Intelligence MEMOS

From: Benjamin Dachis

To: The Hon. Omar Alghabra, Minister of Transport

Date: May 15, 2023

Re: **Budget 2023 Interswitching Changes will Derail Supply Chains**

Ottawa's 2023 Budget re-introduced a controversial railway policy abandoned in 2017. For the next 18 months, railway customers in Alberta, Saskatchewan and Manitoba will have access to extended interswitching. This change will make Canada's supply chain issues worse, not better.

Interswitching is a requirement under the *Canadian Transportation Act* that within a certain distance of an intersection point between rail lines, shippers may request that rail companies pick up their product then hand off to another carrier on another line for long-distance transportation. The Canadian Transportation Agency, a transport regulator, sets regulated rates for this service. Currently, shippers within 30 km of an interswitching point may request interswitching service.

The budget amendments extend this distance to 160 km. This is the same policy change the previous government introduced between 2014 and 2017. Re-introducing a longer distance was one of the recommendation of the National Supply Chain Task Force in 2022.

The past change to a similar threshold meant that many more shippers in Prairie Provinces had the right to seek interswitching rail services. The same likely applies now.

The move towards heavier regulation may benefit some shippers further from switching points. But it comes at the expense of all other rail users, which creates higher risks of delay for other critical goods.

More traffic travelling at prices set by regulation, and not by the market price, or opportunity cost, of a specific line, means congestion may result. If regulations cause railways to charge less than the marginal cost of access to a rail line, the likely long-term result is less investment in rail lines and more congestion. More congestion caused by grain shippers affects other users, leading to more likely supply chain snarls in other goods.

In sum, when one type of shipper pulls the regulatory cover their way, it negatively affects others by aggravating congestion – a classic negative externality. The solution on highways is for the highway owner to charge a price on users that covers both the cost of the individual driver and that driver's effect on others.

There is no negative congestion externality when a single entity controls all vehicles on a line and charges prices for customers according to market demand. A rail company, for example, will internalize the economic cost of adding one vehicle in the context of the others it also owns. Similarly, an airline that operates at an airport can trade off the value of tight turnarounds for connections, which means many planes arriving and landing at the same time, with the risk of delays given the multiple flights.

The potential congestion caused by extended interswitching could harm system efficiency for other energy, resource, and shipped products. The requirement that more rail traffic will be charged at the regulated interswitching rate means railways cannot charge the optimal rate to balance congestion with access. The increase in congestion caused by interswitching may also harm other shippers, such as manufacturers of other goods, that may have based their location decisions on the original interswitching thresholds. This is an example of how competition takes many forms – and includes the long-term location decisions of shippers. Thus, the interswitching change undermines long-term competition.

The stated aim of the government's policy was to "support competition among rail carriers." However, the comprehensive analysis of the previous interswitching experiment by the Emerson panel found that the pilot was ineffective at spurring competition. All sides need to bring evidence to the table as part of evaluating interswitching changes. A clear understanding of the direct consequences of extended interswitching and existing policies should inform future policy action.

The interswitching distance extension did little for other sectors such as forestry or mining, which are often further than 160 kilometres from an interswitching point. The government should stick with the compromise solution it developed after the previous extended interswitching regime ended. Under the long-haul interswitching regime and its dispute resolution mechanism, in addition to comprehensive interswitching within 30 km of a junction, railways are able to internalize the effect of interswitching across all customers. That helps solve the overall congestion problem while alleviating concerns about shippers with access to only one railway.

The government should reconsider its proposal for an extended interswitching pilot.

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