



THE SCHOOL OF PUBLIC POLICY

SPP Research Papers



Volume 5 • Issue 9 • March 2012

THE ROLE OF CROWN CORPORATIONS IN THE CANADIAN ECONOMY

AN ANALYTICAL FRAMEWORK

Edward M. Iacobucci and Michael J. Trebilcock*
Faculty of Law, University of Toronto

SUMMARY

Government interference in markets arouses heated emotions on both sides of the political spectrum. But the fact remains that governments of all stripes routinely play a direct role in the economy. Motivations run the gamut from the economic (correcting perceived market failures) to the ethical (addressing social injustice) to the nakedly political (ideology or the status quo demands it). This paper offers a highly readable theoretical and practical framework for understanding federal and provincial governments' market interventions in sectors including power generation, alcohol and mail delivery. Public ownership can advance a range of normative objectives, so the choices, reasons and outcomes for the government, the Canadian economy, Crown corporation employees and the general public can vary as widely as the enterprises involved. But in asking why and how and assessing ways and means, the authors bring together a substantial body of knowledge and expertise, providing an essential guide to a phenomenon that, like it or not, will remain a major part of Canada's economic landscape for a long time to come.

* The authors are grateful to Julia Potter for her invaluable research assistance.

1. INTRODUCTION

Why and how a government decides to intervene in a market are important questions given the impact these decisions have on economic efficiency and social welfare. In this paper, we discuss the reasons why a government would intervene, and, if so, why it would choose one instrument over another. We focus in particular on the role of state-owned enterprises (Crown corporations), though one cannot appreciate the case for such an instrument of state influence without considering the alternatives.

The main objective of this paper is to offer a framework for evaluating the policy advantages and disadvantages of Crown corporations. Because of the broad sweep of considerations and approaches that might influence thinking on public ownership, general conclusions about whether public ownership or privatization is appropriate are not available. It will often depend on the normative values that one seeks to promote, and in all cases will depend on the particular context. As we discuss, however, political, rather than normative, influences can interfere with the choice to privatize or nationalize an industry, and a deeper understanding of what normative arguments support or discourage the existence of Crown corporations may be helpful in exposing the weakness of certain politically motivated positions on the question.

Section II sets out the major rationales for intervention: for efficiency, ethical, or political reasons. Section III addresses the different types of instruments available to a government and the theoretical benefits and drawbacks of each: tighter control through ownership in its various forms, or less influence through regulation of the private sector. Section IV focuses on Crown corporations in Canada and compares governmental ownership with different approaches in various jurisdictions. Lastly, Section V describes proposals for reform, including discussion of why privatization of Crown corporations is often socially desirable but political considerations prevent it.

II. RATIONALES FOR GOVERNMENT INTERVENTION IN THE ECONOMY

A: Efficiency Rationales

Efficiency is achieved in markets with perfect competition, no externalities, no public goods, and perfect information. Here, competition among suppliers drives the market price to marginal cost. For such markets, there is no need for government intervention (beyond protecting property rights and enforcing contracts). However, as Greenwald and Stiglitz discuss, no existing market meets all of these criteria perfectly and thus none is perfectly efficient.¹ Perhaps reflecting this reality, government involvement occurs in nearly every industry, but to different degrees since markets diverge from ideal conditions in different ways and degrees. Of course, government intervention is itself rarely formulated and implemented perfectly either, implying that most policy choices are made in a second-best world. For example, government actors may be prone to the same kinds of bounded rationality that plague private choices, which might make one sceptical about the wisdom of government intervention on paternalism grounds. But there are a variety of market failures that government intervention could conceivably, even if

¹ Bruce Greenwald & Joseph Stiglitz, "Externalities in Economies with Imperfect Information and Incomplete Markets," (1986) 101:2 *Quarterly Journal of Economics* 229.

not always in practice, address in socially beneficial ways. Natural monopolies, markets with externalities, markets for public goods, and markets with imperfect information may all justify government involvement on efficiency grounds. Each of these economic rationales for intervention will be briefly sketched below.

1. NATURAL MONOPOLY

A monopoly is characterized by a single enterprise having a sufficient market share to the point where it has the power to reduce output and increase the market price of the good or service provided. Monopolies can arise through mergers and increases in market share, or naturally. A natural monopoly exists where economies of scale are such that average costs fall with each additional unit produced. In such industries, the market will tend to result in a single producer since a larger producer always has a cost advantage over a smaller producer. Examples of such industries are electricity transmission and distribution and urban or municipal water supply, which require a large investment in capital equipment to set up methods of delivery to consumers and it is inefficient for competing firms to make duplicate investments. Natural monopolists, operating in a profit-maximizing capacity, will restrict output and raise prices above marginal cost. Government therefore may have a role in restricting this socially undesirable outcome through regulation or public ownership.

2. EXTERNALITIES

Externalities — spillover effects that affect third parties — are frequently relied on to justify government involvement in markets. Externalities are either benefits or costs that are realized by parties outside a particular exchange. Positive externalities may need to be encouraged by the government because in a laissez-faire free market they are likely to be under-produced. Self-interested actors are not willing to pay for benefits that others will receive. An example of a positive externality is having children inoculated, protecting both the specific child as well as broader society against infection. Another important example is intellectual property. Ideas which are essential to technological innovation and economic growth are often widely accessible. Innovations by one firm can be used by competing firms, and this may reduce incentives for enterprises to spend resources on developing innovations. To preserve these incentives, the government protects ideas through intellectual property right laws so that the inventor can profit from the idea before it spreads through the economy. On the other hand, negative externalities need to be restricted in a laissez-faire economy. In this case, they are overproduced because their cost is not fully borne by the person that creates them. A common example is air or water pollution.

Ronald Coase showed that, where transaction costs do not exist, government involvement is not required in cases of externalities because bargaining between self-interested actors can result in an efficient outcome even in the presence of externalities.² However, as Coase also stressed, the conditions under which this theorem holds, especially very low transaction costs, may often not exist. Therefore government intervention is often needed to promote or discourage positive and negative externalities by creating schemes for internalization of the externalities.

² Ronald Coase, "The Problem of Social Cost," (1960) 3 *The Journal of Law and Economics* 1 [Coase].

3. PUBLIC GOODS

A public good is one that is both non-rivalrous and non-excludable; it is a good that may be consumed simultaneously by people who cannot be excluded from enjoying such consumption. Public goods invite a free rider problem in which individuals will seek to take advantage of the benefits of having the good without the disadvantage of paying for it. As a result, there will be a tendency for the good to be underprovided.³ An example is the protection provided by the armed forces or police or fire services. Such protection cannot be offered only to certain individuals who have paid for it. Therefore the government has an important role in ensuring that these essential services are provided.

4. INFORMATION ASYMMETRIES

Another cause of market failure is information asymmetries. The government may have a role in protecting the consumer through the reduction of these information asymmetries. Experience goods are those for which the quality cannot be determined until after purchase and use. In this case, a buyer has less information than the seller about the quality of the good, which leads to distortions in the market resulting in lower-quality goods being sold and fewer exchanges overall than if there were perfect information.⁴ Akerlof famously used the used automobile industry to illustrate these distortions.⁵ If quality is indistinguishable to the buyer at the time of purchase, then this quality level may be estimated based on the average quality of cars for sale in the market. But then sellers of above-average cars are reluctant to sell and may drop out of the market. The result of such information asymmetry is a crowding out of high-quality cars and fewer cars being exchanged.

The market may be able to correct market asymmetries to some extent through the spread of reputational information and the development of brand names, chains (such as restaurant chains), and warranties which signal to the consumers a particular quality of good. However, such mechanisms will typically only resolve informational deficiencies imperfectly, and there will be a tendency for the lemons problem to lead to underprovision of certain goods. These information problems may invite government intervention. The government can also intervene with licensing requirements or regulating or imposing warranties and guarantees for goods.⁶

Credence goods are similar to experience goods but have qualities that cannot be discerned even after purchase or use. One example is pharmaceutical products and their safety and effectiveness. Private entities providing such goods would have an incentive to shirk on quality, as it cannot be detected before and after use.⁷ Therefore there may be a role for government intervention to certify products and services and test them for safety and effectiveness.

³ Michael J Trebilcock & Edward M Iacobucci, "Privatization and Accountability," (2003) 116:5 *Harvard Law Review* 1422.

⁴ *Ibid.*

⁵ George Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," (1970) 84:3 *The Quarterly Journal of Economics* 488 [Akerlof].

⁶ *Ibid.*

⁷ *Supra* note 3

There may also be circumstances in which government intervention is helpful in overcoming problems with insurance markets resulting from asymmetric information. Insurance can result in adverse selection; customers who are most risky are most likely to purchase insurance, thus driving up the price of insurance, which can result in the unravelling of such markets as better risks choose not to buy insurance. Government provision of insurance, such as with public health insurance, can avoid this problem by compelling all citizens in effect to buy insurance. Government regulation can also mitigate adverse selection, as with automotive insurance markets where provinces require all drivers to buy insurance (perhaps from a monopolistic state insurance provider, as in the case of British Columbia).

B. Ethical Rationales

In addition to efficiency explanations for government involvement, governments may have other justifications for intervening in markets including distributive justice, communitarianism, corrective justice, and paternalism.

1. DISTRIBUTIVE JUSTICE

The government may have objectives beyond making markets operate efficiently. While a market may deliver an efficient outcome, this outcome may result in a substantially unequal distribution of wealth. Utilitarianism advocates that resources should be distributed to maximize the aggregate utility, welfare, or happiness of members of a society.⁸ Government involvement, according to this perspective, may increase utility of the worse off more than it decreases the utility of the better off and so even when outcomes are efficient, redistribution still increases society's overall utility. Those who are better off may also be empathetic to the suffering of others and thus may be willing to support redistribution policies increasing their overall utility even as their material resources are reduced.⁹

The Rawlsian perspective focuses instead on the liberty principle and the difference principle. The liberty principle prescribes that each person should "have an equal right to the most extensive basic liberty compatible with a similar liberty for others."¹⁰ The difference principle, on the other hand, states that distributive policies should benefit the most disadvantaged in society.¹¹ If there is a priority in society for equality, then the government can use redistributive policies to improve it. Involvement may go beyond taxes and transfers to include more direct forms of interventions.

⁸ Edward M Iacobucci, Michael J Trebilcock & Huma Haider, *Economic Shocks: Defining a Role for Government* (Toronto: CD Howe Institute, 2001) at 43 [Economic Shocks]; Louis Kaplow and Steven Shavell, *Fairness Versus Welfare* (Harvard University Press, 2002).

⁹ *Ibid* at 44.

¹⁰ J Rawls, *A Theory of Justice* (Cambridge, Mass: Harvard University Press, 1971)

¹¹ *Ibid*.

2. COMMUNITARIANISM

Communitarianism asserts that each member of society has social responsibilities and duties to enhance the good of society based on an idea of communal ethics.¹² This includes the assurance of equality and economic security for all members of society. While distributive justice theorists and communitarians both support equality, their underlying values may be quite different. Communitarians argue not simply for equality and economic security for their own sakes, but because it is important for social solidarity.¹³ Distributive justice allows for self-interested behaviour and a corrective strategy to redistribute resources, but communitarianism sees self-interested pursuits as selfish and detracting from the strength of the community. Therefore government involvement is necessary to protect these communal interests, for example through the universal provision of basic services such as health and education. The universality aspect is important since it includes the wealthy as well, whereas distributive justice only protects the worst off in the community.¹⁴ The regulation of programming in the broadcasting sector by the Canadian Radio-television and Telecommunications Commission (CRTC) is an example of government regulation for communitarian reasons. The CRTC ensures that broadcasting in Canada exhibits Canadian creativity and talent, bilingualism, multicultural diversity, and the unique role of aboriginals in Canada.¹⁵ The mandate of the Canadian Broadcasting Corporation (CBC) reflects a similar rationale.

3. CORRECTIVE JUSTICE

Corrective justice is another non-economic rationale for government to intervene in markets. The government can ensure compensation for parties through the civil justice system for the torts of negligence or nuisance in order to correct wrongs that have been committed. In this way, the party that has suffered receives the value of what was taken. Private law ensures reimbursement between two private parties that does not involve the government and for public negligence when the government compensates a party that has suffered a wrong as a result of government action.¹⁶

Another area in which corrective justice occurs is in takings of property from individuals by the government, which requires compensation in order to restore the equality between the property owner and the government.¹⁷

4. PATERNALISM

The government may also wish to place limitations on the autonomy of individuals in society to reduce potentially self-destructive consequences of their otherwise voluntary choices. Certain categories of people have widely been deemed to require protection, such as minors and the mentally disabled. In addition, the government may wish to influence individual behaviour on a broader scale.

¹² Richard S Gilbert, *How Much Do We Deserve?* (Lanham: University Press of America, 1991).

¹³ Albert Weale, "Equality, Social Solidarity, and the Welfare State," (1990) 100:3 *University of Chicago Press* 473.

¹⁴ *Economic Shocks*, *supra* note 8 at 54.

¹⁵ Lawson AW Hunter, Edward M Iacobucci & Michael J Trebilcock, "Scrambled Signals: Canadian Content Policies in a World of Technological Abundance," (2010) 301 *CD Howe Institute Commentary* 1.

¹⁶ *Economic Shocks*, *supra* note 8 at 50.

¹⁷ *Ibid* at 51.

Individuals sometimes make unfavourable choices due to coercion or information failures. If a decision is coerced through duress, subtle manipulation, pressure from unequal bargaining powers, etc., then the government may wish to adopt laws that nullify decisions made based on those factors.¹⁸ Information failures, such as ignorance of factual circumstances or consequences and temporarily distorting states such as intoxication, can also result in inconsistent choices, which the government may want to intervene to prevent.¹⁹

The government may also want to curb bad or self-destructive behaviours such as narcotics use or not wearing helmets while riding a motorcycle.²⁰ Laws that regulate such behaviours infringe upon the liberty of individuals in order to protect those individuals.

Paternalism can be hard or soft. Hard paternalism occurs when the government bans outright an activity. Soft paternalism instead leaves a choice for the individual but seeks to guide that choice to the socially optimal one. For example, using an opt-out structure for pension schemes has greatly increased the enrolment rate in pension plans. With an opt-in scheme, individuals who have yet to decide whether a pension plan is optimal for their situation may not take the steps to enrol themselves as a result of inertia or myopia. This can be altered by making the default setting enrolment, so that while the freedom to opt-out exists, many will not use it.²¹

The boundaries of the proper scope for paternalism by government are vigorously contested. Opponents of paternalism, such as John Stuart Mill, argue that those who are capable of making voluntary decisions should have that opportunity without government influence so long as they are not harming others.²²

C. Political Rationales

1. PUBLIC CHOICE THEORY

While the previous rationales have all identified normative reasons for possible government intervention in economic activities, public choice theory is a positive analysis of government involvement which seeks to explain why governments may decide to intervene in markets because of the self-interested behaviour of governmental and private actors, notwithstanding the absence of a compelling normative rationale. Like private actors, politicians are assumed to be self-interested. They need to continue to attract the support of their electorate in order to remain in power, which requires resources, including both organizational and financial support.²³ Private interest groups can use this desire of governmental actors to promote their own agendas. The most effective interest groups are likely to be those that have large stakes, significant resources, and strong organizations. These groups can provide the politician with the resources needed to attain or retain political office, either through votes or financial support.²⁴ Therefore an exchange relationship is created; politicians achieve political office

¹⁸ Michael J Trebilcock, *The Limits of Freedom of Contract* (Cambridge: Harvard University Press, 1997) at 152.

¹⁹ *Ibid.*

²⁰ *Ibid* at 160-161.

²¹ Richard H Thaler & Cass R. Sunstein, *Nudge* (New Haven: Yale University Press, 2008).

²² John Stuart Mill, *On Liberty* (London: John W Parker and Son, 1859).

²³ Steven Croley, *Regulation and Public Interests: The Possibility of Good Regulatory Government* (Princeton: Princeton University Press, 2008) ch. 1.

²⁴ *Ibid* ch 2 at 18.

through furthering the objectives of powerful interest groups. This is not a system that can be easily exploited by broad or diffuse groups, which are less able to lobby for their own interests because of information and collective action problems.²⁵ Unlike in economic markets, citizens cannot easily express their distaste for particular actions or outcomes but instead have only an all-or-nothing decision through their vote. These opportunities to elect politicians are infrequent and often are not tailored to express concerns over specific issues. It is often unclear what the political candidate's position is on regulatory issues and many policies are being evaluated in one vote. Therefore interest groups that are more concentrated and able to pursue their narrowly focused objectives are favoured over the larger public interest, even if the losses to broader interests are greater than the benefits received by concentrated interest groups. Thus instead of attaining social objectives, which benefit the public at large, this process works to the detriment of overall society. In this way, the government's involvement may in fact exacerbate the market failures or fairness concerns described above rather than alleviate them.²⁶

2. PATH DEPENDENCY

Once governments are involved in a market or industry, there is a powerful tendency to persist on the same course. This is known as path dependency. Political concerns can explain this reluctance to change the status quo. One fundamental feature of politics is the positive feedback mechanism in which expectations adapt over time.²⁷ As a result, organizations have a strong tendency to persist once they are institutionalized. North argues that this reinforcement is due to the increasing returns that are prevalent in the political context.²⁸ Adaptive expectations, learning effects, network effects, and high start-up costs all increase stakes in preserving existing institutional arrangements rather than switching to new forms.²⁹ Path-dependence is not all-powerful, however, as the general trend in Canada in favour of privatization suggests. Changes in thinking, and/or changes in economic conditions, and especially events like fiscal crises, may have significant effects on policy despite path-dependence.

3. GOVERNMENTAL REVENUE CONSIDERATIONS

Another major factor influencing governments in deciding whether to privatize Crown corporations is the tax treatment of the privatized entity. While the tax issues are complex, a major issue will be the impact on government revenues post-privatization. For example, most provincial Crown corporations in Canada are exempt from most taxes. Following privatization, former provincial Crown corporations will have to pay both federal and provincial corporate income taxes, in effect compelling provincial governments to share revenues with another level of government that formerly accrued to them alone. This is likely, in many contexts, to affect the privatization calculus.³⁰

²⁵ *Ibid* at 20.

²⁶ *Ibid* ch 1 at 9.

²⁷ Paul Pierson, "Increasing Returns, Path Dependence, and the Study of Politics," (2000) 94:2 *The American Political Science Review* 251 at 251.

²⁸ Douglas North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990).

²⁹ Mariana M Prado & Michael J Trebilcock, "Path Dependence, Development, and the Dynamics of Institutional Reform," (2009) 59:3 *University of Toronto Law Journal* 341.

³⁰ Jack Mintz, Duanjie Chen & Evangelia Zorotheos, "Taxing Issues with Privatization: A Checklist," (2000) *The World Bank Policy Research Working Paper* 2348.

III. INSTRUMENTS OF INTERVENTION

Once a government has decided to intervene in a market for any of the reasons described above, the method of intervention or choice of instrument is the next consideration. A government may choose a particular instrument ranging from the most extensive form of control by government departments to highly targeted intervention in private market activity. We discuss each of these instruments and address key factors influencing a government's decision to choose public ownership or a private sector alternative.

A. Publicly Owned Enterprises

The *Financial Administration Act (FAA)* outlines the legal framework for the financial administration of Canada's government and the accountability of publicly owned organizations. Budget approval requirements are imposed pursuant to this Act.³¹ Different schedules of the Act list types of publicly owned organizations, classified as departmental bureaucracies, statutory and other agencies, departmental corporations, and Crown corporations. The entities listed under each schedule are subject to different ways in which government spending may be approved, expenditures made, revenues obtained, and funds borrowed.³² We review each type of organization in turn.

1. DEPARTMENTAL BUREAUCRACIES

Government departments are created by Acts of Parliament and deliver programs and policies of the government. They exercise extensive control over a wide range of policy concerns such as defence, foreign affairs, and health.³³ They differ by size, organizational structure and geographical dispersion depending on the nature and breadth of their roles. There are two types of departments. Central agencies such as the Treasury Board and Public Service Commission provide common services and oversight of line departments; line departments deliver specific programs in a policy field such as transportation, agriculture, and labour.³⁴ Departments are listed under Schedule I of the *FAA*.³⁵

There are also special operating agencies within some departments which are established to provide specific services or particular operational functions, and while many operate commercially, profit generation is not required.³⁶ Managers and staff of the agency have public

³¹ Treasury Board of Canada Secretariat, *The Financial Administration Act: Responding to Non-compliance – Meeting the expectations of Canadians*, (Ottawa: TBS, 2005) at 5, online: <<http://www.tbs-sct.gc.ca/report/rev-exa/faa-lgfp/faa-lgfp03-eng.asp>> [TBS Financial].

³² *Ibid.*

³³ Treasury Board of Canada Secretariat, *Annual Report to Parliament – Crown Corporations and Other Corporate Interests of Canada 2010*, ch 1 (Ottawa: TBS, 2010) at 4, online: <<http://www.tbs-sct.gc.ca/reports-rapports/cc-se/2010/cc-se-eng.pdf>> [TBS Annual].

³⁴ Alex Smith, "The Roles and Responsibilities of Central Agencies," (2009), Library of Parliament at 1, online: <<http://www.parl.gc.ca/Content/LOP/researchpublications/prb0901-e.htm>>.

³⁵ *TBS Annual*, *supra* note 33 at 3.

³⁶ Treasury Board of Canada Secretariat, *Becoming a Special Operating Agency*, (Ottawa: TBS, 1998) at 7, online: <http://www.tbs-sct.gc.ca/pubs_pol/oepubs/tb_b4/bsoa-doss1-eng.asp#note2> [TBS SOA].

service employment status and are required to operate within public service legislation such as the *Public Service Employment Act* and the *Public Service Staff Relations Act*.³⁷ Special operating agencies are not separate legal entities and as such are not listed in the *FAA*.³⁸ An example is the Canadian Conservation Institute within the Department of Canadian Heritage.³⁹

2. STATUTORY AND OTHER AGENCIES

Like departments, statutory and other agencies are financed through parliamentary appropriations but they carry out specialized administrative, supervisory, advisory, regulatory, or adjudicative functions. These organizations are listed under Schedule I.1 of the *FAA*.⁴⁰ For example, the Canadian Transport Agency, a quasi-independent regulatory agency, falls into this category.⁴¹

3. DEPARTMENTAL CORPORATIONS

Departmental corporations are established by legislation and are financed through parliamentary appropriations and sometimes user fees. They deliver services, perform research, or regulate industries and are governed by a governing council or management board.⁴² The President of the corporation reports to the Minister of the Department, and this Minister has the ultimate responsibility for strategic policy and planning.⁴³ These corporations are listed under Schedule II of the *FAA*.⁴⁴ Examples include the Canada Border Services Agency, the National Research Council of Canada, and the Canadian Nuclear Safety Commission.⁴⁵

Departmental corporations that deliver services are called service agencies. They are set up to execute a highly operational task or service where private sector competition is frequently absent. Their legislation specifically defines their level of autonomy as well as organizational arrangements and responsibilities.⁴⁶ An example of a service agency is the Canada Revenue Agency.⁴⁷

³⁷ *Ibid* at 8.

³⁸ *TBS Annual*, *supra* note 33 at 3.

³⁹ *TBS SOA*, *supra* note 36 at 24.

⁴⁰ *TBS Annual*, *supra* note 33.

⁴¹ Canadian Transport Agency, "Role and Structure," online: <<http://www.otc-cta.gc.ca/doc.php?sid=1167&lang=eng>>.

⁴² *TBS Annual*, *supra* note 33 at 4.

⁴³ Canadian Food Inspection Agency, "About the CFIA", online: <<http://www.inspection.gc.ca/english/agen/agene.shtml>>.

⁴⁴ *TBS Annual*, *supra* note 33 at 3.

⁴⁵ Treasury Board of Canada Secretariat, News Release, "List of Crown Corporations, Departmental Corporations, and Shared Governance Organizations," (17 Nov 2009) online: <<http://www.tbs-sct.gc.ca/reports-rapports/cc-se/2010/cc-se-eng.pdf>> [*TBS List*].

⁴⁶ *TBS Annual*, *supra* note 33 at 5.

⁴⁷ *TBS List*, *supra* note 45.

4. CROWN CORPORATIONS

Crown corporations are government-owned corporations that provide commercial services. This has prompted their description as “structural heretics.”⁴⁸ Their goals include commercial as well as public policy concerns. Legislation, letters patent, or articles of incorporation under the *Canada Business Corporations Act* (or provincial Business Corporations Acts) establish Crown corporations⁴⁹ and prescribe a corporation’s name, mandate, powers, and objectives.⁵⁰ Unlike departmental corporations, they operate at arm’s length from the government and are governed by a board of directors.⁵¹ Government control may be exerted through the corporation’s budget and the appointment of its chairperson and directors. Crown corporations are listed under Schedule III of the *FAA*.⁵² Schedule III is divided into two parts, the second of which corresponds to corporations that operate in a competitive environment, do not ordinarily depend on appropriations from the government, earn a return on equity, and generally pay dividends. Schedule III, Part I corporations must submit annually for approval by the Governor in Council (on the recommendation of the appropriate Minister) a corporate plan, capital budget and operating budget, while Part II corporations do not need to submit an operating budget, but instead a dividend proposal in the corporate plan.

The government can also only partially own a Crown corporation. In these cases, the government owns some of the shares and the remaining shares are owned either by another level of government (called joint enterprises) or private parties (called mixed enterprises). In either case, the government shareholder is represented by a Minister.⁵³

A Crown corporation can also wholly or partially own subsidiaries. The parent corporation and other shareholders manage and receive reports from the subsidiaries. If they are wholly owned by the government and directed to do so, they may be expected to report directly to the Minister as though they were regular Crown corporations.⁵⁴ Subsidiaries are not listed in the *FAA*.

Agent Crown corporations are forms of Crown corporations that receive privileges and immunities similar to the Crown. This special status is conferred upon the corporation by an act of Parliament and they are listed under Part X of the *FAA*. Their privileges can include federal, provincial and municipal tax exemptions.⁵⁵ An example is Export Development Canada.⁵⁶

⁴⁸ J Hodgetts, *The Canadian Public service 1867-1970* (Toronto: University of Toronto Press, 1971), at Ch 7.

⁴⁹ *TBS Annual*, *supra* note 33, ch 1 at 5.

⁵⁰ *Ibid.*, ch 2 at 13.

⁵¹ *Ibid.*

⁵² *Ibid.*, ch 1 at 3.

⁵³ *Ibid.*, ch 3 at 100.

⁵⁴ *Ibid.*, ch 1 at 5.

⁵⁵ *Ibid.*, ch 2 at 13.

⁵⁶ *Ibid.*, ch 1 at 10.

B. Intervention in Private Enterprise Activity

On the other end of the spectrum, government does not participate in the market/activity directly, but rather intervenes through the use of regulation or the use of taxes and subsidies.

Regulation can apply to prices and rate structures, supply, rate of return, disclosure of information, methods of production, and characteristics of the quality of a good or service.⁵⁷ Regulation can be administered directly by government departments or it can be delegated either to arm's length agencies (statutory regulatory agencies) or to the industry itself.

Direct regulation by a governmental department varies. The role and discretion of the regulator depends on its mandate and can be limited or broad.⁵⁸

Statutory regulatory agencies vary based on appointment procedures (at pleasure or fixed terms), public participation (rights of access to information, for example), and external relations (the scope for judicial review, the scope for executive or legislature intervention in agency decisions, budget approvals, regular reporting responsibilities, and reviews of agency performance). The government can tailor these agencies to perform such specific functions as analyzing technically complex issues requiring specialized expertise or balancing competing sets of interests.⁵⁹

Self-regulation of an industry is another method of regulation. This can reduce governments' regulatory costs for monitoring, collecting information, taking corrective action, and enforcement. Professions are often regulated in this way in part because self-regulation can help establish trust for activities where trust relationships are significant. Health-care professionals are a case in point.⁶⁰ Self-regulation may entail offsetting social costs because of the self-interest of the regulators.⁶¹

An alternative to regulation is the use of taxes and subsidies to alter the behaviour of firms and industries. Taxes are compulsory payments made to a government that are imposed by law. For example, in 2008 British Columbia implemented a revenue-neutral carbon tax, which puts a price on emitted tonnes of greenhouse gases to provide incentives to reduce negative externalities from burning fossil fuels.⁶²

Subsidies may also be designed to influence incentives, and may be paid by government to producers in an industry to prevent its decline or to achieve other policy goals such as raising wages or increasing employment. A government can also use subsidies for distributional reasons.

⁵⁷ See chapter 7 on Regulation by Michael J Trebilcock et al, *The Choice of Governing Instrument* (Ottawa: Minister of Supply and Services Canada, 1982) [Trebilcock et al].

⁵⁸ *Ibid* at 88.

⁵⁹ *Ibid* at 89.

⁶⁰ *Ibid* at 91.

⁶¹ Michael J Trebilcock, Carolyn J Tuohy & Alan D Wolfson, *Professional Regulation: A Staff Study of Accountancy, Architecture, Engineering and Law in Ontario Prepared for the Professional Organization Committee* (Toronto: Ministry of the Attorney General, 1979).

⁶² Ministry of Finance, "What is a Carbon Tax?" (29 June 2010), online: British Columbia <<http://www.gov.bc.ca/>>.

C. Public Ownership versus Intervention in Private Enterprise Activity

The primary benefit of government (public) ownership is greater government control, most importantly over policy matters, whereas the primary benefit of leaving control in the private sector is efficiency. As we discuss, ownership and competition effects favour intervention in private markets over public ownership, but these effects are partially offset by monitoring and enforcement costs. These trade-offs are likely to have an impact on government's choice of instrument.

1. The Ownership Effect

One reason why public ownership of a firm is usually less efficient than privately owned firms is that it is more difficult to align the interests of management with those of the owners (the public).⁶³ The ideal structure for ensuring efficient operating of firms is to have the owner operating the firm. In this situation, incentives are aligned since efficiency gains are enjoyed directly by the owner/operator.⁶⁴ Large firms expand this structure by separating multiple owners (shareholders) from professional managers who operate the firm. As a consequence, managers have weaker incentives to perform efficiently since the efficiency gains do not benefit them directly.⁶⁵

In the private sector, shareholders have several tools to align manager and shareholder interests and reduce these so-called agency costs. Shareholders have the ability to monitor actions of managers and then incentivize their better performance through the use of such commonly available and measurable indicators of firm performance as profitability, market share, and stock prices. These indicators can be traced over time and compared with those of competitors as benchmarks for efficiency.⁶⁶ For example, if share value is not meeting the expectations of the shareholders, they have the power to remove directors of the corporation. Shareholders can also use these indicators to establish manager compensation.⁶⁷

In addition, the market itself gives rise to natural consequences from poor managerial performance, namely the threat of hostile takeover or bankruptcy. If the share value falls, the firm may be taken over by another firm seeking to manage it more efficiently, or it may go bankrupt, which threatens the manager's future employment, creating an incentive for the managers to work toward maximizing share value.⁶⁸

Unlike private enterprises, public agencies do not have profit maximization as their sole objective and there is no potential for bankruptcy or hostile takeover.⁶⁹ Unlike shareholders who can modify their investment in a company based on performance, citizens pay taxes whether or not the goods and services offered are desired or are being optimally produced.

⁶³ Roy Hrab, "Privatization: Experiences and Prospects," (2003) Panel on the Role of Government at 5 [Hrab].

⁶⁴ Andrew C Smith & Michael J Trebilcock, "State-Owned Enterprises in Less Developed Countries: Privatization and Alternative Reform Strategies," (2001) 12 *European Journal of Law and Economics* 217 at 220 [Smith & Trebilcock].

⁶⁵ *Ibid.*

⁶⁶ Hrab, *supra* note 63.

⁶⁷ *Ibid.*

⁶⁸ Smith & Trebilcock, *supra* note 64.

⁶⁹ John Vickers & George Yarrow, *Privatization: An Economic Analysis*, (Cambridge: The MIT Press, 1988) at 27.

Citizens are also far less able to monitor managerial performance due to difficulties in gaining information on the efficiency and quality of production and in taking collective action.⁷⁰ Additionally, politicians are less directly motivated to ascertain information about the quality of service provided but may actually hide inefficiencies to reduce political costs.⁷¹

Benchmarks or indicators of performance (e.g., profit, market share, and stock value) also cannot be easily utilized because of the influence of diverse policy goals on performance. These work against using market outcomes to incentivize efficient managerial performance or to offer competitive compensation to attract and retain skilled management personnel. This can contribute to government appointments being made based on political considerations rather than merit.⁷²

Public sector corporations have additional misalignment challenges because of their political nature. The self-interest of politicians may diminish their interest in incentivizing efficiency because they can benefit from short-term decisions rather than long-term performance. For example, some services may attract increased spending during election periods to win the favour of voters. Public choice theory suggests that managers of government-owned enterprises (and bureaucracies more generally) endeavour to maximize budgets, rather than efficiency, in order to promote their own income, power and prestige.⁷³ Changes in government can also produce instability with respect to funding which can affect the quality and quantity of the good or service provided and can impede long-term planning.⁷⁴ This also exacerbates the inefficiency of government firms.

All government ownership is prone to these sources of inefficiency. Of the various kinds of ownership discussed above, however, Crown corporations likely perform best along this dimension. Crown corporations are subject to market pressures, including profit and capital budget pressures, to which more internal governmental organizations are not subject.

2. THE COMPETITION EFFECT

In the private sector, competition enhances internal efficiency as firms seek to capture a larger market share from other competing firms, or at least avoid loss of market share or even bankruptcy. This provides a strong incentive to minimize costs and also develop specialized skills, expertise, and technologies.⁷⁵ Competition also ensures that a large portion of the benefits of increased efficiency is passed on to consumers. In a monopoly, the monopolist still seeks efficiency in order to maximize profits, but allocative efficiency is attenuated due to lack of competition and incentives to reduce output and charge supra-competitive prices.

⁷⁰ Michael J. Trebilcock, *The Prospects for Reinventing Government* (Toronto: C.D. Howe Institute, 1994) at 11.

⁷¹ Hrab, *supra* note 63 at 7.

⁷² Smith & Trebilcock, *supra* note 64.

⁷³ William Niskanen, *Bureaucracy – servant or master? Lessons from America* [by] William A. Niskanen, with commentaries by [others] (London: Institute of Economic Affairs, 1973); Trebilcock *et al*, *supra* note 63 at 13.

⁷⁴ Hrab, *supra* note 63 at 8.

⁷⁵ *Ibid*.

In the public sector, the benefits of competition are reduced whether there are competitors or not. Where publicly owned enterprises face private sector competitors, for example in electricity generation, public firms are subject to similar competitive pressures to private firms, but may not be as responsive to these pressures because of other policy goals and soft budget constraints.⁷⁶ They may be efficient enough to retain market share, but less efficient than their profit-maximizing competitors. To simulate private sector firms and further increase efficiency, a hard budget constraint can be imposed on publicly owned enterprises, introducing the threat of bankruptcy if they do not generate sufficient revenue, but even with such a constraint managers lack the incentive to increase efficiency over and above the point of cost recovery. It is also possible that imposing a hard budget constraint will be infeasible or non-credible given the public policy goals of government-owned enterprises.⁷⁷

However, since many publicly owned enterprises are legislated or natural monopolies or have no viable competitors in the private sector, they do not face the same cost-minimizing and innovative imperatives as private sector monopolies. These inefficiencies may exacerbate the problems associated with private sector monopolies so that the change to public ownership may actually be more detrimental than leaving the industry in the private sector (albeit regulated).⁷⁸

3. MONITORING AND ENFORCEMENT COSTS

While private sector enterprises may yield efficiency gains through the ownership and competition effects, these gains are partially offset by governments' monitoring and enforcement costs to ensure that governmental policy goals are met.

The costs of setting up and implementing these instruments of intervention in the private sector are analogous to those of the private sector described in Ronald Coase's theory of transaction costs⁷⁹ that private sector firms incur when they themselves outsource their operations. Coase developed a theory of the firm to explain when firms internalize input coordination as opposed to relying on independent contracts between entrepreneurs and input owners. He argued that transaction costs from external transactions, such as the costs of negotiating and enforcing contracts to coordinate production processes, help explain the existence of the firm. Internalization can reduce contracting and monitoring costs through purchasing the right to direct the allocation of production. On the other hand, internalizing production suppresses the price mechanism and may lead to distortions in intra-firm processes.⁸⁰

Applying the theories of Coase, governmental decision-makers face analogous transaction and enforcement costs to those of their private sector counterparts when choosing whether to own, or to regulate, tax, subsidize or otherwise influence the behaviour of private sector firms. For example, if government decides to regulate private firms, then it needs to monitor and enforce compliance because private firms may have a profit incentive to violate or circumvent the

⁷⁶ *Ibid* at 10.

⁷⁷ *Ibid*.

⁷⁸ *Ibid* at 9.

⁷⁹ Ronald Coase, "The Nature of the Firm," (1937) 16 *Economica* 386.

⁸⁰ *Coase, supra* note 2.

imposed regulations, a profit incentive which public entities would not share to the same extent.⁸¹ Similarly, if government contemplates providing subsidies to a particular industry (for example, to promote job maintenance in the industry), it must obtain and validate information about the industry to justify current and potential future subsidies. This information may be difficult to specify precisely. Examples of such information include: firm costs; conditions prevailing in the firm's output markets; the potential for the firm substituting more efficient technology in the long run; and the likely effects of continuing subsidies on the incentives of the owners of the firm to improve the performance of the firm. Indeed, firms, which have superior access to relevant information, may act strategically and misstate or conceal information to obtain larger subsidies.⁸² Consequently, government monitoring and enforcement can be costly and imperfect, influencing the cost-benefit analysis of ownership versus subsidies. The more complex a government's policy objectives and the less static these objectives are, the greater the challenges in regulating private firm behaviour through a stable, predictable legal orders regime.

On the other hand, if the government chooses to provide the good in question itself, it faces the problems associated with the suppression of market influences on managerial behaviour discussed above. Governments may have better information than when regulating, for example, but may choose to ignore this information in pursuit of political self-interest.

Hart, Shleifer and Visny focus on tradeoffs between quality of service and cost to explain when a government should provide a service through ownership. According to their model, there will usually be contractual incompleteness when a government purchases services externally. Contracting parties cannot fully specify the quality of service, and often objectives are subject to unforeseeable contingencies at the time of contract formation. Hypothetically, with contractual completeness, the government could achieve the same outcome no matter the choice of instrument. Without it, however, private contractors are able to shirk on quality in order to cut costs without breaching their contracts, thus undermining the goals of the government. An extreme example, illustrating the problem of contracting out to the private sector, is the formulation and implementation of a country's foreign or defence policy because they serve complex objectives and are based on unforeseeable contingencies. Overall, their model suggests that government ownership provision is advantageous when non-contractible cost reductions have large adverse effects on quality, when quality innovations are unimportant, and when governmental corruption in procurement is a severe problem. On the other hand, the case for privatization is stronger when quality-reducing cost reductions can be controlled through contract or competition, when quality innovations are important, and when patronage and powerful unions are a severe problem inside the government. They find that in-house provision removes the tendency to shirk on quality through extreme cost reduction but replaces that tendency with a weaker incentive to engage in both effective cost reduction and quality improvement.⁸³

⁸¹ *Trebilcock et al, supra* note 37 at 76.

⁸² *Ibid.*

⁸³ Oliver Hart, Andrei Shleifer & Robert W Vishny, "The Proper Scope of Government: Theory and Application to Prisons," (1997) 112:4 *The Quarterly Journal of Economics* 1127.

Shleifer, in a slightly later paper, distinguishes a narrow set of circumstances in which government ownership is likely to be superior: “1) opportunities for cost reductions that lead to non-contractible deterioration of quality are significant; 2) innovation is relatively unimportant; 3) competition is weak and consumer choice is ineffective; and 4) reputational mechanisms are also weak.”⁸⁴

The tradeoffs between ownership and competition effects on the one hand, and monitoring and enforcement costs on the other, provide a template for analyzing whether public or private provision with or without regulation is socially preferable in any given circumstance. Clear answers are not always available, but the framework provides the right kinds of questions. As a positive matter, public choice theory explains why the rent-seeking behaviour of firms and interest groups and the self-interested behaviour of politicians and bureaucrats can lead to a choice of instrument that may not serve the public best in terms of economic efficiency or social objectives. While the theories above provide reasons for government choice to own or to regulate, subsidize, or tax an industry, they may be counteracted by self-interest and competing motives of political and bureaucratic actors who may, as a result, choose different forms of intervention.

IV. DEFINING AN APPROPRIATE ROLE FOR CROWN CORPORATIONS

A. Natural Monopoly

Industries with natural monopoly features have been prime candidates for government intervention. Historically, these industries included telecommunications, electricity (generation, transmission, and distribution), airlines, railways, and urban and municipal distribution of water. While many of these industries still exhibit natural monopoly properties, others no longer do so because of technological changes (or because they never existed).

The telecommunications industry was transformed by new technologies. However, local telephone service continues to be regulated in a few markets given the incumbent ownership of public switch networks and the absence of alternatives. Benefits from the move from monopoly to competition have included lower prices, greater innovation, and greater responsiveness to consumer needs. Further technological changes may soon alter the remaining natural monopoly properties of the sector.⁸⁵

The airline industry, also historically sometimes considered a natural monopoly, probably incorrectly, now retains only certain elements of a natural monopoly. Airports and air navigation systems remain regulated and retain natural monopoly properties, but air travel now is largely governed by marketplace competition.⁸⁶

While the telecommunications and airline industries are also examples of shifting market structures that demonstrate how government intervention can vary over time, we will focus on the electricity industry and its remaining natural monopoly elements.

⁸⁴ Andrei Shleifer, “State Versus Private Ownership,” (1998) 12:4 *Journal of Economic Perspectives* 133 at 140.

⁸⁵ Edward Iacobucci, Michael J Trebilcock & Ralph A Winter, “The Canadian Experience with Deregulation,” (2006) 56:1 *University of Toronto Law Journal* 1 at 1 [Iacobucci, Trebilcock & Winter].

⁸⁶ *Ibid* at 3.

1. ELECTRICITY DISTRIBUTION

There are four main elements in electricity provision: generation, transmission, distribution, and retailing. While generation historically entailed major economies of scale, suggesting a natural monopoly, the minimum efficient scale has decreased and there no longer is (if there ever was) a constantly decreasing average cost curve.⁸⁷ Retailing is also arguably a competitive sector so generation and retailing will not be analyzed in this paper. Electricity transmission and distribution, however, are considered to be natural monopolies because the capital-intensive nature of these services and scale economies makes competition inefficient.⁸⁸ Historically, Canada's electricity utilities were government-owned corporations and many were vertically integrated given their operational and investment similarities.⁸⁹ Vertical integration often included generation, dating from earlier times when generation too was considered a natural monopoly.

Since the 1990s, the structure of the electricity sector has been shifting to varying degrees of privatization, most notably in Ontario and Alberta. Policymakers in these two provinces recognized that technological changes, such as small-scale electricity generation, meant that a privatized electricity industry was both realistic and desirable because a market-driven structure would produce more efficient pricing and better-informed consumption and investment decisions.⁹⁰

The introduction of privatization has been challenging, partly because the electricity sector has unique elements which make reform and deregulation particularly complex. First, the whole transmission grid can be affected by failing to balance supply with demand continuously, with the potential for widespread service interruptions if this balance is not achieved. This was seen in the August 2003 power blackout in the northeastern United States and Ontario. Second, both supply and demand are very inelastic, so at peak demand times small changes in supply or demand can result in very large price increases.⁹¹

Through the restructuring experiences of Ontario and Alberta, we will illustrate the advantages and disadvantages of government ownership of electricity transmission and distribution versus private sector ownership subject to regulation. Restructuring of the electricity sector has presented major challenges due to its complexity, political risk-aversion, consumer reactions, and unexpected external events.

⁸⁷ Laurence Booth and Paul Halpern, "Regulation of Transmission and Distribution Activities of Ontario Hydro," in Ronald J Daniels, ed, *Ontario Hydro at the Millennium: Has Monopoly's Moment Passed?* (Montreal: McGill-Queen's University Press for University of Toronto Faculty of Law, 1996) 69.

⁸⁸ Ontario Energy Board, *Resource Guide for Regulated Entities* (Ottawa: OEB, 2009) at 4, online: <http://www.oeb.gov.on.ca/OEB/_Documents/Documents/Resource%20Guide%20for%20Regulated%20Entities.pdf>.

⁸⁹ Michael J Trebilcock and Roy Hrab, "What Will Keep the Lights on in Ontario: Responses to a Policy Short-Circuit," (2003) *CD Howe Institute Commentary* 191 at 1 [*Lights on in Ontario*].

⁹⁰ *Ibid* at 2.

⁹¹ *Ibid*.

2. ONTARIO'S RESTRUCTURING EXPERIENCE

The Hydro-Electric Commission of Ontario was created in 1906 by the *Power Corporation Act* and was later renamed Ontario Hydro. This vertically integrated government-owned corporation was responsible for all of the electricity generation and transmission needs of the province. The *Power Corporation Act* required Ontario Hydro to provide “power at cost” and it was not required to either pay taxes or generate profits.⁹² Rates were set by Ontario Hydro and were reviewed, but could not be amended by the Ontario Energy Board (OEB), an independent, self-financing Crown corporation. Power was then distributed by municipally owned utility companies to consumers at a fixed price that bundled together generation, transmission, and distribution costs.⁹³ In the early 1990s, the Darlington nuclear station was completed, at a cost far exceeding projections, leading to price increases of more than 30 percent in three years.⁹⁴ Responding to consumer criticism, the Ontario government implemented a price freeze in 1993, leaving prices below actual costs, a situation that continued until restructuring in 2002.⁹⁵

The perceived poor performance of Ontario Hydro and its high level of debt led to a restructuring of Ontario's electricity system under the 1998 *Electricity Act*. Ontario Hydro was replaced by two provincially owned organizations. Hydro One was created to own and operate the transmission grid while Ontario Power Generation (OPG) was formed to own and operate the generation assets. In addition, local distribution companies (LDCs) were greatly reduced in number (from about 300 to 90 after the restructuring).⁹⁶ Hydro One acquired a significant number of them and is now the largest LDC in Ontario, serving primarily rural areas of the province; the remaining LDCs are owned by municipalities. Today, Hydro One Networks, Inc., a wholly-owned subsidiary of Hydro One owns and operates 97 percent of the transmission assets in Ontario.⁹⁷

The OEB, along with a newly formed Independent Electricity System Operator (IESO), a non-profit corporate entity without share capital established by the *Electricity Act*, regulates the electricity market. The OEB sets transmission and distribution rates, regulating the monopoly parts of the industry as well as monitoring market-power abuses. The IESO operates the wholesale hourly spot market and dispatch functions.⁹⁸ The restructured industry also included competition in electricity generation, and supply by LDCs to customers without a retail supplier.⁹⁹

⁹² Merrill Dennison, *The People's Power: The History of Ontario Hydro* (Toronto: McClelland & Stewart, 1960) [Dennison]; Neil Freeman, *The Politics of Power: Ontario Hydro and its Government 1906-1995* (Toronto: University of Toronto Press, 1996).

⁹³ Michael J Trebilcock and Roy Hrab, “Electricity Restructuring in Canada,” in Fereidoon P Sioshansi & Wolfgang Pfaffenberger, eds, *Electricity Market Reform: An International Perspective* (London: Elsevier Ltd, 2006) 419 at 423 [Electricity Restructuring].

⁹⁴ Dennison, *supra* note 92.

⁹⁵ *Ibid.*

⁹⁶ *Electricity Restructuring, supra* note 93 at 423.

⁹⁷ Blake, Cassels & Graydon LLP, “Overview of Electricity Regulation in Canada,” (2008), online: <http://www.blakes.com/english/legal_updates/reference_guides/Overview%20of%20Electricity%20in%20Canada.pdf> [Blake, Cassels & Graydon].

⁹⁸ *Electricity Restructuring, supra* note 93 at 424.

⁹⁹ Donald N Dewees, “Electricity Restructuring and Regulation in the Provinces: Ontario and Beyond,” (2005) Presented to Energy, Sustainability and Integration the CCGES Transatlantic Energy Conference, Sept 2005 at York University at 4, online: <<http://repec.economics.utoronto.ca/files/tecipa-205-1.pdf>> [Dewees].

In May 2002, when the market had opened, Ontario unbundled electricity prices into separate generation, transmission and distribution components. In addition, in order to finance the stranded debt of Ontario Hydro (totalling about \$20 billion), a stranded debt charge of 0.7 cents per kWh was added to the market price. The following summer was abnormally hot and was accompanied by rapidly increasing electricity prices, due to high consumer consumption as well as, more generally, a shortage of domestic generation capacity, an increasing reliance on imports, and limited import capacity. The IESO issued power warnings and advisories for consumers to conserve energy since power supplies were struggling to keep up with demand.¹⁰⁰

Six months later, in response to consumer criticism arising from these higher prices, the provincial government froze retail prices in December 2002 under the *Electricity Pricing, Conservation, and Supply Act, 2002*. Retroactive to May 2002, it froze retail prices for low-volume consumers, who accounted for half of the electricity consumed in the province.¹⁰¹ However, the price freeze had significant damaging effects as it reduced incentives for consumers to conserve electricity, removed investor confidence in building much needed new generation facilities, and made it more difficult to sell OPG facilities.¹⁰² The government also exposed itself to significant financial commitments. The Minister of Energy had stated that the price freeze would be revenue neutral, but this was not the case.¹⁰³

Overall, Ontario's restructuring was disappointing. Originally designed to reduce the electricity debt and encourage private sector investment in generation, it failed on both counts. The debt grew further, requests to reduce usage had to be issued, and private investors demanded consumer/taxpayer-backed contracts to build new electricity generation.¹⁰⁴

There are a number of reasons for this failure. First of all, private investors were unsettled by the constant delays and uncertainty surrounding the market opening. The market was originally expected to open in November 2000, but this date was delayed first to May 2001 and then further to May 2002 in order to ensure system reliability. In the meantime, investors lost confidence due to the California electricity crisis and the Enron collapse over this period. The Ontario market was then seen to be too risky for investment and new generation capacity lagged for lack of sufficient capital when the market finally opened. Investor concerns also related to OPG dominance and uncertainty surrounding the planned reduction of its market share, and related to lack of LDC consolidation.¹⁰⁵ These concerns were aggravated by the uncertainty surrounding the proposed privatization of Hydro One. The Harris government announced its plan in December 2001 to sell Hydro One through an initial public offering, one year before market opening. However, this failed after two unions effectively argued in court that the *Electricity Act* did not authorize the provincial government to sell its assets. Soon after, the government announced that it would sell a minority stake, allowed under legislation.¹⁰⁶ Before this could happen, a scandal (claims of excessive compensation packages being given to senior executives) erupted in the summer of 2002, leading to the resignation of the board of directors of Hydro One and the termination of its CEO. The concept of privatization was abandoned in January 2003 when the government announced that it would retain 100 percent ownership of Hydro One.¹⁰⁷

¹⁰⁰ *Electricity Restructuring*, *supra* note 93 at 424 - 425.

¹⁰¹ *Ibid* at 426.

¹⁰² *Deweese*, *supra* note 99 at 5.

¹⁰³ *Lights on in Ontario*, *supra* note 89 at 15.

¹⁰⁴ *Electricity Restructuring*, *supra* note 93 at 440.

¹⁰⁵ *Ibid*.

¹⁰⁶ *Iacobucci, Trebilcock & Winter*, *supra* note 85 at 37.

¹⁰⁷ *Ibid*.

Other political difficulties also stood in the way of promoting an efficient electricity sector in Ontario. It can be politically costly to promote efficiency if the move requires an increase in prices. The price freeze prior to the restructuring had the effect of acclimatizing Ontario consumers to low and stable prices, making consumers resistant to price increases. In order to prevent costly policy reversals, it is important for restructuring initiatives to take into account political realities. In this case, the government's promise of lower electricity rates following restructuring was unwise.

The government may have faced less resistance had it publicized the actual benefits of the restructuring such as debt reduction from the electricity industry and conservation/ environmental benefits. Even so, education alone would not have ended the political difficulties since the restructuring would have had adverse effects on certain interest groups who would have resisted the change despite the societal benefits.¹⁰⁸

The government could also have used other strategies to build investor confidence. For example, it could have implemented policies that are difficult if not impossible to reverse by privatizing government corporations or some of their assets to create political constituencies in favour of the strategy.¹⁰⁹ Or it could have demonstrated its commitment to the restructuring by offering incentives to build new generation capacity, which would have protected private investors from changes in the regulatory regime. These incentives would have reduced the cost of private investment and would have reassured investors by reducing the political risk of unstable prices due to too little capacity.¹¹⁰ In the UK, for example, the government paid generating firms to maintain excess capacity to limit political backlash from price spikes or blackouts. While the market itself should provide all the incentives needed for a successful restructuring, the strategies mentioned above may be useful if there is significant political opposition.¹¹¹

Given the failure of the restructuring to encourage investors to assume risk and the resultant lack of long-term system development, the Ontario Power Authority was created pursuant to the *Electricity Restructuring Act, 2004*. This not-for-profit corporation acted to obtain new generation by entering into long-term power purchase or contract-for-differences agreements.¹¹² It has been responsible for over \$27 billion in new generation investment since 2005.¹¹³

¹⁰⁸ *Ibid* at 46.

¹⁰⁹ *Electricity Restructuring*, *supra* note 93 at 441.

¹¹⁰ *Iacobucci, Trebilcock & Winter*, *supra* note 85 at 46.

¹¹¹ *Ibid* at 47.

¹¹² *Blake, Cassels & Graydon*, *supra* note 97 at 18. For harsh criticisms of the implementation of these policies as they relate to renewable energy, see Annual Report of the Ontario Auditor-General, 2011, chapter 3.

¹¹³ Ontario Power Authority, "2010 Annual Report" (2010) at 2, online: <http://www.powerauthority.on.ca/sites/default/files/new_files/news_events/news_from_opa/pdfs/OPA%20Annual_Report%202010%20FINAL.pdf>.

3. ALBERTA'S RESTRUCTURING EXPERIENCE

Before restructuring, Alberta's electricity system was composed of three vertically integrated utilities, two investor-owned and one owned by the city of Edmonton (EPCOR). The province itself did not own electricity assets. Regulation was carried out by Alberta's Energy Utility Board (AEUB). Electricity was then purchased by the government at cost (which differed between different generators) and was then resold to utilities' distribution divisions at an average uniform price.¹¹⁴

Reform began in 1996 under the *Electric Utilities Act (EUA)* with the goals of attracting private sector investment for generation to meet growing demand and fostering competition in generation.¹¹⁵ The Power Pool of Alberta was created to provide a competitive, hourly spot market for electricity. The Alberta Electric System Operator (AESO) was also established under the EUA to manage and operate the Power Pool.¹¹⁶

To facilitate competition in the wholesale market, the government mandated that the incumbent utilities divest the production rights of their generation assets instead of outright divestiture. Generation rights, called Power Purchase Arrangements (PPAs), were then auctioned to private investors. However, the first auction left thousands of megawatts unsold, possibly because of tacit agreements among the low number of bidders or lack of confidence in Alberta's commitment to restructuring. The second auction was more successful.¹¹⁷ While this method did lead to new generation, the PPAs were an unsatisfactory substitute for facilities-based competition so divestiture would have likely been more effective, although politically difficult.¹¹⁸

New generation in Alberta was gas-fired and rising natural gas prices caused the wholesale price of electricity to increase between 1996 and 1999. The province's small import capacity limited its ability to avoid a price shock. The Alberta Market Surveillance Administrator conducted an investigation to look into the rising prices in 2000, finding some evidence of capacity-withholding.¹¹⁹

To respond to the increased consumer prices, Alberta adopted a different strategy from Ontario. In 2000, the government set a default regulated rate option system. This approach maintained the incentives to conserve energy with a high marginal price for electricity, but lessened the financial burden of the high price with a fixed monthly rebate.¹²⁰ This seems to have been preferable to Ontario's inflexible uniform rate freeze.¹²¹

¹¹⁴ *Electricity Restructuring*, *supra* note 93 at 443.

¹¹⁵ *Ibid*

¹¹⁶ *Blake, Cassels & Graydon*, *supra* note 97 at 5.

¹¹⁷ *Electricity Restructuring*, *supra* note 93 at 444.

¹¹⁸ *Ibid* at 447.

¹¹⁹ *Ibid* at 445.

¹²⁰ *Deweese*, *supra* note 99 at 7.

¹²¹ *Electricity Restructuring*, *supra* note 93 at 447.

While private sector investment increased with restructuring, it has not completely displaced public investment. The City of Calgary owns the vertically integrated ENMAX Power. It is the largest retailer in Alberta and owns the distribution network in Calgary.¹²² In January 2004, the AEUB, which, in 2008 became the Alberta Utilities Commission (AUC), took over regulating ENMAX Power from the City of Calgary.¹²³ In Edmonton, EPCOR is also vertically integrated, municipally owned, and regulated by the AUC.¹²⁴ This mix of private and public entities reflects the fact that Alberta's restructuring emphasized regulation rather than ownership. The AUC regulates the distribution system regardless of who owns it.

Alberta has continued to support and refine its restructured market (although it has delayed full retail price deregulation) and has consistently committed to a competitive generation sector. The province has consequently experienced significant private sector investment in generation.¹²⁵

4. COMPARING ALBERTA AND ONTARIO

The different paths followed by the governments of Ontario and Alberta in restructuring the electricity industry and then in responding to the resulting price shocks can likely be explained by their respective pre-restructuring states. Ontario's electricity system was mostly government-owned, whereas Alberta's system was mostly investor-owned and did not have the same central government presence.¹²⁶

B. Negative Externalities/Paternalism

Paternalistic concerns are sometimes related to negative externalities because people who indulge in self-destructive behaviour often turn to government support systems funded by the taxpayer. However, there are many areas where there are significant negative externalities without paternalistic implications. Environmental degradation is one example.

Historically, government has used Crown corporations to intervene in gambling and liquor consumption on paternalistic and externalities grounds. Some provinces have set up Crown corporations, like the Saskatchewan Gaming Commission, which owns and operates Casino Regina and Casino Moose Jaw. Other provinces instead license and regulate private casinos.

The sale of alcohol in Canada has customarily remained in government hands. Although alcohol is produced in the private sector, its distribution is usually limited to provincial Crown corporations. Alberta's private sector model is an exception. Using the Liquor Control Board of Ontario (LCBO) as an example and comparing its performance with that of Alberta's private sector distribution system, we explore the advantages and disadvantages of public ownership of liquor distribution.

¹²² ENMAX Corporation, "How We Govern," (2010) online: <http://www.enmax.com/NR/rdonlyres/ECF63DFC-AD9E-42EA-BA6F-BBAD3E3C7CEF/0/About_ENMAX_How_We_Govern.pdf>.

¹²³ ENMAX Corporation, "Alberta Electricity Industry and ENMAX: Regulation in Calgary," online: <<http://www.enmax.com/Corporation/About+Enmax/Alberta+Electricity+Industry+and+ENMAX/Regulation+in+Calgary/Regulation+in+Calgary.htm>>.

¹²⁴ EPCOR, "The Transmission and Distribution System," online: <<http://www.epcor.ca/en-ca/about-epcor/Regulatory/EnergyDeregulationInformation/Pages/DTSsystem.aspx>>.

¹²⁵ *Ibid*

¹²⁶ *Ibid*.

1. ADVANTAGES AND DISADVANTAGES OF PUBLIC OWNERSHIP OF LIQUOR DISTRIBUTION

Government ownership of liquor sales through Crown corporations is often justified as an effective way to address the problem of irresponsible consumption of liquor. This problem has two dimensions: negative externalities and self-harm by vulnerable people. Externalities include costs to the health-care and social welfare systems from health problems caused by excessive drinking, fetal alcohol syndrome, drunk driving accidents, and alcohol related violence.¹²⁷ People vulnerable to self-harm include those susceptible to alcohol dependence and minors. Both of these dimensions could alternatively be addressed by high taxation and by prohibitions, but with public ownership the government may have more comprehensive control. Given the absence of a residual claimant that benefits from, for example, the sale of alcohol to minors, the incentives of a publicly owned entity to sell irresponsibly may fall relative to private providers. And with a tax-and-regulate approach, there would be incentives for private firms to evade the taxes and circumvent the prohibitions in order to maximize profits.

An additional advantage realized by the provincial government in owning liquor Crown corporations is increased revenues through disguised taxation, via high, super-competitive prices. These revenues are in addition to the explicit taxes on the sale of alcohol (federal excise taxes and the harmonized sales tax). The government especially benefits from the implicit tax system since most taxpayers are unaware of these taxes and are therefore less resistant to them. Politicians prefer this route to avoid the political costs of visible taxation.¹²⁸

The public system leads to distortions in the price of alcohol. The Crown's monopoly can lead to super-competitive prices, with associated deadweight losses from lost surplus from consumers priced out of the market. Another distortion is the subsidization of consumers in remote locations by urban consumers. Although the cost of distribution is higher in remote locations, the LCBO charges identical amounts throughout the province regardless of ease of access to distribution centres, thus resulting in the effective subsidization of rural areas. Private firms would not charge uniform prices throughout the province and thus this unjustified distortion is unique to the Crown corporation structure.¹²⁹

Another disadvantage of public ownership are higher costs due to the relative inefficiency of government-owned enterprises. For example, Crown corporation employees tend to receive much higher wages and benefits than comparable private sector employees.¹³⁰ High costs are to some extent reflected in reduced service rather than higher prices — that is, by the under-allocation of resources to provide consumers with better service. For example, reduced service can take the form of fewer outlets, fewer brands available (lowering inventory costs), and less advertising. Overall the costs of inefficiencies are borne by consumers through higher prices, transaction costs and loss of convenience.¹³¹

¹²⁷ Thomas Babor et al, *Alcohol: No Ordinary Commodity: Research and Public Policy*, 2d ed (Oxford: Oxford University Press and Pan American Health Organization, 2010).

¹²⁸ Bruce L Benson, David W Rasmussen & Paul R Zimmerman, "Implicit Taxes Collected by State Liquor Monopolies," (2003) 115:3/4 *Public Choice* 313 at 314.

¹²⁹ Nuri T Jazairi, "The Impact of Privatizing the Liquor Control Board of Ontario," (Interim Report, York University, 1994) at 71.

¹³⁰ *Ibid* at 315.

¹³¹ *Ibid*.

2. THE LCBO

The LCBO was established in 1927 pursuant to the *Liquor Control Act (LCA)* in Ontario, which grants it wide powers creating an almost complete monopoly over the sale of alcohol, other than beer. The *LCA* replaced the *Ontario Temperance Act* of 1916 (which prohibited the sale of alcohol) and marked the end of the prohibition of liquor in Ontario. The LCBO was developed at a time when the temperance movement was strong, and so it encouraged moderation in alcohol consumption.¹³² The LCBO was then incorporated in 1975 as a Crown corporation.¹³³ Other retail outlets include The Beer Store (privately owned by two major breweries: the Labatt arm of Anheuser-Busch InBev and Molson Coors Canada), small wine stores selling only certain kinds of wine (e.g., wine produced by the owner's vineyard), and duty-free shops. Illegal brewing also occurs.¹³⁴

In the mid-1990s, the Ontario Harris government expanded the LCBO's capital allowance and introduced reforms to revamp the quality of distribution, human resources, marketing, and overall consumer experience.¹³⁵ The Harris government was elected on a mandate that included the privatization of the LCBO, but decided that the political gains from privatization would not be worth the political costs, including opposition from various interest groups such as the LCBO's union and the Ontario public health community.¹³⁶ Instead, the LCBO decided to increase government revenues without selling more alcohol and were successful in increasing the sale of higher-value products and targeting women consumers.¹³⁷

3. PRIVATIZATION OF ALBERTA'S LIQUOR DISTRIBUTION

Alberta is the only province in Canada that has privatized liquor distribution and therefore can be used to evaluate the comparative effects of private versus public ownership. The privatization experience of Alberta highlights the trade-offs between a government-owned Crown corporation system and a private sector regulated system.

Originally, Alberta's liquor distribution system was similar to that in Ontario. The Alberta Liquor Control Board (ALCB) was set up in 1924 to regulate the distribution of alcohol other than domestic beer, which remained in the private sector.¹³⁸ The provinces' systems diverged, however, when Alberta began to slowly allow private involvement in the distribution of alcohol and reduced the scope of the ALCB. Expected social and political problems did not manifest themselves as predicted and in 1993 the ALCB was disbanded and was replaced by a privatized liquor distribution system.¹³⁹ The retail system is now fully privatized so that

¹³² Dan Malleck, "The Bureaucratization of Moral Regulation: The LCBO and (not-so) Standard Hotel Licensing in Niagara, 1927-1944," (2005) 38:75 *Social History* 59.

¹³³ Liquor Control Board of Ontario, "History of the LCBO," online: LCBO <http://www.lcbo.com/aboutlcbo/media_centre/history.shtml>.

¹³⁴ Malcolm G Bird, "Alberta's and Ontario's Liquor Boards: Why Such Divergent Outcomes?" (2010) 53:4 *Canadian Public Administration* 509 at 519 [Bird].

¹³⁵ *Ibid* at 520.

¹³⁶ *Ibid* at 514.

¹³⁷ *Ibid* at 515.

¹³⁸ *Ibid* at 518.

¹³⁹ *Ibid* at 521.

licensed private stores can sell liquor. On the wholesale side, all alcohol (except domestic beer) must be purchased through a highly regulated private firm monopoly, Connect Logistics.¹⁴⁰ The government sets uniform wholesale prices by a formula including the supplier's price, the government's mark-up, and federal government taxes. All retailers are charged the same wholesale price and this cannot be negotiated to gain volume discounts. This has discouraged the formation of retail liquor chain stores by negating their volume purchasing power. This was intended to prevent supermarkets from obtaining too large a market share and gaining an advantage over smaller retailers.¹⁴¹ Even so, retailers can obtain discounts from suppliers by purchasing large volumes of products that are on a "limited time offer" sale by the supplier.¹⁴² The mark-up was also adapted to be a flat rate on the alcohol content rather than an ad valorem amount. Overall, mark-ups were set at a level that would be revenue-neutral.¹⁴³

4. REASONS FOR DIVERGENCE BETWEEN ONTARIO AND ALBERTA

The divergence in the two approaches is largely attributable to the reactions of interest groups in each province. Ontario's government-owned regime is highly favoured by politically influential and well-financed suppliers, large brewers, wine storeowners, and unionized workers. Suppliers benefit from a centralized system through reduced administrative, marketing, labour, and transaction costs.¹⁴⁴ Ontario winemakers receive preferential treatment from the LCBO in the form of in-store promotions such as a high level of product selection, a relatively large amount of shelf-space given their small market share, and annual promotions.¹⁴⁵

In Alberta, on the other hand, political interest groups were not as powerful and the speed with which the plan was implemented curtailed political opposition. Perhaps for these reasons, suppliers of alcoholic beverages changed their business models instead of joining the opposition.¹⁴⁶

5. EFFECTS OF PRIVATIZATION

Various studies of the effects of privatization have come to somewhat different conclusions, perhaps because of changes over time. A study by Douglas West in 2003 described the effects of Alberta's decision to privatize retail liquor stores. The number of liquor stores greatly increased, which also led to more communities being served by liquor stores. This implies lower transaction costs and more convenience for consumers. Price trends differed among

¹⁴⁰ *Ibid* at 513.

¹⁴¹ Douglas West, "The Privatization of Liquor Retailing in Alberta," (2003) *Fraser Institute Digital Publication*, online: <<http://www.lib.uwo.ca/files/business/booze2.pdf>> [West].

¹⁴² Douglas West, "Double Marginalization and Privatization in Liquor Retailing," (2000) 16 *Review of Industrial Organization* 399 at 406.

¹⁴³ *Bird, supra* note 134 at 513.

¹⁴⁴ *Ibid* at 522.

¹⁴⁵ Liquor Control Board of Ontario, Media Release, "LCBO support for Ontario wineries" (24 February 2010) online: <http://www.lcbo.com/lcbo-ear/media_releases/content?content_id=1457>.

¹⁴⁶ *Bird, supra* note 134 at 523.

product classes, but on average, retail liquor prices fell by 2.9 percent for 90 of the 105 products in the sample.¹⁴⁷ This difference in prices can largely be attributed to the falling wholesale prices.¹⁴⁸ Product selection from the warehouse increased overall, although averages for Calgary and Edmonton were lower than before the privatization. Revenues increased for the government after privatization and the province abandoned its revenue neutrality policy. Wages for liquor store employees dropped significantly but employment itself increased as the number of stores increased. The quantity of liquor products sold has modestly increased since the privatization.¹⁴⁹

Although the social impacts of privatization in Alberta are difficult to assess, trends suggest some correlations. While West argues that evidence does not show that privatization has led to an increase in social alcohol-related problems, Greg Flanagan disagrees. He found in 2003 that Alberta had a higher absolute alcohol consumption rate compared to the rest of Canada and that this consumption has been increasing since 1997.¹⁵⁰ While overall there appears to be little increase in crime rates, with Alberta's rate falling below the national average, Flanagan finds that violations of the *Alberta Gaming and Liquor Act* have risen substantially as the availability of liquor increased.¹⁵¹ MacKenzie and Giesbrecht found that there has been an absolute increase in break-and-enters and commercial robberies, which may be linked to extended opening hours and poor security in small private stores.¹⁵² Given the strong links between alcohol consumption and suicide, a study by Zalcman and Mann in 2007 found that suicide rates among men and women increased significantly following Alberta's privatization.¹⁵³ While Trollidal in 2005 found that there was no significant impact on the number of drunk-driving related deaths,¹⁵⁴ many provincial and countrywide policy and educational programs were put in place over the relevant time period, so that it is difficult to isolate the impacts from the privatization.¹⁵⁵ The difficulty in isolating privatization from other causes for change leaves strong conclusions about the social impacts of Alberta's approach to liquor distribution difficult to draw. The economic impacts, however, seem clearly favourable.

¹⁴⁷ West, *supra* note 141.

¹⁴⁸ Bird, *supra* note 134 at 524.

¹⁴⁹ West, *supra* note 141 at 69.

¹⁵⁰ Greg Flanagan, "Sobering Result: The Alberta Liquor Retailing Industry Ten Years After Privatization," (2003) Canadian Centre for Policy Alternatives and Parkland Institute at 16.

¹⁵¹ *Ibid.*

¹⁵² Bronwyn MacKenzie and Norman Giesbrecht, "The Alberta Experience with Privatization: An Exemplary Model or Cautionary Tale?" in Norman Giesbrecht et al, eds, *Sober Reflections: Commerce, Public Health, and the Evolution of Alcohol* (Montreal: McGill-Queen's University Press, 2006) 150 at 165.

¹⁵³ Rosely F Zalcman and Robert E Mann, "The Effects of Privatization of Alcohol Sales in Alberta on Suicide Mortality Rates," (2007) 34:1 *Contemporary Drug Problems* 589 at 600 [Zalcman & Mann].

¹⁵⁴ B Trollidal, "An Investigation of the Effects of Privatization of Retail Sales of Alcohol on Consumption and Traffic Accidents in Alberta, Canada," (2005) 100:5 *Addiction* 662.

¹⁵⁵ Zalcman & Mann, *supra* note 153 at 602.

C. Postal Service: Communitarianism/Distributive Justice

Government involvement in industries for communitarianism and distributive justice reasons are widespread. Two salient examples are the Canadian Broadcasting Corporation and the Canadian Radio-television and Telecommunications Commission, which both are intended to bolster Canadian identity through broadcasting and regulating Canadian content. Public education also has a communitarian function, promoting citizenship qualities that private educational entities may not do. Distributive justice is also one of the main goals of the Toronto Housing Commission, which provides low-income tenants with affordable housing. To illustrate the differences between government ownership and private ownership in upholding communitarian and distributive justice goals, we will analyze Canada Post and its commitment to providing universal service.¹⁵⁶

Two features characterize Canada's postal system: a government-owned monopoly on a defined portion of the letter mail market, and a Universal Service Obligation (USO). The monopoly provides Canada Post with a reserved market in which it is the only legal provider, while the universal service obligation requires it to deliver letters ubiquitously and at a uniform price across Canada. It is this consistent service and pricing across Canada that reflects the communitarianism and distributive justice aspects of Canada Post's mandate.

There have been ongoing debates as to whether to reform Canada Post by privatizing or deregulating it. We will look at the structure of its current regulatory regime and the objectives it fulfils and then compare this to the experiences in other countries that have privatized or deregulated their postal service.

1. AN OVERVIEW OF THE REGULATORY REGIME

The *Canada Post Corporation Act (CPC Act)* was enacted in 1981 to respond to problems in the Post Office Department at the time, including lack of resources, outmoded operations, ineffective policy, rising deficits, labour unrest, and frequent postal strikes. With this Act, the Post Office Department was turned into a corporation wholly owned by the federal government called the Canada Post Corporation (Canada Post). It was also given a mandate to be financially self-sufficient. The government believed that this would create a more effective framework for managerial accountability, and that the corporation would have the ability to bargain more effectively with employees. The *CPC Act* confers an exclusive statutory monopoly on Canada Post for the collection, transmission, and delivery within Canada of letters¹⁵⁷ not weighing more than 500g. The monopoly is subject to a number of exemptions, including delivery of magazines, books, and electronically or optically transmitted material, and urgent letters subject to a fee at least equal to "three times the regular rate of postage payable for delivery in Canada of similarly addressed letters weighing fifty grams." While Canada Post has a degree of corporate autonomy, government maintains substantial control. Canada Post is overseen by a chairman and nine other directors who are named by the responsible minister, and the president is appointed by the Governor in Council.

¹⁵⁶ See Edward M. Iacobucci, Michael J. Trebilcock, and Tracey Epps, "Rerouting the Mail: Why Canada Post is Due for Reform," (2007) 243 *C.D. Howe Institute Commentary*.

¹⁵⁷ Letters are defined in the Letter Definition Regulations (SOR/83-481) as "one or more messages or information in any form, the total mass of which, if any, does not exceed 500 g, whether or not enclosed in an envelope, that is intended for collection or for transmission or delivery to any addressee as one item."

Following the 1981 reform, Canada Post came under repeated pressure from the federal government to eliminate its operating deficits. Struggling to meet its statutory objectives, in 1982 it reduced frequency of mail delivery in rural areas from six to five days and reduced multiple deliveries to businesses to one delivery per day. It also converted selected post offices to privately owned ones, franchised operations that offered retail postal services along with other goods and services, and closed some post offices. After the election of a Progressive Conservative government in 1984, Canada Post followed a more competitive agenda, contracting out some non-core activities, offering clients incentives for pre-sorting their mail, introducing user-pay pricing, and reducing cross-subsidization. Canada Post became a key player in the Canadian courier market in 1993 when it purchased Purolator, a private sector courier company.

In 1995, the federal government commissioned a mandate review of Canada Post,¹⁵⁸ which resulted in the 1999 Framework Agreement, establishing a quasi-contractual relationship between the government and Canada Post. The agreement set a five-year timetable to reach stated financial goals and established a price-cap formula for first-class mail that allowed Canada Post to increase the price of a stamp by a rate no more than two-thirds of the increase in the consumer price index. The financial goals included profit targets and dividend expectations, although the details were not made public. The agreement did not include any type of customer charter or customer-service accountability, or details as to Canada Post's service obligations or expectations about performance targets. The government rejected the report's recommendation to appoint some sort of governance or regulatory supervisor to evaluate and track Canada Post's performance against specific targets.

2. SOCIAL OBJECTIVES OF CANADA POST

The primary social objective of Canada Post is to provide a universal service at common rates across the country. This objective is consistent with other countries' postal services. Worldwide, national postal service operators have been subject to a USO, which typically requires them to provide mail service at uniform rates to all regions of a country, often accompanied by requirements relating to service frequency and quality. The rationale for a universal service obligation historically, at least in North America, was to promote economic development by reducing one of the costs of settling in remote or underdeveloped areas of the country, and to promote national unity and cohesiveness by enhancing social communication.¹⁵⁹

Conventional wisdom in assigning a USO to postal operators is that an exclusively reserved category of mail is required, so that routes where postal revenues exceed costs in densely populated urban areas provide the resources to finance uniform service in less densely populated or remote communities in the form of cross-subsidies. It is argued that without an exclusive privilege, competitive entry would lead to cream-skimming on high-density routes, leaving the national operator with money-losing routes and requiring ongoing government bailouts or subsidies.

¹⁵⁸ George Radwanski, *The Future of Canada Post Corporation – Report of the Canada Post Mandate Review* (Ottawa: Government of Canada, 2006).

¹⁵⁹ Robert M Campbell, *The Politics of the Post: Canada's Postal System from Public Service to Privatization* (Peterborough: Broadview Press, 1994) at 27 [Campbell].

In addition, many parliamentarians defend Canada Post's governmental ownership as it represents the only federal government presence in many smaller communities,¹⁶⁰ stimulating regional economic development and providing stable employment. The Canadian flag identifying the post office serves as an important symbol of Canadian national identity. Some argue that this symbolic presence improves public respect for, and confidence in, the national government.¹⁶¹

The early history of the postal system in Canada demonstrates both its economic and social dimensions. The postal system was under the control of the British postmaster until 1851, when the colonial governments took it over and subsequently greatly expanded it to reach new areas of settlement. This played a significant role in building the nation and became a symbol of the government's positive role in the community.¹⁶² As an inexpensive means of communication between rural and urban areas, benefits of the postal system included increased literacy and improved educational systems. The expanded postal system also facilitated economic development through increasing business opportunities, providing a network for distributing retail goods and establishing commercial links with other countries.¹⁶³

3. CHALLENGES FOR CANADA POST

Today, Canada Post faces new challenges that may require some type(s) of reform. First, the introduction of electronic alternatives to the mail system is resulting in declining mail volumes, causing a reduction in the profitability of the corporation. E-commerce is a growing industry as it becomes more secure and less expensive for its users. Canada Post itself began an e-post service (free bill presentment service) to respond to these changes, which may help it to reduce its costs and increase its operational efficiency. In 2004 it acquired Webdoxs, which provides online bill payment services.¹⁶⁴

A second challenge is competition from private, globally integrated competitors outside Canada Post's statutory monopoly. They are particularly effective because of their technological capabilities, brand-name recognition, and ability to take advantage of the size and density of international markets. These companies merge and partner with courier services, air cargo firms, logistics companies, and surface courier services to provide seamless service from pick-up to final delivery.¹⁶⁵

¹⁶⁰ Philippe Le Goff, "Canada Post Corporation as a Provider of Financial and Government Services: The Way of the Future?" (2005), Library of Parliament at 1, online: <<http://www.parl.gc.ca/Content/LOP/researchpublications/prb0514-e.htm>> [Goff].

¹⁶¹ Katherine AH Graham Gene Swimmer, "The 'Ottawa Syndrome:' The Localization of Federal Public Servants in Canada," (2009) 52:3 *Canadian Public Administration* 417 at 419.

¹⁶² Campbell, *supra* note 159 at 31.

¹⁶³ *Ibid* at 27 – 29.

¹⁶⁴ Goff, *supra* note 160 at 8.

¹⁶⁵ *Ibid*.

4. EVIDENCE FROM POSTAL REFORMS IN OTHER COUNTRIES

Other countries' experiences in privatization or deregulation may serve as a useful guide for Canada Post's future. The evidence is consistent: liberalization improves performance. Deregulating and privatizing postal operators has had a salutary effect on costs, and service has generally improved. The ownership effect has been influential in countries that have followed a privatization path, but the competition effect in countries that have deregulated has not always been substantial. In some countries, there has not been much entry following the abolition of statutory monopolies, perhaps because of remaining regulatory barriers to entry such as excessive licensing requirements. However, even in countries where there has not been entry, it is plausible that the threat of entry has exerted discipline on incumbent postal operators.

Despite potential positive benefits from liberalization, the challenge remains of adhering to the USO. The USO could be accommodated in two ways: it could be relaxed; and cross-subsidies could be replaced with direct targeted subsidies.

It is not clear that a USO requires strictly uniform prices and services across regions. As with other goods or services provided to remote or sparsely populated communities, one of the burdens of residing in such communities (offsetting, in part, some of the benefits) is the additional transportation and communication costs of providing goods and services over longer distances. Similarly, it is reasonable to imagine a relatively uniform package of services provided both to high-volume and low-volume routes, but priced differentially to reflect the costs involved. Alternatively, service frequency and quality might vary across routes. In urban areas, many postal services involve door-to-door delivery, while on rural routes service is provided to roadside mailboxes or local post offices.

Second, even if for political or other reasons, uniform pricing and a uniform package of services are deemed essential elements of a USO, many jurisdictions have forms of USOs that do not entail cross-subsidization, but use targeted subsidies instead. Targeted subsidies are already selectively provided in the Canadian postal sector to finance mailing privileges for parliamentarians, the blind, Canadian newspapers and periodicals, and the shipment of perishables to remote northern communities. Other jurisdictions provide direct and targeted government subsidies to postal operators to maintain the requisite level of service and rates on specific routes. The subsidies simply become an additional source of revenue to operators servicing those routes, and are consistent with a level playing field for competition. Such subsidies can be financed either out of general revenues or through a tax or required contribution based on sales of all operators. A further refinement may be to put out losing routes to competitive tender and award such routes for defined periods of time to either publicly or privately owned postal operators that are prepared to operate these routes for the lowest subsidy.

A subsidy policy has the virtue of political transparency in that explicit, direct, and targeted subsidies can be more effectively evaluated in the political process than implicit and untargeted cross-subsidies buried in overall postal rates. In addition, it removes excuses for not achieving financial performance targets owing to uneconomic social objectives being included in the organization's mandate. Finally, adopting an explicit and targeted subsidy strategy removes from competitors the claim that competition by the national postal operator, outside the exclusive sector, is an unfair form of competition sustained by cross-subsidies from revenues generated by the legally protected monopoly. The strategy is thus likely to enhance competition in hitherto protected and unprotected segments of the sector, to the benefit of all users of mail services.

The telecommunications sector in Canada has already adopted an analogous policy. Following liberalization of that sector and the removal of legally imposed restrictions on competition, all telecommunications service providers fund the USO through contributions. In high-cost areas, where the cost of providing residential local telephone services exceeds sales revenue, the CRTC has established a per-customer subsidy program to ensure service. The subsidy regime is competitively neutral, in that it moves from one provider to another if a customer switches providers. It is not obvious why a similar regime could not work in postal markets.

D. Crown Financial Institutions: Positive Externalities/Information Asymmetries/Distributive Justice

To meet the needs of small businesses in Canada, the government has created a number of Crown financial institutions. We will focus on three of them: the Business Development Bank of Canada; the Farm Credit Corporation of Canada; and the Export Development Corporation.¹⁶⁶ In particular, for each of these, we will explore the rationales for its establishment, its mandate and its governance, and finally the tradeoffs between private sector and government provision of its services.

1. RATIONALES FOR ESTABLISHMENT

The Canadian government has committed itself to promoting small business growth and improving the competitiveness of small and medium-sized enterprises (SMEs), in large part because of a perception that small businesses create jobs. A 2008 study by Industry Canada concluded that small businesses were responsible for approximately 80 percent of net job creation between 1993 and 2003.¹⁶⁷ Moreover, the study concluded that Canadian SME exporters, accounting for only 5.5 percent of all firms, created a disproportionate number of jobs at 47 percent between 1993 and 2002.¹⁶⁸ The connection between small business and job creation is, however, contested. Chen and Mintz suggest that while many small businesses are created, they do not often grow and their positive impact on employment is empirically unsubstantiated.¹⁶⁹

Whatever the precise empirical connection between small businesses and job creation, governments in Canada have taken the promotion of small business to be a policy goal. SMEs, however, face many challenges, including acquiring and maintaining superior management skills, skilled labour, marketing capacity, access to markets, and access to capital. Many SMEs are financed through loans, and so these firms tend to be highly leveraged and vulnerable to economic downturns.¹⁷⁰

¹⁶⁶ While the Canada Mortgage and Housing Corporation is another government-owned financial institution, it will not be addressed in this paper since it performs a different function than those discussed here.

¹⁶⁷ Chris Parsley and David Halabisky, "Profile of Growth Firms: A Summary of Industry Canada Research," (2008) Industry Canada at 1.

¹⁶⁸ *Ibid* at 11.

¹⁶⁹ Duanjie Chen and Jack Mintz, "Small Business Taxation: Revamping Incentives to Encourage Growth," (2011) vol. 4, issue 7, *University of Calgary, The School of Public Policy Research Papers*.

¹⁷⁰ William Schnurr, "Canada's Crown Financial Institutions: Small Business Boost or Bonanza?" (1997) *Centre for the Study of State & Market WPS#46-1997* at 7 [Schnurr].

The main rationale for government involvement in small-business financing is that such loans are small, are higher risk, are collateral-poor, or are based primarily on ideas. Small businesses that require only small loans may not receive financing in the private sector, given the costs associated with selecting, monitoring, and enforcing loans and investments. To compensate by charging higher interest rates is problematic because borrowers at higher rates may behave in a riskier manner (investing the loans in high-risk and negative net present value projects): the borrower realizes the upside of the risky investment if it pays off, while the lender bears the downside.¹⁷¹ Moreover, many financial institutions are unwilling to accommodate flexible repayment schedules that many small businesses require given their small and uneven cash flows at the start of operation.¹⁷² This concern is intensified if the small business is also collateral-poor.

For SMEs that depend highly on the ideas, skill, and motivation of the entrepreneur, the private financial sector may face difficulties in charging lower interest rates due to their general inability to accurately price the risk in these firms. Due to this type of information failure, institutions may grant fewer loans than the risk would have justified.¹⁷³

The role of the Crown corporation in this sector is not self-evident despite these difficulties that the private sector faces. This is because governmental loans will be afflicted by the same problems that plague private sector lenders; loans may not be cost-effective, for example, whether provided by the state or the private sector. But the governmental objective of job creation, whether understood as a kind of positive externality or as a distributive matter, may invite intervention.

2. CROWN FINANCIAL INSTITUTIONS

a) *The Business Development Bank of Canada*

The Business Development Bank of Canada (BDC) is a Crown corporation wholly owned by the government. Originally a subsidiary of the Bank of Canada, it was created in 1944 under the name Industrial Development Bank as a result of a wartime study by the Bank of Canada, which raised concerns about the post-war economy.¹⁷⁴ In 1975, it was renamed the Federal Business Development Bank. The *Business Development Bank of Canada Act* was passed by Parliament in 1995 after the recession of the late 1980s and early 1990s left many members of the small business community with financing problems.¹⁷⁵

Today, the *Business Development Bank of Canada Act* sets out the BDC's purpose, powers and duties. For its mandate, section 4(1) states that “[t]he purpose of the Bank is to support Canadian entrepreneurship by providing financial and management services and by issuing securities or otherwise raising funds or capital in support of those services.” Section 4(2) states that “[i]n carrying out its activities, the Bank must give particular consideration to the needs of small and

¹⁷¹ *Ibid* at 9.

¹⁷² *Ibid* at 11.

¹⁷³ *Ibid*.

¹⁷⁴ Michael Kirby and David Agnus, “Crown Financial Institutions,” (1996) The Standing Senate Committee on Banking, Trade, and Commerce, online: <<http://www.parl.gc.ca/Content/SEN/Committee/352/bank/rep/cfi-e.htm#fres>> [Kirby & Agnus].

¹⁷⁵ *Ibid*.

medium-sized enterprises.”¹⁷⁶ The control and accountability of the BDC is set out in the *FAA* under Part X and the corporation is listed under Schedule III, Part 1. The BDC is governed by an independent board of directors whose members are appointed by the Minister of Industry.¹⁷⁷

In addition to providing term loans, the BDC has developed three financing programs to cater to SMEs: Co-vision to support start-ups and small businesses with financing up to \$100,000; Productivity Plus which supports productivity improvements in SMEs; and Innovation which provides working capital solutions to support growth projects for SMEs. The BDC also provides consulting services and subordinated financing and venture capital.¹⁷⁸ In the 2010 fiscal year, the BDC had a consolidated net income of \$6.1 million (down from the \$90.6 million in the 2009 fiscal year). However, the venture capital, consulting, and securitization business lines all recorded net losses.¹⁷⁹ The BDC had 29,000 clients, including entrepreneur exporters whose exports totalled \$21 billion, and entrepreneurs, who sustained 511,000 jobs.¹⁸⁰

One point of contention relates to competition with the private sector. Theoretically the BDC complements, but does not directly compete with, private financial institutions. While its predecessors were lenders of last resort and thus did not compete with the private sector, the BDC is not a lender of last resort, leading private sector firms to be sceptical of the claim that they are not in competition.¹⁸¹

b) The Farm Credit Corporation of Canada

The Farm Credit Corporation (FCC), originally named the Canadian Farm Loan Board (CFLB), began operating in 1929. Unlike the other two Crown financial institutions, it was created as a result of political pressure from an organized group of farmers that demanded financial assistance for agriculture.¹⁸² Other factors also led to the formation of the CFLB. First, the decreased demand for Canadian wheat and subsequent decline in agricultural prices in the 1920s threatened the viability of Canadian agriculture. Second, a 1923 report had demonstrated that Canadian farmers paid more for long-term credit than farmers in other countries as well as non-farmers in Canada, due to a perceived deficiency in private sector lending competition.¹⁸³

In 1959, the *Farm Credit Act* replaced the CFLB with the FCC and gave the FCC broader powers in order to respond to the criticisms of the older corporation, including its conservative policies. This legislation was replaced in 1992 when the *Farm Credit Corporation Act* was enacted, again substantially expanding the scope and powers of the FCC, in order to better reflect farming conditions in the 1990s.¹⁸⁴

¹⁷⁶ *Business Development Bank of Canada Act*, S C 1995, c 28 s 4.

¹⁷⁷ Business Development Bank of Canada, “Annual Report 2010,” at 63, online: <http://www.bdc.ca/en/Documents/annualreport/BDC_AR_ENG_10_v16.pdf>.

¹⁷⁸ Andrina Lever, “SME Development and Policy in Canada: A Review of Challenges and Opportunities for Small Business 2007,” (2007) *The Policy Environment for the Development of SMEs* at 38, online: <http://www.ctpecc.org.tw/publications/SMEs_p01_314.pdf#page=27>.

¹⁷⁹ Business Development Bank of Canada, “2010 Annual Report,” (2010) at 41, online: <http://www.bdc.ca/en/Documents/annualreport/BDC_AR_ENG_10_v16.pdf>.

¹⁸⁰ *Ibid* at 2 – 5.

¹⁸¹ Kirby & Agnus, *supra* note 174.

¹⁸² *Ibid*.

¹⁸³ *Ibid*.

¹⁸⁴ *Ibid*.

Currently, the FCC's mandate, as set out in the *Farm Credit Corporation Act*, is "providing specialized and personalized business and financial services and products to farming operations, including family farms, and to those businesses in rural Canada, including small and medium-sized businesses, that are businesses related to farming."¹⁸⁵ It is financially self-sufficient and provides its services to more than 90,000 primary producers, value-added operators, suppliers and processors. A board of directors is responsible for the governance of the FCC and its members are appointed by the Minister of Agriculture and Agri-Food and Minister for the Canadian Wheat Board, with approval of the Governor in Council. The FCC is also subject to Part X of the FAA and is listed under Schedule III, Part 1.¹⁸⁶

Services provided by the FCC include primary production financing, agribusiness and agri-food financing, financing for equipment, crop input and livestock at the point of sale, insurance provision, and venture capital financing.¹⁸⁷ In 2010, the FCC had 114,439 loans, 41,418 of which were new for that year, with an average loan of \$159,003. The FCC continues to generate a positive net income (\$281.9 million for 2010).¹⁸⁸

c) *The Export Development Corporation*

The Export Development Corporation (EDC) is also a wholly owned Crown corporation that was established in 1944 to assist with post-war economic reconstruction. Originally under the name Export Credits Insurance Corporation (ECIC), it was created to fill gaps in Canadian export capabilities and markets that were caused by the war. There was a concern that Canada would experience a decline in exports for goods that were related to the war, and that exporters would be unable to obtain credit facilities from private financial institutions given the risks involved.¹⁸⁹

Another gap the corporation was intended to close was the credit problem faced by those importing Canadian goods. Foreign importers, as a result of the war, could not finance the purchase of needed goods from their own domestic financial institutions, so the ECIC gave loans and financial assistance to foreign governments,¹⁹⁰ including Belgium, Norway, the USSR, and the Czechoslovak Republic.¹⁹¹

In 1969, the policies of the ECIC were criticized for being too conservative. This led to the creation of the EDC under the *Export Development Act*, which greatly expanded its mandate. The corporation's legislation was amended again in 1993 to further expand its formal role.¹⁹²

¹⁸⁵ Farm Credit Canada, "Corporate Plan Summary 2010-11 to 2014-15," (2010) at 1, online: <http://www.fcc-fac.ca/en/AboutUs/Profile/pdf/cps_2010_11_e.pdf>.

¹⁸⁶ *Ibid* at 11.

¹⁸⁷ Farm Credit Canada, "Products and Services," online: <<http://www.fcc-fac.ca/en/index.asp>>.

¹⁸⁸ Farm Credit Canada, "Annual Report 2009-10," (2010) at 3, online: <http://www.fcc-fac.ca/en/AboutUs/Profile/pdf/AR2009-10_LO_e.pdf>.

¹⁸⁹ Kirby & Agnus, *supra* note 174.

¹⁹⁰ *Ibid*.

¹⁹¹ Department of Finance, *Public Accounts of Canada, 1948* (Ottawa: Kings Printer, 1948) at F52.

¹⁹² Kirby & Agnus, *supra* note 174.

Under the *Export Development Act*, the EDC's mandate is "to grow and develop Canada's trade, and the capacity of Canadian companies to participate in and respond to international business opportunities."¹⁹³ The Act also exempts the EDC from federal taxes.¹⁹⁴ The EDC is financially self-sustaining and provides Canadian companies with trade finance and risk mitigation services, which allow them to compete internationally.¹⁹⁵ Its control and accountability is set out in Part X of the *FAA* and it is listed under Schedule III, Part 1. An independent Board of Directors comprised of 15 members appointed by the Minister of International Trade governs the corporation.¹⁹⁶ In March 2009, the government increased the mandate of EDC in order to inject the financial system with credit to help struggling, trade-related Canadian companies, especially those in the hardest-hit sectors due to the recent economic downturn.¹⁹⁷

Today, the EDC provides services such as insurance mechanisms,¹⁹⁸ financing for both Canadian and foreign companies, and bonding mechanisms. Support schemes provided by the EDC, such as loans to promote export business or foreign direct investment, are individualized to the needs of companies to expand their investor base and improve their capital structures. The EDC also provides private equity and venture capital through direct investment in domestic and foreign companies. It also collaborates with venture capital funds which invest in Canadian companies to promote export growth.¹⁹⁹ In 2009, the EDC had a net income of \$258 million and no annual appropriations from Parliament.²⁰⁰ It serves 8,469 clients and supports businesses in 200 markets.²⁰¹

3. PRIVATIZATION POSSIBILITIES

The question remains whether government ownership is the best form of involvement to achieve the governmental objectives described above.

¹⁹³ Export Development Corporation, "Mandate and Role," online: <http://www.edc.ca/english/corporate_mandate.htm> [EDC Mandate].

¹⁹⁴ Maciej Kotowski, "Insuring Canada's Exports: The Case for Reform at Export Development Canada," (2007) CD Howe Institute Commentary 257 at 6 [Kotowski].

¹⁹⁵ *EDC Mandate*, *supra* note 193.

¹⁹⁶ *Ibid.*

¹⁹⁷ *Kirby & Agnus*, *supra* note 174.

¹⁹⁸ Insurance solutions include: accounts receivable insurance, which covers receivables resulting from commercial or political risks; single buyer insurance, which covers unlimited sales to one customer for 180 days; contract frustration insurance, which covers losses for one export contract; political risk insurance, which protects overseas assets such as equipment and manufacturing facilities; and performance security insurance, which covers losses if a customer demands payment of a bond issued by the client's bank without valid reason.

¹⁹⁹ Günseli Baygan-Robinett, "The Canadian Risk Capital Market and the Role of Government Policies," (2007) International Consortium of Entrepreneurship at 33, online: <http://ice.foranet.dk/upload/canada_%28nov_2007%29.pdf>.

²⁰⁰ Export Development Corporation, "Annual Report 2009," (2009), online: <<http://www.edc.ca/publications/2010/2009annualreport/english/1.htm>>.

²⁰¹ *Ibid.*

The rationale for originally creating the BDC to fill the credit gaps for SMEs may be less of a concern today than at time of formation. Private sector institutions have since been using innovative financing techniques and setting up flexible repayment options to better serve the SME sector.²⁰² Some argue that the presence of the government-owned institution actually weakens market incentives for the private sector to adapt their services to SMEs. As information technology improvements continue, the information problems associated with pricing risk in new, idea-based markets are being reduced.²⁰³

Similarly, for the EDC, some critics have recommended a partial privatization with a tax scheme to maintain the same extent of coverage while shifting away from government provision of short-term insurance. At present, the EDC has a dominant market share in both short-term and medium-term credit insurance markets and it competes directly with private insurers, crowding out private firms' entry into the market.²⁰⁴ Many other governments have moved towards a private sector model, retaining only extreme and speculative risks within the government sphere. For example, in Europe, 95 percent of export credit insurance is provided by private institutions, and some countries have privatized large areas of their once government-owned institutions.²⁰⁵ During the 1990s, the private sector expanded to provide credit insurance, partially due to transformations in the market including innovations in information technology, regulatory harmonization in Europe, and financial market innovation in delivery methods for credit insurance.²⁰⁶ The federal government would also gain from the partial privatization from increased tax revenue by taxing premium income and firm profits, neither of which are received from the EDC.

Reducing criticism from Canada's trading partners would be another benefit of partial privatization of the EDC. The Subsidies and Countervailing Measures Agreement of the World Trade Organization (WTO) bans export subsidies in general.²⁰⁷ The WTO rules indicate that the operations of export credit agencies should break even in the medium to long term (although subsidies are permitted as long as this constraint is met).²⁰⁸ While the EDC is financially self-sustaining and meets the requirements of the WTO, the EDC differs from other OECD countries export credit agencies in that it both enjoys a dominant market share and competes directly with private insurers.²⁰⁹

While short-term insurance could be regulated and provided by the private sector, medium- and long-term insurance are more complicated to delegate. While several private insurers including AIG, Zurich, FCIA, and Hiscox have begun offering these policies, there are many challenges in this market because of the variable nature of the risks, the length of coverage, and the large transaction sizes.²¹⁰

²⁰² *Schnurr, supra* note 170 at 47.

²⁰³ *Ibid*

²⁰⁴ *Kotowski, supra* note 194 at 1.

²⁰⁵ Jian-Ye Wang et al, "Officially Supported Export Credits in a Changing World," (2005) International Monetary Fund.

²⁰⁶ *Ibid.*

²⁰⁷ Karen H Cross, "King Cotton, Developing Countries and the 'Peace Clause': the WTO's US Cotton Subsidies Decision," (2006) 9:1 *Journal of International Economic Law* 149.

²⁰⁸ *Kotowski, supra* note 194 at 6.

²⁰⁹ *Ibid* at 1.

²¹⁰ *Ibid* at 17.

Political considerations may also be a factor in the government's decision to remain involved. Reforming the EDC may be accompanied by strong political opposition from EDC employees and those exporting companies who have developed a strong relationship with the EDC.²¹¹

V. REFORM PROPOSALS

The key policy decision with respect to Crown corporations is whether to privatize them or not. In Canada over the past 25 years, the following major privatizations have taken place: Teleglobe in 1987; Air Canada from 1988-1989, the Canadian National Railway Company in 1995; Petro-Canada in the 1990s; Nova Scotia Power Corp. in 1992; Manitoba Telephone System in 1996; and Ontario's Highway 407 in 1999.²¹² Privatization occurs frequently when either the rationale for government involvement no longer exists (for example technology has improved and altered a market's structure so that it is no longer a natural monopoly) or when privatization (albeit subject to regulation, taxation, or subsidization) has been identified as better fulfilling the government's policy objectives.

In our view, there are many sectors where further privatization would be appropriate. This is because the rationale that may have once existed for public ownership no longer exists, or as is often true, there never was a good rationale for public ownership. While in many cases public ownership may facilitate pursuit of a particular policy goal, such goals can frequently be achieved under a privatized regime through some alternative means of government intervention. That is, privatization can realize both the economic gains that private ownership tends to promote, as well as the social objective that more limited government intervention may promote. Of course, in some cases it may be that public ownership is indispensable to realizing certain social goals, but too often the social goal is invoked to justify public intervention without adequate recognition of alternative policy instruments that could also accomplish these goals in a privatized regime. Genuine policy debates about privatization, including alternative means of ensuring the realization of social goals, are often swept aside by interest group politics, with groups such as unions strongly opposed to privatization of any sort for reasons that have much more to do with their anticipated well-being post-privatization than the public interest.

An example of the policy wisdom of privatization and the political challenges that confront it is found in the postal service.²¹³ We believe there is a strong case for privatizing Canada Post.²¹⁴ The economic case is clear: there are no apparent market failures in mail delivery that

²¹¹ *Ibid* at 22.

²¹² *Hrab, supra* note 63 at 4.

²¹³ See Iacobucci et al., *supra* note 156.

²¹⁴ *Ibid*.

invite state ownership, and comparative experience with privatizing the mail system suggests significant potential for service and cost improvements. On the other hand, social concerns about universal service are invoked to oppose privatization, as is the fact that the Post Office is profitable and thus contributes to the fisc.²¹⁵ But neither of these objections to privatization withstands scrutiny. If universal service is taken to be valuable from a social perspective, it can be achieved without public ownership. Telecommunications provides a suitable example of private owners being compelled to contribute financially to universal service. And on fiscal matters, it is not at all obvious that super-competitive profits, which Canada Post should earn given its legal protections from competition, are an efficient form of taxation.

In many cases, the arguments in favour of public ownership, including the arguments in favour of retaining Canada Post as a Crown corporation, are made by those who have a clear political agenda. Perhaps most prominently, public unions such as the Canadian Union of Postal Workers actively have campaigned against privatization and may have incentives to invoke such arguments whether they are valid or not. Governments themselves may also prefer the hidden nature of taxation and subsidization that public ownership implicitly entails.

There is no simple answer to managing the politics of privatization, but there are some clear lessons. It is important when government is considering privatizing a Crown corporation to articulate clearly whether the policy objectives that led to its creation have changed, or whether the domestic or comparative experience suggests a superior policy instrument for achieving these objectives, so that the decision to privatize can be subjected to informed public scrutiny. One concern with privatization occurs when the government fails to commit to the nature and scope of future government intervention in the industry and the regulatory, tax, and subsidy policies that are to be put in place. This information will affect the value of the corporations and governments can easily overstate the gains from privatization, thus creating backlash and opposition to further privatization of a particular sector, or in other sectors.

To conclude, it is worth emphasizing that there is a range of normative objectives that public ownership might help advance, and in some contexts, public ownership is the most appropriate policy instrument to accomplish certain goals. But in many cases, focused government intervention in a privatized market will accomplish the same goals as public ownership, but at a much lower cost.

²¹⁵ See, e.g., Canadian Union of Postal Workers, "Postal Privatization: Questions and Answers," November 2010, http://www.publicpostoffice.ca/index.cfm/ci_id/12604/la_id/1.htm: "Governments arguably lose a great deal by privatizing. They lose regular payments to national coffers if post offices are profitable (as opposed to receiving one-time profits from privatizing). They also risk being politically unpopular with the public, especially people living in rural areas. Rural residents stand to lose affordable service, or service altogether, in a privatized postal system geared to profit."

About the Authors

Edward Iacobucci is Professor, Associate Dean – Research, and Osler Chair in Business Law at the Faculty of Law, University of Toronto. He was appointed to the Faculty in 1998. Prior to his appointment, he was a Law Clerk to Mr. Justice John Sopinka of the Supreme Court of Canada in 1996-97 and was the John M. Olin Visiting Lecturer at the University of Virginia School of Law in 1997-98. Since his appointment he has been a John M. Olin Visiting Fellow at Columbia Law School in 2002, a Visiting Professor of Law at the University of Chicago Law School in 2003 and a Visiting Professor of Law at New York University Law School in 2007.

Professor Iacobucci's teaching and research interests include corporate law and governance, securities law, corporate finance, competition policy and law and economics more generally. He has authored and co-authored numerous scholarly articles and books in Canada and internationally on topics that include corporate law, corporate governance, corporate finance, securities law, competition policy and regulation. He has taught courses in corporate and securities law, corporate finance, comparative corporate governance and competition policy.

Michael Trebilcock is Chair in Law and Economics in the Faculty of Law at the University of Toronto. He holds an LL.B from the University of Canterbury in New Zealand and an LL.M. from the University of Adelaide. He joined the Faculty of Law at the University of Toronto in 1972 and was selected as a University Professor in 1990. Professor Trebilcock specializes in Law and Economics, International Trade Law, Competition Law, Economic and Social Regulation, and Contract Law and Theory. He was a Fellow in Law and Economics at the University of Chicago Law School in 1976, a Visiting Professor of Law at Yale Law School in 1985 and 2005, and a Global Law Professor at New York University Law School in 1997 and 1999. He was a Visiting Professor at Harvard Law School in 2011. Professor Trebilcock has published on many subjects and has won several awards for his work, including in 1989 the Owen Prize by the Foundation for Legal Research for his book, *The Common Law of Restraint of Trade*, which was chosen as the best law book in English published in Canada in the past two years. In 2007, he was the recipient of the Ontario Attorney General's Mundell Medal for contributions to Law and Letters. In 2010, he was the recipient of the Ontario Premier's Discovery Award for the Social Sciences.

ABOUT THIS PUBLICATION

The School of Public Policy Research Papers provide in-depth, evidence-based assessments and recommendations on a range of public policy issues. Research Papers are put through a stringent peer review process prior to being made available to academics, policy makers, the media and the public at large. Views expressed in The School of Public Policy Research Papers are the opinions of the author(s) and do not necessarily represent the view of *The School of Public Policy*.

OUR MANDATE

The University of Calgary is home to scholars in 16 faculties (offering more than 80 academic programs) and 36 Research Institutes and Centres including *The School of Public Policy*. Under the direction of Jack Mintz, Palmer Chair in Public Policy, and supported by more than 100 academics and researchers, the work of The School of Public Policy and its students contributes to a more meaningful and informed public debate on fiscal, social, energy, environmental and international issues to improve Canada's and Alberta's economic and social performance.

The School of Public Policy achieves its objectives through fostering ongoing partnerships with federal, provincial, state and municipal governments, industry associations, NGOs, and leading academic institutions internationally. Foreign Investment Advisory Committee of the World Bank, International Monetary Fund, Finance Canada, Department of Foreign Affairs and International Trade Canada, and Government of Alberta, are just some of the partners already engaged with the School's activities.

For those in government, *The School of Public Policy* helps to build capacity and assists in the training of public servants through degree and non-degree programs that are critical for an effective public service in Canada. For those outside of the public sector, its programs enhance the effectiveness of public policy, providing a better understanding of the objectives and limitations faced by governments in the application of legislation.

DISTRIBUTION

Our publications are available online at www.policyschool.ca.

DISCLAIMER

The opinions expressed in these publications are the authors' alone and therefore do not necessarily reflect the opinions of the supporters, staff, or boards of The School of Public Policy.

COPYRIGHT

Copyright © 2012 by The School of Public Policy.

All rights reserved. No part of this publication may be reproduced in any manner whatsoever without written permission except in the case of brief passages quoted in critical articles and reviews.

ISSN

1919-112x SPP Research Papers (Print)
1919-1138 SPP Research Papers (Online)

DATE OF ISSUE

March 2012

MEDIA INQUIRIES AND INFORMATION

For media inquiries, please contact Morten Paulsen at 403-453-0062.

Our web site, www.policyschool.ca, contains more information about The School's events, publications, and staff.

DEVELOPMENT

For information about contributing to The School of Public Policy, please contact Courtney Murphy by telephone at 403-210-7201 or by e-mail at cmurphy@ucalgary.ca.

EDITOR

Timothy Giannuzzi

RECENT PUBLICATIONS BY THE SCHOOL OF PUBLIC POLICY

SOME OBSERVATIONS ON THE CONCEPT AND MEASUREMENT OF INCOME INEQUALITY

<http://policyschool.ucalgary.ca/sites/default/files/research/richardson-comm2.pdf>

Stephen R. Richardson | February 2012

A REVIEW AND ASSESSMENT OF PRIVATIZATION IN CANADA

<http://policyschool.ucalgary.ca/sites/default/files/research/boardman-vining-privatization.pdf>

Anthony E. Boardman and Aidan R. Vining | January 2012

THE INTERNATIONAL EXPERIENCE WITH PRIVATIZATION: ITS RAPID RISE, PARTIAL FALL AND UNCERTAIN FUTURE

<http://policyschool.ucalgary.ca/sites/default/files/research/nellis-privatization.pdf>

John Nellis | January 2012

HOUSING SUBSIDIES AND HOMELESSNESS: A SIMPLE IDEA

<http://policyschool.ucalgary.ca/sites/default/files/research/oflaherty-housing-subsidy.pdf>

Brendan O'Flaherty | January 2012

PUBLIC SECTOR WAGE GROWTH IN ALBERTA

<http://policyschool.ucalgary.ca/sites/default/files/research/boessenkool-public-wage-growth.pdf>

Ken Boessenkool and Ben Eisen | January 2012

CATCHING THE BRASS RING: OIL MARKET DIVERSIFICATION POTENTIAL FOR CANADA

<http://policyschool.ucalgary.ca/sites/default/files/research/mmoore-oilmarket.pdf>

M.C. Moore, S. Flaim, D. Hackett, S. Grissom, D. Crisan and A. Honarvar | December 2011

THE CONSTITUTIONALITY OF FEDERAL CLIMATE CHANGE LEGISLATION

<http://policyschool.ucalgary.ca/?q=content/constitutionality-federal-climate-change-legislation>

Alastair Lucas and Jenette Yearsley | December 2011

THE MYTHS AND FACTS OF FOSSIL FUEL SUBSIDIES: A CRITIQUE OF EXISTING STUDIES

<http://policyschool.ucalgary.ca/files/publicpolicy/MCKENZIE%20MINTZ%20online.pdf>

Kenneth J. McKenzie and Jack M. Mintz | October 2011

HOMELESSNESS IN ALBERTA: THE DEMAND FOR SPACES IN ALBERTA'S HOMELESS SHELTERS

<http://policyschool.ucalgary.ca/files/publicpolicy/homelessness%20in%20alberta.pdf>

Ronald Kneebone, J.C. Herbert Emery and Oksana Grynishak | September 2011

THE NEW SECURITY PERIMETER WITH THE UNITED STATES

<http://policyschool.ucalgary.ca/files/publicpolicy/flemming%20sept011.pdf>

Brian Flemming | September 2011

INCOME SUPPORT FOR PERSONS WITH DISABILITIES

http://policyschool.ucalgary.ca/files/publicpolicy/Kneebone_Disability_Study.pdf

Ronald Kneebone and Oksana Grynishak | September 2011

INVESTMENT REVIEW IN CANADA – WE CAN DO BETTER

<http://policyschool.ucalgary.ca/files/publicpolicy/Herman%20Invest%20Canada%20online.pdf>

Lawrence L. Herman | September 2011

PLUCKING THE GOLDEN GOOSE: HIGHER ROYALTY RATES ON THE OIL SANDS GENERATE SIGNIFICANT INCREASES IN GOVERNMENT REVENUE

<http://policyschool.ucalgary.ca/files/publicpolicy/KMcKenzie%20comm%20sept11.pdf>

Kenneth J. McKenzie | September 2011