

Carnegie Council Privatization Project

Privatization: The Canadian Story



The Honorable
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Minister of State for Finance
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The Honorable John McDermid, P.C., M.P

First, may I congratulate the Carnegie Council for its continuing study of privatization; it is central to the policy approach of governments that are seeking to draw new boundaries for—and new relationships between—the public and private initiative in a dramatically changing world. I'm pleased to have the opportunity to share with you some observations on Canada's experience in meeting this vital challenge.

As in many other countries, the government of Canada has embarked on a program of privatization of state-owned enterprises as part of a comprehensive range of structural reforms, and the underlying thrust of these reforms is to reduce the cost and burden of government and to lay the foundation for a more competitive and market-oriented economy. I have had the pleasure over the last number of years to have the privatization responsibilities, and in doing so have observed privatization programs from other countries. We really look Mickey Mouse in Canada, to be quite frank about it, when it comes to privatization, because when you look at countries like Britain, Mexico, and Argentina which have had massive privatization programs, ours is very small in comparison.

It's been suggested that other countries suffer from too much history; Canada has too much geography. With 5,000 miles coast to coast, it's the second largest country in the world, but we have a relatively small population of just 27 million people. It's hardly surprising that in the early years Canadians looked to their federal government to provide nation-building services, such as rail and air transportation, and communications; services that the private sector could not or would not supply at that particular time.

For example, the federal government created the Canadian Broadcasting Corporation and Trans-Canada Airlines, the forerunner of Air Canada, back in the 1930s. The first, of

course, was to establish a national radio service as an alternative to the United States networks at a time when it appeared that broadcasting in Canada would only be able to serve the local markets. The second was set up to develop a coast-to-coast service at a time when Canadians could only fly from Toronto to Vancouver through the United States.

Over the years, our federal and provincial governments established a number of such state-owned enterprises, which are called Crown corporations, to achieve public policy goals. These goals have ranged from restructuring or revitalizing key

industries in order to meet social needs, to maintaining jobs and activities in sectors considered of prime importance to the national or regional economies.

Canada has thus come into its own as a modern industrial economy with a higher profile of public ownership than has been true of the United States, but at a considerably lower level than prevails in most Eu-

ropean countries. It was worth noting that governments created a Canadian system of Crown corporations not out of any ideological fervor for public as opposed to private ownership, as some countries have; rather they were established on a pragmatic, case-by-case basis, to serve social, cultural, and economic priorities the private sector could not have been expected to meet at that time.

I would add an exception to that which I just said, and that was the establishment of a national oil company in Canada called Petro-Canada; that, I believe, was done for ideological reasons. I have not been convinced yet that Petro-Canada was set up for pragmatic reasons. It was not established out of a burning desire to have a national oil company because other oil companies were not serving Canada well. Rather, I believe it was done out of pure political motivation when, between 1972 and 1974, we had a minority government with the balance of power held by the socialists who forced the sitting

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government into establishing a national oil company as the cost of keeping the government in power over that period of time.

New Times and New Priorities

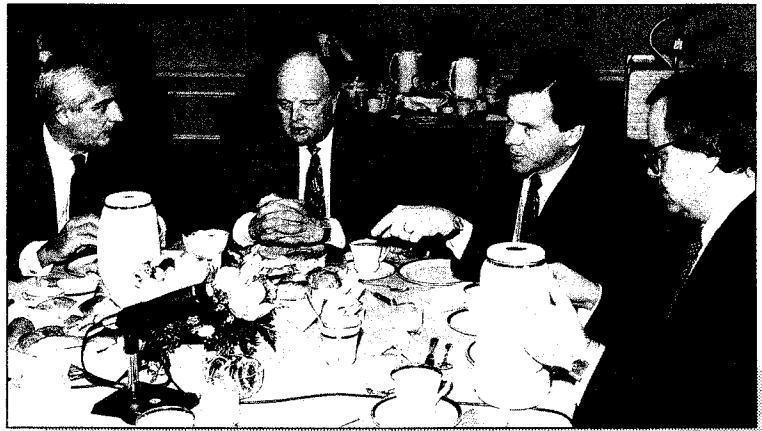
In 1984, when the government of Prime Minister Brian Mulroney came into office, the Canadian economy faced a whole new set of challenges. We were burdened by mounting government deficits at home and tough new competitive pressures in the global marketplace, and we responded with a clearly defined strategy in order to bring federal finances under control, improve our international competitiveness, and strengthen the private sector as the main engine of growth and job creation. Among other fundamental changes, we introduced comprehensive tax reform, including a value added tax, which we call the Goods and Services Tax, and which was probably one of the most difficult and important tax changes that we made. We pursued more liberal international trading rules and we negotiated the historic Canada-U.S. Free Trade Agreement, which is now being expanded to include Mexico.

We deregulated our energy and transportation sectors and transformed a foreign investment review agency that was often hostile to foreign investment, into an investment promotion agency. We also recognized the time had come to privatize some of the larger enterprises in the federal government's portfolio of Crown corporations.

In 1984, the portfolio numbered 61 parent Crown corporations, with assets of more than \$50 billion and 207,000 employees. These companies and their subsidiaries had become a significant presence in our national economy. In the case of companies that were largely, and in some cases entirely, commercial in character, it was time to ask the fundamental question: Was public ownership any longer in the best interest of

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the companies themselves or of the country? And in the case of other companies, it was time to ask whether they could better achieve their objectives at lower cost to the public purse through restructuring and seeking new operational efficiencies. Since 1985, the balance sheet of our privatization program records a considerable success in reducing the involvement of government in the day-to-day running of our economy. We have undertaken 23 privatization initiatives. When I spoke with the finance minister of Mexico, and learned that they have completed some two hundred and seventy privatizations, our number sounds like small potatoes; but for



Seated (left to right) are Ambassador Emilio Cardenas of Argentina, speaker, the Honorable John McDermid, minister of finance of Canada; president, Alan Stoga, Kissinger Associates, Inc.; and Ambassador Johan Straus of South Africa.

Canada, and for the number of Crowns that we had, we feel that we've done extremely well with 23 privatization initiatives. We also wound up 14 other Crown enterprises with limited public policy aims that were costing us money, so we have a total of 37 that have either gone to the private sector or have just been wound up.

Let's consider what they encompass, as some of them are fairly major corporations.

- We sold our national airline, Air Canada, and have initiated the privatization of one of Canada's largest oil companies, Petro-Canada, through public share offerings.

- We have sold two aircraft companies, deHavilland Aircraft and Canadair. Both of these important elements of Canada's aerospace industry are now owned by Bombardier. We initially sold deHavilland to Boeing, and Boeing then sold it to Bombardier with the help of the Ontario provincial government. Bombardier, of course, is a well-known Canadian company with proven technical and marketing expertise. In fact, some of you may have ridden on one of their cars this morning if you took the subway.

- We also sold Teleglobe Canada, a communications and data processing company based in Montreal, to

- We also sold Teleglobe Canada, a communications and data processing company based in Montreal, to Memotech Data, Inc., giving it new opportunities that will help it compete as a world leader in telecommunications.

- Most of the proceeds from these divestitures, which now total more than \$4 billion, had, up until about a year and a half ago, gone into the consolidated revenue fund of the federal government. We've now passed a law stipulating that any money from future privatizations will go into the Debt Servicing and Reduction Account, which is where our Goods and Services Tax, and any gifts that anybody wants to give to the government to reduce the deficit, go as well. Now, everybody laughs at that, but last year about \$400,000 was contributed to

the government of Canada to reduce the deficit, which was a fairly significant amount.

- Through privatization we have transferred 52,000 jobs to the private sector since 1985. At the same time, through operational efficiencies and tighter management, we have cut the payroll in our remaining Crown corporations by another 43,000 employees. As a result, total employment on the part of Crown corporations has fallen by 42 percent since 1985.

Better Management

Developments at two Crown corporations in particular illustrate the kind of improvements we're achieving. Our post office—Canada Post—transformed itself from a chronic drain on the public treasury into a profitable business. In the process, Canada Post has managed to hold increases in its basic letter rate below the rate of inflation, while processing 25 percent more mail with 7 percent fewer employees. It has also taken a leaf from the privatization book by putting many retail counter services into private hands.

I understand that New York is looking at privatizing some of its services. Let me tell you, as a politician one of my greatest headaches in the past was our post office. Having your constituency office right across the road from the post office might have had something to do with it, but I would constantly have irate people coming in and screaming about the post office and the type of service they had received. We have since taken the mail services away from the post office and put them in private sector hands. In many communities, Canada Post's retail services are now provided by private sector franchises. This has improved public access and the level of service.

I come from a commuting community, where people drive into Toronto to work and come home at night. If they received a notice that they had missed the delivery of a parcel, often they had to wait until Saturday morning to pick it up. Now, many of the privately-owned postal offices are open

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during the evenings. They are open Saturdays and some of them are even open Sundays. Furthermore, my constituents get better service because if they don't, the owner of the postal service knows he's going to get the franchise pulled from him, and that it's going to go to somebody else because would-be owners are lined up waiting for these franchises.

So don't buy the ads that you're seeing now in New York, that the private sector cannot do a good job in certain services. There are some services the government has to provide as a government. There are many services, however, that governments have to guarantee are available but don't necessarily have to provide themselves. Instead, they can be provided by



Minister McDermid (left) talks with Meir Baber, Israeli trade commissioner.

the private sector. There are some fine examples here in the United States, including health care in the prison systems of Massachusetts, where you'll find that they get better health care at a much lower cost.

Privatization should not frighten anyone. It certainly hasn't frightened Canadians. The last privatization bill that I put through the House of Commons didn't even get to third reading. And that bill was to privatize a multi-billion-dollar Crown corporation, Telesat. The opposition knew they couldn't stir up enough concern in the country, so they let it go through, and agreed, "We'll debate it until 5:00 and if we haven't finished by then, we'll pass it in any case and send it to the Senate." That's exactly what happened and it illustrates that now the privatization program has a broad base of support in Canada.

The other Crown corporation I wanted to talk about was Canadian National (CN), which was created back in 1919 from an amalgamation of 200 largely insolvent rail companies. It is also making significant strides providing a strong, commercially competitive rail service. Canadian National achieved a 49 percent increase in productivity between 1986 and 1991, through cost-cutting measures such as the rationalization of rail service, employee reductions, and the sale of some of its non-rail businesses, including hotels, truck transport, and communications. It has now set its sights on matching the cost-efficiency of U.S.

railroads by 1997. I can't tell you that CN is a success story yet, but they're heading in the right direction. Canada Post, however, I can cite as a success story; it's showing a profit and is now selling its technology around the world.

The Benefits of Privatization

Taken together, the privatizations that we've undertaken and our efforts to create greater efficiencies in the operations of Crown corporations have convinced us that we're on the right course. First, selling government's corporate holdings improves the efficiency of the companies that are privatized by subjecting them to more market discipline. Freedom to access

private-sector funding and the need to achieve adequate returns tends to make managers focus more closely on cost control, quality, and service to their customers.

Second, privatization creates a fairer marketplace. True competition is obviously difficult to achieve in any sector where publicly-owned industry has a major stake. Almost inevitably, state-owned enterprises are tempted to regard government as a bottomless purse, and their investment decisions run the risk of being made on political, rather than market, considerations. (The other factor that has the post office working well is that we converted it into a Crown corporation instead of a department of government, and took the politics out of it. We still have a minister that answers to the post office in the House of Commons, but he does not interfere in its operations whatsoever.) In addition, firms in the private sector understandably resent having to compete against companies that are funded with their own tax dollars. We saw that in spades with Canadian Airlines and Air Canada, the two major airlines operating in Canada; while Canadian Airlines was in the private sector, Air Canada was in the public sector. Needless to say, Canadian Airlines

strongly encouraged the government to privatize Air Canada.

Third, privatization allows governments to concentrate on governing and reduces the time and resources spent on managing resources that are, in many cases, better managed in the private sector. And, successful privatizations reduce demands on the public treasury. They not only free up scarce resources for other government priorities, but they increase corporate earnings, and thus tax revenues flowing to the government.

Finally, privatization has given Canadians an opportunity to invest directly in major Canadian corporations they previously supported as taxpayers. As well, share ownership plans have allowed employees of privatized companies to participate directly in the success of their companies. When Air

Canada was sold, more than 80 percent of the employees participated in the share ownership plan that was introduced as part of the privatization program, and this participation has helped bring the employees on side in many of these privatizations.

How the Process Works

Let me now turn briefly to a description of how we managed the process. One of the first lessons we learned is that we needed to create a body of expertise and a centralized process within the federal government. So in 1986, the prime minis-

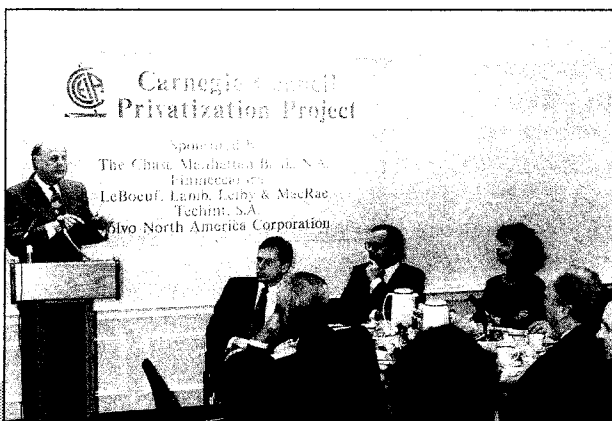
“So don’t buy the ads that you’re seeing now in New York, that the private sector cannot do a good job in certain services. There are some services the government has to provide as a government. There are many services, however, that governments have to guarantee are available but don’t necessarily have to provide themselves. Instead, they can be provided by the private sector.”

ter appointed a minister responsible for privatization. We then established a single organization to implement the process, from the initial assessment of candidates right through to the actual sales. This organization is now the Privatization Branch of the Department of Finance.

In the initial phase, we assess potential candidates on a case-by-case basis against two criteria. The first question we ask is, “Does the corporation serve a public policy purpose for which government ownership is still required?” And since for every sale there must be a buyer, we also ask if the company has the potential to become commercially viable. If the answers to these questions suggest the corporation should and could be sold, a sales proposal undergoes a detailed analysis by our Privatization Branch. If the Cabinet then approves the sale, divestiture legislation is prepared to authorize the sale and, where appropriate, to set limits on individual and/or foreign ownership.

Finally, authority must be received from Parliament before any proposed sale can proceed. This means that privatization initiatives are carefully examined by Parliament in an effort to make the whole process as transparent as possible.

This has really helped us with employee problems. Employees know exactly what we’re planning to do with that firm, how it’s going to be sold, and how they will be treated. It’s all included in the legislation, so it’s very transparent. Unlike some countries that just pass one law granting their governments permission to sell state-owned enterprises, we treat each individually. I think this has contributed to the success of our program in Canada. People have been able to see clearly how we are doing each privatization and, there-



Minister McDermid addressing corporate executives at a Privatization Project breakfast.

fore, they can accept it. Some Crown corporations—our central bank, the Bank of Canada, or the Canadian Museum of Civilization, for example—will obviously never appear on selling lists. We're not, after all, going to sell the family silver. But even so, this does not mean that we are at the end of our program. We are reviewing the feasibility of privatizing additional Crown corporations, and will be announcing new privatization candidates as decisions are made.

I might say, however, that most of the large Crown corporations owned by the federal government have already been privatized. We still have CN, which could be a candidate down the road, once it achieves profitability, and is—pardon the expression—on a better track. A lot of people would also like to see us privatize our national broadcasting corporation, Canadian Broadcasting Corporation (CBC). Yet, there are areas of Canada still served only by the CBC, so to date it does serve a public policy purpose, and I don't think you'll see the CBC on the block in the near future.

We have been able, with our expertise and experience, to help other countries. We have advised 22 countries on the lessons that we've learned in our privatization program, and we've contributed one million dollars to Poland to assist with its privatization program. Also, we've conducted seminars for public- and private-sector executives, both in Poland and in Hungary. Our experience is helping us to redefine the role of government in other ways. A current example, in the area of infrastructure, is an agreement between the federal government and the provincial governments of New Brunswick and Prince Edward Island to build an \$800 million bridge linking our smallest province to the mainland. In an earlier era, governments would probably have seen no alternative but to put up the money for the Prince Edward Island Bridge, and put out contracts for its construction and operate it for the rest of its life. Instead, it will be built by a private developer, who will

recover the cost from tolls and through an annual subsidy equal to what the federal government would have had to pay to continue providing ferry service to Prince Edward Island.

Conclusion

The privatization story continues. Several provincial governments are examining privatization as an option and in a

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number of cases they have already transferred major Crown corporations to the private sector. For example, Alberta has privatized its government-owned telephone company.

We are trying to privatize a number of services currently offered by the federal government. This is an area for which I do not as yet have responsibility, but where I think there is real potential for the private sector to provide the services that government is now providing. We've done one privatization along these lines. The government had a little operation that built all the displays for any of the departments selling their wares around the world, such as at trade shows. We said to the employees, “Look, why don't you buy it? We'll guarantee you work for three years, and then you're on your own.” And they did, and their company has blossomed. They're not only doing government work, but have added additional work from the private sector. Soon they'll be on their own to compete with other companies for government business. That's an area where our new government, which I expect will be elected sometime later this year, should take the challenge and run with it.

It's all about reducing the size of government and giving the taxpayer value for his money. We're making some headway. We've transferred, for example, the responsibilities for managing some of our airports to local airport authorities rather than having the federal government run them. We are examining the most appropriate approach for government to provide a wide range of other services. Economic circumstances change, the objectives of public policy change, and so do the tools to achieve them. Canada's privatization program is consistent with our tradition of balancing public and private initiatives to achieve the best possible benefits for the Canadian public. We believe that it's also helping to shape a stronger, more competitive, and more prosperous Canadian economy in the world we find ourselves in today. ■



Questions and Answers

Q Would you give us a little bit of detail about the postal franchises, such as what areas are covered—I assume these are primarily urban areas—what sort of pricing is used, and other problems between franchise areas?

A Actually, you can't assume franchises are only found in urban areas. Rural areas as well as urban areas are being served by franchised operations. We have had tremendous problems in rural areas in convincing people who have gone to that same old post office for umpteen years—grandfather and great-grandfather and the whole family went there—that closing the post office and providing it through a franchise would provide them with as good a service. However, the post office went ahead with its conversion and after a year our surveys are showing that more than 90 percent of customers feel the service is as good as or better than it was under the old system. In my community of almost 250,000 people, we had only two post offices, and now we have ten or twelve locations throughout the community where people can obtain postal services. They can get their parcels, pick up their registered mail, and obtain most other postal service. In addition, we also have stamp locations, which are not post offices *per se*, but places where you can purchase stamps. I have an anecdote concerning the post office which I want to share with you. We have a neat little package that they sell the stamps in, which contains twenty-five stamps, and they have a picture of the stamp on the cover. One of my constituents cut out the picture on the front, put it on an envelope, and mailed it to himself. The post office delivered the letter, so he then sent it to me, complaining about what a bunch of stupid dolts they were at the post office, to put this through the mail. I'm still trying to figure out what kind of mind would sit and do that type of thing, and I can hardly wait to see the new packages coming out with slashes through the stamp.

Q It appears to me that there seems to be a real hit taken on employment levels. Could you comment?

A Whether we kept Petro-Canada as a Crown corporation or not didn't affect the downsizing; when they were a Crown corporation, they had already done a lot of downsizing. So being a Crown corporation doesn't exclude it from downsizing, restructuring, modernizing, or whatever other terminology you want to use. We as a government expect these Crown corporations to operate as much like a business as possible, without political interference, and without taxpayers' largess going in to prop them up. Today, they're not make-work projects, but back in the old days they were.

In the old post office days, if someone had a buddy, he could get him a job in the post office. That's just the way it used to be. Those days are gone now and there's been tremendous downsizing in a lot of these corporations. But whether they've been private or public, restructuring is going on, and I don't think it has anything to do with the privatization process *per se*. I think it's just a fact of life. I wish we would stop seeing headlines like "Boeing Laying Off 20,000"; and IBM and General Motors as well. I think about what it's doing to the little guy who works at a small company. He is thinking: "The guy at IBM's getting fired; I'm going to be next." Therefore, there's no consumer confidence out there right now. And it's understandable; I think we all feel the same way, and I think that's one of the reasons that this recovery is so slow. When people see this type of thing it frightens the day-lights out of them.

Q I wonder if you'd comment on what you have accomplished with regard to health care and the privatization of any aspect of it to develop the total health-care program you have.

A Our health-care system in Canada is run by the provincial governments, but it's mandated by the federal government. In other words, we have certain criteria that provinces have to maintain, and we are prepared to fund 50 percent of those costs from the federal government.

We are paying approximately 9 percent of our Gross Domestic Product on health care, whereas in the United States you're paying about 14 percent. And if something isn't done here in the United States, it will be 20 percent of your Gross Domestic Product in eight years. I understand President Clinton's concern about health care and his trying to do something about it.

Our system in Canada has problems, too, and I don't want to minimize them: expenses are tremendous, and the pressures for more spending are extremely high. What is different in Canada is that our doctors have a fee schedule that is established by the provinces after negotiating with the doctors. This originally chased a number of doctors into the United States, but a number have come back, and the movement out of Canada to the United States has slowed. But, hospitals are closing beds right now in an effort to try to bring expenses under control. A lot of the hospitals, for example, will close down a portion of their beds over the summer period to meet their budgets. I must say that the doctors, hospital boards, and hospitals have been extremely

responsible in trying to bring costs under control. And because it is a national system, it's a little easier to do than in countries where you don't have a national health-care system in place.

When you say "privatize," you should know that there are private hospitals in Canada, and we have had privatized companies that advise hospitals on their operations and organization. But as far as privatizing the system is concerned, no, you wouldn't see that in Canada. Health care is one of the cornerstones of our social policy in Canada. It's jealously guarded by every Canadian, and politicians who talk about major overhaul are doing so at their own peril. People get very nervous when politicians talk that way. Canadians understand that something has to be done to control costs and I believe they are prepared to support what needs to be done, but at the same time they want to assure that health care is accessible and portable, so no matter where you are in Canada, you're taken care of. People also want the cost to be relatively equal across the provinces. It's a pretty good system. If I were redesigning it, I would do some things differently, such as having a deductible, which we don't have. We have first-dollar coverage right across the board no matter what your state in life is.

Q Minister, in the upcoming national election, are you aware of any platform by the other political parties to roll back, restrain, or otherwise interfere with the privatization program?

A No. I haven't seen or heard anything like that from the opposition parties and the reason I say that is because our privatizations have gone so well. As I said, the Petro-Canada privatization didn't even get to the third reading because there was so little opposition to it.

The opposition—and I can speak fairly authoritatively because I was there for a while—will latch on to issues that they can use to motivate the people of Canada to get on their side and go against the government. In other words, if we ever did something about health care, they'd grab that and run with it and never let it go. They're still trying to use the Free Trade Agreement as a political issue in the next federal election, but I think they're going to get into a little trouble because the trade figures are pretty good. As a matter of fact, trade between Canada and the United States constitutes the largest trading block in the world and it has grown very significantly on both sides since the Free Trade Agreement. It has been a win-win situation. ■

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