees.

Conclusion – The Federal Government Should Deliver Real Reform of Canada Post

It is time for the federal government to reconsider how best to achieve the primary objectives of Canada Post. Given the existing constraints of labour agreements and political considerations on changing the prices for postal services, incremental reform may be the best approach.

Gradually introducing contracting arrangements for more Canada Post services could extend to broader reforms and privatization – akin to the process under way at the Royal Mail – once new competitors are in place and the costs of maintaining the existing universal services become clear. A gradual approach to removing the government monopoly on postal services, along with financing rural and remote area services through general government revenue, would draw on the most successful elements of the many international reforms to national postal services.

It is time that Canada's postal services caught up with those of the rest of the world, and that Canadians benefited from the most efficient system possible.

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