

Producer Coalition Submission to the Canada Transportation Act (CTA) Review Panel in Response to the CTA Review Report

Sept 16th, 2016

Introduction

The producer coalition is comprised of the Saskatchewan Wheat Development Commission (Sask Wheat), the Agricultural Producers Association of Saskatchewan (APAS), and the Saskatchewan Barley Development Commission (Sask Barley). The coalition represents the large majority of Saskatchewan grain producers in matters pertaining to the *Canada Transportation Act* and other policy initiatives related to the grain handling and transportation system.

Saskatchewan grain producers compete in export markets and are highly reliant on Canada's rail service providers to meet our transportation and marketing needs. In 2015, Saskatchewan producers grew 32.9 million tonnes of grains, oilseeds and pulses, generating \$11.5 billion in export sales. Unlike other transportation-dependent industries, producers of agricultural products do not control their own transportation position but ultimately bear the costs of freight. In 2015, Saskatchewan producers paid \$750 million in freight to get our products to market.

Grain producers have few cost-effective alternatives to moving their grain to port and are uniquely affected by federal rail transportation policy and reform. Lack of rail service availability imposes direct costs on primary producers in the form of lost marketing opportunities, burdensome storage costs, and elevated basis levels (i.e. the difference between country and port price). An independent study (Gray 2015 - [Link](#)), commissioned by our coalition, estimated that producers experienced up to \$6.7 billion in cumulative losses resulting from the port and country price differential in the 2013/14 and 2014/15 crop years.

It is in this context that our coalition made our initial submission to the *Canada Transportation Act* (CTA) review panel in December 2014. We now welcome the opportunity to formally respond to the recommendations on grain transportation contained in the CTA review report, which was tabled in the House of Commons on February 25th, 2016.

Background

Our complete perspective on grain transportation is contained in our joint CTA review submission, which encompasses nine recommendations. These recommendations were developed in accordance with the broader objectives of fostering competition in the grain handling and transportation system, increasing market transparency, being positioned for future growth, and ensuring that producers have a voice in the transportation system.

Specific recommendations include(d):

- **A Full Costing Review** - It is recommended that the CTA Review Panel call for the completion of a formal costing review and adjust the maximum revenue entitlement accordingly.
- **Maintained Maximum Grain Revenue Entitlement** - It is recommended that in their consideration of the CTA, a commitment is needed from the federal government that the maximum revenue entitlement will stay in place to ensure fair compensation to railways for hauling grain.
- **Information Requirements** - It is recommended that the CTA and/or other legislation be amended to provide mandatory information reporting for the grain handling and transportation system to function effectively.
- **Higher Priority on Producer Cars** - It is recommended that the CTA review panel ensure that the unique requirements of producer car shippers and shortline railways in the transportation system are recognized and accommodated within the legislative framework.
- **Rail Oversight and Planning** - It is recommended that the CTA require a rail oversight/planning group, that includes agricultural producer representation, be created to establish performance targets and assess ongoing operations of the railways.

Our original submission contains several additional recommendations along with supporting rationale for each. As a coalition, we continue to believe that the recommendations made in our initial CTA submission provide an effective template for modernizing the grain handling and transportation system. We encourage you to review that submission for a complete list of our recommendations.

Assessment of CTA Final Report

The principles outlined above guided our overall assessment of the CTA review final report, which led us to conclude that the report fails to recognize the fundamental issue of railway market power that exists in the grain handling and transportation system. Most of the discussion in the report is centered on reforming what are perceived to be components of a competitive market. The report fails to adequately address railway market power as a primary factor constraining rail service availability and commercial accountability in the grain handling and transportation system. Furthermore the report

goes on to introduce a series of recommendations that, if implemented, would be very damaging to producer incomes and the Saskatchewan economy as a whole.

The primary long-term recommendation in the report calls for the elimination of the Maximum Revenue Entitlement (MRE) program within seven years, with the stated objective of having the grain handling and transportation system evolve into a “more commercially grounded framework.” Our coalition views the proposed elimination of the MRE to be the most harmful recommendation contained in the report, as it would effectively allow railways to restrict service and charge rates that would maximize their profits at the expense of grain producers.

Maximum Revenue Entitlement (MRE)

It is widely understood that the MRE was introduced in August 2001 based on the need to approximate a competitive outcome in a non-competitive market in rail pricing. The MRE affords pricing flexibility to the railways while still providing shippers with protection against unrestricted monopoly power. Since these non-competitive conditions still exist today, maintaining the MRE is a vital component of preserving competitive balance in the system.

In the short term, the review recommends a gradual “modernization” of the grain handling and transportation system through a series of changes including:

- Allowing the railways to allocate one-third of their railcar fleets for exclusion from the MRE as a means of capturing “premiums” from shippers who are willing to pay more;
- Allowing the exclusion of containerized grain from the MRE calculation;
- Excluding inter-switching from the MRE to increase fairness, remove barriers and prevent harm to the railways;
- Reforming the MRE methodology to allow for attribution of individual railway investments in capacity and the renewal of aging equipment (rail cars);
- And several others.

These short term recommendations similarly fail to address the issue of market power within the current system and demonstrate a lack of understanding regarding how the MRE functions. Our assessment of the report’s short-term MRE recommendations include the following observations:

- Allowing the partial exclusion of fleets from the MRE will provide incentive for the railways to limit the quantity and quality of service operating under the MRE, which will increase the demand and market-share of their unregulated (non-MRE) service. This would create perverse incentives by financially rewarding railways for providing less service, thus increasing the likelihood that the

challenges experienced in the 2013 crop year will become a more common occurrence.

- Excluding containers from the MRE will create incentives for the railways to move towards containerized shipments, likely resulting in reduced service for producers who have few shipping alternatives.
- Excluding inter-switching from the MRE calculation will further reduce competition in areas with service by only one railway and will reduce the already limited market forces that might be in play in rate setting.
- With respect to reforming the MRE to compensate for the renewal of aging equipment and capacity investment, it should be noted that the current MRE formula already compensates for this at set levels and includes an annual adjustment that accounts for inflation.

These are just a few examples where the report fails to understand the implications of the changes it is recommending.

Costing Review

The MRE has served to provide affordable access to an efficient rail system for the benefit of the Canadian economy as whole. There are likely improvements and refinements to the MRE that would benefit both railways and shippers. According to Dr. Richard Gray, Professor of Agricultural and Resource Economics at the University of Saskatchewan, the MRE has served to provide affordable access to an efficient rail system for the benefit of the Canadian economy as whole. “There are likely improvements and refinements to the MRE that would benefit both railways and shippers,” he says. “Mutually beneficial changes can only be found by giving both railways and grain shippers an opportunity to have input into how the system should function” (Gray 2016).

Our coalition noted in its 2014 joint submission to the CTA review panel that in order to make sure that the MRE is able to deliver on its mandate, it is necessary to regularly perform costing reviews, in order to get a clear understanding of all of the costs that the railways face associated with moving grain to port. This must be done to make sure that the costs built into the MRE accurately reflect the real costs of shipping grain. We continue to view a costing review as a necessary and ongoing requirement of the system.

For the last several years, various stakeholder groups have publicly advocated for a costing review, largely centered on the issue of the productivity gains that have been produced in the grain handling and transportation system, the fact that the MRE framework is based on the 1992 cost structure, and that there is no provision for costing

reviews to officially gauge the extent of these gains and the degree to which they have or have not been shared with producers.

Conclusions

We continue to believe that the recommendations made in our initial CTA submission provide an effective template for modernizing the grain handling and transportation system. We encourage you to review that submission for a complete list of our recommendations.

The coalition strongly recommends the government reject the CTA report's recommended changes to the MRE program in their entirety. The coalition is not alone in its dissatisfaction with the recommendations made in the report. At a stakeholder meeting in Regina on August 18th, which included Ministers Goodale and MacAulay as well as Parliamentary Secretary Kate Young, there was a strong consensus among producer groups, industry organizations and the provincial government regarding the need for appropriate railway regulation and the continuation of the MRE as an integral component of that system.

As we acknowledged in our original submission to the CTA review panel, we recognize that some modifications to the system are required. We believe that any refinement to MRE policy must begin with a full review of railway costs to assess railway performance in the current operating environment.

References

Gray 2016. Personal Communication via email.

Gray 2015. *The Economic Impacts of Elevated Basis Levels on Western Canadian Grain Producers 2012/13, 2013/14, and 2014/15*. A report submitted to the Saskatchewan Wheat Development Commission.