

CAR: COMPETITIVE ACCESS RATES FOR PROMOTING RAIL COMPETITION



David Goffin

Canada's bulk shippers are proposing a new mechanism for assuring competitive access to the nation's railway infrastructure. "Competitive access rates" (CAR) would modify the current system of "competitive line rates" by giving captive shippers stronger guarantees of their right to interconnect with non-local railways and streamlining Canadian Transportation Agency. The railways' opposition to CAR is overblown.

Les expéditeurs canadiens de vrac proposent la mise en place d'un nouveau mécanisme pour rendre concurrentiel l'accès à l'infrastructure ferroviaire du pays. Selon eux, une « tarification concurrentielle d'accès » remplacerait avantageusement le système actuel de « tarification concurrentielle par ligne » : elle garantirait mieux aux expéditeurs captifs le droit d'interconnexion avec des lignes régionales ou pancanadiennes, et elle conférerait à l'Office des transports du Canada un droit de regard sur les taux négociés pour de telles expéditions. L'opposition des chemins de fer à une tarification « d'accès » paraît donc exagérée.

The Canada Transportation Act Review Panel was appointed by the Minister of Transport to conduct a comprehensive review of the *Canada Transportation Act* (CTA) and related legislation. It is working toward the presentation of a final report to the Minister by Canada Day. Within the review panel's terms of reference, competitive rail access provisions are listed among the issues requiring special attention. In particular, the review panel is to consider proposals for enhancing competition in the railway sector in the broader context of increasing North American integration and ensuring cost-effective service for shippers over the long term.

This emphasis on rail competition is consistent with the National Transportation Policy declaration in the CTA, which states, among other objectives, that a network of transportation services making the best use of all available modes of transportation at the lowest total cost is essential to serve the transportation needs of shippers and travellers. Furthermore, competition and market forces are, whenever possible, to be the prime agents in providing viable and effective transportation services.

Rail competition, where it exists, paves the way

toward lower prices and improved service for thousands of Canadian shippers in a variety of goods-producing industries. It strengthens the competitiveness both of those industries and of the railways themselves by making them more responsive and better able to compete internationally. Recognizing this, the *National Transportation Act, 1987* abolished the right of railways to set their rates collectively and sought to encourage competitive behavior through a "basket" of competitive access and dispute-resolution mechanisms.

The intervening years have demonstrated that some of those mechanisms have worked well while others have not. In the current review, the Shippers' Summit Group of associations, whose members account for approximately 95 per cent of Canadian rail freight revenues, advocates remedying this through proposals including: a "competitive access rate" (CAR) mechanism which simplifies the existing "competitive line rate" (CLR); modified but still limited railway running rights; and removal of deterrents to shipper use of the Canadian Transportation Agency. What follows describes and assesses the CAR (which was originally developed by the Canadian Fertilizer Institute).

Within the basket of competitive access mechanisms in the current CTA, both interswitching provisions and the CLR are designed to provide a shipper with access to a competing railway at an interchange. Under interswitching, a shipper located on one railway is permitted to have its traffic interchanged to another railway for the line haul when the point of origin of a movement of traffic is within a radius of 30 kilometres of an interchange. The Canadian Transportation Agency (“the Agency”) has the responsibility to determine maximum rates charged for an interswitching move. Similar provisions apply to terminating traffic. Shippers have consistently reported that the railways compete for interswitching traffic, and they regularly use interswitching to obtain better routings for their traffic, or to obtain more competitive terms and conditions.

A shipper located on one rail line and beyond the 30 km interswitching limits can ask its local railway to establish a CLR for moving goods to a competing railway line. To use this option, the shipper must have already reached an agreement with the competing railway before requesting a CLR from the local railway. The CLR applies from the point of origin or destination to the nearest interchange with the competing railway. If the parties cannot agree on a CLR, the shipper can ask the Agency to set it according to legislated guidelines. Since the *Canada Transportation Act* was passed in 1996, however, a shipper can only obtain an Agency-established CLR by satisfying a “substantial commercial harm” test and the Agency rate must be “commercially fair and reasonable to all parties.”

The Shippers’ Summit describes the CLR as a good idea gone bad. By 1993 shippers reported that they no longer undertook negotiations with railways for CLRs, and the *National Transportation Act* Review Commission commented that Canada’s two major railways “have effectively declined to compete with each other through CLRs, and as a result the provision is largely inoperative in Canada.” This is a very serious result for resource-based shippers, whose plants, mills and mines are often served by only one rail line, are beyond interswitching limits and either have no access at all to other modes of transport or no access to modes that are economical for them.

Why did the CLR fail and how can that failure be remedied by the CAR? The Shippers’ Summit Group believes that there are two major reasons why the CLR ceased working. One is the legislated requirement for an “agreement”

between the shipper and the connecting railway before a CLR can be obtained. Connecting railways are reluctant to enter into such agreements, which demonstrate their willingness to “short-haul” the local railway, when there is no guarantee that a CLR will even be established to permit them to access the business. The other reason is the complexity imposed by the requirement for an Agency hearing when the parties cannot agree upon the CLR. The complexity and costs for a shipper seeking a CLR from the Agency were considerably increased when the subjective “substantial commercial” harm test was imposed in 1996.

To remedy these defects, CAR would carry out relatively minor repairs and improvements to the current CLR provisions. It would: remove the requirement for agreement with a connecting carrier; delete the requirement for an application to the Agency; abolish the substantial commercial harm test; and use a single method of rate calculation when the CAR must be established by the Agency, that being the “system average revenue-per-tonne-kilometre” for the commodity being moved. A CAR would also be specifically permitted at both the origin and destination of a shipment, something which arguably is already permitted for the CLR under the existing legislation.

The philosophy underlying CAR is to make it as close as possible to interswitching, a competitive access mechanism having a proven track record. Like interswitching, CAR would be rate-on-demand, with the Agency issuing the rate to the interchange upon the shipper’s request. This would avoid costly and time-consuming hearings before the Agency. It would also eliminate application of the “substantial commercial harm” test. Furthermore, like interswitching, CAR is pro-competitive. It is designed to allow the home railway to continue to compete for the traffic over the long haul even after it reaches the interchange at the CAR rate. Under the present CLR, this cannot happen. The traffic must be switched to the connecting railway once it reaches the interchange.

Would these improvements upon the CLR be sufficient to make CAR effective? Many shippers are convinced that that they would, while others are not so sure, but all Shippers’ Summit members believe that CAR should be given the chance to provide shippers, especially resource-based shippers, with the rail competition originally expected from the CLR.

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When the CLR was first developed in 1987, the government of the day built in a number of safeguards and limitations designed to minimize the extent of its intervention in the marketplace. CAR continues these safeguards and limitations with little change. For instance:

- Where a CAR cannot be negotiated it would, like the CLR, be established by the Agency by order or regulation and incorporated into either a published tariff or a confidential contract at the option of the shipper and the local railway.
- Like the CLR, CAR would be established at the request of a captive shipper to or from the nearest interchange with a connecting railway of the shipper's choice in the reasonable direction of the haul over a route designated by the shipper.
- Like the CLR, CAR would be limited to not more than 50 per cent of the total rail distance between origin and destination and it would be rated using the Agency's regulated interswitching rates for the first 30 km of the movement.
- Like the CLR, CAR would continue to be set on the basis of rates which have been commercially negotiated between shippers and railways rather than on the basis of costs.
- Like the CLR, CAR would require the connecting railway to provide the rail cars for the movement and to carry out any physical modifications required at the interchange.
- CAR would continue the CLR restrictions applicable to intermodal equipment, and shippers using CAR would not be permitted to also use Final Offer Arbitration to resolve rate disputes with the local railway.

Notwithstanding these safeguards and limitations, some participants in the CTA Review process have raised questions or concerns regarding the CAR proposal. They raise three main concerns, which will be dealt with in turn.

CAR would constrain the ability of railways to engage in differential or "Ramsey pricing." Differential pricing refers to the fact that railways charge different rates to different shippers, generally based on the shipper's dependency on rail. The more captive a shipper is to rail, the more likely it is to be charged a higher rate. Economists refer to this as pricing according to "Ramsey principles." According to the Ramsey pricing model, pricing at marginal cost would not allow monopolies with long-run decreasing costs to meet their average costs. In order to remain in business,

such firms must price above marginal cost.

The federal Competition Commissioner points out that the Ramsey pricing model was designed to assist regulators in determining rates for natural monopolies. It does not justify allowing monopoly railways to use their discretion in establishing differential prices for their customers. Moreover, efficient Ramsey pricing requires regulatory oversight and the Commissioner's opinion is that "Effective dispute resolution mechanisms and competitive access provisions were designed for this purpose and are much less intrusive and more efficient than cost-based regulation and as such are an integral component of efficient Ramsey pricing in Canada."

In other words, the Competition Commissioner considers the constraints on differential pricing imposed by competitive access mechanisms such as CAR to be essential for efficient application of the pricing mechanism itself.

The CAR average revenue-per-tonne-kilometer rate formula would lead to an average rate structure for all rail traffic. History tells us that CAR will not drive rates to the system-wide average. Between 1987 and 1992, when shippers were using the CLR mechanism in rate negotiations with railways, the Agency established CLR rates on five occasions. In three of those, rates were set on the basis of the rate formula proposed for CAR, yet there was no discernible movement towards the average rate structure for all rail traffic. Moreover, the CAR rate would be based on rates which have been commercially negotiated for the commodity in question and would include an additional built-in allowance for interswitching of \$365 per rail car. Shippers would only want to use a rate constructed in this manner to reach a competing railway at an interchange, i.e. they would not view the CAR rate itself as providing a competitive rate.

CAR might not achieve greater efficiencies in the rail system. It is true that any competitive access mechanism based on switching of traffic between railways is potentially less efficient than direct haul. The potential efficiency loss is offset, however, because shippers use competitive access to obtain not only more competitive rates and services but also better routings for their traffic. Shippers would be able to use CAR to achieve shorter, more direct and less costly routes from both eastern and western Canada, particularly to US destinations.

Concerns have also been expressed that an inappropriate "access price" (e.g., in this case, the CAR rate) could permit an inefficient railway to

take traffic from a more efficient local railway, thus decreasing overall rail system efficiency. In Canada, this argument would seem to have little validity since in most cases access would be divided between the two major railways, both of which are highly efficient carriers. Moreover, under inter-switching less than five per cent of the two major railways' total cars are switched annually to the lines of the competing railway. Under CAR even less actual access by competing railways would be expected. While economists have developed theoretically efficient access pricing methodologies for railways, in the real world they would have to include burdensome regulatory processes to avoid monopoly rents, rendering them of little use to shippers. The streamlined CAR mechanism and rate formula avoids that serious shortcoming.

The bottom line is that CAR carries out relatively minor repairs to the existing CLR provisions. CAR would differ from the CLR in just three significant ways: No prior agreement with the connecting carrier would be required; no "substantial commercial harm" hurdle for reaching the Agency would be imposed; and CAR would be permitted at both ends of the rail movement. Shippers believe these rather simple amendments could allow CAR to deliver the rail competition for captive shippers originally promised by the CLR mechanism. That is why shippers are asking "Why all the fuss?"

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CAR could deliver the rail competition for captive shippers originally promised by the CLR.

Benefits for Children: A Four Country Study

Edited by Ken Battle and Michael Mendelson

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Benefits for Children: A Four Country Study reports on the system of income benefits paid on behalf of children in Australia, Canada, the United Kingdom and the United States. The study compares the structure and functioning of child benefit systems, focussing especially on the new income-tested programs for children that operate or are being introduced in all four countries. But these initiatives cannot be discussed in isolation from the rest of the income security system, which may contain substantial additional benefits for children that 'fit' — or fail to fit — together to form a whole picture. To understand this context, the volume includes a review of all major income benefits paid to families with children in each country as well as important subsidies and services that deliver income in-kind. *Benefits for Children: A Four Country Study* differs from many international studies in that it compares the design of social programs per se rather than treating them as a 'black box' without delving into what happens inside the black box. This report opens up the black box and reveals what is inside, in sufficient depth and detail to be of practical use to policy makers and administrators who design and deliver child benefits.

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