

**ROYAL COMMISSION  
ON TRANSPORTATION**

**VOLUME I**

**MARCH 1961**

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VOLUME I

To His Excellency the Governor General in Council,

MAY IT PLEASE YOUR EXCELLENCY,

We, the Commissioners appointed by an Order in Council dated 13th May, 1959, to inquire into and report upon the problems relating to railway transportation in Canada and the possibility of removing or alleviating inequities in the freight rate structure:

BEG TO SUBMIT TO YOUR EXCELLENCY

VOLUME I OF OUR REPORT

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## PREFACE TO THE REPORT

We were aware even before beginning our work that the task entrusted to us would be formidable. The intervening months have more than confirmed this initial impression. Transportation is, after all, of the very fibre of the Canadian experience and any investigation into it must, of necessity, be both extensive and intensive.

Throughout the course of our investigation we have been both heartened and sustained by the quality and quantity of the material submitted to us and the wide public interest which attended our activities. The amount of time and effort which has been contributed to this Commission by representatives of the provinces, the transportation industry and other interested groups demands from us the utmost deference and consideration.

We have, therefore, earnestly sought to devise an approach to our task which would do full justice to the vital nature of its subject matter and to the contribution - touching on virtually all industry and all parts of the country - which has been made in the form of submissions and evidence brought before us. To do this we have had to interpret our Terms of Reference broadly and, as a consequence, the material in the Report, while it will deal with all those matters which are embraced in our Terms, does not fall conveniently into their precise order.

Essentially, what we have tried to do is to proceed from the general to the particular in the firm belief that an understanding of the general - the problem as a whole - is a prerequisite for adequate treatment of the particular - the specific problems. To have done otherwise would, we feel, have exposed us to the temptation to treat symptoms rather than causes of a problem which has existed for so long in this country. We do not believe that the transportation industry, or the nation, should be asked to accept anything less than our utmost endeavour to arrive at fundamental solutions. We sensed in our hearings across the country an impatience and a dissatisfaction with attempts to deal with the problems of transportation on a piece-meal or short-run basis. We ourselves felt that such an approach on our part, although it might have made our task easier, would in time compound the difficulties and, very likely, lead to expensive contradictions in public policy.

Against this background then, we have decided to divide the Report into three separate volumes of which this is the first. Work on the other two volumes is well in hand and they will appear without undue delay.

Volume I, which is presented herewith, concentrates on those basic problems which, we believe, afflict the transportation system in Canada. It attempts to extract from the complexities of the present competitive transport situation those difficulties, associated with law and public policy, which have beset the railways with increasing intensity since the end of World War II. As we shall point out, these difficulties of the railways have in a very real sense become difficulties also for the users of rail services. Steps towards their removal have been recommended by us in the full knowledge that such action will involve considerable adjustments in

the Canadian transportation scene. Some familiar landmarks in that scene will undoubtedly disappear but those that remain should be more plainly visible and have their presently unstable foundations restored to strength.

The presentation of Volume I at this time, in advance of the remaining two, will, we hope, draw particular attention to the fundamental problems discussed in it. Unless the underlying anomalies in our transportation system are adequately understood and properly treated, lasting solutions to particular transportation problems cannot be expected.

Volume II will, among other things, examine these particular problems. To say that they are less vital than those dealt with in Volume I would be to understate their importance. The growing intensity of these special problems - local, regional, or industrial in nature - is, as we are well aware, immediately responsible for the appointment of this Commission. However, we feel strongly that we are in a better position to treat them now that our analysis in Volume I has given us insight into the structural nature of the transportation foundation upon which they rest.

The policies which relate to these special problems are different in nature from those which we discuss in Volume I. They are not directly associated with the need to remove the burden from the railways arising from law or public policy since, generally speaking, carriers involved in regional or industry transport assistance are not required to perform a service without suitable remuneration. It is our intention in Volume II to make recommendations concerning these special transportation problems. We hope that our proposals will help the Government and the people of Canada



to assess policies which might be implemented for their solution in the light of the transportation circumstances of today and tomorrow.

Volume III will consist of such special studies as we have conducted, or caused to be conducted, in order to assist our investigation. We believe that, with the publication of these special studies, those responsible for carrying out such of our recommendations as the Government of Canada may decide to accept will derive benefit from the labours performed by the Commission's research staff and consultants. Many of the subjects dealt with in these special studies, will of course, be built upon or altered in the light of future experience. Nevertheless, we trust that the studies contained in Volume III will prove to be of substantial interest and assistance to all those concerned with transportation in Canada, including those who have the task of evaluating the recommendations contained in this Report.

A later volume of our Report will make particular reference to those who assisted in our task. At this time, however, we do want to express our gratitude to the Honourable Charles P. McTague, Q.C., LL.D. Initially appointed Chairman of the Commission he, unfortunately, found it necessary for reasons of health to resign shortly after our hearings began. We are deeply conscious of the contribution made by him when we first charted the course of our investigations.

## CHAPTER 1

### THE TRANSPORTATION ENVIRONMENT IN CANADA

#### Introduction

An adequate system for transporting men and material is a necessary condition of a modern industrial society. For some hundred years or more the railway has been the principal constituent of the transportation system in most of the developed countries of the world. In addition to its economic function the railway has, of course, often played a more extensive role in the building of nations - a circumstance which has been particularly apparent in the case of Canada. History records how the Canadian railways provided the means of meeting not only the demands of a developing economy but, also, the goals of national policy directed towards the establishment of national unity. And today the railways continue to play a vital part in the maintenance and growth of the nation. However, their capacity to carry out this function has been profoundly affected in recent years by important developments which have taken place in the field of transportation as well as in other sectors of the economy. To examine the present position of the railways in the light of these developments - and to consider what might reasonably be done to improve the ability of the railways to contribute to the further development of Canada is, in broad terms, the task with which this Commission has been charged.

In considering this task, we became convinced very early in our work that a process which had been underway for some years before had, since the end of World War II, wrought a fundamental change in the character of

the transportation environment in Canada, and, moreover, that it was this transformation which underlay the varied problems with which we had been called upon to deal. Previous to this change taking place the environment was one in which the railways possessed a monopoly or near-monopoly position in the transportation market. The present environment, on the other hand, is no longer monopolistic and the railways are engaged in a vigorous competitive struggle for the available traffic with a number of alternative forms of transport. Following on this view, we undertook to investigate this new competitive environment and the basic forces at work in it so that when the time came to consider particular railway and related transportation problems they could be seen in their proper perspective. We wished, in other words, to look for long-term solutions rather than for palliatives which would simply gloss over the problem on a short-term basis. In the following pages of Chapter 1 of this volume of the Report we have sketched our interpretation of the transportation environment in Canada - as it existed in the formative years of our railway system and as it exists today. A number of key areas of this broad tableau will be examined in more detail in Chapter 2.

### The Previous Environment: Monopolistic<sup>1/</sup>

When first introduced into Canada about the middle of the nineteenth century the railways proved to be such a superior means of transportation that they obtained a virtual monopoly of the traffic available wherever they were built. Only in Central Canada did a network of canals together with the

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<sup>1/</sup> The term "monopolistic" as it is used in this Report is taken to include situations of near or quasi-monopoly, as well as complete monopoly.

St. Lawrence River and the Great Lakes system provide, for part of the year at least, a reasonably adequate alternative means of carriage. By the late nineteenth century it was apparent that the country had become extremely dependent upon the railways; a circumstance which, understandably, had a penetrating effect on the thinking of both the public at large and the railway companies themselves. On the part of the public, a demand for controls to guard against possible abuse of the railways' growing power was soon forthcoming and by the first decade of the twentieth century in Canada the practice of railway regulation in the protection of the public interest had become firmly established. Even before the introduction of regulation, however, had come a recognition by public authorities that this new transport medium offered a uniquely effective instrument to help achieve the goals of national unity. By means of subsidies and land grants, as well as other forms of inducement, the railways of Canada were encouraged to develop along lines that would establish a firm east-west axis of communication and help to offset the divisive economic and political forces generated by the sprawling half continent out of which the infant Canadian Confederation was striving to establish a viable union. This governmental assistance also permitted the construction of a railway network at a pace which strictly private venture could not have matched and, by reducing construction costs for the railways, allowed a lower scale of rates to be maintained than would otherwise have been possible. By 1876, less than ten years after the Confederation, the Intercolonial Railway had been built at Government expense to link the Maritime Provinces with Central Canada. In 1885, in a feat which reflected great credit on both the Canadian Pacific Railway Company and the Federal Government, a rail line of almost 3,000 miles running for much of its length through uninhabited territory was completed to the Pacific Ocean. And in a

variety of other ways the railways were used as instruments of national policy - a role for which, in general, they proved to be well fitted - and such obligations relating to rate policies and conditions of service which were assumed by the railways in the exercise of this function constituted little or no burden in the monopolistic transportation environment of the times.

In addition to these public responses to the railway era of the late nineteenth and early twentieth centuries in Canada, the impact of the circumstances of the day upon railway management policy was of great significance. With no desire to minimize the complicating effects of competition between the railways themselves, it can justly be said that the company policies which guided the development of the railway system of Canada reflected in large part the substantial monopoly position the railways enjoyed in the transportation field, and that railway operations tended to adapt themselves to the fact that shippers had virtually no other suitable means of transport at their disposal. The railway rate structure, in particular, proved responsive to this circumstance and the development of a "value of service" pricing system in which the value of the commodity assumed a crucial role was a logical outcome of the existing environment. Under this system of differential pricing the railways hauled bulk commodities which had a relatively low value per pound such as grain, coal, ore, gravel, etc., at low rates which sometimes covered little more than actual "out-of-pocket" costs, and recovered most of their overhead costs from the high rates applicable to more finished goods with a much higher value per pound such as clothing, tobacco, hardware, machinery, etc. Without the low rates a good deal of the bulk traffic would not have moved at all because transportation costs would have been too high in proportion to

the value of the commodity to make their shipment profitable - whereas the finished goods, because of their greater value, could and did move at the higher rates.<sup>1/</sup> The railways thus obtained a volume of traffic which might not otherwise have come into being and they did so with the active encouragement of the Federal Government which saw in the low-rate policy a further means of stimulating the development of primary production in Canada. The rate classification system which developed on this basis allowed rates to vary from a low of as little as one-half cent up to as much as ten cents per ton-mile and they bore little relation to the cost of performing the service; a rate was considered "just and reasonable" if it displayed what seemed to be an equitable relationship to the remainder of the rate structure. The traditional principle of ratemaking, then, represented a form of cross subsidization under which some users of the rail service contributed through higher rates a relatively greater amount to the total transportation bill than did others - on a sort of capacity-to-pay basis. It was a system that seemed eminently suited to the needs of the developing Canadian economy as well as to the needs of the railways for the maximum volume of traffic consistent with adequate revenue returns - and if there were certain shippers who questioned the reasonableness of the rate structure there was, in the transportation environment of the day, very little they could do about it.

Clearly, the character of the railway transportation system which became established in Canada, and of the basic policies, both public and private, which guided the operation of that system were strongly conditioned

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<sup>1/</sup> To the extent, of course, that bulk commodities contributed to railway overhead, their movement meant that less of this overhead had to be met by the higher valued commodities, thus keeping their rates lower than would otherwise have been the case.

by the requirements of an economy oriented to the production of primary products and by a transportation environment in which the railways exercised a substantial monopoly. While the history of transportation during this period is replete with railway problems, usually of a financial nature, which often required government attention, and occasionally, investigation by Royal Commission, it does not appear that the fundamental policies on which the system was based were seriously called into question and, indeed, it was not until well into the second quarter of the twentieth century that there was any real indication that these policies might be in need of revision.

### The Present Environment: Competitive

#### The Growth of Competition

The process by which the present highly competitive transportation situation in Canada evolved was a gradual and complex one involving a number of elements, some of which arose on the supply side of the transportation function and some on the demand side. Probably the most important factor in the latter category developed out of a shift in the pattern of Canadian industry which reflected a decline in the importance of the primary resource sector of the economy relative to that of manufacturing. The railway structure, as we have pointed out, had been adapted in terms of plant, service and rate policies to an economy largely dependent on the production of primary commodities and the structure did not prove readily adjustable to the new conditions brought about by this change in the character of Canadian industry. These new conditions arose, in particular, in connection with the rapid growth of secondary manufacturing industry which created a greatly increased demand for specialized transportation services

such as pick-up and delivery and for fast and flexible shipping schedules geared to meet the requirements of both shipper and consignee. Secondary industries, moreover, were prone to pay considerable attention to problems associated with internal costs and inventory control which led to an emphasis upon the concept of total costs of distribution rather than simply line-haul rates and, as a consequence, reinforced the demand for more specialized and flexible transport services. In addition, the tendency of secondary industries to locate at or near major markets meant that short-haul rather than long-haul movements became characteristic of their transportation requirements. In brief, the new kind of demand for transportation which began to develop in the second quarter of the twentieth century proved to be of a type to which the railways were not entirely suited - and which, particularly in the area of services, they were not always able or willing to meet.

The limited ability of the railways to meet this new demand situation was a factor which coincided with, and gave added stimulus to, developments that were taking place on the supply side of transportation. During the nineteen-twenties and -thirties, steady technological advances had been made in the design and operating efficiency of the motor vehicle. By the late thirties the horsepower of gasoline engines had increased to a point where, with the introduction of truck trailers having very much larger volume capacities than had been possible previously, heavy trucking became a practical proposition. A few years later, a suitable diesel engine for trucks became available which added further to the efficiency of heavy hauling by providing increased power together with improved fuel and maintenance economies. Along with these technological advances in trucking came a substantial improvement in the road and highway systems, particularly



in the more populated areas of the country. The fact that their right of way, unlike the case with the rails, was both built and maintained by public authorities, of course, was a factor of great significance in the development of the trucking mode of transport. These circumstances, coupled with the demand created by a burgeoning manufacturing industry, contributed to a rapid growth in the number and size of trucking firms and as these firms matured and their investment and standards of efficiency increased, the degree of competition that they were able to offer began to assume serious proportions for the railways. While this development was temporarily curtailed by the shortages of men and material consequent to the all-out war effort, with the return of peace and the added stimulus provided by wartime technological developments and a booming economy the trucking industry quickly came into its own. If there is any purpose served by putting a date on the emergence of our modern competitive transportation era it could be said that the events of August 1950, when a nation-wide rail strike tested the capabilities of the alternative forms of transport available, gave clear evidence that a breakthrough had been made and that the railways had finally lost the monopolistic position in Canadian transportation which they had maintained for almost a century.

The growth of competition to the railways was, of course, not entirely confined to the trucking industry. Progress in the field of aviation, improvements in motor bus operations, the development of highly efficient pipeline facilities for the bulk movement of gas and oil, all helped to cut into the traffic which traditionally had been the domain of the railways and to hamper their efforts to obtain new traffic. Rail-passenger traffic was particular hard hit by the improvements in speed and comfort which technological advances had brought to the private motor

car as well as the commercial motor bus. As was the case with the movement of freight, developing trends in passenger transportation were held up by the exigencies of the war effort but as soon as the war was over they resumed with increased emphasis. Competition to railway passenger traffic was further stimulated in the post-war period by the tremendous strides which had been made in the field of aviation. Within a few years, with the establishment of country-wide scheduled services featuring speedy, comfortable and safe air travel at a reasonable price the railways found it more and more difficult to obtain sufficient traffic to cover the costs of operating a passenger service. With respect to passenger traffic it was apparent that, within a relatively short span of time, a basic change in personal tastes had taken place and that the motor car, the motor bus and the airplane had replaced the railways as the favoured means of travel for the majority of Canadians.

The railways, of course, were not standing idly by during this period of competitive growth in transportation. However, their capacity to respond to the challenge of these various alternate forms of transport which came into their own after World War II was inhibited by a number of circumstances. For one thing, the extreme demands which the war effort had put upon the railway system and the inability during that period to pursue normal replacement programmes had left it with a plant that was run down in considerable degree. A large programme of rehabilitation was an obvious necessity before the railways would be in a position to put forth their maximum competitive effort but, unfortunately, the rehabilitation programme was complicated by shortages of material and rising costs and proved to be a more lengthy and expensive task than had been anticipated. The railways were also hampered

in their efforts to adjust to competition by a steady post-war rise in labour and other internal costs.

There were certain other factors affecting railway operations which had arisen out of the previously existing monopolistic environment and proved to be substantial handicaps for the railways in the new competitive situation. For example, regulation of the transport industry in Canada has until recent years been almost exclusively confined to the railways. Beginning in 1897 and with the exception of a brief period at the end of World War I, it has been accepted national policy to maintain a fixed ceiling on the rail rates applicable to grain and grain products moving to export positions; these rate levels, which were made statutory by Parliament in 1925, are still in effect. And with the passage of the Railway Act of 1903, establishing the Board of Railway Commissioners (now the Board of Transport Commissioners), regulation of railway operations was set up on a broad basis. Close supervision over the railway rate structure was a particular feature of the regulatory system and the railways' freedom to adjust rates to meet competitive situations, although gradually increased since World War II by the Board, remains, in varying degree, something less than that experienced by their competitors. While airlines and pipelines as they developed were, like the rails, required under regulation to file and publish rates which must be the same for all shippers, most water carriers remained free from rate regulation. Most significantly, the railways' principal competitors - the trucks - operated almost entirely outside of federal jurisdiction and, while some of the provinces did regulate certain aspects of the trucking industry's activities, there was little attempt made to exercise any real control over their rate policies.

Many other vestiges of the monopoly era besides rate regulation presented difficulties to the railways in their efforts to adapt to the competitive environment. The problem of over-capacity was particularly serious since it was readily apparent that the railways needed to make significant adjustments in the size of their plant if they were to bring it into line with existing conditions. In this they were handicapped, not only by federal regulatory requirements, but also by public pressure which customarily took the form of intense resistance to the dislocations which might be occasioned by these adjustments. For example, such matters as the removal of passenger services operating at a loss or the abandonment of unprofitable branch lines proved virtually impossible to decide solely with reference to normal commercial considerations. The fact was, of course, that during the monopoly era the railway system had grown up in response to both commercial and national policy considerations and when the advent of competitive conditions revealed that in many cases there was a serious element of conflict between these two factors, incompatibility was not accepted as sufficient grounds for their separation. The railways' status as an instrument of national policy, which had proved to be no encumbrance during the monopolistic period of transportation, was now turning out to be an albatross around their neck - a burden which certainly affected the degree to which the railways could adjust successfully to the new environment in which they were operating.

#### The Effects of Competition

The transformation from a monopolistic to a competitive transportation environment in Canada has had pervasive effects both inside and outside the transport field. Increased capacity associated with the growth of alternative modes of transport and improved efficiency arising from the competitive

stimulus resulted in lower rates and better services than might otherwise have prevailed, and the country as a whole has benefited greatly from the over-all improvement which has been wrought in the transportation system. In this connection, it is of interest to note that, notwithstanding its recent rapid growth, the cost of the transportation function relative to the Gross National Product appears to have declined from about  $8\frac{1}{2}$  per cent in 1946 to something in the order of  $6\frac{1}{2}$  per cent in 1959.<sup>1/</sup>

The advent of the competitive era in Canadian transportation was accompanied, therefore, by a considerably expanded, more efficient, and more broadly based transportation structure - one which provided the capacity and flexibility which was required to meet the demands of the rapidly developing economy which characterized the post-war Canadian scene. In industry, one of the more obvious consequences of the development of competitive forms of transportation has been the improved ability of producers to adapt the transport element in their operations to their particular needs rather than be forced to adapt their needs to transport - a circumstance which, at least in some areas, has helped to bring about a degree of diversification in industry which the lack of flexibility inherent in the railway monopoly era had tended to inhibit.

For the railways themselves, the consequences of the radical change which had taken place in the transportation environment in which they had developed were not entirely adverse. Competition certainly did help to stimulate efforts in the direction of increased efficiency; dieselization, improved signalling and road maintenance techniques, modernized terminal facilities, and other advances in railroad technology, were introduced as

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<sup>1/</sup> Source: DBS figures prepared especially for this Commission.

rapidly as conditions permitted and the resultant reduction in the operating costs of the system appear to be very impressive. However, in spite of these movements in the direction of increased efficiency, it became apparent within a few years after the end of World War II that the railways' role in transportation relative to competing carriers was undergoing a steady decline. Although in absolute figures the tonnage carried by the railways continued at a fairly constant level, their share of intercity revenue freight ton-miles fell from about 75 per cent of the total in 1949 to just over 60 per cent in 1953. By 1959 the figure was close to 50 per cent.

A more revealing indication of the decline in the railways' competitive position than that provided by ton-mile figures is to be found in the change which took place in the composition of the traffic, with an increasing share of the railways' total consisting of low-rated commodities. The inability of the rails to maintain their former balance between low- and high-rated traffic had, of course, an adverse effect upon net revenues since under the traditional rate structure it was the high-rated commodities which provided the extra margin of profit which made the low rates on the bulky raw material products of farm, forest and mine possible. Unfortunately, a full and satisfactory explanation of why the railways have lost so much of their former traffic in high-rated products and at the same time failed to obtain any substantial share of new traffic of this kind provided by the expanding manufacturing plant of the country is not easily arrived at. The superior brand of service that the trucking industry has been able to offer this type of traffic is certainly a partial answer. At the same time, however, the cost of line-haul movement should remain an important element in the determination of traffic movements and it is our distinct impression that, except in the range of the short haul, the railways are still in a

position to move a considerable share of this high-rated traffic at a cost per ton-mile and, therefore, at a rate to the shipper which is significantly below that of even the most efficient trucking firms. In other words, very little of the so-called "creaming" of freight traffic by the trucks came about because the trucks have a cost advantage over the railways in the movement of high-grade products. While it arose, in part, because the shippers preferred the kind of services provided by the trucking industry it also was associated, in our view, with the fact that the railway rate structure was based not on the cost of moving goods but rather on the value of the goods moved. This traditional rate policy featuring high rates on high-value products and low rates on low-valued products evolved, as we have emphasized, during the monopolistic era of Canadian transportation and it is our considered belief that the railways' continued adherence to this principle of ratemaking in the substantially different circumstances which have existed for the past ten years has prevented them from making the most of their inherent cost advantages. To the extent that this has happened, it has resulted in an uneconomic diversion of traffic to competing carriers - with adverse consequences for the railways and for the transportation system as a whole.

In fairness to the railways, however, it should be pointed out that their ratemaking practices - as distinct from their ratemaking principles - have recently shown an increasing tendency to take account of the cost advantages inherent in railway operations. So-called "normal" rates, which are related directly to a Freight Classification based on the value of commodity principle and under which the great bulk of the railways' traffic formerly moved, have, under the pressure of competition, come to occupy a steadily shrinking place in the rate structure. By means of competitive rates and

agreed charges, the railways have often reacted vigorously to truck competition and, while it is hard to determine on balance what the net effect has been upon the competitive situation, it can certainly be maintained that this trend represents a more realistic approach to the problem of railway pricing in the modern era.

Notwithstanding these recent indications of progress by the railways in their endeavours to adapt to the new transportation environment, their position of late, as the appointment of this Commission attests, is not one which engenders a ready optimism. Caught in a squeeze between declining revenues relative to traffic volume and the steady post-war rise in costs, the railways in order to meet their financial requirements have been forced to resort periodically to general rate increases - so-called "horizontal rate increases". Under the terms of the Railway Act, approval by the Board of Transport Commissioners permits the railways to raise their rates (statutory rates excepted) by a certain across-the-board percentage which is related to their revenue requirements. They are then able to apply these increases where, in their judgement, they are most likely to be effective. There have been twelve such increases (including interims) approved since 1948 which has resulted in a permitted level of increase amounting to 157 per cent. However, even abstracting the effect of statutory rates, the consequences of the competitive situation are revealed by the fact that with this permitted amount of increase in rates the railways had only been able, by the end of 1958, to obtain an increase in average revenues per ton-mile of less than 55 per cent. It is apparent, therefore, that as far as its effects are concerned a horizontal increase is horizontal in name only - it does not apply evenly across the entire rate structure but is applied selectively by the railways according to what they think the traffic



can bear. Obviously the more competitive a block of traffic is, the less likely it is to receive all, or even part, of the increase. And conversely, the less exposed to competition a type of traffic is, the more likely it is to have the full increase applied to it. With permission from the Board to so apply the "horizontal" increases and with a need to secure additional revenues, it is perhaps understandable that the railways would act in this way - that is, obtain as much as possible of their needed revenues from the traffic which is the least subject to competition and as little as possible from that traffic where competition is keen and alternative forms of transport readily available. With each successive increase in rates, however, certain traffic ceases to move because it cannot bear the higher rate; also, of course, the area of traffic exposed to competition expands and the railways, experiencing both erosion and attrition of their traffic, are faced with a situation where, if they are to continue to attempt to meet their financial needs in this way, they must apply larger and larger increases to a smaller and smaller portion of traffic. Thus, in what appears to be a self-defeating process the railways find themselves, metaphorically speaking, running faster and faster in order to stay in the same place.

At the same time, of course, shippers throughout the country are affected by this continuing search by the railways for sources of revenues through the medium of "horizontal" rate increases - and they are affected, generally speaking, in proportion to the degree of competition which relates to their particular traffic. Those shippers who have alternative means of transport readily available are relatively insulated from the effects of railway rate increases, whereas shippers who remain dependent upon the railways - the so-called "captive shippers" - are apt to find themselves bearing the full brunt of the horizontal increases. It is this process

which has been developing with increasing intensity over the past decade and which is a direct outcome of the uneven impact of competition on the transportation system. The loss of a good share of their most lucrative type of traffic to competitive carriers has forced the railways, in order to maintain an adequate level of revenue, to raise their rates on the traffic still available to them. However, the degree of "availability" varies with the competitive conditions and the railway rate increases, if they are not to result in substantial traffic losses to alternative carriers, can only be applied unevenly in a manner which reflects the uneven impact of competition on railway operations. In brief, the benefits which the new competitive transportation environment has brought to the Canadian economy are not being distributed in an equitable fashion and it is this phenomenon which is at the root of the "freight rate inequity problem" which is the principal raison d'être for this Commission.

This trend in the railway rate structure, resulting from the uneven impact of competition, is tending to disrupt the regional pattern of relative transportation costs which evolved over the years in Canada. Central Canada, where a concentration of the bulk of the country's population and manufacturing industry conjoins with a relatively well developed highway system, has provided ideal conditions for the growth of the trucking industry; add to this the competition provided by an improved Great Lakes-St. Lawrence system and a situation is created wherein the railways must use every device at their disposal to retain traffic. The greater portion of railway traffic in this area, therefore, moves under competitive rates and agreed charges rather than normal rates and rate increases are kept to a minimum in order to prevent the loss of traffic to alternative carriers. Thus, the shipper in Central Canada does, in fact, derive substantial benefits from the effects

of competition on the transportation structure. While, of course, a very large share of the railways' revenues continues to be obtained from traffic in the industrialized central Canadian area, the evidence indicates that the railways are no longer able to obtain from this area the same relative contribution to their increased revenue requirements as was the case in former years.

It is the regions of Canada where competition to the railways is less intense upon which the present freight rate structure bears most heavily. Although monopoly no longer characterizes the transportation system as a whole in Canada, there are still vestiges of it in areas which, because of inadequate highway facilities, distance from markets, or other factors which have inhibited the development of competition, continue to be dependent to varying degrees on railway transport. While it is true that the number of competitive rates and agreed charges is growing in both the Atlantic Provinces and Western Canada, the indications are that they are comparable neither in quantity nor quality to those applicable within Central Canada. The end result appears to be that the uneven impact of competition, transmitted through the freight rate structure, tends to produce a greater relative increase in the price of moving goods by rail for the Atlantic and Western shipper than that experienced by shippers in Central Canada. This effect is particularly noticeable on long-haul shipments to the markets of Central Canada. For example, the marketing consequences of a 20 per cent increase to a long-haul shipper who has been paying \$500.00 a carload to get his product to the Toronto market and will now pay an additional \$100.00 are obviously more serious than those upon his short-haul competitor who has been paying \$50.00 a carload to get to the same market and will now pay only \$10.00 more. A further adverse consequence of "horizontal"

increases which often faces the long-haul shipper is that the 20 per cent increase is not always applied in its entirety to his short-haul rival because competition in this area is so pervasive that the railways face a loss of the traffic if the rate is raised unduly.

Undoubtedly, however, in terms of equity the most serious regional outcome of the effects of competition upon the railway rate structure arises from the fact that the railways, because they can only be certain of applying their fully allowable increases to a constantly shrinking area where competition is weak or non-existent, are forced to ask for greater percentage increases than they would if the increased rates could be applied more broadly. As a consequence, the regions where competition is weakest are being called upon to pay a larger and larger share of the revenues required to cover railway costs. To put it another way, it would appear that an attempt is being made to preserve the traditional railway rate structure, based on differential pricing and cross subsidization, by means of the profits obtained by increasing the level of rates in the residual monopoly areas of the transportation system and not, as was originally done, from the profits derived from high rates on high-grade traffic. Thus, the divisive effects of distance and other geographic and economic factors which the railway freight rate structure in Canada has traditionally sought to mitigate are, under present competitive conditions, being aggravated by that selfsame freight rate structure. It is obvious that the long-run effects upon the Canadian economy of a continuation of this process are a matter for serious concern.

We should add here, that there are two factors which are tending to offset in some degree the adverse consequences associated with the uneven impact of competition upon the various regions of Canada. One is the

increasing pervasiveness of the trucking industry which is steadily bringing more intensive competitive conditions to areas which hitherto have almost entirely depended upon the railways. For the shippers in these areas such a development should prove most welcome but for the railways, given the continued existence of the burdens under which they now operate, it can only bring increased pressure for higher rates on their remaining traffic and the danger of ultimate financial collapse.

The other factor which has helped to mitigate the unequal effects of competition in transport is the provision by the Federal Government of financial assistance to those areas most seriously affected. The Maritime Freight Rates Act, for example, has since 1927 provided for a 20 per cent reduction in rates on shipments moving within the Atlantic Provinces and that part of Quebec lying east of Lévis and Diamond Junction and south of the St. Lawrence River (the so-called "Select Territory"). On shipments from that territory to points west of it, the reduction, raised to 30 per cent in 1957, applied to that part of the rate attributable to the haul within the "Select Territory". By 1959 the total amount of assistance provided under MFRA had risen to about \$14 million annually. Federal financial assistance has also been given since 1951 in the form of the so-called "bridge" subsidy which provides \$7 million a year to be applied to the reduction of "normal rates" on traffic passing east and west over the rail lines in northern Ontario.

A somewhat broader form of assistance was enacted on August 1, 1959, when the Federal Government, with the passage of the Freight Rates Reduction Act, introduced what has been referred to as a "roll-back" subsidy. This legislation provided for one year from that date a sum of \$20 million for the purpose of lowering, in respect of non-competitive rates, by approximately

seven per cent a general increase of 17 per cent which the railways had been authorized to apply on December 1, 1958. Since May 6, 1960, the subsidy has permitted a decrease of nine per cent rather than seven per cent. At the end of the yearly period, a further \$15 million was provided for the same purpose for a term of nine months ending April 30, 1961.

Measures such as these, while they help to alleviate freight rate inequities, cannot by themselves solve the underlying problem. Moreover, in the form in which they have been applied, they may tend to distort the competitive market in transportation with resultant adverse effects upon the transportation system as a whole.

#### Trends in Transportation

Before attempting to bring together the various threads which have run through our discussion of the new competitive environment in transportation, it would appear desirable to mention, briefly, some of the more significant trends which are emerging in this field and which must be taken into account if we are to offer an adequate picture of the present transportation scene.

An improving highway system is one of the more important elements in the developing transportation picture. Modern expressways such as are becoming common in certain areas of the country are having an impressive effect upon the efficiency of trucking operations and thus upon their competitive position. It is to be assumed, under the pressure of public demands for faster and safer road travel, that the building of expressways will continue apace and, judging by experience in the United States, will stimulate the expansion of trucking facilities in considerable degree. Growth in long-haul trucking is another trend which has entered the competitive

picture in transport and with the completion of the Trans-Canada Highway more firms are becoming interested in this relatively new area of trucking operation.

The advent of the airplane as a factor of some importance in the movement of freight is a development which deserves consideration. Now that the rate of growth in air passenger traffic has shown signs of levelling off, the interest of the industry in the possibilities of air cargo is becoming more evident. Moreover, with the rapid progress which is being made in the development of cargo carrying aircraft, as well as terminal loading facilities, there are indications that a real breakthrough on costs is imminent in this area. While it is unlikely that, in terms of tonnage, the movement of freight by air will bear comparison with other modes of transport for some time to come there is a real probability that the carriage of high-value products where speed of delivery is the prime concern will provide a growing and highly lucrative form of traffic for the airlines. It is even conceivable that the trucks which have been accused of "creaming" the railways' traffic may be making a similar claim against the air industry in the foreseeable future.

Developments in the transport of materials by pipeline is another area which cannot be overlooked. The economics of pipeline operation have some substantial advantages over all other methods of transportation and if experiments which are now under way, particularly in the United States of America, in connection with the movement of a variety of bulk products prove successful, the pipeline may loom very large indeed in the transportation picture of the future.

Piggyback, the movement of truck trailers on railway flatcars, is an already well established trend which has shown very rapid growth in the

past two years and now constitutes between four and five per cent of total railway revenue carloadings in Canada. While it is too soon yet to attempt to make accurate predictions, there are grounds for believing that piggyback is a development which will prove to be of profound significance to the future of rail-truck competition. For one thing, piggyback offers a form of transport that makes use both of truck and rail facilities and can thus combine the short haul and service advantages of the truck with the long-haul, low-line costs of the railways. Its rapid development both in Canada and the United States indicates that it has proven in many ways to be a nexus for these two types of carriers, providing a transport operation in which traffic is shared and from which both derive benefits. Obviously, piggyback holds out possibilities in the direction of integration of rail-truck operations which could make an important contribution to increased efficiency in the transportation system.

Another feature of piggyback which has interesting implications for rail-truck competition, derives from the fact that this form of operation has added a new dimension to competition between the two mediums. Customarily, rail-truck competition takes the form of competition between the freight train and the truck as carriers of freight, whereas with piggyback the competition is between the rails and the highways as carriers of truck trailers. In other words, truck trailers have become an actual freight item, as well as a freight conveyer, and are being competed for by one type of hauler moving on the rails and another type moving on the highways. It is evident that the element of rail - road comparative costs of movement, and the degree to which these costs are reflected in rates, will determine the extent to which piggyback contributes to an improvement in the competitive position of the railways in the future.



Containerization, which although it has a long history, has really only developed to any extent in North America as a refinement of the piggy-back operation, permits a more intimate degree of cargo interchange between rail and truck than does piggyback. This technique is generally conceded to hold great promise but it also involves a lot of expensive experimentation to determine the most satisfactory type of container - a process which is being proceeded with very actively in the United States but has so far, in the different circumstances prevailing in Canada, not made very much headway.

An aspect of the trucking industry which has not been referred to previously is that of private trucking. While reasonably adequate statistics on the industry are only available for the past few years, it is apparent that private trucking, like for-hire trucking, has experienced a phenomenal growth since the end of World War II. The economics of private truck carriers are not as readily ascertained as those of for-hire forms of transport since, by their very nature, they do not carry on the sort of public market operations which characterize the others. The degree of expansion of this sector of the transportation system would suggest, however, that there are very real advantages, economic and otherwise, which this form of transport provides. It should be noted, also, that the question of applying any form of economic regulation to private truck carriers has already created difficulties in the United States and we can assume that regulatory attempts which might be made in Canada would not be free of such problems.

Another trend in transportation that certainly deserves serious consideration is the movement of the railways themselves into the trucking business. Initially this action was viewed in terms of a marginal operation on the part of the railways in their effort to improve and integrate their services - pick-up and delivery, short-haul feeder operations, substitute

services, etc. Now, however, the railways are into the trucking business on an impressively large scale - the Canadian Pacific Railway in fact, owns or controls one of the largest trucking fleets in Canada, while the Canadian National has recently bought up several good-sized trucking lines and appears to be in the trucking business to stay. The implications of this trend are complex and difficult to assess. The railways view it as a natural development in response to competitive forces which, by integrating their transport services, will improve both their competitive position and the transportation services available to the public. The truckers, on the other hand, fearful of the very great financial resources of the railroads, have claimed that it represents a potential return to a monopoly era in transportation - once the railways have achieved a dominant position in trucking, say the independent truckers, the competitive stimulus in transportation now provided by this form of carrier will disappear. While there is cause for concern, certainly, in this trend toward a sort of "transportation supermarket" owned and operated by the railways, it would appear that the economics of the trucking industry, unlike that of the railways, inhibit the likelihood of monopoly tendencies becoming pervasive and, in particular, the ever present alternative provided by private trucking would seem to rule out the possibility of a re-emergence of a monopolistic transportation environment dominated by the railway companies. We would also assume, on the basis of our experience during this investigation, that the virile and articulate trucking industry, through its Associations, should be able to alert the public and the federal authorities in the event of cases of restraint of trade arising from this source.

One possibility which appears to be a more likely product of the trend toward railway-owned trucking lines is the use of the more flexible

trucking operations as a replacement for the traditional branch line railway services. The conception of a more highly integrated system with the railways pared down almost completely to a trunk line, high density operation and the trucking industry, both railway and independently owned, providing the necessary feeder role, has some attractive economic implications.

Finally, we should refer to the impressive developments which are taking place in the railways' approach to costing, to marketing, and to services generally. Some of these improvements are, of course, primarily the product of technological developments but, significantly, many of them have resulted from a broad programme of research and study which suggests that a fundamental re-orientation process is going on at the policy level within railway management. It is trends of this kind which we feel hold out considerable promise for the future of railroading and the entire Canadian transportation system.

#### Summary and Conclusions

Since the end of World War II, the transportation environment in Canada has been transformed from a monopolistic one, very much dominated by the railways, into a highly competitive one in which a number of different modes of transport are vying actively for the available traffic. This fundamental change in environment has been accompanied by the development of a transportation system responsive to the greatly increased and changing demands of an expanding Canadian economy. The consequences of this evolutionary development in terms of growth in the systems' capacity, efficiency and conditions of service have been, as we have emphasized, of substantial benefit to the country as a whole. It is apparent, however, that the railways

have not participated in full measure in this process. It is also apparent that all areas of the country have not benefited equally from this maturation in our transportation system and that some, in fact, might even be said to have been affected adversely.

Insofar as these circumstances have been a consequence of what might be termed "the economic facts of life" it is not reasonable to expect that they can be resolved within the scope of transportation policy per se.<sup>1/</sup> What does seem reasonable to expect, however, is that the gains derived from the evolution of our transportation system should not be distributed inequitably simply because of the failure of policies affecting this system to properly adapt to the change which has taken place. And this is, in large part, what our investigations have led us to conclude has happened and is continuing to happen in the field of transportation in Canada. Thus, the aspect of uneven regional impact of competition which does concern this Commission very much is that which takes the form of inequities in the railway freight rate structure. These inequities are principally a result of the fact that the railways' competitive position relative to other carriers has declined and, as a consequence, they have been forced to obtain a greater relative share of the revenues they require from the traffic which is least affected by competition. And, since the position of the railways vis-à-vis their competitors seems to continue to decline with each passing year, the degree of inequity experienced by the traffic still tied to the rails continues to grow with each general increase in freight rates which

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<sup>1/</sup> This does not mean, of course, that within the broader range of national economic policy it might not be desirable or necessary to improve the transportation situation in specific regions and industries by means of public assistance.

the railways are permitted to apply. If such a process is allowed to continue the end results are dismal to contemplate; either railway rates will become so high that "captive" traffic cannot move at all or else competitors will inevitably arrive on the scene to relieve the "captives" from their bondage - in either case, a source of revenue upon which the railways are increasingly dependent will have disappeared and the railways' financial position will have become completely untenable.

We do not believe, however, that this dismal process must or should continue. Our investigations have led us to conclude that the potential competitive power of the railways in the present transportation environment is considerably greater than their actual performance in recent years would seem to indicate. To unleash this potential is, in our view, the solution to the railways' financial dilemma and, thus, the sine qua non for a solution of the freight rate inequity problem which is, essentially, a projection of this dilemma.

The competitive position of the railways has been seriously weakened, we are convinced, because of the burden which the railways continue to carry as a legacy from the monopolistic environment of the past. It is a burden which, in our view, derives in part from public policy and in part from policies pursued by the railway industry. This burden, which bears upon the plant, the rate, and the regulatory structure within which the railways operate, prevents them from adapting fully to the new competitive environment and it must be lifted if the railways are to take their proper place in a transportation system which adequately reflects the needs of our Canadian society.

There is much that can be done at the public policy level to assist in this process and, in this connection, our investigations have

led us to the following general conclusions:

1. The regulation of transportation in Canada should be minimized as much as possible, consistent with the protection of the public interest, and such regulation as is retained should bear in a reasonably equitable fashion on all carriers.
2. The rationalization of railway plant and operations should be actively encouraged by public policy and where, for national policy reasons, it is considered necessary to retain rail operations such as unprofitable passenger or branch line services, the railways should be entitled to payment from public funds to cover their deficits on such services.
3. No particular form of transport should be singled out as an instrument of national policy if any burden is involved in the performance of the function unless sufficient compensation is provided to that mode of transport to prevent distortions in the competitive transportation market.
4. Assistance to transportation which is designed to aid, on national policy grounds, particular shippers and particular regions should be recognized for what it is and not be disguised as a subsidy to the transportation industry. Moreover, whenever assistance of this kind is distributed through the transportation medium it should be available on a non-discriminatory basis to all carriers.

In brief, the broad aim of public transportation policy should be to ensure - consistent with the other goals of national policy - that all the various modes of transport are given a fair chance to find their proper place within a competitive system. The application of such a policy is, we believe, essential if we are to obtain - at a minimum cost - a balanced and efficient transportation system which is fully adequate to meet the nation's transportation requirements.

Public policy is, however, only one aspect of the problem. The achievement of the kind of transportation system we require necessitates, also, the adoption of policies by the railways which are properly related to the new environment. The removal of the burden on the railways, which has been a product of public policies formulated during the monopolistic era of transportation, should provide the stimulus for the railways to take a fresh look at the principles and policies of management which have guided their operations in the past. Particularly with respect to the rate structure, we feel that an opportunity exists for a more dynamic approach to railway pricing. There has been, in our view, an excessive preoccupation on the part of the railways with the problem of increasing the level of revenues obtainable from their present traffic - a preoccupation which, among other things, has hampered the development of a broadly based, cost-related programme of rate adjustment which would enable the railways to secure the kind of traffic for which they have an inherent cost advantage and relinquish that traffic which might better be transported by other carriers. While we recognize the complexity of the rate structure issue, we cannot help but believe that railway resistance to the adoption of a more cost-oriented basis for ratemaking is essentially unrealistic and reflects a degree of institutional rigidity which is out of place in the

transportation environment of today. However, as we have said earlier, there are also indications that a fundamental re-orientation process is going on at the policy level within railway management - a process which, if carried through, holds forth much promise for the future.

To conclude this discussion of general principles we would add two final considerations. Firstly, we are concerned about the possibility that there is a certain amount of freight traffic which, for one reason or another, will remain very much dependent upon the railways for some time to come. In our view, it will be necessary, in order to avoid increasing inequities, to establish some kind of maximum rate control on the particular railway rates which move this type of traffic. Secondly, it is our considered opinion that, even given the early adoption of the kind of transportation policies which we are proposing, the rationalization of railway plant, rate structure and regulatory procedures will take some period of time before it can restore the railways to their proper role in the transportation structure. It would appear, moreover, that it is desirable that such a process should not take place too precipitously since, otherwise, those whose operations have become oriented to the present structure would not have sufficient time to make the necessary adjustments. There will of necessity, therefore, be a certain transitional period during which federal assistance to the railways of a financial nature - on a definitely diminishing scale - will be required to ease their burden. The rationale for this proposal, as well as recommendations for its implementation are elaborated in Chapters 2 and 3 of this volume.



## CHAPTER 2

### THE IMPLICATIONS OF A COMPETITIVE TRANSPORTATION ENVIRONMENT FOR PUBLIC POLICY CONCERNING RAILWAYS

#### Introduction

It is the purpose of this chapter of the first volume of our Report to present and analyse the reasons for the conclusions our investigations have revealed insofar as they imply action by the Government of Canada to remove certain national obligations which reside with the railways of Canada as the legacy of tradition, law and public policy. These obligations were acceptable, tolerable, and necessary during the era of Canadian development when railways, with their technological superiority of overland transportation, had an effective functional monopoly and were used as major instruments of national development.

The march of technology has removed much, and perhaps most, of the monopoly element from railways and we believe this trend will continue. Overland transportation, therefore, is no longer synonymous with railways. To the extent that public policy does not accept this fact and declines to assist in removing certain obligations from railways, the users of rail services must bear the burdens associated with those obligations in an increasingly inequitable manner. Consequently, the analysis and recommendations associated with this first volume are designed to point a way to correct those particular inequities which exist in the freight rate structure because of obligations and limitations of another era which were imposed upon railways for reasons of public policy.

There are other special problems affecting regions and industries in Canada which, it is alleged, are susceptible to cure by special transportation assistance. Transportation, because of its pervasive function in a nation as widespread as ours, is often the first means used in attacking locational problems associated both with distance from markets and the resource base. These problems of regions and industries could, however, be overcome or ameliorated by the use of any number of public measures singly or in combination. Transportation is only one of these possibilities. As we shall suggest in a subsequent volume, in seeking solutions to these regional and industrial problems transportation must be evaluated with other measures to find a combination to achieve the most effective results. But because transportation is no longer synonymous with railways, any decision to attempt to take care of regional or industry economic problems by means of transportation should consider the whole transportation environment. Under competitive conditions, the use of a single chosen instrument of transportation, rail, or another, to achieve regional or national objectives may seriously distort the allocation of resources, may achieve the desired ends by unduly expensive means, or may prove to be of greater assistance to that chosen mode of transport than to the region or industry the policy is designed to assist. Such measures as the "Bridge Subsidy", the Freight Rates Reduction Act and the Maritime Freight Rates Act must be evaluated in the light of these considerations.

Great and urgent as these special problems are, they cannot be treated at this stage when it is vital to recognize and deal with the larger and nation-wide problem of inequities in the freight rate structure which exist because of public policy obligations on the railways.

There is, in our opinion, no merit in singling out any special industry or regional problem at this point. All industries and all regions feel that their particular transportation problems are great and important. It is too much to ask from a rail user in Newfoundland, at the Lakehead or in the Okanagan Valley that he agree that the difficulties which he has brought before the Commission are of a lesser significance than, for instance, the problems of the Maritime Provinces.

The Commission is convinced that consideration can only effectively be given to these and many other special problems in the light of the wider context dealt with in this volume of its Report. First, there are basic and broad correctives to be applied through changes in public policy which are necessary to help the railways find their proper place in the increasingly competitive transportation environment. The recommendations we will make in this volume will be designed to remove from rail shippers, particularly from those whose opportunity of using alternate forms of transport is limited or non-existent, the heavy burden of obligations left on the railways as a legacy from another day. By the same token these recommendations should allow the railways as business corporations to take their rightful place in the Canadian transportation scene.

#### Railway Plant and Services

Technological efficiency over all other forms of land transport from its inception until very recent times meant that the railway was called upon to provide a total transportation service. This total service involved two functions. Within a monopoly environment these two functions are not easily discernible; it is only when competition assaults part of

the performance of the transport function by the railway that it becomes practical to consider the service performed in two parts. One of these parts, that first assaulted by truck competition is designated for analysis as the "feeder" function;<sup>1/</sup> the other is the "main-line haul". Associated with them, of course, are the necessary "terminal" operations.

Technological superiority over the horse-drawn wagon meant that railway services attempted to move so closely to the shipper and consignee, or vice versa, that the intermediate cartage function from rail head to factory door or farm was as small as possible. This meant that stations were closely located, and that industrial sidings were common. The branch line network, with a multitude of industrial sidings, became so pervasive that it was acknowledged that its servicing by the railways was an expensive task and not always a profitable one. However, the extraordinary technological advantage derived from adapting the steam engine to locomotion on rails meant that goods moved over long distances at prices infinitely cheaper than was possible before the establishment of railways. Except for that task associated with terminal operations known as pick-up and delivery, the total transportation function was performed on rails. Service was often offered on lines without any direct consideration of the profitability of each line. The branch line was said to be needed to "feed" traffic to the system and this was literally true. Taken as a whole, the system, main and branch lines, heavy density and light, was expected to be profitable - carrying goods over the whole system under a traditional pattern of charges which assessed high-valued goods a high rate regardless of whether those goods travelled over heavy density main lines where unit

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<sup>1/</sup> For purposes of the analysis to follow "feeder" includes short-haul main line movements.

costs are low, or over branch lines where unit costs are, by the nature of railway investment, high. The same practice operated for low-value commodities which, though low rated, might make a considerable contribution to overhead when hauled on heavy density, low unit cost main lines but were less likely to do so on high unit cost branch lines. "Equity" demanded that all similar types of goods should pay similar rates almost without regard to the costs directly assignable to the route over which they travelled.<sup>1/</sup> In a sense, this is a type of "cross subsidization" of one part of the plant by another; a practice successful only to the degree to which a monopoly situation exists.

The existence of the functional monopoly served national policy objectives. With public assistance in construction, service was extended by branch lines into areas where by strictly commercial considerations no railway would have gone. Managerial vision and foresight and public assistance operated to give the Canadian nation a network of railways offering swift accessibility to markets comparable to that available in nations of smaller size and greater population. The private and public costs of building and operating the network were necessary pre-conditions of national growth - and, it was assumed, would be repaid when this growth took place.

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<sup>1/</sup> Certain regional exceptions existed. The "mountain differential" for example, was a surcharge to compensate for higher operating and maintenance costs. The extant "bridge" subsidy is a later adjustment intended, apparently, to have the opposite effect: to transfer from certain shippers to the nation that part of the long-haul rate which was attributable to costs incurred by the railways over a specified portion of their route.

However, the development of the motor truck accompanied by large public expenditures on improved main and secondary roads, upset this assumption and removed from the railway practically all monopoly in the performance of the "feeder" function and began, almost at the same time, to erode the monopoly of main-line haul over increasing distances for the more highly-rated goods. As the performance of the trucks improved and reduced the cost of hauling by highway, rail traffic, for service reasons as well as price, began to be distributed from rail head by road over longer and longer distances, bypassing the existing rail branch lines and the service the railway offered.

Rail branch line service where density is light could never compete with truck for frequency of service. In addition, the truck has the same flexibility to pick-up and deliver goods at the door of every user as had the horse-drawn vehicle of an earlier day. These two characteristics, reflecting the very different investment patterns in road haulage equipment as compared to the investment pattern in railways, meant inevitably that the "feeder" function was lost to the railways on great portions of traffic. When one considers that the truck with a smaller capital investment provides an operating unit with a very high proportion of costs variable with miles run and tons hauled compared to the railways with their great portion of "fixed" costs, it is easy to understand why the branch line densities on the railway systems of Canada have not noticeably improved over the past thirty years in spite of a substantial growth of total traffic on the railways. The truck with its smaller full load, its high percentage of variable costs, and the flexibility to go from door to door, is the ideal transportation unit for areas of the country where diffusion of population and pattern of industry demands a

high quality of service for smaller shipments in terms of frequency, care and convenience. Except for those goods moving in sufficient tonnages to make it worthwhile to have the railway come directly to the plant or site in order to avoid the pick-up and delivery trans-shipment costs, it is becoming more and more worthwhile for shippers having once loaded a truck to send it a considerable distance before undertaking the additional expense of trans-shipment to the railway car.

The truck not only essentially removed the feeder function from the railways as a mode of transport, it has also taken substantial amounts of traffic for the entire haul of certain goods. The very characteristics of the truck which give it superiority in the ancillary feeder function are sufficient to ensure active competition with the rails on main-line hauls for goods whose origin and destination are within the range of economic truck operation. It is in this area where the most serious implications of truck competition for the railways have been and will continue to be found. The competitive ability of the truck is encouraged as improvements in technology are reflected in price under competitive conditions.

Technical characteristics alone are not responsible for the increasingly active competition of the trucks for traffic. During a decade of considerable rail rate increases the trucks have been able to remove some traffic from the rails, and acquire some new traffic which might have gone to the rails had railway rates not increased so much. Since competition is on the basis of both service and price, rising rail rates will cause the shipper to assess more critically the relative service benefits of the two modes in the light of his total distribution costs. Where one mode has the advantage of speed and flexibility it may be able

to charge a relatively high price which is still advantageous to the shipper. Another shipper may be able to minimize his total distribution costs by taking advantage of the economies to be gained by heavy loading and distance if they are reflected adequately in the price. In this area of competition one would expect to see the advantages of both truck and rail being blended in joint operations in which the flexibility of the truck for the feeder function combines with the low cost line-haul and the loadability advantages of the rail. The development of piggyback and other more sophisticated forms of containerization holds out promise of this sort of rationalization.

Truck competition has been growing for a number of years and will continue to intensify and pervade all sections of Canada. As it does so, the ability of the railways to perform by rail the functions for which the branch lines were built will progressively deteriorate. Facing the loss of traffic on lines which perhaps never carried sufficient density to justify themselves alone, the railways have attempted first to reduce service and eventually to withdraw it and abandon uneconomic lines. Without seeking to minimize the historic and institutional role played by the railways in Canada and the extent to which this role has built them into the social consciousness of large sections of the country, it is apparent that the nation must now face the fact that the railway branch line network is no longer vital to either the well-being of the communities on the branch lines or the larger society. Considerable resistance has, of course, been directed against attempts to abandon railway service and lines. Eloquent spokesmen have arisen to declare that the railway in its attempts to withdraw service or abandon branch lines, is, through carelessness or neglect, going to bring about the ruin of the region. These speeches can



be examined for evidence of the institutional responsibility which the railway is supposed to have toward every region where it once operated part of its system. Sober realism suggests, however, that it would be more correct to say that in most instances where the railway finds it necessary to reduce service or abandon a line, the communities have deserted the railway - making use of it only as a standby service when it is temporarily inconvenient to move goods and people by alternate methods.

Speaking in general terms and for the moment overlooking individual traffic characteristics, it becomes apparent that the emergence of road transport has removed from the railways the competitive ability and the universal necessity of providing a complete transportation function by rail. At the same time this competitive environment has curtailed the ability of the railways to recoup from high-valued goods a surplus sufficient to enable them to carry low-valued commodities at rates below the full costs associated with the commodities. The railways' role as an instrument of national policy promoting settlement and production of traffic by the incentive of cross subsidization through the medium of the classified rate structure is obsolete. It follows that the only way to preserve the railway (as distinct from a railway company) as a viable commercial operation is to have it concentrate on fulfilling those transportation functions in which it has inherent cost advantages. Broadly speaking, these functions can best be performed under conditions of heavy loading, full trains and few stops. The truck, on the other hand, has investment and operating advantages which are different though overlapping. This leads to a conception of overland transport in which there are clear advantages to each mode which, if they are to be achieved in free enterprise, must be translated by the carriers into their ratemaking policies. The full economies of

rail operation (as distinct from railway company operation) can only be achieved by a plant and service adjusted to the realities of the new competitive environment. If rail services are demanded by the nation beyond inherent competitive advantages the costs of such demands cannot be avoided by the nation. The present environment dictates that the burdens of excess rail plant and services can no longer be thrown on to the users of rail without serious distortions in the allocation of resources in transportation. The ultimate consequence - if these burdens are not removed - could be a breakdown of rail operations and the loss to the nation of their inherent economic advantages.

#### Special Considerations of Rail Branch Line Abandonment

The implementation of conclusions drawn from the analysis presented above will inevitably cause some disturbance in those sectors of the economy where investment has been traditionally tied to rail movement and which would be left in isolation should the railway companies undertake sudden abandonment of all unprofitable portions of their plant. There is, in our view, no doubt about the ultimate necessity of consolidating rail plant to conform to those functions which can still be performed profitably by rail. However, because of the institutional and social considerations associated with the railways' historic role as instruments of national policy and because of the close economic ties of certain industries to the rails, an abruptly implemented programme of rail line abandonment will cause dislocations which would not be in the interests of the community as a whole. At the same time we believe that the finances of the railway companies and rail shippers cannot and should not bear alone the burden

of the necessary period of adjustment. It is here that the Government of Canada can acknowledge the nation's responsibility. In the interests of change with a minimum of dislocation, the continuation of rail services on uneconomic branch lines should be supported over a period of time sufficient to enable the adjustments to be made both by investment in rail and investment tied to rail movement. There should continue to be opportunity to examine, through a regulatory agency, proposals for rationalization of rail plant and the public concerned ought to continue to present its views on the impact of this rationalization in each case under review in order that the regulatory agency may assign priority. Throughout the adjustment period, continuous assessment of the cumulative effects of progressive rationalization must go on. At the same time the regulatory body, empowered by the Parliament of Canada, can ensure that remaining uneconomic services are continued so as to preserve through the period of retraction, a healthy condition in industry and investment still dependent on rail transport. This gradually diminishing maintenance of uneconomic services should be undertaken by the public at large both in recognition of the current importance of railways in Canada and in order to lift the burden of those uneconomic services from the rate structure so that the railways may be able to put an attractive price upon the services they offer. It should not be the objective of this policy to make uneconomic lines profitable to the railways, for this will serve only to perpetuate a situation which misallocates resources.

It may be that, allied to the proposals which will be made for rationalization of rail plant, the Government of Canada may, because of its interest in the well-being and welfare of the nation, choose to accept some suggestions which can be made for the assistance of industries which

will find it necessary to do considerable relocation in the light of the necessity to abandon many railway branch lines.

Looking to the future one can visualize a rail system which is no longer geared to perform the entire transportation function to all segments of the community. The objective would be to have a rail system in which the uneconomic portions would be small, kept in existence either because of the national necessity to provide a certain level of service in certain areas regardless of commercial considerations, or kept in existence at the discretion of railway management for reasons of their own. In the first instance such lines would incur losses by commercial criteria which would be borne by the public at large and would not be a burden on other users of rail transport. In the second instance, the lines would exist because of managerial discretion and the burden would be a corporate one, which managements would need to justify only to their shareholders.

#### Passenger Services

Within the context of this analysis there is one category of rail service which deserves special mention. It deserves special mention not because it is different in its ability to be subjected to the same analysis but because of its separate character in the mind of the nation. As a result of our investigations we have concluded that the basis for many of the complaints of inequity has been the development of the competitive environment in transportation and its effects upon a railway structure which developed in the previous monopolistic environment. One of these effects, perhaps the most important one, is the railways' continuing need of revenues to cover deficits incurred because of the apparent inability

of railway management to slough off the historical, traditional and institutional obligation to provide passenger services.

Passenger services are clearly one aspect of rail operation which is uneconomic, taken as a whole. As in the case of branch line abandonment, public resistance to changes in passenger services has been widespread and vociferous. The railways are accused of deserting communities by withdrawing passenger-train service, when a more objective view would be that the communities have deserted passenger-train service. The reasons are not difficult to find. The same conditions which promoted the spread of truck competition for freight traffic have promoted alternative methods of transporting people over short and medium distances. A situation analogous to the loss of the "feeder" and erosion of "main-line" functions has occurred. People, having the private passenger automobile available, do not simply use it to convey themselves to the nearest railway station. Because of flexibility and convenience they use the car to complete journeys of short and medium length. The careful economic planning which accompanies a decision to ship goods is also utilized, although to a much lesser degree, in private transportation. The average car owner, having accepted the burden of his capital investment, realizes that it costs him very little more to make fairly full use of his automobile. The same flexibility and convenience which is found in trucks for "feeder-line" functions attends the passenger car. And, as highways improve, the distance increases over which people decide to use their own automobiles for the "main-line" journey instead of railway passenger services.

The growth of good highways has also brought into existence a commercial competitor to the railways for passenger service. Passenger bus operators with cost patterns comparable to trucks, and something of the

same flexibility, can offer more frequent passenger service in light density areas. In addition, the cost patterns of bus operation have enabled bus fares to be highly competitive with rail fares over considerable distances. A further technological development, air travel, has proven so attractive in terms of speed and price that it has more than tripled in the past decade. The net effect is that except in specific instances where a combination of distance, speed and convenience gives an advantage to the railways, the bulk of intercity movement of people takes place by other modes than rail.

We conducted no independent study of the relative impact of competition on rail passenger operations, but sufficient evidence was brought before us to make it abundantly clear that the competition for passenger business from airlines, bus lines and private passenger cars has rendered the railway passenger business as a whole unprofitable and a burden which at present must be borne by the users of rail freight services. The competitive environment in the transportation industry has made it impracticable for the railways to continue to accept the great burden - dictated not by economic considerations but by social, political and traditional pressures - which is involved in the maintenance of rail passenger-train services. Therefore, our conclusion is that the railways must eventually withdraw all uneconomic rail passenger services, subject to similar time limitations imposed in connection with the abandonment of uneconomic plant. Immediate and abrupt withdrawal of rail passenger services where they are unprofitable would cause dislocations far outweighing the advantages to be gained. But the pressing necessity of relieving the railway freight shipper of inequities arising out of the competitive environment causes us to make immediate recommendations for the

removal of the financial burden of maintaining uneconomic passenger service, with the necessary incentives to see that these services are withdrawn as rapidly as possible. The net effect to the railways, if these recommendations are adopted, will be, not to make all extant passenger service profitable, but to lift the burden of direct losses which railway managements have hitherto sought to recoup from the freight shipper.

Our prime responsibility, as we see it, is to seek out and recommend measures to eradicate the causes of inequities in the freight rate structure and to draw attention to those restrictions which, because of law or public policy, may prevent a more efficient operation of railways. The evidence we have gathered and the criteria we have developed for testing it indicate that the burden of passenger traffic deficits is the most onerous of all those which have been left on the railway because of the legacy of traditional, social and national obligations. It is our considered opinion that the recommendations we shall make regarding measures to lift the burden of passenger losses from the shoulders of rail users are necessary to bring about a reduction in the inequities we are commissioned to advise upon. It is impossible to view the railway problem apart from railway operations in their entirety and we find that there is little social justification and less economic, for the permanent provision of railway passenger services as we know them today. The public, by and large, has already indicated its preference for other modes of travel, and except in a few instances where no alternate form of overland travel exists, we look forward to the time when the railways will be supplying passenger services only in those areas where they find economic justification for them. In the interim it is, we repeat, most important that the burden resulting from losses on railway passenger services be lifted from the freight shipper.

The railways in the evidence they brought before us indicated that they regarded the provision of passenger services essentially as a matter of managerial discretion. In evidence, and in private consultation, officials of both trans-continental railway companies expressed their belief that the passenger problem could be brought within manageable proportions over a period of about five years. This is not a long period of time in the history of a nation and it might be argued that under these circumstances the railways be left to manage the problem alone. But we would point out that to those freight shippers already burdened with high freight rates and the possibility of increases in freight rates, five years may prove to be long enough to have serious consequences. It will, therefore, be our recommendation that the Government of Canada should, in the interests of the nation as a whole, absorb in declining measure for a period of five years, this most substantial of all obligations now incumbent upon railway management. Unless remedial action, attended by a change in public attitude is introduced, a significant and inequitable burden will continue to rest upon the users of railway freight services.

To the extent that there remain after this five year period rail passenger services operating at a loss but essential because of a lack of alternate surface transportation it shall be the responsibility of the nation to bear the burden of that loss.

Other Burdens Imposed on Railways  
by Reason of Law and Public Policy

Evidence was brought before us that there were a number of operations being conducted by the railways which in the opinions of the witnesses could be proven to be unprofitable. Passenger services were one



of these. Excess rail plant was another. Outmoded management and labour practices were others. All were said to be contributing to the inability of the railways to operate more efficiently and compete more effectively. Certain special services came in for criticism such as the Express and Less than Carload (L.C.L.) traffic. However, in the face of these claims, the railways maintained that the requirement to carry grain and grain products to export positions at statutory rates was the only major obligation which involved a loss and, moreover, was of surpassing importance because railway management had no discretion regarding it and no means of escaping it.

Assessing all the evidence in the light of the responsibilities put upon us, we have concluded that managerial discretion and responsibility is severely limited by tradition, law and public policy in four major ways. The two we have analysed - excess plant and passenger services - can be said to have as their common characteristic an obligation chiefly resulting from tradition and public policy. The two remaining have the common characteristic of being obligations expressly imposed by law to perform a function which now occasions a loss. The first of the remaining two is associated with the obligation to carry grain and grain products to export positions at a statutory rate. The second concerns statutory obligations to provide free transportation.

Apart from other lesser regulatory restraints which will be evaluated in a later volume, in all other important areas we find that either railway managerial discretion is solely responsible for services offered and related losses, or that the institutional rigidities of the railways themselves prevent them from adjusting to their environment as rapidly as management might desire. Within a competitive environment and

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with the free enterprise philosophy these adjustments must be made internally by each railway, and between the railways and railway labour.<sup>1/</sup> If sufficient adjustment cannot be made to enable the railway to be an active competitor, then the responsibility is not upon the public to assist. But, let us reiterate, for those obligations which involve losses imposed upon railways by law, there is an obligation to assist.

### Statutory and Related Rates

The first special area where we find that such an obligation throws a burden on to other shippers by rail results from the decision of Parliament to take the responsibility to set by statute the rate for moving grain and grain products to export positions. Our independent assessment of assumptions, methods, and the calculations in the cases put before us has not been completed, but sufficient progress has been made to enable us to advise upon the order of magnitude of the burden imposed by the statutory rate. A special study which will be presented in a later volume of this Report will illustrate our reasoning in detail.

To be consistent with the approach we have taken in assessing other burdens, we will recommend that losses associated with the obligation to carry grain and grain products to export positions at a rate set by statute, which must of necessity now be recovered from other shippers, should in future be borne by the Parliament of Canada, who in its wisdom sets the statutory rate. In this way Parliament remains the sole judge

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<sup>1/</sup> The productivity of labour on the railways and the efficiency of rail operations generally are fertile fields for special study. The Productivity Council might be well advised to undertake them in the light of the importance to Canada's export trade of efficient rail operation.

of whether or not the grain industry can bear rates higher than it presently bears for its movements to export positions. We note that none of the parties appearing before us disagreed that this should be so or advocated that Parliament should relinquish this responsibility.

In the instances of excess plant and passenger services it was our objective to lift the burden but to stop short of making operations on light density branch lines and passenger operations profitable enterprises by public assistance. To accept an obligation to make such uneconomic enterprises profitable is to forego any hope of seeing railway plant or passenger services brought into line with the economic realities of a competitive environment. In brief, assistance will be suggested in these two areas with the short-run objective of ameliorating those inequities in the freight rate structure which can be ascribed to the burden but with the long-run objective of removing the cause of the inequities - the burden of uneconomic plant and services.

In the case of the grain traffic different conditions apply. So far as we can see at the present time there is no economic justification for the railways to get out of the business of transporting grain. The more uneconomic portion of the grain haul will be rationalized as total plant is rationalized and once that is accomplished grain will move over the rails by a means more economical than any other which is apparent to us. Therefore, the remuneration which should accrue to the railways is in our opinion based on two considerations. First, this remuneration should ensure that there is no burden on other users of railway facilities. Secondly, since this is a business in which the railways should be encouraged to continue, the traffic should yield a reasonable return upon investment. We demonstrate in Chapter 3 how we arrive at the

figure which we consider is the necessary remuneration for the work performed in moving grain and grain products to export positions. We shall do this by separating the costs associated with moving the grain traffic from those costs which are associated with the plant upon which the traffic moves. Since the payment received for work performed in the movement of grain achieves its special distinction by virtue of the fact that Parliament has taken the responsibility for setting the rate we shall suggest that the Parliament of Canada, the authors of the statutory rate, ensure that the railways receive sufficient remuneration to cover costs and achieve a return on investment associated with the work performed.

#### Statutory Free Transportation

There is one further example of an obligation placed upon the railways by reason of law which illustrates very aptly the principle behind each of the instances examined in this chapter of the Report. This obligation, set out by statute, requires the railways to provide free transportation to certain persons by virtue of the public office they hold. In addition, the Board of Transport Commissioners has the right, among other things, to require the free carriage of persons by rail. It is significant to note that the list of persons to whom such free transportation is presently granted, is extensive.

Where the railways decide of their own free will, subject to the over-all control of the regulatory agency, to grant free or reduced transportation to passengers, they should continue to be allowed to do so. Where, however, the law compels them to extend such free or reduced carriage, they should be compensated. To take any other course would be to require the railways or the users of their services to assume a burden

which does not properly belong to them. Here again, the railway pricing structure would be distorted and transportation resources would be misallocated.

It is not, of course, within the purview of this Commission to pass judgement upon this national policy decision to provide free transportation for certain members of the society. We do, however, consider it within our Terms of Reference to propose, consistent with the principle enunciated throughout this volume, that the railways be properly compensated for these services which the law obliges them to perform. It is, therefore, recommended that the Government of Canada should assume the costs of implementing the national policy as it pertains to this aspect of transportation.

#### Summary and Conclusions

This chapter contains the analysis necessary to establish the principle which we believe to be basic to achieving any long-run solution to the problems which beset railways in Canada and to the establishment of a greater degree of equity amongst the users of rail transport. The principle developed is that burdens, which are the result of obligations imposed upon railways by tradition, law and public policy, be lifted. The increasingly competitive transportation environment, aggravated by price increases, occasions losses to railways because obligations to perform cannot be escaped even when the conditions which initiated these obligations have passed. The obligations make it necessary to pass on to the users of rail services the associated costs. The railways, to survive as an active component of the transportation environment,

must meet their competition by price and service. This is only possible where national obligations do not distort their ability to do so. Insofar as they can be discerned, these national policy obligations should be removed in the long run by adjustments to plant and services. Where these national obligations cannot be removed, remuneration should be found for the services performed to prevent distortions in resource allocations and distortions in pricing of rail services.

We believe we have set out all the most important areas in illustration of the principle. In the next Chapter we will make specific recommendations concerning these areas. These recommendations necessarily are tied to a point in time. From time to time, as circumstances change, the extent of the necessary remuneration will change. But with the acceptance of the principle, in recognition of the changing environment and the changing role of railways in that environment, further assessments may be made by the regulatory authority. Vigilance on the part of the railways and the regulatory authority will ensure that the railways do not continue to be hampered and the users of railways be forced to meet charges which are in part properly a burden of national policy.

## CHAPTER 3

### SOME SPECIFIC RECOMMENDATIONS FOR PUBLIC POLICY CONCERNING RAILWAYS

#### Introduction

The railways presented studies intended to show the costs associated with the movement of grain and grain products from Western Canada to export positions. The techniques developed are, in our opinion, significant contributions to the science and art of solving the very complex and vexatious problem of transportation costing. The techniques used to achieve the results are not unique to railway costing, although the results are of necessity couched in terms of the railway accounts. We are aware that the studies are not solely applicable to the movement of grain, but have utility also in costing other movements.

The techniques are adaptations of well known statistical and mathematical principles. They achieve special prominence in railway costing by virtue of the introduction of the technique known as multiple regression analysis. This is a statistical tool by which variations in one quantity can be related simultaneously to variations in a number of relevant other quantities. Regression techniques have been used for some years in resolving certain types of demographic problems and in costing a number of complex industrial processes.

In any problem where there are a number of expense items which are not obviously assignable to work performed, a method of apportioning these expenses to the work performed in a rational manner permits a closer estimate of the true costs attributable to the performance of that function.



Before the utilization of the regression technique was made practicable in large commercial operations by the development of electronic data processing equipment, attempts were made to allocate expense items by a number of methods of apportionment. The difficulty of arriving at a wholly satisfactory method is attested in the literature of railway costing and pricing over a long period of time. There has never been any particular problem associated with those expenses which could be readily attributed to a task performed. Depending upon the detail with which accounts were constructed, many direct expenses could appropriately be assigned. There remained, however, a number of expenses which resisted ready identification with specific tasks performed. Some of these were obviously variable with total work done but could not be apportioned rationally amongst specific tasks performed. In addition to these, some expenses associated with the existence of the whole railway operation did not vary with work performed, and could not directly be assigned from the accounts to particular operations.

Insofar as the present cost studies are concerned, directly assignable expenses receive their measure of accuracy on the basis of the Uniform Classification of Accounts. With them no problem of assignment is associated. For that considerable body of expenses in the Accounts which are known to be variable with work performed to a greater or lesser degree, but are not directly assignable, the availability of computers and the regression techniques give a sound statistical basis for apportionment amongst various segments of traffic. However, there remains a significant amount of expense incurred in the operation of the railway as a whole for which there exists no tool known to the statistician or the accountant which

will uniquely apportion the items between various operations performed by the railway. In these apportionments, judgement must be used by the analyst.

The cost studies presented by the railways made use of all three methods in presenting to the Commission a basis of cost on which to judge the adequacy of revenues for the movement of grain and grain products from Western Canada to export positions. The use of the methods was not challenged by those who contested the results of the railway studies. The very large disparity of results between the railway studies and those who challenged them is attributable to the general and specific lack of agreement on the assumptions necessary before any of the methods are applied. One such failure to reach agreement concerns the cost of maintaining track, in which four separate sets of assumptions were used; one by each railway and one by each of the two challengers. All these four sets of assumptions have common elements, and taking these as points of departure, assignment of track maintenance costs can be made with confidence.

In spite of the apparent complexity which differences of opinion introduce, the state of railway accounts, the state of knowledge of regression techniques, and the precedents established for apportioning constant costs, make it reasonable to attempt to arrive at cost decisions with confidence. Consequently we will proceed to present recommendations based on our judgement of the assignment of variable costs and the apportionment of fair and reasonable overheads associated with the performance of certain rail functions in the light of our objectives which are developed at length in this volume of our Report.

Since it is possible with present knowledge and techniques to make use of all the methods to determine confidently fair costs associated with the movements of various types of traffic, it follows that apportionments of expense may be made to maintenance and operation of sectors of the railway plant irrespective of the traffic moving over them. Where we have found that part of the railway plant is now less used and useful than formerly, due to changing conditions, and that total railway operation and expense would be improved by rationalizing plant, we have used the appropriate methods and techniques to isolate expenses so related in order to provide a basis for encouraging plant readjustment.

With the care necessary to avoid double counting, we have attempted to provide a basis for national assistance in the four cases developed in Chapter 2, where railway expenses are incurred due to a variety of historical, traditional, and legal obligations together with inadequate opportunities for finding sufficient revenues. These four obligations we regard as national in scope.

Uneconomic passenger services exist over the whole length and breadth of the nation but with different degrees of intensity. We do not know, and no purpose would have been gained by attempting to discover, the regional incidence of these uneconomic services. Regardless of the prevalence of uneconomic passenger services in the various regions of Canada, we regard the provision of these services, whether they be required by law, tradition or public policy, as national obligations upon the railways and a burden upon them and the other users of rail services.

Similarly, light density lines which occasion a system net loss are to be found throughout the nation. It may so happen that historical circumstances attending the development of the nation may have caused

lines which are uneconomic to be built to a greater extent in some parts of the country than in others.

The legal obligation to transport designated individuals without recompense constitutes a burden upon the railway companies and since it, like the other burdens, must be passed on to the users of the railways, it has a distorting effect upon the railway pricing structure and contributes to the misallocation of transportation resources. This problem, too, we regard as national.

Respecting the obligation to move grain and grain products to export positions at statutory and related rates, special considerations apply. So long as the obligation remains upon the railways to perform this service under conditions of cost which make the rate unremunerative we regard it as a national responsibility to lift the burden.

#### Passenger-Train Service

The Canadian National Railways testified that their passenger-train service deficit in 1958 was \$40,858,000. The Company did not include in its estimates amounts to cover either the depreciation of equipment or the interest on the money invested in equipment devoted to passenger-train service. Since depreciation represents a real cost which was borne by the railway, we have restored to the estimates an amount of \$9.5 million for depreciation. On this basis, the operating deficit on passenger-train service in 1958 was \$50,358,000 for the Canadian National.

The Canadian Pacific Railway Company testified that the passenger-train service burden in 1958 was \$15,556,811. This figure was their estimate of the increased supply of money which would have been

available for distribution to shareholders or for other corporate purposes after payment of income tax had passenger-train services met all their variable costs. The Canadian Pacific testified that, before income tax but after an allowance for interest on the investment to be perpetuated, the deficit was \$29,352,474. Deducting the interest charge of \$8,401,805 the operating deficit becomes \$20,950,669.

The Canadian Pacific's submitted figures included in passenger revenues an amount of \$6.7 million as the estimated value of free transportation granted by the Company during the year. While this procedure is satisfactory for many other purposes, we believe that it tends to confuse the issue we are now discussing, that is, the operating deficit of the passenger-train services. Excluding this hypothetical revenue (as did the Canadian National in its submission) the estimated operating deficit of passenger-train services on the Canadian Pacific is increased from \$20,950,669 to \$27,650,669 in 1958.

Supplementary information received from the two railways confirms that, since 1958, each has continued to attack the problem vigorously with a wide programme designed to increase revenues and reduce expenditures. The passenger deficits are, therefore, declining. To relieve freight shippers and the railways during the five-year period before the target date for the elimination of these deficits, we recommend that an adjustment grant be paid on a declining basis. We have not included in our recommended payment any amount to cover interest since we do not believe that the railways should be encouraged to remain in unprofitable segments of the passenger business.

The railways should, during this period, be required to submit annual estimates of their passenger deficits. The annual amounts we recommend be paid during the years 1961 to 1965 inclusive are the actual deficits or the figures below, whichever are less. From 1966 we recommend that no subsidies be paid on account of the passenger service generally.

MAXIMUM ANNUAL PAYMENT IN RESPECT OF PASSENGER SERVICES

Year	Canadian Pacific <sup>1/</sup>	Canadian National <sup>1/</sup>
1961	\$22,000,000	\$40,000,000
1962	17,600,000	32,000,000
1963	13,200,000	24,000,000
1964	8,800,000	16,000,000
1965	4,400,000	8,000,000

<sup>1/</sup> The maximum annual amounts shown will be reduced in any year to the actual passenger-train deficit incurred.

To facilitate the reduction of the passenger deficits, we recommend that the pertinent statutes be amended to enable the railways, upon application to the Board of Transport Commissioners, to remove any uneconomic passenger service except when the Board is satisfied that no reasonable alternative public highway exists.

It should be understood that the passenger services dealt with in this Report do not include commutation services.

Light Density Lines

In Chapter 2, we noted that the continuation of rail services on uneconomic branch lines should be supported over a period of time

sufficient to enable adjustments to be made both in rail investment and investment tied to rail movement. In our view, fifteen years is a reasonable period to expect this process to continue.

Evidence placed before us does not enable us to determine either how much mileage should be removed from service or where that mileage is. Ascertaining these facts is a matter for continuing study. We are, therefore, in no position to offer a detailed plan for the rationalization of Canada's railway plant. We are, however, prepared to make recommendations, the implementation of which would have the effect of encouraging the railways to pursue a course of rationalization, and to lift from shippers the burdens which they presently must carry because of the continued existence of basically uneconomic miles of track. Not knowing which miles of track are unremunerative, we have been forced to accept density of traffic as an indicator of economic worth. In doing this we have been aware that lines carrying a heavy density of low-rated traffic may be uneconomic, while on the other hand, lines with a light density of highly rated traffic may be profitable. The data we have collected on costs and average revenues suggest that it is not unreasonable to assume that railway lines on the average would probably break even with an annual traffic density of 100,000 net ton-miles or 200,000 gross ton-miles per mile of track. It appears, according to the latest figures made available to us by the managements of the two railways, that each of them operates about 4,300 miles of track over their systems, below the indicated density figures. We are not suggesting that traffic density is the sole, or even the paramount, criterion for determining the profitability of individual rail lines. Profitability can only be established on the basis of revenues and expenses to the system occasioned by each line. Furthermore, because

of different traffic characteristics, the problem may not be of equal magnitude on each of the two railways. For these reasons we attempt only to indicate the magnitude of the problem in the nation as a whole and to recommend a method of assistance which will allow the development of a detailed plan.

Using estimates presented by the two railways we have reached the conclusion that maintenance of miles of track (irrespective of traffic) on about 8,600 miles of light density lines occasioned a cost of approximately \$13 million in 1958.

We, therefore, recommend that, under the administration of the Board of Transport Commissioners for Canada, an annual grant of \$13 million be made available to provide compensation for losses actually incurred in the operation of lines which the railways are prepared to abandon, but which shall be continued for a period of time to be determined by the Board. In Volume II of the Report we will make recommendations on the procedures to be followed in the application of this grant.

#### Export Grain Traffic

Evidence was presented by the railways to the effect that the deficit on the transport of grain to export positions was approximately \$70 million for the two railways in 1958. Each railway presented its estimates of the costs in two parts. The first part was the amount which, in the opinion of the railways, represented the cost which would be escaped, given a sufficient period of adjustment, if they were no longer required to carry grain. This was defined as variable cost. The second part was an apportionment of those expenses which, at the present state of the costing art, cannot be traced to any particular railway activity. This was defined as constant cost.



In considering variable costs, the Commission made two significant changes in the railway figures.

In the first place, the railways included in variable cost maintenance costs attributable to the maintenance of miles of track said to be "solely related" to grain. We were impressed, during our hearings, with evidence which indicated that many of these lines are in fact carrying very light traffic. We have said above that we consider the existence of light density lines of importance in the group of problems facing Canadian shippers and railways. Recommendations to meet this problem have been made. In our present considerations we have, therefore, removed this expense from the costs applicable to the carriage of export grain.

In the second place, in both the variable cost and the constant cost, the railways included an item which they termed the "cost of money". This item was tantamount to interest on the investment required for the transport of grain (variable cost) or of investment which could not be assigned to particular activities (constant cost). The railways asked for an amount of approximately six per cent after income tax or something over ten per cent before income tax. In considering this item we have concluded that the rate of return on grain should not be different from that which the railways could earn on rail investment generally under the permissive earnings formula of the Board of Transport Commissioners. With this in mind, appropriate adjustments were made.

Our examination of the variable costs has not yet been completed in detail. We, therefore, submit these cost figures with some reservations for the present. However, we have reached the conclusion that the variable cost of moving grain from Western Canada to export positions in 1958 was \$37.6 million for the Canadian Pacific Railway, and \$33.1 million for

the Canadian National Railways. The shortfall of revenue on variable costs in 1958 was of the order of \$2 million for the Canadian Pacific and \$4 million for the Canadian National.

Should the recommendation which follows be implemented, the exact amounts of variable costs will need to be calculated at the end of each year. By their nature they vary with the volume of traffic and railway costs. The procedure that will be presented in our special costing study in a later volume will provide a guide for the calculations to eliminate any serious administrative problems.

Turning to the problem of apportioning constant costs to the carriage of export grain, we found that there were a number of different ways in which the allocation could be made, and in fact no single consideration was found to be satisfactory. We could find little justification for the contention that, because grain constitutes a significant proportion of work done by the railways, it must automatically bear some fixed proportion of constant costs. In making our own assessment of the proper assignment of these constant expenses we kept two considerations in mind. The first is that the traffic should not be a burden to other traffic, nor be unduly onerous to railway owners, by failing to bear any share of overheads. Further, the extent to which the grain traffic contributes to overhead will have a bearing on the total profitability of rail enterprise which in its turn helps to determine the cost of borrowing in the money market.

The second consideration arose from the fact that in our opinion a rationalization of railway plant is required. To allow a full return on all plant might be construed as an admission that all of the railway plant in Western Canada is "used and useful". The recommendation respecting

the payment on behalf of export grain is based on the decision that it is not. Such a full allowance would, therefore, discourage railways from abandoning redundant lines.

In the light of these considerations, of the analysis presented in Chapter 2, and of the recommendations for meeting passenger service deficits and the problem of light density lines, we recommend that in the case of the Canadian Pacific Railway a sum of \$9 million annually shall be paid on behalf of the export grain traffic as a contribution to constant costs. This should place export grain traffic in a position comparable to other segments of traffic in the light of the permissive level of earnings.

Making adjustments necessary due to the different financial structure of the Canadian National Railways, the payment recommended to that Company as a contribution on behalf of the export grain traffic to overheads is \$7.3 million.

Our recommendations respecting the deficits on passenger services and the rationalization of railway plant will have a considerable bearing upon the total financial position of the railways. As these programmes progress it will be necessary to re-evaluate the portion of constant costs which should be assigned to the export grain traffic. We recommend that the payments we suggest in the matter of constant expenses be continued annually without alteration until the end of the five-year period when public responsibility for passenger deficits has been completed. At that time, the first re-evaluation of railway overheads pertaining to the grain traffic should be made.

We, therefore, recommend that upon submission and approval of reports of the variable cost of moving grain and of the revenue therefrom for the previous year, the railways be granted annually a sum of money

equal to the shortfall of revenues on variable expense plus \$9 million in the case of the Canadian Pacific Railway and \$7.3 million in the case of the Canadian National Railways. In any of the years where for one or both of the railways the revenues from the carriage of grain from Western Canada to export positions were greater than the variable costs, the railways would be granted the sum of \$9 million in the case of the Canadian Pacific and \$7.3 million in the case of the Canadian National less the excess of revenue over variable costs.

When the process of rationalizing plant by the elimination of rail lines occasioning a system net loss has substantially progressed, or when it appears that there has been any other substantial change in the overhead costs of the railways, the constant costs of the railways should be re-evaluated. After these re-evaluations the remuneration paid on behalf of the movement of grain and grain products to export positions at statutory and related rates should be adapted to the changed situation.

## CHAPTER 4

### SUMMARY AND CONCLUSIONS TO VOLUME I

In this volume of our Report we have concentrated our attention on what we consider to be the underlying aspects of the broad task which, by our Terms of Reference, we were assigned. To begin with, we have examined the basic forces at work in the new competitive transportation environment and drawn certain general conclusions which appear to follow from this examination. Secondly, within the framework of these general conclusions, we have attempted to analyse certain specific railway problems which have implications for, and invite adjustments in, public policy. Finally, we have sought to indicate the magnitude of the financial assistance to the railways that we believe is necessary in the transition period which these policy adjustments will require before they can take full effect.

We have adopted this approach because we are convinced that, while palliatives abound, the country cannot find its way to a fundamental solution of its transportation problem until the railways are relieved of the burden derived from policies which are no longer appropriate to the modern competitive era. We believe that the remedies we have suggested will enable the necessary adjustments to take place without distorting the competitive nature of our present transportation system or discouraging its further development. We are also convinced that these remedies will help to ensure that the railways will take their proper place in a Canadian transportation system designed to encourage and facilitate national unity

and national development to the greatest degree. Relief from obligations of the past and the burden associated with these obligations - eased in the short run and removed in the long run - should permit the railways to adapt successfully to the increasingly competitive environment. It is this fundamental aspect underlying the myriad other problems in the Canadian transportation structure which we have dealt with in this volume of our Report.

There is another issue calling for remedial action which, although it cannot be dealt with in detail in this volume, we feel is of such pressing nature that it requires some reference at this time. In submissions from all over the nation complaints were brought before us concerning the increasingly onerous burden of rail freight rates with predictions of disastrous results which would follow any further increase in these rates. We are impressed with the seriousness of these complaints.

The complaints, while differing in other respects, were unanimous in condemnation of the device of the "horizontal" percentage rate increase. The railways, on the other hand, professed to know of no other method which, within the regulatory and institutional fabric, is as satisfactory to administer. The examination of causes, effects, and proposals for cure associated with securing additional rail revenues must await the second volume of our Report. However, certain basic indications can be made here.

The problem of securing additional revenues arises because the pace of technology on railways has, to this moment, been unable to increase productivity sufficiently to offset price and wage increases. If any commercial enterprise is to survive, cost increases must eventually be passed on to the users of the company's product. No one denied this before

us. Dissatisfaction arises because of the inequitable manner in which the increases are passed on. The questions naturally occur: Why are the increases passed on inequitably? and What way would be equitable? There is no unanimity of answer amongst the participants in our investigation. We do, however, wish to point out here certain bases upon which our conclusions rest.

There is nothing inequitable about a high freight charge per se. Distance and other factors in transportation costs make it necessary that the long-haul shipper will have a higher freight bill than a short-haul shipper, other things being equal. This simple axiom is self-evident by itself but often it is obscured in the complex of factors which beset an industry or a region facing serious market competition. The cost to the industry of transporting its products is the most exposed cost and therefore one of the most obvious. The historic place of the railway in Canada has left a tradition of obligation which encourages industries or regions to seek redress by public action against this particular cost, and against increases in it. Such appeals are not without considerable measures of success as is attested by the transportation policies inaugurated by the Federal Government at various times and for a variety of good reasons.

Viewed in this context, the various complaints made against high and rising freight rates are an amalgam of the traditional complaints against high transportation charges for the longer distances and the increasing degree of disparity and inequity which a general percentage increase throws on to the long-distance commodity. Consequently, long-haul commodities already suffering a transportation cost disadvantage to a market, have to bear a percentage increase which is, of course, larger

in dollars than a shorter haul, with disturbing effects on the ability to compete in the market. In addition, and this is the real aggravation, the pattern of competition has tended to affect most intensively the shorter-haul commodities. Thus the necessary increase cannot in fact be applied horizontally: some shipments bear none of the increase, some a little of it, and some a great deal - sufficiently more, indeed, to attempt to make up for the increments which cannot be placed on the other traffic.

This is a phenomenon of unequally pervasive competition. And, however right the railways are in claiming that it is beyond their power to extract the necessary increases in revenues from much of the competitive traffic, the fact remains that, in a competitive environment, the tool of the "horizontal" percentage rate increase is self-defeating for the railways as well as inequitable for the shippers still dependent on the railways. As it is used it does not produce the necessary revenues on any basis of equity, and it encourages the erosion of traffic or the spread of competition into those commodities and for those hauls which could remain with the railways, if an unbalanced application of cost increases could be avoided.

It is correct to infer, as the railway companies do, that the total expenses of the operation must be borne by the users of rail facilities. But it is not correct to infer that equity is preserved regardless of how the burden is borne. No shipper could properly claim to suffer inequity if he were asked to bear only the average percentage increase in costs. The determination of these cost increases, of course, must be evaluated with adequate statistical data by a trained and experienced costing section in the Board of Transport Commissioners. Certain criteria for that evaluation will be examined in a subsequent volume of our Report.



The argument will be made, particularly by the railways, that their revenues will suffer a shortfall if the specific increases to be imposed are limited by the average increases in costs. This may be true. No one can, or should, guarantee that the revenues of any competitive business will be adequate. This is just as true of competitive transportation as of any other business. In the free enterprise environment, when revenues fall short of expenses, either a selling campaign, a reorganization of operations, a curtailing of unremunerative services, or all of these is the only avenue of economic salvation. It is incongruous, contradictory, and indefensible to claim on the one hand that the railways must be freed from obligation and restriction to enable them to compete, and on the other hand to infer that rail revenues somehow must be guarded and protected because of the important "national" position occupied by railways. In this we have already stated our position, and it is that obligations imposed upon railways by reason of law or public policy should not be a financial burden upon the railways and upon the users of rail services. To the extent that we find that the public of Canada and the Government of Canada do have obligations to preserve rail revenues, we have already recommended. This alone will relieve the exposed shipper from some pressure for increases in rates. From this point on, should the railways make further applications for freight rate increases, the permissive level of increase should be established by the Board of Transport Commissioners in such a way that no shipper is obliged to bear more than his fair share of increased railway costs. The fact that some shippers may not, because of competition, bear even that proportion is a fact of life in transportation today and does not in our view give rise to inequity between shippers. If increases in railway costs continue for any number of reasons, in spite of increases

in productivity and in spite of the curtailment of excess plant and services, and should the railways choose to seek another general rate increase, no shipper can justly complain if, in using rail services, he is asked to bear his fair proportion of increasing costs. If, on the other hand, he is fortunate enough to be situated in the competitive sector and the railways do not feel that they can increase his rate in the light of potential competition then this is a locational benefit accruing to some shippers but not to others.

Locational and resource disadvantages are well known in Canada. Remedies for overcoming them have been built into national policy. Transportation has been used as one instrument for mitigating locational disadvantage. We have attempted to show in the first and second chapters of this volume something of the development of this characteristic, and to demonstrate how these remedies have had their original purpose diluted and diverted by the growth of competition. To show this is not to suggest that the transportation medium cannot be used in the future to achieve national stability or national growth. Locational disadvantages can still be ameliorated by national transportation policies. But to be consistent and to have any measure of success, the costs of such assistance should be nationally borne. It is no longer feasible to require the railways to level out disadvantage through the medium of the railway rate structure.

When transportation assistance is introduced as a policy designed to assist a region or an industry it should be implemented so that there is no distortion introduced into the transportation industry itself. Placing upon one mode a burden because of regional or industry transport policies will force a shifting of the burden to some shipper unprotected by competition. Placing upon one mode of transport a benefit because of

regional or industry transport policy is to give it an advantage over its competitors not dictated by efficiency, with consequent over-expansion of the favoured mode, and constraint upon the others.

To conclude, we see the problems which beset both the railway sector of the transportation industry and those who use it, as being intimately associated with the unequal impact of competition in transportation across the nation. The inability of the railways to adjust quickly to competition because of the yoke of organization, plant and services suited to another age, has accentuated the difficulties. Attempts to preserve and increase railway revenues by methods which, in their effects, are both inequitable and self-defeating, have aggravated public discontent and have led to the present impasse: we find regions and industries accusing each other, and the railways, of creating unwarranted burdens in the form of an inequitable proportion of railway costs. Such charges and counter-charges had little meaning, and were not so strident, under a regulated transportation monopoly and traditional pricing practices. In competition which is unevenly pervasive all these charges take on meaning and substance. Solutions to these problems, however, require methods appropriate to the present, not to the past. They can only be found, we are convinced, within a framework of public policy designed both to facilitate the spread of a fair and competitive transport market and to simulate competitive conditions in areas where competition has yet to take effect.

We have suggested in this volume some of the steps we consider necessary to formulate such a policy. Our second volume will offer further recommendations in this regard. The objective is to help the railways find their proper role in the present competitive transportation

environment because we believe this to be fundamental to the solution of the problems which brought this Commission into being. The evidence is clear that the railways continue to retain a real economic advantage with respect to many essential traffic movements and - in a country of vast distances, still dependent, in large measure, for its economic welfare on the production and export of primary products - they are and will remain for the foreseeable future the backbone of the transportation system in Canada.

It is also apparent that each of the different modes of transport comprising the system - rail, road, water, air and pipeline - makes its own unique and necessary contribution to the functioning of the whole. There is a need for all, and there is room for all. We have reached, in other words, the era of competitive coexistence in transportation in Canada and it is the task of the public, and of the industry itself, to ensure that present and future policy is formulated in the light of this development.

In a subsequent volume we will more closely focus our study on the effect which uneven competition has on railway pricing, plant and regulation. We will do so with a twofold objective: first, to develop an analysis which is common to the problems affecting the railways, their competitors and the users of their services. Second, to give the further recommendations which, we believe, are necessary, if Canada is to have a railway system able to perform its appropriate function in an increasingly competitive environment.

ALL OF WHICH WE RESPECTFULLY SUBMIT FOR YOUR EXCELLENCY'S  
CONSIDERATION

*H. A. M. Stephens*

Chairman

*H. Anscomb*

\*

*René Gobeil*

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*A. H. Balch*

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*H. A. M. Stephens*

*Prof. Plato*

F.W. Anderson  
Secretary and Director of Research

March 30, 1961

- \* Mr. Herbert Anscomb has signed the Report subject to the Observation and Reservation which follows immediately.
- \*\* Mr. Archibald H. Balch associates herewith with Mr. Anscomb (Page 76).
- \*\*\* Mr. René Gobeil has signed the Report subject to the Reservations on Grain (Page 77).

Reservation and Observation

by Herbert Anscomb

I regret that I am unable to associate myself with the conclusions reached by my colleagues in this volume of our Report without making the following observation and reservation.

It should be understood that during the course of our public hearings the railways - the grain trade - the Provinces and other interested parties took the position - without supporting evidence - that under existing economic conditions the western grain growers were not able to pay a greater proportion of their export freight charges on grain than that provided in the rates set by Parliament in 1925. It is my view that this condition should not be and must not be an accepted fact for all time.

I suggest that the Government (Parliament) should constantly review world economic changes and conditions of the grain trade and as and when conditions record obvious improvement the freight rates to the western grain growers should be increased over those now in effect (1961) in order to ensure that at the earliest possible moment the burden now imposed on the Canadian taxpayer (assuming these recommendations are accepted) and/or the railways will be removed.

Reservation and Observation

by A.H. Balch

I concur in the reservation and observation made by my colleague  
Commissioner Herbert Anscomb.

RESERVATIONS ON GRAIN

A.R. Gobeil

I am in basic accord with this volume of the Report, and agree that, in general, the philosophy of the Report is sound. The discussion of the evolution of Canada's transportation system is accurate and well developed. The problem of adjusting the railway price structure to the growth of competing forms of transport is clearly set forth, as are the future trends of transportation. It is my belief, however, that, in view of the importance and magnitude of the question for the Atlantic Provinces, the historically unique position of the Maritime Freight Rates Act should have been discussed in this first Report. Nevertheless, on this particular issue, I am prepared to accept my colleagues' view that discussion of it shall be reserved to Volume II of our Report.

I cannot, however, accept the other Commissioners' decision that a subsidy is required in order to compensate the railways for alleged deficits incurred on the carriage of grain and grain products to export positions. There are three reasons for my disagreement with this decision.

Firstly, I believe that the Canadian Pacific Railway, having obtained certain very real advantages when it undertook - in perpetuity - to accept a ceiling on these grain rates, became party to a contract which is still in effect and which must be abided by.

Secondly, I do not believe that the grain cost studies which have been brought before this Commission have succeeded in their attempts

to measure the extent of the loss which, it is alleged, the railways incur in the movement of grain under statutory rates. I am not convinced, furthermore, that the studies in question have been able to establish that there is any loss whatsoever.

Thirdly, I believe that, if there is a loss associated with the carriage of grain it is due to the cost of maintaining light density lines rather than the cost of carrying grain.

In the following pages, I will attempt to set forth in more detail the reasons which have led me to these conclusions.

### Legal and Historical

The voluminous and detailed cost evidence presented by the railways was the only new evidence introduced on this question of the Crowsnest Pass Grain Rates. The discussions on the legal, historical and political aspects of the Agreement generally repeated what had already been presented before other Commissions. I do not believe that the repetition of the earlier presentations makes the material any less valid. For this reason I believe that this aspect of the Crowsnest Pass Agreement should not be ignored in the Commission's appraisal of the situation.

The Saskatchewan Argument sets out the objectives of the original Agreement (Royal Commission on Transportation, Summations and Arguments, [Saskatchewan], Vol. 2, p. 50). These are:

- "1. the more rapid development of the highly promising mineral area of southern British Columbia,
2. the effective integration of this area into the Canadian economy in defiance of geographic facts and despite American designs,



3. the enlargement of the prairie and inter-mountain markets for eastern manufacturers through the provision of lower freight rates on the western movement of certain important products,
4. the stimulation of agricultural settlement and general economic expansion in the Prairie Provinces by means of the statutory assurance of lower and stable grain rates and lower rates on the inward movement of capital equipment, and
5. the acceptance by the Canadian Pacific Railway Company of the principle of governmental rate control in the national interest, without qualification or reference to any level of the Company's earnings."

From 1902 to 1918 the rates on grain were below those specified in the Crowsnest Pass Agreement, having been reduced in the case of the Winnipeg to Fort William movement from the Crow level of 14 cents per 100 pounds to 10 cents per 100 pounds. It should be noted that the railways voluntarily established these lower rates during this period.

It is important to remember that while the CPR was an instrument of national policy in binding the Central Provinces with Western Canada, it was nonetheless a business organization. Its primary object was the creation of a profitable enterprise. Therefore the determination by the Company to construct the Crowsnest line into the Kootenay region of British Columbia was for the obvious purpose of improving their corporate business and it was for this reason that the CPR entered into the Agreement of 1897. The atmosphere of that day is illustrated by the quotation from J.W. Dafoe's "Clifford Sifton In Relation To His Times" of the Manitoba Argument:

"Apparently there were also questions of high policy involved in this arrangement. In an open letter to the Press of Canada, dealing with railway questions, written by Sir Clifford Sifton, in January 1929 there appears this passage: I remember when as a young minister in Laurier's cabinet, Van Horne and Shaugnessy said a line into the Kootenay mining district would not be considered for fifteen years. Also I remember that within six weeks the same two gentlemen came into my office and said that they had to build this line and wanted a large bonus for doing it, that the C.P.R. was on the verge of bankruptcy. We gave them this bonus against the public sentiment of two-thirds of the people of Canada. They built the line and the Kootenay mining development saved the C.P.R. and saved a good many other things in Canada." (Royal Commission on Transportation, Summations and Arguments [Manitoba], Vol. 1, p. 159, para. 336).

By 1925, when Parliament again examined the Agreement, the rate ceilings on grain had only been operative for five years of the preceding period, namely from 1899 to 1902, and from 1922 to 1925. At that time, it was not Parliament who sought to impose an obligation on the railways, but the railways themselves who sought partial relief from the Agreement which had only been effective for a total of five years. During these discussions the CPR made it clear that "we are not asking for any change in the conditions established in 1897 in regard to grain and grain products". (Royal Commission on Transportation, Summations and Arguments [Manitoba], Vol. 1, p. 167, para. 356). In view of the above statement by the CPR, the grain rates were not imposed by Parliament. They were not only freely accepted by the railway but were offered by them as an inducement to persuade Parliament to lift that part of the Agreement which pertained to westbound rates on other commodities.

At no time in 1925 was there a suggestion by either party that the Agreement of 1897 was being terminated. In addition to the statement of the CPR that they were not asking for a change in the conditions of the Agreement pertaining to grain, we have the statement of the then Minister of Railways that "we are asking Parliament to remove from the

agreement, that part relating to westbound traffic, leaving to the Prairies and the West for the future all the benefits they have ever received, and more too, I think on grain and flour". (Royal Commission on Transportation, Summations and Arguments [Manitoba], Vol. 1, p. 167, para. 359).

From the above, it seems clear to me, that the Agreement of 1897 is still in effect, and that in 1925 the CPR was simply unable to negotiate more favourable terms for itself. Since the Agreement is still in effect, the Commission must consider the implications of disregarding a valid contract. If some of the terms of this contract can be set aside unilaterally how can we justify the retention of the other terms of the Agreement and the terms of other contracts negotiated by the CPR?

An agreement or contract between two parties can only be changed or set aside with the full consent of both the contracting parties. Certainly no suggestion of consent in this case was presented to this Commission. Evidence was submitted to show that the CPR has strongly resisted attempts to change parts of other agreements that they have entered into, some of which were in existence for longer periods than the Crow Agreement.

The Manitoba Argument (Royal Commission on Transportation, Summations and Arguments, Vol. 1, p. 171, para. 369), shows where the City of Winnipeg attempted to change its Agreement of 1880 with the CPR relative to taxation in that City, the CPR fought through to the Privy Council to uphold the sanctity of this contract.

In view of the fact that the CPR insists that the other parties must consider the benefits which they have received from the Agreements with the Company, I cannot accept the position that we must now disregard the benefits the CPR has received from the Crow Agreement.

I cannot accept the proposition that the value of a binding

agreement which has been in existence for over sixty years should be determined on the basis of a simple but uncertain mathematical calculation.

The Report of the Commission finds that the shortfall on variable cost on grain is \$2 million for the CPR. I will comment on my inability to accept this figure. No consideration has been given in the Report to the benefits which have been received by the CPR from the Agreement. Some of these benefits have been given a dollar value but most are non-measurable. They do, however, in my opinion, in total far exceed the \$2 million alleged deficit.

#### Grain Cost Studies

The Commission received a number of studies which attempted to prove what the cost of moving grain was. Each time one of these cost studies was discussed before the Commission, the parties admitted errors in their previous study and asked the Commission to accept the new cost figures. The conflict between fully qualified experts and the resulting difference of \$17,390,631 in the variable costs attributable to grain as provided by CPR and the Manitoba/Alberta experts (Royal Commission on Transportation, Summations and Arguments, [CPR], Vol. 3, p. 53), coupled with the alternative figures arrived at by experts retained by the Commission, makes it impossible for me to accept any figure for the cost of moving grain as being accurate and final.

The Commission's independent assessment of the grain cost studies concluded that the statutory rates for the movement of grain and grain products to export positions occasioned a loss to the CPR of \$2 million on variable costs and assessed that the traffic should bear \$9 million of the constant costs. The comparable assessment for the Canadian National

Railways was \$4 million on variable costs and \$7.3 million on constant costs. Based on its findings the Commission is recommending a subsidy from the Federal Government of approximately \$11 million to the Canadian Pacific Railway and \$11.3 million to the Canadian National Railways to compensate them for the losses incurred in this movement of grain.

After a careful examination of the detailed cross-examination of the Canadian Pacific witnesses, I feel the use of Canadian Pacific figures as the basis for cost determination would not result in accuracy. For example, in their Argument, the Grain Organizations state: "If the method employed by the Railways in costing export grain movement were also used for costing passenger service, the deficit on a full cost basis for the Canadian Pacific for 1958 would be at least 75 millions of dollars and for the Canadian National 180 millions of dollars or a combined passenger deficit of some 255 millions of dollars." (Royal Commission on Transportation, Summations and Arguments [The Grain Organizations], Vol. 4, p. 178). The combined deficit on passenger services, as determined by the Commission's experts, is \$78,008,669, not \$255 million. Such a wide divergence in results dependent upon the method used points up my difficulty in accepting judgments based solely on mathematical calculations.

Another item of cost which remains questionable is the use of average weight trains and train-miles. In the CPR cost study as described by Mr. Stenason, the line-haul common cost attributable to grain was based on constructive train-miles which in turn were based on the average weight of trains of grain proportionate to the total traffic on each train-run. Under this method, if there were 1,000 cars of grain and 1,000 cars of other traffic from points A to B, and the CPR operated 52 trains during the year studied, grain would be charged half of the cost associated with

trains and train-miles including fuel and crew wages, etc. (Royal Commission on Transportation, Summations and Arguments [Manitoba], p. 222, para. 491). In point of fact the 1,000 cars of grain could have been carried in ten trains. To arbitrarily charge grain with the cost of 26 trains is in my opinion to overstate the actual cost attributable to grain.

This is particularly unwarranted since the evidence of experienced traffic men has established that grain can and does move in solid trains. (Royal Commission on Transportation, Transcript, Mr. H. Arkle [CPR], Vol. 66, p. 11695, and Mr. R. Bandeen [CNR], Vol. 75, p. 13203).

A further deficiency in the CPR figures was brought out in the discussion of expenses incurred in the solicitation of grain traffic. The Manitoba Argument showed the contradiction which exists between the CPR claim that they spend money to obtain additional grain traffic and their contention that each additional car of grain costs them money. (Royal Commission on Transportation, Summations and Arguments [Manitoba], Vol. 1, p. 230, para. 518). I find it difficult to accept that grain should be charged with a portion of the expense associated with traffic solicitation, since I cannot believe that the Canadian Pacific Railway would solicit non-compensatory traffic.

The danger in accepting the CPR figures as a base is graphically illustrated in the Manitoba Argument. (Royal Commission on Transportation, Summations and Arguments [Manitoba], Vol. 1, p. 234, para. 526). The inconsistency in the railways' method strongly suggests an overcharge to grain of 100 per cent in the number of car days.

Possibly the best indication of the inadvisability of using the CPR figures as a base was the frequency with which they themselves changed

their own figures during the course of our investigation. Even when the witness for the CPR was on the stand presenting his cost findings, the staff of the railway were preparing changes in those costs. While the CPR witness presented his costs in December, 1959, revisions to those figures were already underway in November, 1959. In May of 1960, the CPR had to revise every cost exhibit filed in December. Although, as the CPR states, the final total of their revision was minor, the change in the individual accounts was not so minor and, for example, constant costs were increased by \$2,250,000. Subsequently, further changes were made by the CPR and I have no doubt that if more time were devoted to the task further changes would be made.

The CPR, in my opinion, has failed to prove the extent of the burden resulting from the carriage of grain under the Agreement, nor has it proved conclusively that there is any burden due to grain. The Commission has estimated the CPR's passenger deficit as \$27,650,669 in 1958. In their evidence, the CPR has said that the burden put upon freight shippers because of the existence of passenger services was tolerable. The Commission has found that the deficiency attributable to grain in the case of the CPR is only \$2 million. I cannot accept the reasoning that a \$27,650,669 deficiency on passenger services is tolerable to freight shippers but that an alleged \$2 million deficiency on grain is intolerable. To follow the logic of the CPR's argument this deficiency should be more tolerable to other freight shippers.

Another fact to be kept in mind is that the rate on grain is based on the assumption that the car supplied by the railways is fully loaded by the shipper which means that if the railways supply a larger car, they will get the same rate per 100 pounds or per ton-mile, but they

will receive more revenue per car or per car-mile. At the time of the initial Agreement in 1897, railway cars of 20 ton capacity were quite common. Today, the car used for grain is usually of 60 ton capacity. Thus, while the railways have not received more money per ton-mile for handling grain, their average revenue per car-mile has trebled since 1897. Conceivably, still larger cars will be available in the future and if a deficit does exist, the railways' solution may lie in this direction.

It was established in evidence, that in the United States of America coal does not return to the railways its full cost. However, it was also proven that coal makes a larger absolute contribution to overhead than any other commodity. Thus, if it were not for the carriage of coal at below full cost, the rates on other commodities would be higher.

In contrast to coal cars which have an extremely limited use, grain is handled in cars which can also be used for the shipment of other goods. Without the grain movement there would be a very marked increase in empty return movement since the normal flow of traffic in Canada is of manufactured goods westbound. If these cars were to return empty the revenue of the railways would be reduced and the movement of manufactured goods westbound would be required to bear a greater burden. In addition, the flow of grain creates purchasing power in the Western economy and generates the flow of consumer and producer goods westbound. To this extent the railways are better off to handle grain at the present rates, rather than to not handle it at all. Grain is therefore of benefit to other traffic and not a burden as alleged by the railways.

On the question of the cost of moving grain, I find myself in accord with the statement made by Dr. F.K. Edwards that "I have to be able to rationalize the result. I wouldn't trust any statistical device that



I couldn't independently check by plain observation from current data reported in the accounts and in the statistics". (Royal Commission on Transportation, Transcript, Vol. 72, p. 12750).

That the cost figures brought before this Commission are at best only "educated guesses" is borne out by the Grain Organizations where they state "the costing of a single traffic moved over such railway systems as the Canadian National and Canadian Pacific is so dependent on judgment factors, arbitrary allocation of cost and assumptions that results at the best are 'educated guesses'". (Royal Commission on Transportation, Summations and Arguments [Grain Organizations], Vol. 4, p. 171). The Premier of Saskatchewan sums up the entire question as follows: "Saskatchewan emphatically rejects as wholly unreliable, unrealistic and unproven any conclusion reached on the basis of costing a single segment of railway freight traffic, hived off by itself without regard for other traffic which it engenders or with which it dovetails in the utilization of plant and equipment". (Royal Commission on Transportation, Summations and Arguments [Saskatchewan], Vol. 2, p. 72).

In making a judgement on the issue of a grain rate subsidy we must, I believe, also take into account the fact that there has been, particularly since the War, a pronounced change in the economy of Western Canada. What was an economy based largely on agriculture is now changing into a more diversified and increasingly industrialized economy. Even in farming, the trend is away from grain growing, particularly wheat, to diversified mixed farming. The Federal Government is encouraging these changes and under the proposed "Agricultural Rehabilitation and Development Act", it is intended that from \$300 million to \$600 million will be made available to further diversify agriculture and to develop industry. As a

result of these changes, I believe grain will become an even smaller part of the Western economy and any burden alleged to exist in connection with the grain traffic will disappear. In this regard, one of the points emphasized by the CPR was that grain represented 40 per cent of their traffic in Western Canada, measured in ton-miles. This raises the question of what percentage of total traffic was grain in, say, 1930? What percentage will be grain by in, say, 1970 or 1980?

### Light Density Lines

While, as the above facts indicate, the railways have not proved that grain is a deficit traffic, this does not mean that deficits do not occur.

I am satisfied that the railways have shown that they have financial problems. It is our duty as a Commission to find the particular areas where those problems occur and to make such recommendations as will enable the railways to overcome them.

In the evidence of Mr. R.A. Emerson the statement is made that 2,500 miles of track would be uneconomic if higher rates for grain were not obtained. It seems to me that the reverse may well be true. That is, if the 2,500 miles of track were now economic there would be no need for an increase in the rate on grain. The Argument of the Grain Organizations states: "the portion per unit of traffic on branch lines resulting from capital investment is six or seven times as high as on main lines". (Royal Commission on Transportation, Summations and Arguments [Grain Organizations], Vol. 4, p. 176). If the railways had recognized that these costs were costs attributable to light density lines rather than to the movement of grain, they would then have identified the real problem.

That is, the problem is one of light density lines and not a grain rates problem. Significantly, the railways did not attempt to prove that there was any loss on the movement of grain on the high density or main lines.

I agree with the statement of the Grain Organizations in their Argument that "It is very difficult for the Grain Organizations to understand why the railways chose to ignore a major problem (excess capacity) of this nature and select the movement of statutory grains as 'the only inequity' thereby making the western grain producer 'the whipping boy' for the railway financial ills". (Royal Commission on Transportation, Summations and Arguments [Grain Organizations], Vol. 4, p. 175).

I have stated that I am convinced that a problem does exist. With that one exception I agree with the Manitoba statement that "The problem for the Canadian Pacific Railway, if a problem exists, is that it has been unwilling or unable to compete with the other modes of transportation and retain sufficient traffic to justify the branch line facilities". (Royal Commission on Transportation, Summations and Arguments [Manitoba], Vol. 1, p. 187).

The Commission has recognized the burden of these low density lines and recommended a subsidy of \$13 million for the readjustment of these lines. To me, any additional payment to the railways, designated as a grain subsidy, is completely unwarranted.

My conclusion, therefore, is that under no circumstances should any subsidy be identified with the grain traffic, but be considered as part of general readjustment subsidy, particularly, in this case, one attached to light density lines.

### Implications of Subsidy on Grain

If the Commission persists in its decision to designate for grain a portion of its recommended subsidy on light density lines we cannot overlook at least two important consequences if this decision is implemented by the Government. In contrast with the other subsidies which will diminish from year to year, the proposed subsidy will continue to grow. The Canadian Pacific Railway in its Argument, states: "The statutory grain rate issue is not a transitory issue. In fact, the burden of the fixed grain rates will grow". (Royal Commission on Transportation, Summations and Arguments [CPR] Vol. 3, p. 7).

The railways base their case not only on the alleged cost of moving the grain but also on the "reasonableness of the rates". The Grain Organizations point out that "statutory grain is being asked to produce a profit factor about 2.5 times as great as the average traffic". (Royal Commission on Transportation, Summations and Arguments [Grain Organizations], Vol. 4, p. 181). It is here that Mr. Saunders points out that "the core of many items of cost in the railway studies is 'branchness' rather than 'graininess'".

### Conclusion

I oppose the conclusion and recommendation that a portion of the proposed subsidy should be attached to grain on the grounds that:

- (a) The railways have not established that grain is deficit traffic.
- (b) If a deficit does exist it is attributable to low density lines rather than to grain.

- (c) The contract of 1897 is still binding on both parties although in a varied form.
- (d) Certain benefits from this Agreement have accrued to the CPR which must be balanced against the obligations.
- (e) The Western Provinces were required to make certain concessions for which they are entitled to the benefits of the Agreement as part of their historical and provincial rights.

The foregoing represents my reservations on the majority's conclusion that the grain traffic represents a deficit of \$2 million below variable cost in the case of the CPR and of \$4 million below variable cost in the case of the CNR. While I disagree with the conclusion, there is no disagreement with the principle involved, namely, that this Commission was directed to determine those obligations and limitations imposed on the railways by law or public policy.

I now wish to deal with a fundamental dissent from the majority report. Clause (b) of the Commission's Terms of Reference states as follows:

"The obligations and limitations imposed upon railways by law for reasons of public policy, and what can and should be done to insure a more equitable distribution of any burden which may be found to result therefrom;"

It is clear from the Terms of Reference that this Commission was required to determine those obligations which have resulted in burdens which have had to be borne by other freight traffic.

Clearly, such burdens will result where the revenue from providing a particular service is less than the cost of providing that

service. This cost is termed the variable cost. The Commission has adopted this determinant of "burden" in their treatment of passenger services and light density lines. The Commission has concluded that the deficit on passenger services for both railways in 1958 was \$78,008,669 (\$27,650,669 for the CPR and \$50,358,000 for the CNR) and we have recommended that the "burden" resulting from this deficit be removed. In the case of light density lines the Commission has determined that there is a shortfall of revenue over operating cost of \$13 million, and we have again recommended that this "burden" be removed.

In the treatment of the movement of grain, consistency demands that the Commission itself determine "burden" as above defined, namely the shortfall of revenue as computed to the directly assignable cost of providing that particular service. In other words, in the case of grain this would amount to a total burden, according to the majority decision of \$6 million (\$2 million for the CPR, \$4 million for the CNR). However, in the case of grain, the majority has departed from the principle which they adopted with regard to determining burden for passenger services and light density lines. They have, in the case of grain, recommended an additional \$16.3 million (\$9 million for the CPR, \$7.3 million for the CNR) as an additional "burden" assignable to grain by way of allocation of constant cost.

I cannot accept this finding for the following reasons:

1. By definition, constant costs are those which cannot be allocated to any specific segment of traffic or service.

2. Every expert who appeared before the Commission agreed that constant costs were distributed among the various traffic movements on the basis of what each particular traffic movement could bear. The majority, by its decision, has determined not what the grain traffic can bear but rather what, in the opinion of the Commission, the grain traffic should bear. In my opinion, the Commission has assumed the function of the ratemaking authority and has exceeded its function as set out in Term (b) of the Reference, namely to determine burden.
3. I cannot accept a decision that finds that in the case of grain which has a shortfall of \$6 million there should be added thereto a sum of \$16.3 million, but that in the case of passenger services and light density lines, having a combined shortfall of \$78 million or 12 times greater than grain, no allocation of constant cost should be made.

P.C. 1959-577

Certified to be a true copy of a Minute of a Meeting of the Committee of the Privy Council, approved by His Excellency the Governor General on the 13th May, 1959.

The Committee of the Privy Council have had before them a report from the Right Honourable John G. Diefenbaker, the Prime Minister, stating that it is in the national interest that a comprehensive and careful inquiry be made with all reasonable despatch into problems relating to railway transportation in Canada and the possibility of removing or alleviating inequities in the freight rates structure.

The Committee, therefore, on the recommendation of the Prime Minister, advise that

Herbert Anscomb, Victoria  
Archibald H. Balch, Ottawa  
René Gobeil, Québec  
M.A. MacPherson, Sr., Regina  
Howard Mann, Moncton  
Honourable Charles P. McTague, Toronto  
Arnold Platt, Lethbridge

be appointed Commissioners under Part I of the Inquiries Act to inquire into and report upon the problems relating to railway transportation in Canada and the causes thereof, and to recommend solutions thereto, and in particular, without restricting the generality of the foregoing, the Commission shall consider and report upon:

- (a) inequities in the freight rate structure, their incidence upon the various regions of Canada and the legislative and other changes that can and should be made, in furtherance of national economic policy, to remove or alleviate such inequities;
- (b) the obligations and limitations imposed upon railways by law for reasons of public policy, and what can and should be done to ensure a more equitable distribution of any burden which may be found to result therefrom;
- (c) the possibilities of achieving more economical and efficient railway transportation;
- (d) whether, and to what extent, the Railway Act should specify what assets and earnings of railway companies in businesses and investments other than railways should be taken into account in establishing freight rates; and
- (e) such other related matters as the Commissioners consider pertinent or relevant to the specific or general scope of the inquiry.



The Committee further advise:

1. That the scope of this Commission shall not extend to the performance of functions which under the Railway Act are within the exclusive jurisdiction of the Board of Transport Commissioners;
2. That the Commissioners be authorized to exercise all the powers conferred upon them by section 11 of the Inquiries Act, and be assisted to the fullest extent by government departments and agencies;
3. That the Commissioners adopt such procedure and methods as they may from time to time deem expedient for the proper conduct of the inquiry and sit at such times and at such places in Canada as they may decide from time to time;
4. That the Commissioners be authorized to engage the services of such counsel, staff and technical advisers as they may require at rates of remuneration and reimbursement approved by the Treasury Board;
5. That the Commissioners report to the Governor in Council with all reasonable despatch; and
6. That the Honourable Charles P. McTague be Chairman of the Commission.

(Sgd) R.B. Bryce,  
Clerk of the Privy Council

PRIVY COUNCIL CANADA

Certified to be a true copy of a Minute of  
a Meeting of the Committee of the Privy Council,  
approved by His Excellency the Governor  
General on the 22nd December 1959.

The Committee of the Privy Council have had before them  
a report from the Prime Minister submitting that the Honourable  
Charles P. McTague has, by reason of ill health, asked to be relieved  
of the responsibilities placed on him as member and chairman of the  
Royal Commission on Transportation to which he was appointed by Order  
in Council P.C. 1959-577 of 13th May, 1959.

The Committee accordingly advise that Mr. McTague's  
resignation as a member and chairman of the said Commission be  
accepted and that Murdoch Alexander MacPherson, Esquire, Q.C., a  
member of the Commission, be Chairman thereof.

(Sgd) R.B. Bryce  
Clerk of the Privy Council

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Archibald H. Balch  
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## HEARINGS

Public hearings were held in 14 cities in Canada including the capitals of the ten provinces. Some 141 submissions were heard and 185 exhibits were filed during the course of these hearings which lasted 134 days.

The Commission received 12 submissions in addition to those heard during the public hearings.

Public hearings were held in the following cities:

Ottawa .....	September 17-18,	1959
Quebec City .....	October 22,	1959
Montreal .....	October 23,	1959
Fredericton .....	November 9-10,	1959
Charlottetown .....	November 12,	1959
Halifax .....	November 13-16,	1959
St. John's .....	November 17-18,	1959
Ottawa .....	December 4-17,	1959
	January 18-27,	1960
Winnipeg .....	February 8-11,	1960
Regina .....	February 12-15,	1960
Edmonton .....	February 16-17,	1960
Victoria .....	February 22,	1960
Vancouver .....	February 23-25,	1960
Toronto .....	March 14-16,	1960
Quebec City .....	March 17-19,	1960
Ottawa .....	March 21-30,	1960
	April 25-29,	1960
	May 2-13,	1960
Port Arthur .....	May 28,	1960
Ottawa .....	May 30 to June 10,	1960
	September 8-29,	1960
	October 11-31,	1960
	November 1-23,	1960
	January 4-17,	1961