WESTERN GRAIN EXCEPTIONALISM:
TRANSPORTATION POLICY CHANGE SINCE 1968

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The “exceptionalism” referred to in the title of this paper is largely, but not exclusively, rooted in Canada’s grain transportation policies – and specifically rooted in the former Crow’s Nest Pass rates on grain that came into effect in 1899. Their level was originally set under an agreement between the federal government and the Canadian Pacific Railway. In 1925, the rates were legislated and extended to cover all rail movements of grain from the designated Prairie Provinces. They were more accurately called “the statutory rates,” but in everyday parlance, continued to be referred to simply as “The Crow.” Since 1982, the Crow rates have undergone several modifications, but unlike all other commodities in Canada, grain freight rates are still subject to control. The purpose of this paper is to trace grain transportation policy since the National Transportation Act (1967) and to consider the wisdom of its continuance.

This exceptionalism has been difficult to understand for those outside the western grain industry – and indeed for many within it as well. This bewilderment is encapsulated in a remark made by Carl Snively, the American transportation economist who headed the 1979 inquiry into railway losses under the rates, when he said, “I don’t think I altogether understand a country in which a freight rate could be regarded as a constitutional right.” It becomes somewhat more understandable, however, if considered from the point of view of John Brownlee, who was President of United Grain Growers from 1948 to 1961. Brownlee mounted what was probably the best defence ever for the Crow, but did so from the assumption that the western Canadian grain industry was not a business like any other, but a national enterprise. Or from Justice William Turgeon’s perspective, who, in his 1951 Royal Commission on transportation, said that terminating the Crow “would mean that Parliament no longer looks upon the Western Canada’s production of grain [as] requiring special consideration in the national interest.” Turgeon saw the grain rates as one of “four great measures of relief” that “tempered … the hardships arising from our necessarily long east-and-west railway haul.” (His other three were The Maritime Freight Rate Act in the Atlantic Region, the toll-free canals in Central Canada, the competitive transcontinental railway rates at the Pacific coast.)

What is more difficult to understand is the seeming willful blindness with which, in the 1960s and 1970s, the defenders of the rates ignored the perverse effects that they had begun to have on the grain handling and transportation system, impeding its modernisation, stifling efficiency, and undermining the grain industry’s competitiveness in international markets. In clinging to a regulated system, the industry was again “exceptional” insofar as it lagged the rest of the world in moving steadily toward a more free enterprise economy, and away from a reliance on the public sector. This reluctance to allow market forces to operate went far beyond anything experienced in the rest of Canada, or throughout the western world, and was not confined to transport. It was attributable in part to the 1930s Depression that hit rural western Canada more severely than elsewhere, in part to the effectiveness of the Canadian Wheat Board (CWB) in moving Canadian grain to market during WWII, and in part to a long history of steadily increasing regulatory control over grain transportation and handling, dating back to the turn of the 20th century.

It was not long, however, before change became unavoidable. The railways had emerged from WWII with plant and equipment in urgent need of renewal – a challenge that could not be met without an increase in revenues. At that time, grain represented about 25 percent of rail traffic in Canada, and was on
its way to being a money losing proposition. Moreover, the first half of the 20th century had seen regulation of all rail rates grow ever tighter, and by the early 1950s it became obvious that a new policy framework had to be developed. Accordingly, in 1958, the federal government appointed the MacPherson Royal Commission to recommend changes.

The MacPherson inquiry operated under a different economic philosophy than Turgeon, starting with “the premise that competition was now the major factor in Canadian transportation,” and recommended that the railways be freed from regulatory controls in order to compete effectively with other modes – especially trucking, which had burgeoned in importance after the War. It identified four areas where the railways were providing services at a loss, and recommended subsidies to cover the shortfalls: uneconomic passenger services, unprofitable branch lines, the statutory grain rates and statutory free transportation. And, it accepted the railways’ contention that they were losing money carrying grain, setting the losses at $11 million on each railway (Currie, 18 – 22).

The principles that MacPherson laid down were generally carried into law in the 1967 National Transportation Act (NTA). The first section of this legislation defined a new national transportation policy, declaring that “an economic, efficient and adequate transportation system” would “most likely” develop “when regulation does not impede competition, each mode of transport bears its fair share of facilities and services provided at public expense” and is compensated for services provided as “an imposed public duty.” In contrast to Turgeon, who had put national interest first and who saw nothing wrong with cross-subsidisation between shippers, this policy implied that the price and supply for transportation services should be determined by market forces. Neither MacPherson nor the NTA were unmindful of the need for transport services required in the public interest, but stipulated that such “imposed public duties” should be specifically identified and subsidised. Three such duties were identified in the legislation: passenger services, uneconomic branch lines and grain movement.

Politics, however, intervened. Clause 50 of the bill dealt with grain, but to many people in the West and their representatives in Parliament, this clause was nothing more than a ploy to allow the railways to escape from its sacred obligation to preserve the Crow rates “in perpetuity.”

The bill was sufficiently sensitive and controversial that, in committee stage, it was referred to “the committee of the whole,” meaning that it was to be debated by the whole House of Commons. Just before 6:00 p.m., on January 16, 1967, the House turned its attention to clause 50. Debate continued for much of the following two days, at the end of which the Official Opposition proposed an amendment to delete clause 50. Whether the party whip was asleep, or someone miscounted, will never be known, but the amendment carried, 59 to 58, and the National Transportation Act (NTA) was left with an enormous inconsistency, providing subsidies for branch lines and passenger service, while leaving the railways to cover the losses on grain – and, as an unintended but not unpredictable result, bringing railway investment in grain to a halt.

At roughly the same time, the federal government protected over 12,000 miles of line in the prairies – about two-thirds of the total – from abandonment. In theory, this worsened the railways’ losses, by making rail rationalisation impossible. In practice, however, the inconsistency in the NTA distorted the branch line subsidy program, turning it into a hidden subsidy on grain movement. The situation, in summary, was that the branch line subsidies provided for in the Act were determined by calculating revenue earned from moving traffic from origin to final destinations, and deducting the cost of moving the traffic plus the fixed costs of the line. If the net revenue from moving the traffic covered the fixed cost of the line, the line was considered to be profitable and could not be abandoned. If a loss was determined, the line was then either abandoned, or kept in the public interest and subsidised to the level indicated by the calculation. This procedure worked satisfactorily if the cost of moving the traffic – excluding the fixed cost of the branch line – was less than the revenue earned. With grain, however, the traffic itself was no
longer profitable, and so the calculated loss included not only the fixed cost of the branch line, but the loss on the traffic as well. Thus, even if the railways had been free to abandon prairie branch lines, they soon lost any incentive to do so.

It was not only the railway system that stood in need of rebuilding after the war. The elevator system dated from the pre-war era and was not only old, but technologically out of date. There were approximately 5000 individual country elevators located at about 3000 delivery points across the prairies, and spaced about seven miles apart to accommodate the delivery of grain by horse and wagon. As trucks and roads improved, and as dieselisation permitted longer trains, the obvious direction was towards a consolidation of the system, with larger elevators and fewer costly branch lines. That, however, did not happen. In the quarter century, from 1945 to 1970, the number of elevators declined by only about 12 percent, from 5463 to 4971. The Crow lay at the heart of this stagnation for the simple reason that, with rates frozen at a depressed level, neither the railways nor the elevator companies had the incentive or the ability to negotiate a better freight rate for a consolidated elevator located on a railway mainline and to offer farmers part of the savings to haul the extra distance.

While rail rates were the primary factor, they were by no means the only impediment to change. Subsidies for storing wheat gave elevator companies an incentive to keep older elevators open in order to collect storage revenue, and CWB regulatory restrictions on movement in and out of the elevator system robbed the grain companies of their management responsibility that impeded change.

The result of all these regulatory arrangements was that modernisation of the grain transportation and handling system was stymied, and it remained 25 to 30 years out of date until the 1990s. So severe was the problem that in the late 1950s and early 1960s, when Canada opened up wheat markets in the Soviet Union and China, the system very nearly broke down.

By the mid-1960s it became abundantly clear that the situation could not continue, and so the federal government appointed the Honourable Otto Lang to the post of Minister Responsible for the Canadian Wheat Board, with a mandate to examine all aspects of federal grain policy. He assembled a number of experienced specialists, known as the Grains Group, who completed a series of studies on the transportation issues. These studies were subsequently turned over to the Canada Grains Council, a newly formed industry body, which was asked to “undertake a full assessment of the grain handling and transportation system” (Canada Grains Council, 1973b, One-10). The Council started its work in early 1973, and in March of that year it published an influential report entitled The State of the Industry. This report, which was intended to be a rather innocuous summary of current operational problems, had unexpectedly delved into the Crow issue, analysing the evidence for losses contained in the branch line subsidy figures and boldly portraying them as solid proof that the rates were a losing proposition for the railways. “The federal government,” it said, “must come to terms with the statutory rate issue” and in doing so must recognise, inter alia, that it was an indirect means of supporting farmer income, and that it was constraining the development of a least cost system (Canada Grains Council, 1973a, 184).

The defenders of the status quo were outraged, but the cat was well out of the bag: the Crow had to change. A year and a half later, at the 1974 annual meeting of the Canada Grains Council, Lang somewhat gingerly declared that the government was “committed to a new national policy” that would “see freight rates based on real costs.” This meant, he went on, that “we may have to examine the effect of the Crows [sic] Nest rates” (Lang, 9, underlining in the original). The speech, set off a storm of controversy, but the tide was clearly turning against the opponents of change, not only because 1899 freight rates made no economic sense, but because too many people were coming to recognise that the rates were doing more harm than good.
The latter half of the 1970s saw two major initiatives undertaken by the federal government to address the transportation issues in the grain industry. The first was an inquiry under the chairmanship of former Supreme Court Justice, Emmett Hall, into the network of little-used branch lines across the prairies. While most of the prairie rail network was under the abandonment prohibition order referred to above, approximately 6300 miles were unprotected, and Hall was asked to rule on their future. The second was the appointment of Carl Snavely, a Washington D.C. transportation consultant, to investigate railway costs and revenues under the statutory rates. Snavely’s work finally provided an independent professional assessment of the costs and revenues of moving grain by rail. His report showed that the railways had lost $103 million carrying grain in 1974. Snavely was later commissioned to update his figures, finding that the losses had risen to $244 million by 1980. The Snavely inquiry overlapped Hall’s work, and by the time the two commissions had reported, it was becoming clear that the long-denied losses were real and that the railways would have to be made financially whole.

While some right-wing farm groups – notably the newly formed Palliser Wheat Growers Association and an ad hoc group of farm organisations called the Prairie Farm Commodity Coalition – had already begun to finger the rates as a problem, and to press for changes, it was to the larger and more representative Western Agricultural Conference (WAC) which government looked for policy direction. In 1979 this body boldly declared that there should be a sharing of future railway cost increases between the farmers and the government. It looked, therefore, as if progress to resolve the issue might be possible.

Then in quick succession came the 1979 election which brought the short-lived Clark government to power, and the 1980 election which brought back the Liberals. Lang had lost his seat in 1979, and the 1980 election returned only two Liberals in the four western provinces, both of them urban seats in Winnipeg. Having no representation from the West, prime Minister Pierre Trudeau appointed two senators: Bud Olson, from Alberta, as Minister of State for Economic Development, and Hazen Argue as Minister Responsible for the Canadian Wheat Board. The latter, a former NDPPer, was an implacable supporter of the Crow regime. However, Trudeau also made what proved to be a fateful step of appointing Jean Luc Pépin as Minister for Transport. Pépin took an unexpected interest in the Crow file and he and his deputy, Arthur Kroeger, undertook a round of meetings with western interests through 1980 to gauge support for change. They returned with a significant degree of consensus and, convinced that change was possible, took their findings back to Cabinet. It was to no avail. The matter went before both several cabinet committees and full Cabinet, but failed to gain support.

And that, it seemed, was that. At this point, however, fiscal reality intervened. As Kroeger put it, “what finally determined the Cabinet’s course of action was not what ministers would have liked to do, but what they could afford” (Kroeger, 62). Following the near-crisis in grain movement in the late 1960s, the federal government, in 1972, had been forced to buy 2000 hopper cars just to keep grain moving. However, that was only the beginning. By 1980, the government had purchased a total of 8000 rail cars, and had provided a total of $170 million in capital grants to rehabilitate the western rail network. Meanwhile, the branch line subsidies continued to grow, and at the same time, railway transportation capacity overall was becoming constrained, particularly to the West Coast – a situation that threatened havoc throughout the whole economy. The government, therefore, did an about face, and committed itself to addressing the Crow issue, appointing Clay Gilson, a well-known and highly respected professor of agricultural economics from the University of Manitoba, to conduct negotiations with the various western agricultural interests to develop a way of dealing with the Crow issue. He started his work in the spring of 1982, and by June had submitted his final report. The report recommended that the federal government absorb the railways’ current annual financial shortfall on grain (which the report set at $650 million), that future cost increases be shared between the federal government and the farmers, and that task forces be established to work out the implementation details of the package.
This, more or less, was what happened, although not without bitter negotiations over some of the details, notably the issue of whether the federal government subsidy would be paid to farmers or to the railways. The pro-market forces in this debate wanted the subsidy paid to the farmers, with the actual freight rates established by negotiation between shippers and carriers, and individual rates varying to reflect the efficiencies of elevator size and location. The proponents of a more regulated regime wanted the subsidy paid to the railways, and the freight rates set by regulation, and varying only by distance. In the end, the pro-regulatory forces won this debate. Hence, on November 14, 1983, The Western Grain Transportation Act (WGTA) was passed, ending the Crow regime, and replacing it with a set of compensatory administered rates set on an annual basis by the Canadian Transport Commission. The Crow was now history.

Although the passage of the WGTA marked the end of the Crow, and terminated the railways’ losses on grain, it retained a tight control on grain freight rates, setting them just to cover costs. The WGTA regime was to last for 10 years, by which time government deficits and international trade considerations forced the government to end ongoing payments to the railways. In 1994, the WGTA was repealed and the obligation to the farmers was “bought out” by a one-time payment of $1.6 billion. Following the passage of the Canada Transportation Act (1996), the Canadian Transportation Agency (CTA) was charged with setting grain freight rates based on distance, known as the Maximum Rate Scale, but now these costs were borne entirely by shippers.

The Estey Review (1998) and the Kroeger process (1999) represented the federal government’s attempt to find a new competitive balance for the grain handling and transportation system. Although Justice Estey had warned against “cherry-picking” his recommendations, this is exactly what happened. The CWB was not reformed and the amendments to the Canada Transportation Act replaced the CTA rail freight rates were replaced with a Maximum Revenue Entitlement (MRE). The MRE is based on the railways activities in the 2000-2001 crop year.

With farmers paying the full freight rates, incentives were created to modernise the grain handling and transportation system, causing the number of country elevators to fall from 1,578 in 1990 to 336 by the end of 2007 (Canadian Grain Commission, 2008). The price of grain in the prairie provinces fell, encouraging livestock production. A shift in production patterns saw grains not formerly included in the Crow regime increase, and exports of raw grain decrease.

The MRE incorporates flexibility to reflect larger crop movements (volume and distance), pricing flexibility of the railways with respect to rail car numbers, seasonality, etc. and a formula to adjust for inflationary changes in rail input costs. The pricing freedom of the railways is more illusionary than real because of the MRE is calculated at the end of the crop year. If the railways exceed the MRE, they are assessed fines and required to repay the difference. In effect, the MRE amounts to de facto rate regulation with some premiums and discounts for car numbers.

The MRE is a legacy of just over a century of freight rate control for western grain, and as the “residual western grain exceptionalism” that survives over one hundred years of regulation. Unlike all other commodities in Canada, grain transport has a level of protection that is available to no other traffic. So is it a benefit or a curse to the industry? Two perspectives on this question are provided for the reader to consider without prejudice.

**The Case for Ending the MRE**

Unlike the Crow rate, the MRE permits some adjustment for inflation, but it contains many of the drawbacks of that misguided transportation policy. Space does not allow for a full discussion of the implications of the MRE, but five distortions are identified.
Rate regulation discourages efficiency enhancing investment and technological improvements in grain handling. The Crow caused boxcars to be used in Canada long after they were abandoned in the US. Today, Canadian grain is carried in hopper cars that have been replaced by more efficient cars in the US. It is impossible to know how the railways set investment priorities, but opportunities to improve lower yielding traffic are unlikely to be seen as important as investment in more lucrative freight.

The MRE calculation, which dates back to costing in 1994, includes no provision for the movement of grain in containers. Source loading of containers with grain on the Prairies is discriminated against by the MRE, in favour of transloading at the coast. This adds cost and removes the benefits of traceability and product specificity that source loading containers could provide.

If the level of the MRE is so low that grain shippers pay less than their total costs to the railway, or so low that the railways earn less than their cost of capital, other commodity shippers must pay more to pick up the shortfall. The higher freight rates are equivalent to an implicit export tax on all other rail borne traffic.

High-fixed-cost network industries with strong seasonality can only operate under a revenue cap by rationing supply during the period of peak demand (i.e. grain harvest). Consequently, as Prentice (2015) illustrates, customer service complaints are chronic. Moreover, customer service failures at the beginning of the supply chain get translated into customer service failures for the end receiver. The result is that Canadian grain earns a worldwide reputation for unreliability that leads to price discounts and lost sales. Unreliable service is destined to continue for as long as peak demand pricing is prevented by the MRE.

Markets and commercial contracts work well throughout the Canadian economy. The MRE prevents the normal back and forth of negotiation between the railways and the large grain handling corporations to establish normal incentives and penalties related to performance. The MRE leaves grain shippers with nothing but the common carrier obligation and the remedies of the CTA to deal with service issues.

Western grain exceptionalism has created a remarkably flawed system that cannot make the necessary adjustment to volatile changes in crop production, accommodate unpredictable shipping and market conditions or generate the revenues for investment in the system essential for the international competitiveness of Western Canada. The MRE did not come about because of any reasoned policy or national necessity. It is an anomaly in what is otherwise a free market economy should end, and with it the exceptionalism of Western grain transportation policy.

The Case for Preserving the MRE

To begin with, it must be appreciated that the deregulation of transport over the last half century has taken us back toward the environment that existed ca. the late 1880s, when “the railways themselves determined the level of freight rates, the charges for individual shipments, and the quality of their services” (Currie, 5). It is true that there is both competition in transport and regulatory safeguards that were not present in the 19th c., but the general trend, from the 1950s to the NTA 1967 to the CTA 1994, has been contrary to the trend of the previous half century which saw shippers and other members of society demanded ever stronger controls on the railways. While this trend undid what was widely recognised as too tight a regulatory regime, the chorus of criticism that emanated from the shipping community during the 2008 Rail Services Review raises the question as to whether the pendulum of deregulation may have swung too far. For example, the Western Canadian Shippers Coalition (WCSC) alleged that “market forces” – which the Canada Transportation Act describes as “the prime agents in providing viable and effective transportation services” – “are in reality market dominance by rail carriers.” The Western Grain Elevator Association (WGEA) echoed this sentiment, claiming that, “because there is no competition and no commercial market for rail freight in the grain trade, it needs to
be controlled by regulation or legislation.” The lack of competition was also cited by the Canadian Canola Growers, the Grain Growers of Canada, the Shipping Federation of Canada, the Alberta government, the Canadian Industrial Traffic League, and the Forest Products Association of Canada.

More dissatisfaction emerged from the grain industry when 2013 brought a record crop which was beyond the railways’ capability to move. It was not, of course, the railways’ fault. The winter of 2013/14 was the coldest in over a century, and there is no question that moving a record crop during a record winter cannot be done. However, the criticism did not stop after the winter of 2013/14 was long gone. In November of 2014 the WGEA was still complaining that: “The railways have been increasing their profitability by reducing their capacity, which means we can’t get the rail cars we need. Even in warm weather we’re not getting the service we need. So the government must get involved with meaningful sanctions.” Andrew Paterson, CEO of Paterson GlobalFoods, charged that “CN and CP are not providing timely service.” The grain industry, he went on, “is a captive shipper” and “has no options” other than rail” (MacDonald).

CP Rail had done nothing to assuage these sorts of concerns. In the spring of 2014, the company’s CEO acknowledged that bulk commodities had been “modestly” affected by the severe weather but said that container traffic had not, “[b]ecause that’s one commodity that we’re sensitive to. If you miss, you miss. It’s not like grain or it’s not like coal, [where] if you’re a little bit late you’re still going to haul it” (Atkins). Whether or not this comment meant that CP Rail prioritised container traffic over grain is not particularly important. What is important is, however, to realise that, if it did, it would have been a completely rational and appropriate commercial decision, and precisely what the Canada Transportation Act policy environment instructed them to do. It is a fundamental economic principle that when resources are in short supply, they are to be devoted to the demand that yields the highest return. In short, having created a commercial system, no one should be surprised when commercial decisions are made. However, whether a decision which is CP’s best interest, is also in the best public interest, is another matter. Economic theory assumes that, in a free enterprise economy, the “invisible hand” of the market gets around this problem, but even Adam Smith realised that it does not always do so.

While the point of contention in 2008 and 2013/14 was service levels, market power can also be an issue when it comes to rates – and they are particularly an issue in the case of the long-recognised case of commodities that are highly dependent on rail – the so-called “captive shippers” – where the railways and their customers do not meet as equals in the market place.

The intent of the MRE is to guard against exorbitantly high rates, but to provide flexibility beneath the maximum to allow rates to vary with market forces: volumes, demand, capacity constraints, and so on. From this perspective, and given the strong prima facie case for the power imbalance, the MRE does not seem like such a bad idea. There is a legitimate question as to whether the maximum is set too low and thus incurs the problems discussed above. If it is, then the question is whether the remedy should be to revise it upwards, or to terminate it.

The question of “why grain” when no other commodity is protected in a like manner is a bit more complex, but one can start by asking why such distinguished people as John Brownlee and William Turgeman saw the western grain industry as a national enterprise. That is a question beyond the scope of a short paper like this one to address. Suffice it to say that all countries intervene in agriculture, and they do so because a healthy agricultural sector is essential for its survival. In a country like Canada, which was said by Mackenzie King to have “too much geography,” it is surely not strange that such intervention would be directed at transportation. Whether this kind of protection is still needed, or whether grain production in the west still possesses, in any way, the status that Brownlee and Turgeman saw, is debatable. But, for over a century, Parliament has operated on the premise that it does, and while that premise could,
and should be debated, there is a strong argument that, in the meantime, the MRE should remain as a safeguard that the grain industry would be ill-advised to surrender.

Conclusion

A conclusion that emerges from this brief review of “western grain exceptionalism,” is that Canadian grain transportation policy still has outstanding issues. The continuing presence of rate control in the form of the MRE is a controversial issue that has both its defenders and its opponents. It awaits further consideration and either revision, removal, or retention. And the question of whether regulatory intervention is warranted to counter an imbalance of bargaining power requires more analysis before that question is settled. As with transport policy in general, the discussion of grain transportation issues is not over.

References


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