Railway Association of Canada

April 27, 2023

EXTENDED INTERSWITCHING WILL SLOW DOWN SUPPLY CHAINS AND INCREASE TRANSPORTATION COSTS FOR ALL CANADIANS

A submission to the House of Commons Standing Committee on Finance

RECOMMENDATIONS (BILL C-47)

1. **REMOVE EXTENDED INTERSWITCHING PROVISIONS IN DIVISION 22**
2. **IF PARLIAMENT INSISTS ON THIS DAMAGING POLICY, AMEND THE LEGISLATION TO MITIGATE THE HARMFUL CONSEQUENCES TO THE EXTENT POSSIBLE:**
   A. **The regulated rate under extended interswitching must be based on commercial rates for comparable traffic.**
   B. **This option must be limited to Canadian domestic movements only.**
   C. **Limit the application to grain only.**

INTRODUCTION

The Railway Association of Canada (RAC) is providing this brief to the House Standing Committee on Finance (FINA) to register strong objection to the misguided extended interswitching provisions contained in Bill C-47, the *Budget Implementation Act, 2023, No. 1*.

Bill C-47 proposes the resurrection of the tried and failed policy of extended regulated interswitching in the Prairies. Extended interswitching will unavoidably harm Canada's supply chains. This policy will increase transit and dwell times, elevate greenhouse gas emissions, raise transportation costs for all Canadians, and give U.S. railways a competitive advantage over Canada's Class 1 carriers (CPKC and CN) by allowing them to solicit Canadian freight at regulated cost-based rates with no reciprocity. It will mean lower supply chain throughput and capacity; the exact opposite of what Canada's supply chains need.

The current government prudently sunset the previous extension of regulated interswitching in 2017 following the independent Emerson Report[1]. That report recognized the harms of this policy and recommended its elimination. That was the right policy decision based on facts and evidence.

Resurrecting the policy now via Bill C-47 will negatively impact all shippers and all consumers. It would be, simply put, bad for everyone and detrimental to the Canadian economy.

A FLAWED PROCESS

Canada's railways strongly oppose the budget's policy commitment and the process that led to its announcement. The government's decision to extend the interswitching limit was made absent any evidence of a market failure that would justify a need for regulatory intervention. To the contrary, independent international analyses conducted in recent months confirm Canada's railways are delivering for shippers by providing world-leading safety, value, and performance.[2]

The decision appears to the RAC to be motivated solely by political considerations, not fact-based decision-making. It ignores the serious concerns raised repeatedly by railways through their extensive participation in Transport Canada's various supply chain roundtable discussions. In fact, not one member of the National Supply Chain Task Force even raised the subject of interswitching with any railway before making this hasty, ill-advised policy recommendation in its report last Fall. The report does not include any factual or evidentiary basis or justification for the need to return to this failed, damaging policy. This was not a serious public policy process.

Transport Canada officials then confirmed to railways at the Commodity Supply Chain Table meeting held on November 15, 2022, and many times since, that the implications of extended interswitching for the Canadian supply chain would be fully assessed before the government would decide on its implementation. **Transport Canada committed to consulting railways if the government were to proceed with this policy. That did not happen for political reasons.**

RAILWAYS: HIGH PERFORMANCE, LOW COST

Canadian railways are best in class when compared to their U.S. counterparts. Both CN and CPKC report weekly on their performance with detailed data such as revenue ton miles, train speeds, dwell times, railway cars online, railway cars spotted against orders, grain volumes hauled versus the annual grain plan, and weekly demand. These public data are in addition to the highly sensitive and detailed data both railways are required to supply Transport Canada and by which the government closely monitors rail service.

Despite the enormous challenges of COVID-19, the war in Ukraine, and recent extreme weather events, Canada's railways remained a reliable supply chain partner; delivery times remained consistently low while delays in other modes of transport ballooned. In 2022, average rail terminal dwell times remained below eight hours, which is historically consistent. Port dwell times averaged 157 hours in 2022.

In many cases, railways acted as 'shock absorbers' to the other links in Canada's supply chains by opening temporary container storage facilities as well as holding and staging traffic on their lines until ports, warehouses, and customers could reopen to receive and clear their cargos. During these challenging times, Canadian railways volunteered efforts and resources to make a difference in the interest of all.

Robust competition between railways has also kept Canadian freight rates among the lowest in the world. This was confirmed by an independent study[3] in January 2023 by respected consultancy CPCS. The study found that Canadian freight rates are 11 per cent lower than American rates and far lower than in Europe[4]. It costs on average 4.16 U.S. cents to move one ton of goods one mile by rail in Canada. It costs on average 2.97 U.S. cents to move one ton of grain one mile – the lowest freight transportation cost of all countries studied.

In short, **the evidence clearly shows Canadian Class 1 railways offer reliable and consistent service at among the lowest freight rates globally**. The Canadian rail market is functioning well. It is puzzling why the federal government would pursue a policy of deliberately adding costs and congestion to Canada's supply chains given the available evidence and previous reviews recommending against this policy – and amid 40-year high inflation. The government should be pursuing a policy agenda that supports improved supply chain fluidity, efficiency, and capacity.

ADDRESSING SHIPPER CONCERNS

In temporarily extending the regulated interswitching distance, the federal government is reacting to a flawed argument by a group of shippers. These shippers argue that they are less concerned with value and more concerned with improving rail service. Unfortunately, the shippers seem to have convinced themselves and others that expanding the 30 km interswitching distance will somehow lead to better rail service. In fact, nothing could be further from the truth.

Interswitching extends rail car cycles – meaning it takes longer for cars to get back to origins or destinations to pick up or drop off their next shipments. Expanding regulated interswitching would degrade service and investment levels by increasing transit times, triggering congestion, requiring more assets and crews, providing unfair advantage for U.S. railways, and discourage private-sector investment into critical rail infrastructure – all while increasing emissions.

This runs counter to government efforts to improve the capacity and efficiency of supply chains, protect our environment, and grow investments in infrastructure. It is well known and largely accepted that variations in a supply chain, such as those created by interswitching activities, reduce capacity and throughput. For this reason, the decision to nevertheless move ahead on extended interswitching without data analysis is particularly troubling. It also runs counter to the market-based principles and commercial mechanisms that are the cornerstone of Canadian rail policy which derived benefits in all transportation modes.

Since 2018, shippers have had access to Long-Haul Interswitching (LHI) which allows shippers to ask one railway to interchange a shipment to a second railway for movements of up to 1200 km. Rates for LHI are determined by the Agency based on market prices for similar shipments. If the shippers' argument is about access to competitive carriers, then a remedy already exists. The only difference between LHI and extended regulated interswitching is the rate paid. **What the shippers are requesting in seeking to expand the rate-regulated distance is a below-market rate.**

EXTENDING REGULATED INTERSWITCHING: A PROBLEM IN SEARCH OF A SOLUTION

Canada's low rail freight rates and highly efficient networks require Class 1 railways to continuously balance cost and service levels to provide a reasonable level of affordable service to all shippers. Shippers and consumers alike benefit from low costs and efficient rail service.

Expanding regulated interswitching simply to accommodate shippers who want "optionality" is an example of flawed logic by those who are not experts in day-to-day rail operations. The Canadian rail industry embraces competition but at competitive rates and on a level playing field. The notion that this measure will increase competition misstates the desired outcome for those asking for it: a below market rate. Instead, service degradation and higher costs will impact all shippers and contribute to inflation.

If the rules of the game change, everyone will need to adjust. Costs will increase, leaving less for network investments. This is why the prospect of again expanding regulated interswitching zones is particularly ill-timed and ill-advised. No fact-based analyses have been presented to back up this policy.

The argument comes from a group of shippers more focused on their immediate interests than the full impact of their proposal. They suggest service will improve. It will not. It will come at a huge cost in terms of service degradation by introducing more handling, more time to complete transit, and more potential for congestion. The direct consequences will be higher freight costs as it will require extra assets (more cars, crews, locomotives, tracks, etc.) to move the same traffic volumes.

Those shippers who believe their rail service is not delivered at a reasonable or adequate level and who cannot remedy a dissatisfaction with their rail service directly with the railway may avail themselves of the existing remedies through commercial tools and the Canadian Transportation Agency. LHI already enables competitive carrier access.

COLLABORATION AND INVESTMENTS, NOT REGULATION

Collaboration moves supply chains; regulation slows them down. Instead of incentivizing inefficiencies, the federal government should work with industry to implement tangible supply chain solutions. Canada needs a new level of cooperation, not finger-pointing.

For example, the government could work with supply chain partners to design policies that incentivize infrastructure investments. Canadian railways are disadvantaged due to slower tax depreciation relative to U.S. railways. The RAC has asked the government for further support in the form of tax policies and accelerated depreciation measures without success.

Labour is a challenge in the railway industry, as it is in the broader transportation sector. Railways need more assured access to human capital and in-demand skills. Key professions could be added to the National Occupation Classification (NOC) codes for Express Entry eligibility. Proposed anti-replacement worker legislation should also exclude railways given their essential function.

Port terminal workers are prevented from loading grain onto vessels in the rain in Vancouver where it rains 165 days per year on average. While railways set records for grain movement, upholding their end of the transportation bargain, trains are getting delayed at port because their grain cannot be loaded onto vessels in the rain – creating backlogs. Collaborative solutions exist to permit safe loading. These have been used in the past or are being used elsewhere like Seattle, another rainy port and direct competitor to the Port of Vancouver. One such solution could be the creation of structures or facilities where grain can be safely loaded onto vessels out of the rain.

Canada needs more innovation, accountability, and data-sharing from all supply chain partners – including shippers – especially at operational levels. Better forecasting and sharing of information by shippers would go a long way to improving their consistency and reliability as shippers. This will be important as Canada further builds out a strategy on critical minerals, roughly half of which currently move by rail (and more of which could in future).

RECOMMENDATIONS

1. REMOVE THE EXTENDED INTERSWITCHING PROVISIONS IN DIVISION 22

The RAC strongly recommends that FINA amend Bill C-47 to remove provisions related to extended interswitching. Extended regulated interswitching has been done before and it failed. Bringing it back now will lead to demonstrably negative consequences. The best solution is to abandon the proposed policy entirely.

2. IF PARLIAMENT INSISTS ON THIS DAMAGING POLICY, AMEND THE LEGISLATION TO MITIGATE THE HARMFUL CONSEQUENCES TO THE EXTENT POSSIBLE.

If the Committee does not see fit to remove the provisions related to extended interswitching, it should amend the legislation to mitigate the harms that will result to Canadian shippers and Canada's supply chains and railways.

A) The regulated rate under extended interswitching must be based on commercial rates for comparable traffic.

When extended interswitching was implemented previously, the rates were cost-based and non-compensatory. Cost-based rates deter railway investment in capacity-enhancing infrastructure. The Emerson Report recognized this as a significant harm undermining the health of Canada's freight transportation system. Transport Canada agreed and in 2018 introduced LHI as a replacement to extended interswitching. The regulated rate under LHI is determined by the Canadian Transportation Agency based on market rates for comparable traffic. This provides the shipper access to a so-called regulatory remedy while avoiding the damaging impacts of cost-based, or even non-compensatory, regulatory rates that drive investment dollars and jobs out of Canada.

If the government is now going to implement extended interswitching again, the policy logic that led to LHI should apply to rate determinations. The government should require the Agency to set rates for extended interswitching based on commercial rates for comparable traffic. This can be easily adjusted within the text of Bill C-47. Canada's railways have indicated their willingness to discuss with Transport Canada how this principle could be implemented.

B) This option must be available to Canadian domestic movements only.

There are no similar provisions for regulated interswitching in the U.S. If extended interswitching is implemented again in Canada, U.S. carriers will solicit Canadian traffic under the regulatory regime just like they did from 2014-17. The reverse will not be true for U.S traffic. This will put CN and CPKC at a competitive disadvantage relative to U.S. carriers. This cannot happen again. It will result in a loss of Canadian investment dollars and jobs. Canada's railways welcome intense competition, but this requires a level playing field. Canadian railways cannot effectively compete against U.S. carriers when Canadian law is designed to put them at a disadvantage.

C) Limit the application to grain only.

This policy is primarily introduced at the request of the grain industry. The scope of extended interswitching must therefore be limited to exclude all commodities except for grain on the Prairies. This exclusion would help limit the unintended consequences from unpredictable market distortions caused by this blunt regulatory intervention in complex markets.

CONCLUSION

Canada's railways reiterate their strong view that the Committee should do what is right for Canada's supply chains and remove this damaging policy from Bill C-47. The mitigating recommendations outlined above can only limit the harmful consequences to an extent. The goals of maximizing capacity, throughput, and efficiency of Canada's supply chains are incompatible with extended interswitching.

ABOUT RAC

The Railway Association of Canada (RAC) represents close to 60 freight and passenger railway companies. The RAC also counts a growing number of industrial railways and railway supply companies in its associate membership. As part of the fifth largest rail network in the world, RAC members are the backbone of Canada's transportation system.

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[1] Online: https://tc.canada.ca/sites/default/files/migrated/ctar_vol1_en.pdf.

[2] Online: https://lpi.worldbank.org/sites/default/files/2023-04/LPI_2023_report_with_layout.pdf.

[3] Online: https://www.railcan.ca/wp-content/uploads/2023/02/International-Comparison-of-Railway-Freight-Rates.pdf.

[4] This conclusion is consistent with a similar study of the OECD published in 2016. See: OECD Economics Department Working Papers No. 1322, C. Luu, "Strengthening competition in network sectors and the internal market in Canada," 2016, page 31.