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# U.S.-Canadian Transportation Issues

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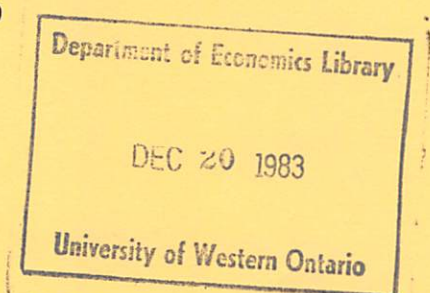
U.S.-CANADIAN TRANSPORTATION ISSUES

Kenneth D. Boyer

This paper contains preliminary findings from research still in progress and should not be quoted without prior approval of the author.

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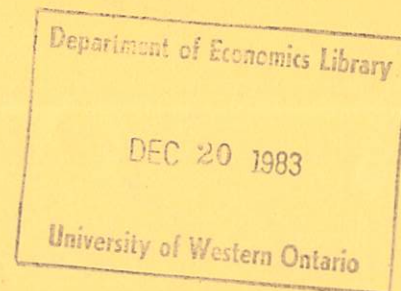
U.S.-CANADIAN TRANSPORTATION ISSUES

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Prepared for presentation to the Second Annual  
Workshop on U.S.-Canadian Relations

London, Ontario  
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This paper will describe several transportation issues of current importance to Canadian-U.S. trade. Most issues involve regulations on one side of the border that are different from those on the other. With the markets for transportation services in the two countries overlapping in so many areas, the country with the stricter regulation is under some pressure to conform with the other. Since, with several exceptions, it is the United States that has taken the lead in altering the regulatory climate, the pressure to conform has fallen primarily on the Canadians. Canadians feel an understandable annoyance at being pressured to make their policies conform to those in the U.S. when they had no say in the U.S. of regulatory reforms. Nonetheless, with the transport markets linked as closely as they are, it is economic forces rather than diplomatic maneuvering that is exerting pressure on the Canadians.

#### Regulatory Reform in the United States and in Canada

Until 15 years ago, the regulation of the transport sectors in Canada and in the United States was remarkably similar: the

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tools and outcomes were very much the same. As a general rule, regulation controlled prices, entry, and the technical rules of traffic interchange. It is now recognized that this system created various inefficiencies; but the arrangement did have the virtue of making cross-border shipment little different from domestic transportation in either country. Due to similar forms of regulation, transborder traffic moved quite smoothly, to the benefit of both economies.

The economic inefficiencies and financial losses created by the static system of regulation forced revisions of policies in both countries. The changes began with the Canadian railroads in 1967, but continued and accelerated in the late '70's and early '80's with some remarkable developments in the United States. Today, today for virtually all transport modes, the regulatory environments in the two countries are quite distinct. This condition has combined with technological change in the deep draft shipping industry to create a series of new and unusual frictions in freight and passenger transportation between the two nations.

In retrospect, what is remarkable is not that Canadian and American transportation regulations have moved in different directions over the last fifteen years, but that they ever had been so similar. The difference in attitude toward government intervention in the two nations is well known:

\*In English Canada, a radical spirit of laissez faire or fear of government which might have been

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assumed to characterize most of those engaged in commerce and industry rarely seems to have taken hold. In contrast, the United States' political culture emphasizes individualism, the institutionalized dispersion of power--including that held by governments--pluralism, and participation in public life."

Even conservatives in Canada distance themselves from those in the United States, emphasizing that they stand for freedom as well as responsibility:

"Compared to Americans, Canadians have more frequently looked to their governments to take a strong role in economic development through the use of subsidies, taxes, and the direct provision of goods and services, to maintain a sense of cultural or national identity in the face of fundamental economic forces that contradict such desires, to restrict market forces (domestic and international) so as to provide a less risky environment for Canadian firms and individuals, and to achieve consensus and coordination of contending private or public sector efforts in order to avoid "waste and duplication"...

"There does not exist in Canada any fundamental belief in the virtues of competition as a method of allocating scarce resources...our more structured, authoritarian society takes business power for granted."

The American movement towards deregulation of transportation while the Canadians retained much of the institution is consistent with the historical inclinations of the two nations. Antitrust and regulation are not substitutes for Canadians since market forces are not an acceptable replacement for government supervision.

But in another way, regulation and antitrust have never been

1. Stanbury, W.T. and Thompson, Fred, "The Prospects for Regulatory Reform in Canada: Political Models and the American Experience," *Osgood Hall Law Review*, Volume 20, No. 4, 1982

2. *Ibid* pp. 708-709

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perfect substitutes. Market failure is only one rationale for regulation, the other being the provision of goods and services that the market would not offer, or with a price structure that a market would not allow. The main reason to choose deregulation--and this is the same justification for user fees for the provision of transport infrastructure--is to increase economic efficiency. In the case of both regulation and the provision of transport at prices that are not directly related to the cost of the service, a primary rationale has been the use of transportation to achieve goals other than maximizing the value of the goods and services produced in the economy.

That transportation should be used to achieve such non-economic goals as regional development, national integration, or a more equitable distribution of income has long been one of the arguments for regulation and against user fees. It was thus striking that part of the National Transportation Act of 1966, which gave Canadian railroads a large degree of commercial freedom, stated "It is hereby declared that an economic, efficient, and adequate transportation system, making the best use of all available modes of transportation at the lowest total cost is essential to protect the interests of the users of transportation and to maintain the economic well-being and growth of Canada." Yet in the implementation of the policy, the

3. McManus, John C., "On the 'New' Transportation Policy After 10 Years" in Stanbury, ed., *Studies on Regulation in Canada*, Toronto: Institute for Research on Public Policy, 1978) p.239.



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Canadian Transport Commission has been willing to consider other parts of the Act which deal with the far vaguer and more traditional non-economic goals of "the public interest", "undue obstacles", "unfair disadvantages", "and unreasonable discouragements". The result, believes at least one Canadian scholar, is that, "Ten years after the National transportation Act, it seems we don't know if we have a new transportation policy based on minimizing cost or the old one based on an "equitable" regional distribution of economic activity." It appears that the changes have been quite uneven across modes, with some being effectively deregulated and others (notably aviation and trucking), almost untouched by the deregulation movement.

By contrast, the cumulative effect of the series of transportation bills and regulatory agency actions over the last six or seven years show clearly that the United States has made a decisive movement toward efficiency as the sole legitimate goal of transport policy. This paper will describe how this change in U.S. policy, in the absence of a parallel shift in Canadian law, has led to a variety of difficulties for transporters and for the passengers and shippers that they serve.

Since the focus of this paper is on the roll of differential regulation in creating transportation problems between the two countries, the regulations describing each mode will be presented

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4. Ibid

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along with the issues that they have created. The paper starts with the Motor Carrier industry, and then moves on to the Airline and Railroad sectors. The maritime transportation issues are described in the final sections before the conclusion.

### Disclaimer

This paper does not claim to be a compendium of all current transportation issues that affect U.S.-Canadian trade. Ignored are several categories of problems that might be included in a paper with this title. They are:

1. Issues unrelated to the core of the field of transportation economics. In particular, this paper will not deal with topics related to the provision of transportation equipment or to the transportation of fuels and energy.
2. Issues of technical coordination of transportation. Included under this category would be descriptions of hazardous materials and safety rules governing the construction of tank cars and trucks carrying transborder traffic.
3. Issues based on more speculative concerns, such as repeal of various provisions of the Jones Act or passage of cargo preference bills.

The neglect of these concerns should not indicate that they

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are of lesser importance. In terms of the effects on the magnitudes of trade between the two nations, these issues may be more important than some covered in the following pages. Rather the emphasis is a reflection of the fact that the author, as a transport economist, wishes to deal with topics in which he has a comparative advantage.

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### Motor Carrier Issues

The clearest example of regulatory-induced problems in Canadian-American transportation is seen in the highway freight industry. The complaints are heard primarily in the United States, and particularly from American trucking interests since they are the biggest losers under the current imbalance of regulatory regimes. The issue concerns more than just the trucking industries of the two nations, however. Smooth-flowing truck traffic across the U.S.-Canadian border is important to continued integration of the manufacturing economies of both the nations.

The movement of goods between Canada and the U.S. has, of course, never been as routine as domestic shipments across state or provincial borders. The impediments to transborder truck traffic consist of far more than different regulations covering the industry. Problems that transborder trucking has long faced include:

- a highway system in both countries that is oriented east-west rather than north-south.
- a lack of uniformity of vehicle size and weight regulations.
- an absence of highway tax reciprocity (a problem that will

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be exacerbated by the new highway equipment taxes contained in the Surface Transportation Assistance Act of 1982)<sup>5</sup>

- normal tariff and customs regulations and procedures.

With the passage of the Motor Carrier Act of 1980, which confirmed the substantial reduction in the regulation of motor carriers practiced by the ICC, another item was added to the list--a divergence of regulatory philosophy and practice in the two countries.

### Canadian and U.S. Trucking Regulation Compared

Trucking regulation in the U.S. and Canada appeared on paper to be remarkably similar until 1980. In both countries, authority to control routes, entry, and rates was given to the Federal governments. In fact, however, the enabling legislation necessary under the Canadian National Transportation Act was never passed and thus control of all aspects of for-hire trucking has remained at the provincial level.<sup>6</sup> The Provinces have chosen

5. This list is adapted from Chow, Garland, "Canadian-U.S. Transborder Trucking: The Impact of U.S. Trucking Deregulation", a paper delivered at the American Economic Association Meetings, New York, Dec. 29, 1982, photocopy, p.7

6. Janisch, H. N., "The Regulatory Process of the Canadian Transport Commission", (Ottawa: Minister of Supply and Services Canada, 1978, pp.34-36.

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to regulate both inter- as well as intra-provincial trucking in a variety of different ways.<sup>7</sup> Table 1 summarizes some of the main characteristics of Canadian provincial trucking regulation.

Table 1:  
REGULATION OF CANADIAN TRUCKING

Province	Intraprovincial				Interprovincial			
	Entry	Rate Filing	Rate and Apvl	Rate Prescrip- tion	Entry	Rate Filing	Rate and Apvl	Rate Prescrip- tion
Brit. Columb.	Yes	N/A	Yes	No	Yes	No	No	No
Alberta	No	No	No	No	Yes	No	No	No
Saskatchewan	Yes	N/A	N/A	Yes	Yes	No	No	No
Manitoba	Yes	N/A	N/A	Yes	Yes	No	No	No
Ontario	Yes	Yes	No	No	Yes	Yes	No	No
Quebec	Yes	N/A	Yes	No	Yes	N/A	Yes	No
New Bruns.	Yes	Yes	No	No	Yes	Yes	No	No
Nova Scotia	Yes	Yes	No	No	Yes	Yes	No	No
Prince Ed. Is.	Yes	Yes	No	No	Yes	Yes	No	No
Newfoundland	Yes	N/A	Yes	No	Yes	N/A	Yes	No

Source: Chow, Canadian Business Review, Spring, 1983, p.46

All inter-provincial motor carriage has reasonably strict entry restrictions, but lax rate regulations. The intra-provincial trucking markets of Ontario, New Brunswick, Nova Scotia, and Prince Edward Island and to a lesser degree Quebec,

7. A good description of the complexity of provincial trucking regulation can be found in Maister, David H.; "Regulation and the Level of Trucking Rates in Canada," Motor Carrier Economic Regulation, (Washington: National Academy of Sciences, 1978), pp. 199-232.



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British Columbia and Newfoundland can be similarly described. At the opposite extreme is Alberta which long has had the freest<sup>8</sup> entry into motor carriage of any area in North America. The strict regulators among Canada's provinces have followed the American lead in requiring certificates of convenience and necessity for every route that a trucker wishes to serve. In both the United States and in Canada this practice of route certification led to (among other practices) considerable inter-lining of traffic among companies that have complementary operating authorities. In the case of transborder carriage, such interlining of traffic has traditionally taken place at the border or at terminals in so-called gateway cities like Buffalo.

### International Interlining of Traffic

Some inter-lining of traffic would be expected even in the absence of route certification. Inter-lining can, by allowing carriers to serve only a few industries or regions, be a means of achieving economies of specialization. It is felt, however, that in general, truckers would rather not interline traffic, but do so because they lack operating authority for the complete

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8. Chow, Garland, "How Much Longer can we Live with Regulation of Canada's Trucking Industry?", *Canadian Business Review*, Spring 1983, pp. 45-52.

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movement. Inter-lining is more expensive than single-line service due to interchange handling. In addition, single line carriers are considered to have more desirable service to shippers as well--faster speeds, lower transit time variability, better loss and damage experience and easier tracing of shipments.<sup>9</sup>

Nonetheless a great deal more of Canadian-U.S. transborder traffic has (at least before 1980) been interlined than has been the experience south of the border--more than 50% of international shipments compared to about 10% of all U.S. trucking.<sup>10</sup> Since U. S. trucking deregulation 1980, Canadian carriers have been rushing to expand their service in the United States to avoid the need to inter-line traffic with U.S. carriers.

### U.S. Carriers have Difficulty Getting Certificates to Operate in Canada

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9. Chow, Garland, "Canadian-U.S. Transborder Trucking: The Impact of U.S. Trucking Deregulation", American Economic Association Meetings, New York, Dec. 29, 1982, p. 6.

10. American Trucking Associations, 1978 Motor Carrier Annual Report, Washington, D.C., 1978, quoted in Chow, Garland, "Canadian-U.S. Transborder Trucking: The Impact of U.S. Trucking Deregulation", American Economic Association Meetings, New York, Dec. 29, 1982, p. 6.

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Canadian provincial authorities have not been nearly as eager to grant certificates of convenience and necessity to American carriers. The American Trucking Associations recently complained to the Ontario Transportation Board that the ICC has granted more than 400 new operating rights for Canadian owned or domiciled motor carriers since the beginning of the year as opposed to receipt of authority by "less than a handful" of U.S. based lines from any Canadian province in the same period.<sup>11</sup>

Moreover, U.S. carriers have had difficulty expanding into Canada not only because of the licensing requirements of each province, but also due to the regulations of the Foreign Investment Review Agency.<sup>12</sup> When operating rights are granted to a U.S. carrier, they are invariably restricted to international movements of commodities, while there are no such restrictions on Canadian carriers operating in the United States. Since there are complementarities between operating domestic and international networks, this practice has apparently worked to the advantage of Canadian carriers.

It is too early to have firm figures on the extent of diversion of transborder traffic from U.S. to Canadian carriers. In the past, there has been an approximate balance in the

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11. *Traffic World*, "ATA Informs Ontario Body of Continued Imbalance of U.S.-Canadian Truck Rights", July 11, 1983, p.5.

12. Chow, Garland, "How Much Longer Can we Live with Regulation of Canada's Trucking Industry?" *Canadian Business Review*, Spring 1983, pp. 45-52.

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participation of carriers of the two countries--with either Canadian or U.S. carriers having an overall advantage depending on the measures used (tons, ton-miles, truckloads or revenues) and the types of traffic examined (Less-Than-Truckload vs. Truckload, exports to Canada vs. Canadian exports to the U.S.).<sup>13</sup>

### U.S. Truckers Try to Induce Changes in Canadian Law

U.S. carriers have been loud in their protests over their newly disadvantaged position and have requested their representatives to pressure Canadian authorities to reduce what they see to be inequities in their position relative to that of their Canadian competitors. The best publicized result was a short-lived moratorium on the granting of operating rights to Canadian carriers passed by Congress in December 1982. The moratorium was an embarrassment to the U.S. administration since it followed the publication of a letter of understanding between U.S. Trade Representative Brock and Canadian Ambassador Gotlieb in which each country promised negotiation instead of unilateral action to solve trucking disputes.

The five point letter of understanding stated that the two

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13. Chow, Garland, "Canadian-U.S. Transborder Trucking: The Impact of U.S. Trucking Deregulation", American Economic Association Meetings, New York, Dec. 29, 1982.

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governments recognized differences in policies and economies of the two countries, and promised consultation to encourage a competitive and efficient motor carrier industry, including more encouragement of single-line service. Both governments recognized, however, that the best that the Canadian federal government could be expected to do was to point out the problem to the provincial governments in the hope that they would free entry into their own motor carrier industries.

Most of the promised pressure has fallen on Ontario. This is not surprising in view of the fact that Ontario has both the most restrictive entry rules in Canadian trucking as well as the largest number of carriers engaging in cross-border haulage. The government of Ontario has responded by commissioning several studies.<sup>14</sup> In addition, several private groups have published reports and comments in an attempt to influence entry policy in the motor carrier industry.<sup>15</sup>

Following the pattern which was seen in the United States until the late 1970's, the Ontario motor carrier industry and

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14. A report on the likely consequences of freer entry into the trucking industry, written by the Ontario Highway Transport Board for the Minister of Transportation of Ontario had not yet been released at the time this paper was written; a two year study by the Public Commercial Vehicles Act Review Committee was published by the Minister of Transportation under the title *Responsible Trucking* in June, 1983.

15. A private study by Blue Apple Consulting of Toronto for the Ontario Trucking Association and a statement by the Canadian Manufacturers' Association are described in Foster, Cecil, "Trucker's report warns of dislocation under open border policy," *Globe and Mail*, July 25, 1983, p.87

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regulatory authorities are far less willing than others to introduce radical changes in regulatory statutes. These parties have cast the issue as one of national sovereignty. For example, James Snow, Minister of transportation and communications of the Province of Ontario, stated recently that, "We never pushed American trucking officials for a loosening of operating authority allowing us freer movement through the U.S... The regulatory changes brought about by the Motor Carrier Act were not designed to enhance trade between the U.S. and Canada." Snow is further quoted as arguing that "Simply because the U.S. has changed its transport rules is no reason for Canada to enact similar reforms."<sup>16</sup> Snow's statement was well received by the Trucker's association whose own study indicated that as many as 5000 Ontario jobs could be lost if American carriers were allowed free entry into Ontario.

John Kennedy, head of Kingsway group, a large Canadian trucking company that has just expanded into the US, says that with the big US truck lines poised to enter Canada, there will be no market left for "Ma & Pa Kettle" international operators interlining traffic at Buffalo. He predicts cross-subsidization of international routes by the large American carriers when they get into Canada. As an example, the Canadian Trucker note that when St. Johnsbury, an American firm, got operating rights in

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16. *Traffic World*, "Canadian Regulator Hits Charges of Unfairness to U.S. Truck Companies", July 13, 1981

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Canada, it promptly cut rates 30%.<sup>17</sup>

Freeing of Entry by American Carriers into Canadian Trucking Inevitable

Nonetheless, there is a remarkable consensus that within the next two years, Ontario will find itself changing its trucking rules to make entry freer. The same trucker that deplored the effects of free entry sees deregulation as inevitable. Aside from diplomatic pressure that U.S. carriers have been able to exert on Ontario, Canadian manufacturers, fearing for their markets in the United States and hoping to lower intra-provincial rates as well, have called upon the Ontario Transport Ministry to drop all tests of public convenience and necessity in motor carrier licensing and replace them solely with a fitness test.<sup>18</sup>

Phased elimination of "convenience and necessity" showings for truck licenses is the key recommendation of the Ontario Public Commercial Vehicles Act Review Committee, in its report issued in June, 1983. It appears at this writing, that Ontario will pass such legislation, and that Manitoba and Quebec, which

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17. French, Carey, "Regional carriers under fire in cross-border trucking war," *Globe and Mail*, July 25, 1983.

18. *Traffic World*, "Canadian Manufacturers Urge Equal Controls on Ontario, U.S. Truckers", July 11, 1983.

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also have committees reviewing motor carrier legislation, will follow. U.S. motor carrier interests have been relatively quiet recently on the expectation that significant changes will soon be passed.<sup>19</sup>

Economic Issues in the Regulation of Cross-Border Trucking

There are several economic consequences of different trucking regulations in Canada and the United States: first, is the health of the two economies. If it is conceded that further integration of the Canadian Economy with that of the U.S. is desirable, then it is in the interests of both economies that trucking of goods between the two countries be performed as efficiently as possible and that no unusual impediments on trucking be placed at the border. The regulations that have encouraged interlining at the border clearly lead to inefficiencies, and the rise of a single-line cross-border trucking industry is economically desirable.

But deregulation of entry on only one side of the border is all that is necessary to provide cross-border shippers with single line service; that is what we have today without any

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19. Chow, Garland, "How Much Longer Can we Live with Regulation of Canada's Trucking Industry?" *Canadian Business Review*, Spring 1983, pp.45-52.

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action necessary by Canadian regulatory authorities. What the current situation does lead to is a distortion in the production of a traded good--international trucking services. Ontario truckers are able for no economic reason to bid for traffic that American carriers are disadvantaged at offering.

This is the second economic consequence of the differential regulations: a distortion in the comparative advantage of the production of trucking services. Such a distortion could be justified on grounds of either market failure or the use of regulation to promote non-economic policy. But there appears to be no market failure in the transborder trucking industry. Since there appear to be no scale economies or unusual government subsidies available to one country's carriers but not the other, there is every reason to expect that a normally working market for transborder traffic in which both country's carriers competed<sup>20</sup> would lead to an efficient allocation of traffic.

If there are non-economic goals served by Canadian trucking regulation, they are not well articulated: equalizing the advantages of different Provinces cannot logically be a goal since the regulation is not at the Federal level. The American

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20. The primary form of subsidy provided by the U.S. (underpriced roadway) is equally available to Canadian carriers. Canadian carriers receive only minor subsidies not available to U.S. carriers (occasional loan guarantees, subsidies to carriers who engage in shipping with the Atlantic region, and financial connections of some firms with Crown corporations) Chow, Garland, "Canadian-U.S. Transborder Trucking: The Impact of U.S. Trucking Deregulation", American Economic Association Meetings, New York, Dec. 29, 1982.

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experience demonstrates that an unregulated industry does not have difficulties with discrimination or undue preference to particular shippers or localities. It is hard to provide any credible explanation for the continuation of Canadian entry restrictions other than classic protection. Ironically it may not be the Canadian carriers who are using the laws for protection--Minister Snow reports that it is primarily U.S. carriers who already operate in Ontario that are responsible for the protests against providing operating rights to new U.S. carriers.<sup>21</sup> The annoyance of Canadian regulators at being expected to follow the U.S. lead in the regulation of trucking is understandable, but there are economically sensible reasons for them to do just that.

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21. Traffic World, "Canadian Regulator Hits Charges of Unfairness to U.S. Truck Companies", July 13, 1981

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### Aviation Issues

While the source of the unhappiness is the same in the airline industry as in trucking--regulation altered in the U.S. and unaltered in Canada--the parties who are hurt are on opposite sides of the borders. In this case it is the unregulated U.S. industry that has benefitted, while the Canadian carriers have lost business to the U.S. The main reason for this outcome lies in the different motivations and practices of airline and trucking regulation.

Canadian policy towards airlines has always been suspicious of market forces.<sup>22</sup> From the 1940's through the 1960's, Canadian airlines were more strictly controlled than those south of the border--not only were entry and fares controlled, but unlike the U.S., route and service restrictions were placed on licenses. The announced reason for this policy was to improve transport opportunities to otherwise disadvantaged localities, especially those in the North. Transcontinental service was made the monopoly franchise of Air Canada, a Crown corporation. In order

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22. Much of the descriptive material in this section is drawn from Stansbury, W.T. and Thompson, Fred, Regulatory Reform in Canada, The Institute for Research on Public Policy, Ottawa, 1982, pp. 39-50.

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to ensure the expansion of regular service to all localities, charter operations were very carefully controlled. Through the 1970's, these regulations were very slowly liberalized, as CP air was allowed to enter the transcontinental market, the familiar form of advanced booking charters were permitted for non-business passengers, regional airlines were permitted some expansion of routes, and some discount air fares were permitted to the two transcontinental carriers.

In 1981, at approximately the same time, two reports on the reform of airline regulation appeared. The first, by the Economic Council, recommended:

- new entry into the long-distance airline industry based on a "one-way swinging gate" which would temporarily shield the regional airlines from entry by the national carriers
- free entry into transborder operations, consistent with approval of the other country involved
- removal of all restrictions on service and all inter-airline understandings
- free abandonment of routes and almost free setting of fares
- great liberalization of charter service regulations
- restrictions on airline mergers
- an even handed attitude toward government and non-government airlines.<sup>23</sup>

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23. Stansbury, W.T. and Thompson, Fred, Regulatory Reform in Canada, The Institute for Research on Public Policy, Ottawa, 1982.

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The other report of 1981 was prepared by the Minister of Transport who noted that

- the performance of the industry in Canada has been generally satisfactory
- deregulation in the U.S. can not yet be given a fair evaluation, and has probably harmed the financial condition of airlines
- there is no evidence that U.S. deregulation lowered air fares
- the stability of the Canadian airline industry is an important goal and one that cannot be pursued through deregulation.

For these reasons, the Minister of Transport recommended steps to assure the financial health of airlines and to guarantee the stability of airline service.<sup>24</sup> The opinion that prevailed in the end was the one held by the Minister of Transportation. Thus in aviation policy, Canada has consciously continued to use pricing and entry restrictions to serve non-market goals.

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24. Minister of Transport, "New Domestic Air Carrier Policy", (Ottawa: DOT, Public Affairs, No. 148.81), p.2; quoted in Stansbury, W.T. and Thompson, Fred, Regulatory Reform in Canada, The Institute for Research on Public Policy, Ottawa, 1982.

25. For an excellent description of the process by which U.S. airline deregulation was effected, see Stanbury, W.T., and Thompson, Fred, "The Prospects for Regulatory Reform in Canada: Political Models and the American Experience", Osgoode Hall Law Journal, Vol 20, NO. 4, 1982, pp. 678 - 720; see also Reschenthaler, G.B., and Stanbury, W.T., "Deregulating Canada's Airlines: Grounded by False Assumptions", Canadian Public Policy, IX:2:210-222, 1983.

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The contrast with U.S. policies could hardly be greater.<sup>25</sup> Over the last seven years or so, the United States has engaged in thorough reduction in government oversight over the passenger airline industry. In keeping with a market-oriented approach to the provision of air services, the CAB has recently extended this policy to air freight.<sup>26</sup> Behind these policies was a decision to abandon non-market criteria and to replacement them with economic efficiency as the single goal of aviation policy.

Airline Relations Determined by Economics and Treaties

By an accident of geography, neither country has the ability to chose an airline policy without taking that of the other into account. With some American air fares now drastically lower than comparable fares in Canada, the passengers that Canadian policy has been depending upon to generate the revenue to pursue other goals have been streaming across the border to the United States and paying the lower U.S. fares. While unambiguous figures on the extent of the diversion are not yet available, some impressionistic evidence suggests that the change in travel patterns has not been minor, particularly for Canadians who have

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26. Traffic World, "CAB to Suspend International Rates only When 'Extraordinary Circumstances Prevail'", Feb. 7, 83, pp.46-48.



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easy access to such American airports as Buffalo, Syracuse, and Burlington, Vt. Canadians appear to be taking short hops across the border, either driving or taking a regional carrier. and then continuing on a U.S. domestic or international ticket with a lower fare.<sup>27</sup> Canadian regulators and the regulated industry appear to be powerless to stop the practice of crossing the border to avoid the Canadian regulated price structure.

The fact that Canadian and U.S. air markets clearly have at least some overlap is contrary to the standard conventions of international aviation. Under standard procedures, two countries will negotiate landing rights for carriers of each country. Under a well behaved system, the international traffic that a nation's airlines carry is determined primarily by the negotiating skill of the diplomats discussing air treaties.

There are such treaties between Canada and the United States just as there are between any two sovereign nations. International service between the United States and Canada is governed by three treaties: Scheduled Services (from 1966, amended in 1974), Preclearance (1974) and Charter (1974). As in all treaty negotiations, the question of equity is placed in a central position: equitable opportunity for airlines of both countries and equitable exchange of economic benefits. But

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27. Klymchuk, Andy, Office of Strategic Policy, Transport Canada, 593-5696, personal communication, August 5, 1983; see also, Wall Street Journal, "U.S. Air Fares Pull Canadians Across Border," March 18, 1983, p. 1

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equity is an especially difficult criterion for making decisions, especially when those decisions must be confirmed in the market place.

For example, to facilitate travel between two countries, the standard procedure is to engage in bilateral negotiations to increase the number of routes between two countries. But how does one decide on equity grounds which country's airlines should fly the new routes? In the case of the U.S. and Canada, Canadian travelers represent a substantial majority of those traveling between the two countries. But considerably more routes between the two countries are flown by U.S. than by Canadian airlines. Moreover, the Canadians point out that the identification of routes makes imbalance appear even worse: for example, Toronto-Atlanta, a lucrative route, is flown only by US carriers. But a substantial proportion of traffic is Canadian vacation travel to the U.S. South, and on this traffic Canadian charters have a virtual monopoly.

Canadians believe that a one-for-one parcelling out of new routes to the airlines of the two countries to be unfair, given the imbalance that they perceive existing already. Even more serious from the Canadian perspective is that U.S. airlines will add Canadian spokes to existing hub-and-spoke systems, making each route added from Canada considerably more than just one new route. In addition, since hub-and-spoke systems have better frequencies than non-stop links, Canadian airlines believe that they must be granted a larger number of long-haul non-stop

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routes to compensate for the inevitably lower frequency of service that they can offer absent a similar hub-spoke system for Canadian airlines.<sup>28</sup>

The Canadian attitude that air relations between the U.S. and Canada should be a diplomatic rather than economic matter is illustrated in the recent Continental Case. A U.S. airline which did not have authority to fly to Canada requested permission from the Canadian government to quote a through fare from Canada to Australia via Los Angeles, making use of a Canadian connecting carrier. When the Canadian authorities refused to officially sanction this divergence of international traffic to U.S. airports--a movement that is currently underway, treaty or no--the CAB applied undiplomatically strong pressure on the Canadians in the form of a cancellation on short notice of discounts for Air Canada passengers flying to the United States.<sup>29</sup>

### Can Canada Maintain a Regulated Airline Industry?

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28. Pelkola, D.W., Transportation and Communications Division, Department of External Affairs, Ottawa, Personal Communication, August 4, 1983.

29. New York Times, "Air Canada Plea Denied", March 4, 1983, p.D15.

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The hub-and-spoke service, which U.S. airlines have been able to develop due to the nature of American geography is inherently more efficient than a series of long-distance non-stop services. If entry into the transborder market were free and passengers allowed to reach their destination in the least costly way, many Canadians could receive better and cheaper service by making greater use of the U.S. networks. This might, of course have the effect that Canada loses control of its international air connections as a more efficient American industry provides services at a price that Canadian carriers can not match.

But Canadian airline regulation is not based on the pursuit of efficiency, but on concepts of equity among customers and stability of the industry. Certainly the Canadian attitude is consistent with international aviation policies in most parts of the world. In international aviation the advantages of specialization are less obvious than in other parts of international trade. Thus, countries have been willing to subsidize and protect national airlines even when it would be efficient to have other countries perform air transport services.<sup>30</sup>

The policies may prove more and more expensive to maintain in an area where a competing unregulated industry exists in the same market. It is still too early to tell whether a

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30. Gertler, Z. Joseph, "Nationality of Airlines: A Hidden Force in In The International Air Regulation Equation, Journal of Air Law and Commerce, Fall 1982, pp. 51-88.

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sufficiently large overlap between the Canadian and U.S. markets exists to permit a pricing and entry policy north of the border that is different from that in the deregulated airline market. If U.S. airline fares attract a large enough number of Canadians across the border, the question of whether Canadian airlines are granted a large number of route authorizations to Texas may become irrelevant. The important question may be whether Canada is willing to bear the expense of an inefficient Canadian flag aviation system, or whether the nation will, as it does for deep draft maritime services, depend on foreigners to provide its airline service.

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### Railroad Issues

Competition from airlines, the St. Lawrence Seaway, and the Transcanada highway forced governmental changes in the way Canadian railroads were regulated more than a decade before U.S. railroads were granted relief in the Staggers Act of 1980. In many ways the relief granted to the railroads in the two countries took much the same form: reducing the ability of shippers to protest rates on the grounds of discrimination, equity, or reasonableness, and encouraging the use of long term contracts between shipper and carrier as a way of preventing either side from taking advantage of short run difficulties of the other.

Both the Staggers Act and the National Transportation Act, gave railroads a great deal more commercial freedom than they had enjoyed before. The stated goal was to rely on competitive forces to improve the efficiency of the provision of freight transportation. A closer inspection of the two laws reveals that the forces counted on to achieve efficient freight transportation in two bills were not identical. In Canada, it was intermodal competition that is to restrain railroad ratemaking. In the United States, the Staggers Act is premised on the desirability of both inter- and intra-modal competition. For that reason, the

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American rules forbid the use of rate bureaus to discuss any rates other than end-to-end joint movements, and invoke the penalties of the Sherman Act against parties that continue the century old practice of discussing rates with competitors. By contrast, Canadian law requires that the Canadian National and Canadian Pacific Railroads discuss rates with one another in an attempt to prevent ruinous competition between them.

Perhaps nowhere else in the transportation policies of the two countries is the U.S. distrust and Canadian acceptance of monopolies as clear as in these provisions of the two laws governing railroads. While apparently similar in most provisions, the two laws are philosophically opposed--the Americans requiring competition between their railroads, and the Canadians forbidding it, preferring instead to rely on the responsible behavior of large organizations.

But the difference can also be explained simply by the operating environments of the two railroad systems. <sup>31</sup> In Canada, the railroad industry is organized effectively as a bilateral monopoly--two systems that interchange very little traffic between each other. With one of the participants a Crown corporation and the recipient of various capital assistance, it

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31. An excellent summary of the rationale for collective ratemaking in Canada is found in Heaver, Trevor D., "Competition and Collective Pricing Between Railways in Canada," A study of the issues with and alternatives to railway pricing under Section 279 of the Railway Act and Section 32(2) of the Transport Act, prepared for Transport Canada, January 1983.

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would appear unrealistic to count on the benefits of intramodal competition.

The structure of the U.S. industry is in the process of rapid change. Under the provisions of the old Interstate Commerce Act, a large number of regional systems interchanged traffic under the supervision of the ICC. In the last two decades, mergers have reduced the number of railroads and extended their lengths. The reduction of ICC rules on traffic interchange is similarly encouraging railroad systems to keep traffic on their own tracks wherever possible. The structure of the American industry is beginning to resemble that of the Canadians. Nonetheless, it is unlikely that the American railroad map will ever contain as few major carriers as the Canadian. Intra-modal competition appears more feasible in the United States, as well as more in keeping with economic philosophy.

## Canadian Grievances

The major complaint currently voiced by Canadian railroads is the contradictory requirements placed on them by Canadian and U.S. railroad regulations. Under the National Transportation Act, the CN and CP are required to consult jointly before signing a contract with a shipper for services, and the terms of the

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contract must be made public. The contracts can technically be  
32 protested as being discriminatory, but none has ever been.

With one major exception--that of grain rates--the Canadian system can be described as compulsory collective ratemaking with a non-confidentiality restriction, but otherwise unhampered by government supervision.  
33 The American system introduced under the Staggers Act is one which forbids collective ratemaking and permits secrecy of the contract provisions. Both systems can be called deregulation, however, because they limit the ability of the government of affect the pricing of services.

American railroads have been quick to take advantage of the new freedom to negotiate secret contracts. Agreements covering

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32. Heaver, T.D., and Nelson, James C., *Railway Pricing Under Commercial Freedom: the Canadian Experience*, (Vancouver:Center for Transportation Studies), 1977, p80.

33. The Canadian Parliament is currently discussing a series of measures to substitute subsidies for the current statutory grain rates known as Crows Nest rates. While there appears to be general agreement on the logic of higher remuneration to finance the addition of grain hauling capacity to serve Canada's expanding Pacific markets, there is no agreement on the form that the new subsidization scheme should take. The literature on the desirability and effects of the Crows Nest rates is huge. Some of the recent discussions include, Maister, D. H., "Technical & Organizational Change in a Regulated Industry: The Case of Canadian Grain Transport", in Stansbury, W.T. ed., *Studies on Regulation in Canada*, (Toronto: Institute for Research on Public Policy, 1978); Chapman, R. Stanley, "CITL Worries about Competition As Canadians Ponder Crow Rates," *Traffic World*, August 15, 1983, p17-18; Stewart-Patterson, David, "Economist sees rail rationalization as goal of new grain-moving rates," *Globe and Mail*, Aug 19, 1983, p.B1; Foster, Cecil, "Removal of protection to Railways Sought in rate-making procedures," *Globe and Mail*, June 13, 1983, p. B9.; *Traffic World*, "Canadian Government Plans to Spend Billions to Upgrade Western Rails", Feb.7,83, p.77.

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cross-border movements, however, put Canadian railroads in the uncomfortable position of being required to discuss rates with their competitor in Canada but nonetheless being able to show to a United States court that they have not violated the Sherman Act by discussing prices for services purchased by American citizens. Since the laws are logically contradictory, the railroads find that they must violate the laws of one country or another. (This extraterritorial reach of the U.S. antitrust laws has been a constant source of friction between the U.S. and its trading partners in many areas, not just in railway policy.)

While the ICC has indicated a willingness to accommodate Canadian railroads, the Justice Department has been firm that no discussions of deregulated movements (COFC/TOFC, boxcar movements, and fresh fruits and vegetables) will be permitted. The CN and CP are afraid that they will be required to pay huge antitrust damages.  
34 While the source of the difficulty is the extraterritorial application of the U.S. antitrust laws, it should be noted that this problem could be solved by the Canadians by providing a special exemption on consultation for cross-border shipments.

A second difference in regulation of railroads in the two countries has reduced the ability of Canadian railroads to engage in competitive ratemaking against U.S. carriers. Imagine that

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34. Lande, Richard, "A Comparison of Canadian and U.S. Transportation Regulation, photocopy, 1983.

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the CN or CP wished to encourage a shipper to use a routing most advantageous to it rather than a competing routing which used a U.S. carrier for a greater portion (or all) of a movement. The U.S. carrier could offer the shipper contract terms confidentially, while the Canadian carrier would have to inform the shipper that Canadian law might require that the terms of the contract be published for competitors and for other railroads to read.

The Canadian carriers believe that any shipper would be reluctant to sign a non-confidential contract when a secret agreement was available. Under these circumstances, Canadian railroads have followed the unsatisfactory procedure to letting their American partners in a joint movement take the lead in contract negotiations, under the understanding that the Canadian railroad would never know the true rate agreed upon, and that the contract might impose far higher loss-and-damage liability on the Canadian carrier than on the U.S. railroad. The result is sure to be either less traffic or lower rates than could be obtained if the the carriers could negotiate equally against American railroads.

A final procedural matter which used to be smoothly handled under regulation is now a further source of friction between the railroads of the two countries. The Interstate Commerce Act used

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35. Lande, Richard, "Possible Remedies to Reconcile the Differences Between Canada and U.S. Rail Regulation," Montreal, 1983, photocopy.

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to set rules for interchange of freight cars among railroads. Deregulation has given U.S. railroads greater freedom to route boxcars at will, except for Canadian cars. Under U.S. Customs law, Canadian cars must be returned in a northerly direction if they are loaded. Thus Canadians are at a disadvantage with respect to the return of equipment and empty mileage charges, raising their costs and further removing them from an integrated North American railroad system.

In summary, the Canadian railroads argue that the differential requirements on collective ratemaking have exposed them to antitrust liability; differences in regulations concerning the confidentiality of contracts has hampered their ability to bid for preferred routings of transborder and overhead traffic, allowing them less traffic and smaller revenues on traffic that they manage to retain; and the deregulation of equipment interchange has economically exchange traffic with U.S. carriers.

## American Concerns about Canadian Railroad Behavior

Under these circumstances, it is small wonder that the Canadian railroads are aggressively trying to expand south into more U.S. markets. Canadian railroads, unlike their American counterparts, are already strong on the opposite side of the

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border. U.S. railroads with freight bound for Canada are required to interchange almost all international traffic with one of the Canadian railroads. The American subsidiaries of Canadian railroads--the Soo Line is the Canadian Pacific affiliate and the Duluth, Winnipeg and Pacific, Grand Trunk, and Central Vermont railroads are owned by the Canadian National--enable the Canadian routes to tap traffic as far south as Chicago, Cincinnati, and New London. Under merger plans currently under review, the reach of the Canadian lines could be extended to Kansas City.<sup>36</sup> This attempt to further expand penetration into U.S. railroad markets has been met with loud unhappiness in certain sectors of the U.S. economy.<sup>37</sup>

The unease arises due to the long-standing railroad practice of long-hauling--that is, interchanging traffic with other carriers or modes in places that guarantee the longest practical haul for the originating carrier. This practice was encouraged by rate division policies followed by the Interstate Commerce Commission before the passing of the Staggers Act whereby

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36. The Soo Line was recently denied entry to Kansas City when the Chicago and Northwestern's competing offer for trackage of the bankrupt Rock Island was accepted in place of the Soo's. The Chicago and Northwestern is similarly challenging the Grand Trunk's purchase of the Milwaukee Road. See *Traffic World*, "Soo Line Board Makes No Decision on Proposal to Buy Milwaukee Road, Aug. 15, 1983." ; also *Traffic World*, "C&NW Cites Court Order, Seeks Stay of GTC Bid to Buy Milwaukee Road, July 18, 1983, p.60; and *Traffic World*, "C&NW hits ICC Ruling in GTW Takeover Case", February 7, 1983, p.76.

37. See, for example, Gross, Linda, "Closing the Ring", *Enr*, March 1, 1982, pp 106-107.

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railroads that interchanged traffic divided the through rate approximately on distance. Since railroads have very low marginal costs relative to average costs per ton-mile of operation, if a railroad managed to hold traffic longer, it could get a larger proportion of the revenue while costs are not greatly increased. In the late 1970's this phenomenon led to such bizarre behavior as routing traffic from London to Chicago via Winnipeg.<sup>38</sup>

Long-hauling can take the form of pricing to encourage a shipper to use a destination on the railroad line as opposed to an alternative which would require interchange. Great Lakes as well as East Coast port interests believe that the Canadian presence in the United States allows the Port of Montreal to bid for traffic to the disadvantage of both the Great Lakes as well as U.S. East Coast ports. The reason is seen in the geography of the Canadian rail systems which give Canadian carriers have direct, long-haul routes to that destination. If the CP and CN purchase additional American lines, the fear is, even more traffic will move via Canada rather than Chicago or Baltimore.<sup>39</sup>

On the basis solely of theoretical reasoning, unregulated railroads should not engage in long-hauling. According to long-standing tenets of economic theory, firms that maximize

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38. Klymchuk, Andy, Office of Strategic Policy, Transport Canada, personal communication, August 5, 1983

39. Ambruster, William, "Ports Urge New Study of Diversion," *Journal of Commerce*, June 16, 1983, p.1



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profits will not vertically squeeze or foreclose markets to upstream competitors. Thus if railroads are free to negotiate rate divisions, originating carriers should interchange traffic optimally. It is clear from the first experiences with U.S. deregulation that the theory is invalid, at least as applied to unregulated railroads--they have been rushing to close interchange points with other carriers as rapidly as they can. In the East, the most important American railroad for Canadian traffic interchange has used deregulation to close all interchange points where it does not have a long haul. <sup>40</sup>

The Canadian wish to maintain their sources of traffic by expanding further into the United States thus appears to be logical and legitimate. In fact, it is somewhat surprising that they have not been even more active in the merger movement. One of the unforeseen effects of the Staggers Act appears to be a squeeze on small railroads that must interchange traffic with other carriers. Those parts of the bankrupt properties that the Canadian railroads wish to purchase will thus inevitably become part of another system; if the traffic is not diverted to Montreal by a Canadian purchase, it could equally as well be diverted to New Orleans by an Illinois Central acquisition. The point is simply that traditional traffic patterns will change as the American railroad system is reduced to a few competing closed

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40. Lande, Richard, "Possible Remedies to Reconcile the Differences Between Canada and U.S. Rail Regulation," Montreal, photocopy, 1983.

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networks. With traffic patterns determined by the historical accident of trackage ownership, there is no economic rationale for preferring one owner over another.

It seems anachronistic to mourn for the old system of smooth interchange across the border and the effects that differential regulations have had. It is difficult to imagine any U.S. government policy that could be implemented that would allow Canadian lines to compete for American interchange traffic as aggressively as they have in the past when the institution of traffic interchange appears to be in the process of disappearing. If the Canadian carriers are to maintain their favored position in the American market, they will have to become even more deeply involved in the American merger movement.

Deep Draft Shipping Issues

The exception to the rule that Canada regulates its transportation more strictly than the United States is deep draft shipping. Perhaps because Canada has no deep-draft liner industry under its own flag which can ask to be protected by regulatory authorities, the regulation of overseas shipping lines is laxer in Canada than in the U.S. Nonetheless, the differential regulations appear once again to have caused problems for the country with the tighter controls.

Both the United States and Canada have imposed rate filing requirements on all liner cartels under their jurisdiction, and both countries specifically exempt rates discussed by such cartels from prosecution under the relevant antitrust statutes.<sup>41</sup> The economic rationale for these policies are the familiar worries about ruinous competition, and chronic excess capacity, as well as the more novel claim that the cartel will provide a more efficient level of service by internalizing the externality implicit in the quality of service being determined by the

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41. Tetley, W., "Liner Conferences in Canada under Canadian Law & the U.N Code of Conduct for Liner Conferences", Transport Canada Marine, 1982.

aggregate frequency of all sailings.<sup>42</sup>

The contrast between the language of the Canadian statutes governing surface land transport and those covering the liner cartels is striking. In the former, the rationale for the regulations is couched in terms of equity, stability, and non-discrimination. By contrast in the statutes covering the liner trade, "the main policy consideration is to provide Canadians (manufacturers, farmers, businessmen and consumers in general) with efficient inexpensive transportation of goods to and from Canada."<sup>43</sup>

U.S. and Canadian treatments of liner cartels differ in two major respects: 1) Under U.S. laws, all cartels must be open, while under Canadian Law, closed cartels are permitted; and 2) Canada depends on rate filing, "on the assumption that filing will inhibit nefarious activities", while the FMC in the United States requires prior approval of rate schedules as well as

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42. Heaver, Trevor, "Liner Conferences Issues with Special Reference to Freight Rates", Ottawa: Transport Canada, 1982. Heaver notes that the argument of chronic excess capacity of an unregulated industry appears to be contradictory to the claim that absent regulation, sailings would be less frequent than desirable.

43. Tetley, W., "Liner Conferences in Canada under Canadian Law and the U.N Code of Conduct for Liner Conferences", Transport Canada Marine, 1982, p. 1-25.

44. Tetley, W., "Liner Conferences in Canada under Canadian Law and the U.N Code of Conduct for Liner Conferences", Transport Canada Marine, 1982. There are provisions for suspending rates under Canadian Law, but they have never been used since no rate has ever been protested.

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filing of rates. Entry does not require government approval in either country, the level of service is not specified, and (in Canada), the level of rates is not under government authority. It is argued that "There is no integrated scheme in Canada for regulating the non-coastal and non-internal shipping industry, nor is such a scheme intended...there is no policy and no administrative body to regulate external shipping."<sup>45</sup>

While U.S. regulation is laxer than that that was traditional in surface transport, the U.S. clearly still does regulate the deep draft industry. In requiring prior approval of cartel agreements, the United States differs from most nations. Under U.S. law, the Federal Maritime Commission must find each agreement to be not unjustly discriminatory, to the detriment of the commerce of the U.S., contrary to the public interest, or in violation of the terms of the Shipping Act. The right of a shipping line to act outside the cartel is, however, guaranteed (in both countries), and that right has been exercised.

### The Issue of Traffic Diversion

American Atlantic Ports complain that U.S. shippers have

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45. Tetley, W., "Liner Conferences in Canadian under Canadian Law and the U.N Code of Conduct for Liner Conferences", Transport Canada Marine, 1982, p. 112

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diverted cargoes through Canadian ports in order to take advantage of the laxer Canadian regulation of the ocean freight industry. The question of traffic diversion has already appeared in the previous section of this paper where was noted that the choice of port for export cargoes is often influenced by the railroad map as well as by the service and costs of using particular ports.

The ability to divert cargo derives from the same accidents of geography that have hampered Canadian regulation of airlines. Cargoes from the northern tier of the United States or from virtually any part of Canada which are bound overseas can be shipped from either country's ports. The direct route for exports from the Great Lakes region of the United States to Europe is through the St. Lawrence valley and Canadian territory. (This situation is not unique in the world, being replicated in Europe where Holland controls the direct all-water route for West German exports to North America.) One would expect, therefore, on the basis of geographical considerations alone, that some U.S. freight would be transshipped through Canada. On the other hand, the size of the American economy makes service at U.S. ports to destinations other than Europe better than from Montreal; for this reason if no other, one would expect some Canadian freight to be transshipped through U.S. ports.

Most public discussion of cargo diversion has concerned containerized container trade. Table 2 shows figures used by Canadian authorities to argue that containerized cargo travels

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both directions across the border for transshipment, and that the idea of an unbalanced diversion of cargo is thus illusory. The table shows that in 1982 there was an approximate balance of <sup>46</sup> cargoes crossing in each direction. There appear to be no contradictory figures in the U.S. to doubt the Canadian claim <sup>47</sup> that there is such a rough balance in containers.

Table 2: Summary of Transborder Container Movements  
In Canadian and U.S. Overseas Trade, 1982

(All figures in twenty-foot equivalent units)

	East Coast	West Coast	Total
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Canadian Trade via U.S. Ports			
Canadian Exports	27539	13415	40954
Canadian Imports	18545	41041	59585
Total Canadian Trade	46084	54456	100539
U.S. Trade via Canadian Ports			
U.S. Exports	45481	854	46335
U.S. Imports	53760	109	53869
Total U.S. Trade	99241	963	100204
Balance: Canadian Containers			
Less U. S. Containers	53157	-53493	-335

Source: Revenue Canada

46. Canada, Government of, Embassy to the United States, Note No. 266 to the U.S. Department of State, July 8, 1983

47. U.S. figures combine container and bulk cargoes. In addition, the U.S. Department of Commerce publishes statistics on movements of U.S. cargo through Canadian ports but not vice versa. According to the Maritime Administration, 1.2 million metric tons of U.S. exports valued at \$2.1 billion and 982,000 tons of U.S. imports, valued at \$2.2 billion moved through Canadian ports in 1980. The export tonnage was up 33% from 1979, while import tonnage was down 20%. See U.S. Department of Transportation, Maritime Administration, Office of Market Development, "U.S. Exports and Imports Transshipped Via Canadian Ports", June 1983.

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A closer inspection of Table 2 reveals, however, that the balance is achieved by combining together two quite unequal ratios. According to the table, about 50000 Canadian containers traveled through each of the two U.S. coasts in 1982 while about 100000 U.S. containers traveled through Canadian Atlantic ports. Virtually no American containers exit through Canadian West Coast ports.

There is, of course, no economic virtue in equal numbers of containers transhipped through transborder traffic unless the balance is achieved due to a search for efficient routes. Economic reasoning and experience does not suggest any reason why such a physical balance should be generated by economic forces. In fact it appears as if it is an accident, with unrelated forces together producing a not-necessarily-efficient equality of container movements. A partial explanation appears available in the difficult labor situations in the ports of Vancouver, B.C., which shifted freight on the West Coast, <sup>48</sup> and in the Port of New

48. Tetley, W., "Liner Conferences in Canada under Canadian Law and the U.Ns Code of Conduct for Liner Conferences", Transport Canada Marine, 1982.

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York which has diverted East Coast freight to Canada.<sup>49</sup> It seems plausible in addition that many of the Canadian containers were attracted to American ports simply because U.S. ports have more frequent sailing schedules to places other than Europe.<sup>50</sup>

It is, however, undeniable that the long term trend in transborder shipment of international traffic has favored the Canadians, and that this diversion has accompanied a divergence of freight rates favoring Canadian over U.S. East Coast Ports. The diversion has also coincided with the offering of a new inter-modal through billing service by carriers serving Canadian ports--in particular CAST North America, formerly a subsidiary of the Swiss-domiciled firm, Eurocanadian Shipholdings.<sup>51</sup>

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49. The recession also appears to have interacted with certain pension and pension-equivalent provisions of labor contracts at U.S. East Coast ports to push up surcharges on cargoes going through such ports as New York--all to the benefit of Montreal. "Surely the rise in minibridge and the tremendous growth in cargo at Montreal are largely attributable to the differences (in labor costs) that already exist. The danger is that ever greater cost-differentials will just lead to more and more cargo diversions." Armbruster, William, "Container Industry is Buffeted by Changing Business Conditions," *Journal of Commerce*, June 27, 1983

50. Pelkola, D.W., Transportation and Communications Division, Department of External Affairs, Ottawa, personal communication, Aug 4, 1983

51. Following financial difficulties, CAST has recently been restructured and merged with a former competitor, Sofati Container. The restructuring completed separation of CAST Container from Eurocanadian Shipholdings. Eurocanadian has been placed in receivership by the primary creditor, Royal Bank, but no changes are planned in CAST operations. See, Gibbens, Robert "New Company to Manage Cast Container Operations", *Globe and Mail*, Aug 9, 1983, p.B1.

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The new service was offered beginning in the early 1970's, and differed in a number of ways from traditional transportation of export and import cargoes: the service was intermodal, allowing a shipper to deal with a single firm rather than separately with a domestic carrier to a port and then with an overseas liner; the domestic and international rates were rolled together in a single price; and the services were provided outside the traditional liner cartels. Under the new system, containers are trucked or sent by railroad to Montreal for placement on container ships for Antwerp.

This so-called Canadian landbridge has attracted 80% of the container cargo from Michigan to Europe, and large quantities of traffic from other Great Lakes states.<sup>52</sup> Following the success of Cast in attracting cargoes, the service has been imitated by other carriers. An American carrier, Sea-Land Services, has recently started container service from Halifax to Europe in what may be yet one more rival for American export cargoes.<sup>53</sup>

Immediately before the introduction of the new Canadian service, such export traffic would have been funnelled through

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52. The port of Detroit, oddly, has benefitted from the new shipping patterns as containers are placed on railroad cars on barges in Detroit, and then floated across the Detroit River, where the cars are made into trains for Canadian ports. Auwers, Joseph, "Making it work", *Seaway Review*, June 1983, V. 12, n.3., pp83-85.

53. Sea-Land insists that their service is primarily aimed at Canadian traffic. See Armbruster, William, "Ports Urge New Study of Diversion", *The Journal of Commerce*, June 16, 1981, P. 1A

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U.S. East coast ports. These ports have complained bitterly about the loss of cargo. For example, Fred DiBona of the Philadelphia Port Authority is quoted as saying, "The Congress cannot allow this sorry situation to continue and deprive American motor and rail carriers of these cargo movements, American workers of the right to handle this cargo, and the northeast ports of millions of dollars of needed revenue to<sup>54</sup> revitalize our own ports and infrastructures." The shipment of American containers through Canadian ports is not limited to those originating in the Mid-west, however. Complaints by U.S. North Atlantic Ports claim that CAST is the "leading predator of<sup>55</sup> New England cargo" as well.

Is Regulation the Reason for Traffic Diversion?

That U.S. East Coast ports have lost traffic to Canada is thus undeniable. Part of the explanation for the change in shipping patterns is explainable in terms of technological change. The introduction of containers has altered radically the economics of port operation. In particular, the tremendous

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54. *Traffic World*, "Cargo Diversion Bill Elicits Strong Approval in House Unit Hearing", June 22, 1981, p.7

55. Salzano, Carlo, "Canadian Cargo Diversion Takes Limelight at NAPA Annual Meeting", *Traffic World*, June 22, '81, pp21-25.

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increase in the size of container vessels has increased the economies of scale of port operations. Technology makes it inevitable that most ports will lose cargoes to the few that have the volume of shipments necessary to enable container lines to offer frequent service.<sup>56</sup>

Another reason for CAST's success apparently lies in the innovative use of inter-modal service, offering a shipper the opportunity to deal with a single transport service for all parts of the business.<sup>57</sup> Following Cast's lead, most U.S. members of liner cartels have now applied for authority to offer inter-modal rates through the liner cartel.<sup>58</sup>

Technological change and innovative service offerings do not alone explain the success of the Canadian ports in attracting U.S. traffic. CAST has operated outside of liner cartels, and it is presumed that the rates that it is offering represent classic undercutting of cartel prices by non-member competitors.

Moreover, as a non-member, CAST and similar lines are not subject to the tariff filing requirements imposed on both U.S. flag and

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56. Tetley, W., "Liner Conferences in Canada under Canadian Law and the U.N. Code of Conduct for Liner Conferences", *Transport Canada Marine*, 1982, p. (VII-2)

57. According to a spokesman, "Cast's efficiency is based on a true door-to-door intermodal service and simplified documentation." *Traffic World*, "Cast Tells House Panel Cargo Diversion Bill Would Hurt U.S. Firms," July 20, 1981, pp.38-39.

58. Armbruster, William, "Container Industry is Buffeted by Changing Business Conditions," *Journal of Commerce* June 27, 1983.

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foreign flag carriers for shipments loaded and discharged at U.S. ports.<sup>59</sup> U.S. ports complain that Cast operates with an economically unjustified advantage of secrecy while the rest of the cartel must publish rates.

## The Cargo Diversion Bills

U.S. East Coast port authorities have responded to the loss of cargo to Canada by proposing that FMC regulation be extended to U.S. cargoes travelling through Canadian ports. There have been a variety of "cargo diversion bills" proposed over the last several years, and some that are currently under consideration.<sup>60</sup> The provisions most favored by U.S. port interests would require filing by CAST and other carriers of rates charged for shipment of U.S. cargoes transiting through Canada.

This requirement appears innocuous at first. American

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59. Tetley, W., "Liner Conferences in Canada under Canadian Law & the U.N. Code of Conduct for Liner Conferences", Transport Canada Marine, 1982.

60. For a description of the previous and current wave of cargo diversion bills, see Nealse, Tim, "Canadian Diversions Still a Concern in U.S.", *Journal of Commerce*, June 22, 1983, p.12A; Salzano, Carlo, "Canadian Cargo Diversion Takes Limelight at NAPA Annual Meeting", *Traffic World*, June 22, 1981, pp.21-25; and Salzano, C., "N. Atlantic Ports Broaden Attack Against Canadian Cargo Diversion", *Traffic World*, June 27, 1983, pp.25-26.

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proponents stress that, "the change would not place carriers offering a service through the ports of our neighbors at any regulatory disadvantage, but rather it would place such carriers on an equal regulatory footing with competing common carriers by water."<sup>61</sup> Also, "It is not new regulation, it is merely patching a large loophole in the present regulatory scheme."<sup>62</sup>

A closer inspection of the proposal shows that it is far more significant than it appears on the surface, since filing the rate with the FMC would give that body jurisdiction for finding the rate to be unjust or detrimental to United States trade. Confirmation that the concern of U.S. ports is not rate information but the ability to protest rates from Canada to Europe is found in the observation that a bill which would allow interested parties to inspect but not protest Canadian rates was found unacceptable to American concerns.<sup>63</sup>

Cargo diversion bills have been favored by U.S. East Coast congressmen, but have been opposed by Midwestern representatives and shipper interests, as well as the Canadian government which considers the attempt to regulate rates at Canadian ports to be an infringement of its sovereignty. It appears that there is not

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61. *Traffic World*, "Cargo Diversion Bill Elicits Strong Approval in House Unit Hearing", June 22, '81, p.7

62. Salzano, Carlo, "Canadian Cargo Diversion Takes Limelight at NAPA Annual Meeting", *Traffic World*, June 22, '81, p. 22.

63. Auwers, Joseph, "Making it work", *Seaway Review*, June 1983, V. 12, n.3., pp. 83-85.



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currently enough support for the bills to pass.

Another form of cargo diversion provision is found in a bill (S.865) currently in Congress under which ships using U.S. ports would be taxed to pay for port development. Recognizing that this might encourage greater use of Canadian ports, the bill states that

It is unlawful for any person engaged in waterborne commerce knowingly to divert or cause to be diverted any deep-draft commercial vessel containing commercial cargo destined for use or consumption in the United States from a port within the United States to a port outside the United States for purposes of avoiding the tax imposed. Any person in violation shall be subject to penalty not to exceed double the amount of the tax which would otherwise be imposed.

The author of the bill does not suggest any means for determining which cargo has been diverted to avoid the tax, which to avoid regulation, and which to take advantage of superior service. The provision in its current form is thus unenforceable. But this is the problem with all cargo diversion bills. There is no way of knowing to what extent differential regulation has caused diversion; and even then there is no economic justification for solving the problem by making regulations for cargo exiting through Canada the same as those in the United States rather than

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64. This does not mean that U.S. port interests have been completely unsuccessful in their attempts to reduce the flow of U.S. cargo through Canadian ports. In 1979 foreign freight bills were rolled into dutiable value of imports, one affect of which was to put the Canadians at more of a disadvantage vis a vis U.S. ports. Klymchuk, Andy, Office of Strategic Policy, Transport Canada, personal communication, August 5, 1983

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vice versa. Here is one situation where the overlap of U.S. and Canadian transportation markets makes it difficult for the United States to avoid following the Canadian lead in regulatory reform.

Coming changes in regulation of liner trade.

Overshadowing all of the cargo diversion bills are two policy changes that will apparently come into effect during this calendar year: first, a comprehensive rewriting of U.S. regulations covering deep draft international trade; and second, a new international code for the liner trade which promises to drastically alter the role of shipping cartels.

The current administration has promised a bill, to rewrite U.S. deep draft regulations and several other bills are currently under consideration by Congress. <sup>65</sup> At this point it is impossible to predict whether the new bills will increase or decrease FMC powers over the container trade. <sup>66</sup> In recognition of the fact that a bill which removed tariff filing requirements would

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65. *Traffic World*, "Senate Subcommittee Opens Hearings on New Maritime Reform Legislation", Feb. 7, 83, pp.42-44.

66. Armbruster, William, "Container Industry is Buffeted by Changing Business Conditions," *Journal of Commerce*, June 27, 1983.

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eliminate the principle device in the cargo diversion bills, the latter have been tabled until the question of new shipping regulations is resolved.

More serious for all international cargo movements by water is the introduction of the UNCTAD Code in October of this year.<sup>67</sup> The immediate effect of the code will be to discourage the use of third countries for carrying cargo in bilateral trade. This should gradually reduce the influence of the familiar liner cartels as third world nations begin to carry their own imports and exports on ships with their own flag. The changes should be especially noticeable in Canada which has no deep sea fleet at all. It remains to be seen how the North American Governments will implement the UNCTAD agreement and what effect this will have on the current practice of shipping U.S. cargoes for export to Europe through Canada on ships which generally fly the flag of yet a fourth nation.

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67. Tetley, W., "Liner Conferences in Canada under Canadian Law and the U.N Code of Conduct for Liner Conferences", Transport Canada Marine, 1982.

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### Inland Water Transportation Issues

The major Canadian-U.S. transportation issues surrounding inland water transportation relate to the Great Lakes and the St. Lawrence Seaway. The St. Lawrence Seaway is a joint operation of the United States and Canada, but far more of the operations and far more of the cargo is on the Canadian side. Canada operates 13 of the 15 locks between Montreal and Lake Erie, and 70% of the traffic is Canadian. Virtually all of the Canadian merchant marine is engaged in carrying cargoes (primarily grain) from the Lakehead to lower St. Lawrence ports for transshipment, and carrying iron ore and coal upbound for U.S. and Canadian mills. Seaway cargoes have recently been confined to dry bulk commodities--in addition to grain, ore, and coal, there is a little salt, stone, petroleum, cement, coke, and gypsum. There is no package service left on the Lakes and no container ships will call this year.<sup>68</sup>

There is no regulation by either nation of rates or service on the St. Lawrence Seaway, except to the extent that domestic

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68. Gemmell, A.W. Uhm, I.H., and Shaw, G.C. "Economics of Canadian Water Carriers on the Great Lakes and Saint Lawrence Seaway System *Journal of Transport Economics and Policy*, May 1983, pp. 191-209

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cargoes on either side must be carried in ships of that nation. It would appear that differences in regulation could not be at the source of problems of transportation policy. But in a sense, the problem--how to charge for use of the system--is a close relative to regulation. Currently, the Great Lakes connecting channels are used free of charge by both nations, but the Seaway is unique, as the only North American waterway to charge tolls for use. Tolls are jointly set by agreement between the Authorities on both sides of the Lakes, with Canada receiving about 70% of tolls on the Montreal-Lake Ontario segment and 100% of the revenue from the Lake Ontario-Lake Erie segment.

On the Canadian side, there is no difference between Seaway policy and domestic inland waterway policy--there are no other navigable Canadian waterways. On the American side, the Seaway is a small fraction of domestic water commerce. Since it is the largest segment of the industry, inland waterway policy tends to be made with shipments on the Mississippi River and tributaries in mind. This has worked to the detriment of development interests on the U.S. side of the Great Lakes, since the system competes directly with the Mississippi and New Orleans for export cargoes of dry bulk cargoes, particularly grain.

While the U.S. government provides navigation aids on the Mississippi free of charge, those who export through the Lakes are obliged to pay tolls. Negotiations on tolls and improvement of navigational aids on the Northern Coast requires international consultation, while those favoring improvement of competing

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facilities in the United States interior need only talk to those in Washington. This necessity for international consultation (something to which U.S. policy makers are not generally accustomed) has brought about some impatience and annoyance on both sides of the border.

Illustrative of the American forgetfulness to consult before proceeding is the Corps of Engineers unilateral decision to study the effects of winter navigation on the Great Lakes and connecting channels, despite the opposition of Canadian interests,<sup>69</sup> and Corps studies of modernization and expansion of Seaway locks, despite vociferous complaints of Canadian environmentalists.<sup>70</sup>

More serious from the Canadian government perspective, however, is the current series of bills in the U.S. Congress to move to a system of user charges for the general provision of maritime infrastructure. User fees are being proposed as a way of recouping the cost of maintenance as well as construction of port and waterway facilities throughout the United States--including the Great Lakes and the connecting Seaway. The proposals in two bills (S.970 and S.865) would place user fees on Lakes navigation and change the system for paying for the Seaway

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69. Pelkola, D.W., Transportation and Communications Division, Department of External Affairs, Ottawa personal communication, Aug 4, 1983

70. *Seaway Review*, "Expanding the Bi-National Seaway System--an Option under Attack, Autumn, 1982, pp4-6.

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from a toll to a tonnage or ad valorem based user charge  
71  
scheme.

The unilateral attempt to charge for use of the Great Lakes  
(opposed by all navigation interestes) and remove tolls from the  
Seaway (something long favored by American Great Lakes interests)  
has been coldly received in Canada. 72 According to official  
Canadian policy, the concept of user fees for infrastructure  
provision is not in itself unacceptable, but the lack of  
consultation is irksome, and against treaty provisions. If the  
U.S. government wishes to change the means of financing of joint  
waterway, it should expect to negotiate the action. 73

It appears that the negotiations will be difficult. User  
fees for infrastructure provision is opposed both to the  
traditional U.S. approach to transportation as well as current  
Canadian policy for other modes. While the likelihood that  
either bill will pass in current form is slim, a move to user  
charges for the American inland water system appears likely. How  
to coordinate those changes with Canada (or whether to leave the

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71. *Inaffic World*, "Senate Panel Examines Proposals for Funding  
Port Improvements", June 27, 1983, pp. 46-47; also *Inaffic World*,  
"Administration Announces User Fee Program, Sends Proposal to  
Congress", May 30, 1983. Unlike the Senate bills, the  
Administration proposes a ton-mile tax to finance inland waterway  
(as opposed to port) improvements.

72. *Globe and Mail*, "User Fees worry Seaway Official", June 27,  
1983.

73. Canada, Government of, Embassy to the United States, Note No.  
266 to the U.S. Department of State, July 8, 1983.

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American Great Lakes as an orphan of transport policy) are  
questions that will have to be answered eventually.

### Conclusion

This paper has demonstrated that differences in regulation lie at the base of many of the U.S.-Canadian transportation issues. The preceding pages have described these problems for each mode of transportation.

- Motor Carrier issues are primarily those of licensing. The U.S. has allowed free entry of Canadian motor carriers into domestic and transborder routes, improving the efficiency of movements by offering single-line service on links international traffic interchanges had been necessary before. In what appears to be protectionism, the Canadian provinces, which have authority over motor carrier issues, have been reluctant to grant similar authority to U.S. carriers. Responding to a combination of pressure from the Canadian manufacturing community and the U.S. trucking industry, it appears that the provinces will soon allow freer entry into the Canadian trucking industry.
- The primary aviation issues involve the contradiction between standard international procedures for governing air relations--bilateral treaties where questions of equity play a central roll--and the market reality that both Canada and the United States are in much the same airline market. The diversion of passengers to U.S. carriers as the Canadians

have tried to maintain the regulated price and route structures has made it difficult for the Canadian authorities to continue to regulate their domestic market as they would wish and has changed the terms under which air treaties with the U.S. can be negotiated.

- The complaints of the Canadian railroads center on Canadian rules which contradict those which they must follow in international movements to the United States. The Canadians complain that they are placed at a cost and bargaining disadvantage by the Canadian laws, and risk exposure to U.S. antitrust violations. The result has been a weakened presence in the U.S. market--a change from their position during the last fifteen years or so. This paper argues that while the Canadian railroads' problems stem from U.S. deregulation, their problems can only be solved by lessening reliance on interchanging traffic with other U.S. carriers.
- The regulation of deep draft shipping is laxer in Canada than in the United States, and some U.S. port interests have urged extension of U.S. regulation to U.S. traffic transshipped through Canadian ports in an effort to prevent traffic diversion. This paper concludes that there is no economic justification for the port diversion bills. In any case, it appears that there will soon be major shifts in the rules governing all trade by deep draft vessel, and the U.S. port attempts to disadvantage their Canadian rivals will be overwhelmed by the changes that will soon affect all maritime interests.

- Inland Waterway issues concern the Great Lakes and the St. Lawrence Seaway. It appears that the U.S. will wish to introduce a system of user fees on the common waterways that conform to taxes imposed on other facilities in the United States. Since under previous treaties, the waters are used free of charge (or in the case of the Seaway, under a jointly-set toll) by both nations, the American attempts to impose user fees (that is, implicitly setting efficiency as the criterion for waterway development) will create problems similar to those that have been seen with other modes of transportation.

It appears that with the transportation market overlap between Canada and the U.S., deregulation in one country has limited the options available to the other to regulate its transportation industries as it would wish. Since Canada is, in general, the country with the stricter regulation, it is that country whose transportation options have been narrowed.

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DISCUSSANT'S REMARKS

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COMMENTS ON DR. KENNETH BOYER'S PAPER  
"USA-CANADA TRANSPORTATION ISSUES"

- 2 -

I appreciate the opportunity to comment on Professor Boyer's paper which is a very useful contribution to discussion of Canada-USA transportation issues. I look forward to any observations that come out of the discussion.

Several years ago transportation would have been an unlikely topic for a workshop on frictions in the relationship. The system worked. The Seaway was often cited as a model of international cooperation. Now, however, as Professor Boyer has made clear, things have changed and there are some problems and policy makers have had to focus more on the transportation relationship. (The Seaway, for example, has twice in the past few months been the subject of diplomatic communications by Canada in response to USA initiatives which Canada feels could threaten this close cooperation.) This said, I do not think we should lose sight of the fact that the system does still work - the transportation network still facilitates the largest amount of trade in the world between two countries - and the largest movement of people across its borders. I would like first to make several general observations, after which I will make some selective specific comments on the various modes described in the paper to try to illustrate my general observations.

I think the paper provides a good catalogue and summary of the major issues in the transportation relationship and while Dr. Boyer adds a disclaimer, I think his study is remarkably comprehensive. I cannot quarrel with the basic position that differences in regulation lie at the base of many of the USA-Canada transportation issues, although I am less certain that resulting frictions or solutions can be seen purely in terms of the economic efficiency of the transportation sector alone. I think it is worth noting that international regulatory conflicts are a relatively recent phenomenon and problems can result from the fact that very often the players do not understand the purposes which regulation serves in the other country. In addition, there is no simple procedure for how we resolve disputes.

While there is a growing tendency to see transportation as a service which can be traded and measured much like a traded good, in Canada, historically, transportation policy has responded to unique political imperatives related to nation building flowing from factors of geography, population, resource development and, without doubt, of Canada's relationship with the United States. Professor Boyer notes that, until recently, the regulation of the transportation sectors in both countries was remarkably similar. There are, however, noteworthy differences in approach (to regulation) as a result of different forms of government and different approaches to economic development. Canadian governments (both federal and provincial) have been more directly involved than their USA counterparts

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in economic development and the provision of services through enterprises they owned or sponsored. In the USA, private enterprises have tended to fulfill this role. Accordingly, in the USA, a complex regulatory system was developed to oversee private activities which were perceived to be abusing their economic power. In Canada, on the other hand, governments have the ability to control directly many services because they own them. As a result there has probably tended to be less regulation in Canada than in the USA. Another important fact is that regulatory agencies in the USA tend to enjoy considerable autonomy from the executive branch and even the legislative branch. This is much less true in Canada and Canadian political traditions have developed in a way which points to the government of the day for management of public policy issues. There is, for example, often an appeal from regulatory bodies to Cabinet. This has resulted in a more consensual and less adversarial approach in Canada than exists in the USA.

Canadian governments have, however, recognized the need to balance the use of the transportation system as an instrument of national policy (through both ownership and regulation) against commercial forces. The trend, over the past 20 years, has been toward less regulation. However, in keeping with its approach to economic questions in general, Canada has proceeded carefully in an effort to maintain a national consensus on the proper role for the regulatory system which is intimately tied to Canadian national development. National interest is not, though, a set of static objectives. Rather, it is a process, a process of redefinition. This approach to regulation has permitted a regulatory system in Canada which enabled it to respond to intermodal competition, as Professor Boyer states, with the National Transportation Act, parts of which were adopted as a model for the Staggers Act which deregulated rail in the USA almost 15 years later. The Canadian system of regulation has been, and is, an evolving one, responding to a number of factors, but not always to the dictates of economic efficiency alone. The latest example of this evolution, and an example that in Canada transport is more than "just another sector" where pure economic efficiency for the transportation sector governs all has been the debate on the Crow rate. Other economic goals - in this case Canada's grain trade - influence transportation policy. The Canadian system, then, is evolving. The current problems as Dr. Boyer has described have resulted from sudden and broad changes, under the banner of economic efficiency, in the USA system. The challenge, therefore, facing Canada is how to respond to the changing situation, taking into account the types and mix of

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broad national interests (which have determined changes in the past). In assessing the challenge and the future, I think it is therefore important to recognize the context of Canadian transportation policy in order to understand and manage the specific issues and problems.

I would like now to make some specific and selective comments on the various modes described in the paper.

#### Trucking

With regard to trucking which first raised the profile of transportation services as an area of dispute, I think it is fair to say that the regulatory systems in Canada and the USA were similar in many ways with regard to trucking, but I think it is worth noting, to demonstrate what I have just said about Canada having less regulation, that there is the general view in the trucking industry that the USA system was, in fact, more restrictive than the Canadian. While there is no doubt that the reverse is now true, it would be more accurate to say that the USA system caught up and overtook the Canadian system all at once rather than to imply we were starting from the same place.

My main comment on trucking relates to the moratorium which shows the importance of understanding differences in order to prevent such costly disputes. The moratorium did not, in fact, occur following the signing of a letter of understanding between the two countries. The opposite is true. In early 1982 the ICC, in response to USA trucking concerns about increased entry of Canadians into the USA market following deregulation and to claims of discrimination by Canada, stopped processing Canadian applications while it undertook a study of the issue. While the study was underway, Congress, responding to similar pressure, legislated a moratorium, despite strenuous Canadian government efforts to explain that Canada did not discriminate. (It is interesting that Canadian provinces had great difficulty in preparing material for the ICC study because applications were not filed by the applicants' country of domicile.) When he signed the law, President Reagan asked Ambassador Brock to negotiate an understanding on trucking with Canada that would permit him to lift the moratorium. During the negotiations the ICC released its report. Although it found Canadian regulations somewhat more restrictive, it concluded that Canada did not discriminate. The year-long dispute had cost the Canadian industry heavily in lost business and legal fees. The consultative mechanism set up by the understanding aims to focus industry complaints, bring them to governments' attention - a

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sort of early warning system - to prevent precipitous unilateral retaliatory action resulting from an imperfect understanding of each other's regulatory system. I think it is particularly important to manage grievances - or perceived grievances - in this way, as Canadian jurisdictions study their legislation and make decisions on the reform of their regulatory systems.

#### Air

The section of the paper on air addresses an extremely complex relationship - by far the most complex bilateral air relationship in the world. In view of that fact, I think it must be emphasized that for such a relationship, it works rather well. I do not share entirely Dr. Boyer's position that Canada treats the relationship as a diplomatic rather than an economic one - although certainly we have different views on what is economic. I think the paper incorrectly implies that Canadian airlines are inefficient tools of government policy. Canadian lines are certainly more efficient than USA airlines were and are probably the most efficient non-USA lines in the world now. Canadian lines can compete with USA lines for Canadian traffic to the Caribbean, for example, where geography makes such competition inevitable. USA lines get about 20% of such traffic - Canada does not complain. These so called 6th freedom rights are not negotiated in the international air system as the paper suggests under the discussion of the Continental seat sale. In his description of that case, I think Dr. Boyer reflects well the CAB position but not that of Canada - or perhaps other USA agencies. Canada would not object if Continental attracted Canadian passengers from Los Angeles to Australia, just as Canada does not object to the USA lines attracting Canadians flying on USA lines to the Caribbean from New York. Canada can compete. However, in the Continental case, that airline was offering fares to Canadians only from Canada to Australia (which were not to be available to Americans) and which were below the fare available to Americans to fly the same route to Australia from the USA. In principle, Canada would have been able to compete but was, in this case, unlike in the Caribbean, restricted in the flexibility it had as a result of its bilateral agreement with Australia which imposes capacity controls.

The paper refers to the Preclearance Agreement but omits to mention the importance of preclearance facilities. The Preclearance Agreement which permits Canadians to clear USA customs in Canada before travelling to the USA, was a result of diplomatic negotiation and provides an extremely important economic advantage to USA airlines, as well as a convenience to

...5

passengers. With passengers cleared in Canada, flights to the USA essentially become domestic flights. The lucrative Toronto-Atlanta flight mentioned in the paper does not, for example, exist as a negotiated route. It is a Toronto-Buffalo flight which, as a result of preclearance, can continue as if it were domestic. One final word on air. The fact that fares under the bilateral agreement can be disallowed by either side enables the CAB or CTC to disallow certain rates. CAB practice has tended to keep fares down to the extent that some transborder fares are lower than domestic ones.

#### Rail

The paper recognizes the importance of the Canadian National Transportation Act in recognizing early, intermodal competition and in permitting Canadian railroads to operate on a more commercial and competitive basis. Canadian railways were, as a result, much more efficient than USA roads. This was the reason why traffic in the 70's could be routed from Europe to Chicago via Winnipeg. I do not think it was because of the practice of long-hauling, as Dr. Boyer suggested on page 37 of the paper. Canadian roads offered better service at a time when USA railroads were very inefficient. Use of Canadian roads as a result cannot appropriately be termed "bizarre" behaviour.

#### Conclusion

I would like to make a few final observations. From the perspective of a department which must manage the frictions in the transportation relationship to try to minimize their impact on the system, on trade and on Canada-USA relations in general, I think we must be careful to recognize why differences exist - what, for example, are the Canadian reasons for Canadian policies. We also need to keep in mind how broad and complex and, in fact, good, the transportation relationship is. And taking into account these factors, I think policy makers need, above all, in managing the transportation issues, to keep in mind that, in Canada, (and, in fact, in the USA as well) transportation has responded, and I think will continue to respond, to more than pure economic efficiency. Equally, we should understand that it is an evolving, developing system which does respond to commercial pressures and which is less regulated and more efficient than in most countries. The challenge is to work out ways for it to continue to respond to national interests in light of rapid changes in the situation in the USA.



DISCUSSANT'S REMARKS

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Canada - U.S. Transportation: Current Issues and  
Some Qualifying Factors

Harold Handerson, Trade Liaison  
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My task is nominally an easy one: to comment on the paper prepared by Dr. Boyer. However, the conference organizers said that I should not feel constrained to limit myself to points raised in that paper. Therefore, it will not do to simply state that Boyer paper is generally excellent, and resume my seat.

Since I have in effect been given license to roam, I will first provide a personal gloss on the Boyer paper, then suggest some additional matters that may be worth keeping in mind because of their direct and indirect impacts on the provision of cross-border transportation service.

The Boyer Paper

In his 63 pages of draft text, Professor Boyer has made good use of materials from over two dozen other writers, including those for

the New York Times, The Wall Street Journal, Traffic World (which I no longer see on any regular basis) and The Globe and Mail (which I regrettably had not previously seen). At page 3, for example, he quotes Stanbury and Thompson (though the introduction to the quotation might more felicitously cite "responsibility" before "freedom") as follows: "There does not exist in Canada any fundamental belief in the virtues of competition as a method of allocating scarce resources".\*

I was surprised that Boyer did not reject the contention (p. 16) that U.S. domestic rates could be used to cross-subsidize Canadian operations; nor to note with respect to footnote 17 (pg. 17) that regardless of the reason for St. Johnsbury rate cuts, that clear benefit does lie with Canadian shippers and consignees. There may be some minor errors (e.g., citing the "National Transportation Act of 1966" at p. 4, and the reversal of the time frame with respect to congressional action

\*In contrast, I might quote Agriculture Secretary Block, speaking at the Agriculture Outlook Conference in Washington, October 31. "I am not proposing that we get government entirely out of agriculture. A safety net of some kind is necessary. I am just saying that the government does a poor job of allocating resources. Government is ill-equipped to accurately set prices. The true signals that farmers should respond to are market forces undistorted by government interference."

and the Brock-Gotlieb letter of understanding at p.14\*), and potential misperceptions (e.g., citing Chow at pg. 18 as to why U.S. truckers have been quiet about changes in regulation -- which they do not see as affecting them); but the thrust of the paper appears to me to be correct: that regulation imposes excess costs on the broader public which can only be justified on the basis of broader national interests such as regional development or economic stability; and that cross-border divergences breed problems.

As we are currently seeing with respect to the new Crow's Nest Pass rate legislation, however, these costs may in fact become too large for some sectors (in this case, the rail lines) to offset; and even where they are not so large or so well documented, they entail an economic drag on those who must bear them. There are, for example, costs now borne by Canadian shippers and receivers of goods which pay the salaries of those Ontarians which the Trucker's Association says would be "lost" if U.S. carriers were allowed freer entry into the Ontario market.\*\* The jobs could

\*The latter point already noted by Michael Brock

\*\*Report of the Ontario Highway Transport Board to the Honorable James W. Snow, Minister of Transportation and Communications on The Balance of Trade in International Trucking Services Between the United States of America and Canada (Toronto, 30 July 1983), page 5 schedule G; cited and discussed at pp. 30-31. Also referred to by Boyer, p. 16.

only be lost if the service which is currently foregone was in fact of at least equal quality, and lower cost. The question then becomes one of both economics and politics, since the economists would say that those people should (eventually) be employed elsewhere in the economy, while the politicians would be concerned about their reaction in the meantime.

This in turn raises a point worth underlining: while even the U.S. firms with existing Canadian operating authority would agree that market demand increases as rates drop, they would not, ipso facto, support freer entry into Canadian markets. Therefore, politicians with the best interests of their constituents at heart must press for and promulgate better information on the costs and benefits of the current system and its alternatives, to build public understanding and support for actions which are in the public interest over the long run. At the same time, extreme care must be taken, and publicly perceived, that transition arrangements do not unduly disadvantage anyone. Both these points are easier made in theory than implemented in practice; but the second is perhaps the trickier of the two.\*

\*See chapter 15 of Conrad Winn and John McMenemy, Political Parties in Canada (Toronto: McGraw-Hill Ryerson, 1976) as to why neither is probable: basically, one is giving hostages to fortune by developing information which may be adverse to one's own (or one's supporters') position. Royal Commissions, however, may be appear to exceptions to this general line of reasoning.



It seems to me that like it or not, the fact that the U.S. has changed its regulatory approach is a factor to which Canada will have to adjust\*. The manner and extent of that adjustment is not yet clear. However, it is unfortunate that FIRA can make stipulations which are unacceptable to the provincial trucking regulatory authorities\*\*. The ensuing muddle not only looks bad, it is the type of waste of resources which produces cross-border ill feelings rather than efficient transportation service.

In summary, the Boyer paper highlights the problems of economic inefficiency and political intractability which characterize the modal operations under cross-border regulatory regimes which are at variance with each other. It is the fullest and best treatment of the subject I have seen. The implications I have drawn are simple: better economic impact information, widely disseminated, can lead to politically palatable adjustments in the best interests of the general public (if not to the complete satisfaction of all parties at interest), and further expansion of efficient cross-border transportation service.

Other Selected Factors: Having given you my "bottom line" on the Boyer paper, let me mention several additional classes of politico-economic factors that will bear attention over the coming months and years.

\*Wonnacott, p. 28, "...such adjustment costs must be kept in perspective. Over time we are incurring more and more of these costs simply in an attempt to maintain the status quo."

\*\*Roadway in re: Berkema Express

The first class is transport-related, and largely focused on domestic situations. Some have suggested, for example, that our current concerns regarding Canadian trucking arise because we didn't pay enough attention to the topic at the time we were trying to deregulate U.S. domestic trucking. If this is so, then the prospective simplification of truck fees by federal action\* (perhaps with some sort of sharing arrangements for replacement of state revenue which may be foregone) will provide another opportunity to either include or exclude Canadian-based truckers from explicit consideration. I might note here that so long as the Canadian federal government chooses not to establish federal regulations with regard to extra-provincial trucking, it would seem to me that Canada will be at a disadvantage in making representations in such matters to the U.S.

A second type of problem is that posed by action in respect to one mode in either of our countries that may impact other modes in both of them. Raising the ceiling on Crow's Nest Pass rail rates may (and probably will) have effects on port traffic and the St. Lawrence Seaway with implications for other transport fees, subsidies or investment.\*\* Exclusion of trucking as an entire

\*To meet the requirement of section 19 of the Motor Carrier Act of 1980 (P.L.96-296). Promised by Secretary of Transportation Dole in a speech to the Highway Users Federation; and reported in the 4 November 1983 issue of The Journal of Commerce.

\*\*When I mentioned this yesterday, John Curtis, sitting on my right, immediately muttered something about Mississippi River barge traffic. See also Boyer on mergers and long-hauling, p.38ff.

sector from FIRA review is at least in theory a possibility, though it is currently the only way in which federal concerns are certain to be applied.

The final class of problems I would mention is caused for transportation by actions taken to serve other purposes.

One of my responsibilities is to represent the U.S. in multilateral transport facilitation matters in Geneva.\* Import and export documentation, and Customs and Immigration checks for illegal movements of goods and people impose costs and delays on otherwise free flows. Our friends in Agriculture, Customs and Immigration have been taking significant steps to simplify or eliminate some previous requirements, but some irritants still remain; and sometimes the best that can be done is simply to share perceptions and concerns in a nonconfrontational manner. Sometimes this discussion is more productive, since it can help us, and devise methods of meeting all parties' desires/needs in a better way than before the discussion began.

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\*For this reason, I particularly liked Boyer's introductory paragraph (pg. 18) on "Economic Issues in the Regulation of Cross-Border Trucking."

Concerns over trade balances or the value of the dollar -- American or Canadian -- can result in the imposition or maintenance of obstacles or outright bars to the free flow of investments and purchases of goods and services; and transportation is typically affected, at least indirectly.\* In this regard, let me mention FIRA one last time. I would suggest that so long as FIRA is something more than a monitoring operation, it will discourage some of the foreign investment that Robert Logan says you will continue to need;\*\* and will certainly have two other costs: the cost of preparing and processing the applications that are made; and the psychic costs of absorbing the sniping that is delivered in even this friendly atmosphere. As relatively well-to-do countries, both Canada and the U.S. will continue to experience pressures from lower-cost purveyors of goods and services based elsewhere in the world,\* as well as continuing pressures, foreign and domestic, from those seeking to protect or improve their existing situation. Thus, the prospects for a full agenda for the Third Annual Workshop appear bright.

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\*The IMF reports that the value of total industrial country exports for the first quarter of 1983 was 5.6 percent below the prior year, despite an upturn in March. The impact on transport operations is clear.

\*\*Although a report in The Journal of Commerce of 10 November states that net foreign investment in Canada has again turned positive: \$250 million for the first six months of 1983.

\*\*\*My exhortation to be attentive to this broader perspective had been anticipated by several other participants, even before Ambassador Warren drew our attention to the subtitle of the workshop in his remarks last night.

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- 8104C Laidler, David. On the Case for Gradualism.
- 8105C Wirick, Ronald G. Rational Expectations and Rational Stabilization Policy in an Open Economy
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- 8107C Burgess, David F., Energy Prices, Capital Formation, and Potential GNP
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- 8213C Markusen, J.R. and Melvin, J.R. THE GAINS FROM TRADE THEOREM WITH INCREASING RETURNS TO SCALE.
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- 8215C Laidler, D. DID MACROECONOMICS NEED THE RATIONAL EXPECTATIONS REVOLUTION?
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- 8331C Grey, Rodney de C. and Curtis, John. INSTITUTIONAL ARRANGEMENTS FOR U.S.-CANADIAN NEGOTIATIONS. PART I: CANADA-U.S. TRADE AND ECONOMIC ISSUES: DO WE NEED A NEW INSTITUTION? PART II: INSTITUTIONAL ARRANGEMENTS FOR MANAGING THE CANADA-U.S. ECONOMIC RELATIONSHIP.