THE CANADIAN CHAMBER OF COMMERCE
LA CHAMBRE DE COMMERCE DU CANADA

Pillar #3: A Competitive Regulatory and Fiscal Environment

Introduction

Transportation is a value-added sector and an economic enabler for the entire Canadian economy, allowing businesses to develop, to grow, to create jobs, and to compete. The government understands transportation's importance. It has put in place many positive initiatives and policies over the years, but these efforts are piecemeal and are missing a fundamental element: a long-term strategy. Our transportation infrastructure needs major investments while our transportation regulatory environment – with its wasteful tax and operating constraints and split responsibilities between levels of government – must be updated.

Last year the Canadian Chamber of Commerce and a coalition of 22 business associations presented a framework for a *National Transportation Strategy*. After broad consultations we determined that to build the safest, most effective and sustainable multimodal transportation system, and to make Canada a gateway into North America, this essential *Strategy* should to be based on four guiding pillars:

- A North American vision,
- A multimodal transportation infrastructure investment strategy,
- A competitive regulatory and fiscal environment, and
- An economically, environmentally, and socially sustainable plan.

The *Strategy* does not need, nor do we have the luxury of, five years to be put together. Rather, we need leadership from our government and practical recommendations for putting the *Strategy* into action now.

This report builds on the *National Transportation Strategy* and gives specific recommendations to the federal government on how to carry out Pillar #3: *A Competitive Regulatory and Fiscal Environment*. By the end of 2009, we will release a detailed report on the last pillar.

A National Transportation Strategy

Pillar #1: A North American Vision

Pillar #2: A Multimodal Transportation Infrastructure Investment Strategy

Pillar #3: A Competitive Regulatory and Fiscal Environment

The safest and most effective multimodal transportation system, one that is a competitive gateway for North America, needs an infrastructure platform that can handle the movement of goods and people within Canada. But for Canada's transportation system to reach its full potential, its infrastructure platform must be coupled with a competitive regulatory and fiscal environment in which supply chain stakeholders can operate. A competitive regulatory and fiscal environment would encourage private sector investment in transportation infrastructure, while providing the assurance of a level playing field between countries to which that investment may otherwise flow.

A given supply chain may contain a marine or air carrier, a port of entry, intermodal hub or distribution centre, a rail service provider, and a truck before the cargo makes it to its final destination. Similarly, a traveller may use a combination of public transit and international and domestic carriers and transfer facilities. In both cases, one inefficient player can affect the entire supply chain and travel system.

Given the multimodal nature of the transportation system and recognizing the distinct advantages and competitive situations of each mode of transportation, the federal government should develop a national, non-discriminatory, transparent, and consumer focused regulatory and fiscal environment that fosters competition in the transportation system.

To put in place a competitive regulatory and fiscal environment, the Government of Canada must amend regulations and legislation that give one carrier or port of entry or embarkation an advantage over another or that discourages private sector investment in the transportation system. The government should create an environment that is conducive to competition between modes of transportation and between domestic and international carriers. Supply chain services providers should compete on their distinct advantages without government influence. Policy makers should look also at programs such as foreign trade zones that could enhance the efficiency of our supply chains and contribute to developing value-added sectors in our economy.

Putting into action a competitive regulatory and fiscal environment meets our *National Transportation Strategy's* key objectives of:

- Developing the safest and most effective multimodal transportation system,
- Making Canada a competitive gateway for inbound and outbound trade and travel between North America and the rest of the world,
- Having an environmentally and socially sustainable transportation system,
- Creating a productive partnership with the private sector, and
- Building on current and past government initiatives.

Fixing the Regulatory and Fiscal Environment

To put in place the safest and most effective multimodal transportation system and be a North American gateway, the regulatory and fiscal environment should encourage competition and infrastructure investment. The divesture and devolution of transportation infrastructure and modes of transportation over the last number of years has made the transportation sector more effective and responsive to customer needs. Recently passed amendments to the *Canada Marine Act* encourage ports to invest in and expand their infrastructure to keep up with demand. And recent *Blue Sky* agreements signed between Canada and other major economies such as the United States and the European Union provide more options to shippers and travellers. Despite these positive steps, the Canadian government has not yet made a clear commitment to overhauling the regulatory and fiscal burden placed on transportation service providers. Here are examples of regulatory problems in the Canadian transportation system:

- In the air transportation sector, carriers and airports are burdened with taxes and charges. The federal government continues to collect airport rent despite the fact that the amount of the rent now considerably exceeds the original value of the assets that were transferred over to airport authorities. These costs result in increased landing fees and higher airline ticket prices and cargo prices. Carriers and airports are also discouraged from reinvesting in their infrastructure. In 2007, Canada's airports paid $300 million in airport rent to the federal government and since 1992, paid $2.5 billion for assets that were worth $2 billion at the time of transfer. Canadian airports are losing business to U.S. competitors that are not subject to high airport rents. Almost two million Canadians travel through the Buffalo Niagara International Airport. The airports in Bellingham, Washington, Grand Forks, North Dakota and Plattsburgh, New York are undertaking similar strategies to poach Canadian travellers from Vancouver, Winnipeg, and Montreal. For example, the Plattsburgh airport is one hour from Montreal and is not subject to property taxes, federal rent, or interest on debt. On the other hand, the Montreal airport pays $60 million in government rent and taxes annually in addition to $34 million in municipal taxes and $70 million for interest on debt.

- In some cases, the regulatory environment limits the amount of transportation options available to users. For example, the government has not committed to maintaining the St. Lawrence Seaway beyond 2018, discouraging marine services providers from investing in new infrastructure and assets, some of them with 40 year life spans. To be a competitive gateway to North America, carriers and users need effective access to all major trading routes. As Canada increases its trading relationship with Asia and Europe, the importance of the St. Lawrence and Great Lakes trade corridor will only grow.

- In the trucking sector, differences in trucks weights and dimension standards differ from province to province creating a patchwork of regulations for carriers driving across the country.

- In the rail sector, capital cost allowance (CCA) rates for rolling stock do not reflect the true life of the asset. For example, the CCA rate for rolling stock in the United States is 30 percent compared to 15 percent in Canada meaning U.S. railroads can fully depreciate their assets in 8 years versus 20 years for Canadian railways. As a result, Canadian railroads are at a competitive disadvantage relative to their U.S. counterparts.

- Some ports of entry are limited by how much they can grow as a result of Canada Border Services Agency (CBSA) customs services. For example, a port of entry that determines an interest or receives a commitment for services from a specific carrier to provide new services in an international market must pay CBSA for customs services. These services could cost hundreds of thousands of dollars. Yet some ports of entry do not have to pay because the services are assigned based on a grandfathering model. CBSA recently completed its review of the air sector and will now look at each new service offering on a case-by-case basis to assess the economic impact of paying for the service through CBSA or charging a cost recovery fee. Inequities still exist in the marine and rail sectors.

- As a result of shared land and waterways, transportation regulations in the United States impact Canada's transportation sector and competitiveness as a North American gateway. Changes to ballast water regulations and air emissions at both the state and national level in the United States, which create a patchwork of regulations in shared bodies of water, could cripple domestic shipping in Canada. Differences in services fees and diesel fuel taxes also put U.S. carriers at competitive advantage over Canadian transportation services providers.

In addition to fixing current regulatory barriers in the transportation sector, as part of a *National Transportation Strategy*, the federal government should commit to maintaining a competitive transportation sector where each mode of transportation competes based on its own distinct advantages.

Putting in place a competitive regulatory and fiscal environment in the transportation sector meets the objectives of the Canadian Chamber's *National Transportation Strategy*. Goods and people would be able to move more efficiently by using the infrastructure platform to its full capacity, leaving the decision making for appropriateness of mode in the hands of the consumer.

Recommendation

- The federal government should commit to put in place a competitive regulatory and fiscal environment in the transportation sector. As part of this initiative, the government should:
    - Eliminate airport rent and that an immediate interim step be taken to amend the rent formula for all airports by removing debt financing costs and the Airport Improvement Fees used to offset the capital requirements from the definition of revenue for the purpose of calculating the rent due,
    - Commit to maintaining the St. Lawrence Seaway past 2018,
    - Work with the provinces and territories to establish national regulations in the trucking sector,
    - Align CCA rates in the transportation sector with their actual asset life,
    - Put in place an equitable CBSA core services and cost recovery model for all modes of transportation, and
    - Work with the U.S. government to make sure that Canadian transportation-related regulations are compatible and competitive with those in the United States.

Putting in Place Foreign Trade Zones

To grab a greater share of global logistics and be a competitive gateway for North America, Canadian businesses need to excel in value-added manufacturing, distribution, storage, and transportation. Foreign trade zones (FTZs) encourage businesses to take advantage of these opportunities and expand a country's trade position. As part of a *National Transportation Strategy*, the Canadian government should consider putting in place a globally competitive and understood FTZ program to spur the use of Canadian gateways and encourage value-added manufacturing for domestic and re-export opportunities.

The U.S. Foreign-Trade Zone Board defines an FTZ as a physical area within the United States that is considered outside the country for customs purposes. FTZs encourage value-added manufacturing and processing by allowing participating companies to source low-cost materials and input them into final products. The playing field with competitors in low-cost countries becomes more levelled as companies operating in FTZs can defer certain duties and federal sales taxes to improve cash flows. Input materials can then be assembled into final products and re-exported for final sale or sold domestically in the United States.

Besides attracting economic activity that would be done offshore, FTZ add to the economic activity of a given region. According to the U.S. Foreign-Trade Zone Board, general purpose zones and sub-zones attracted $410 billion worth of shipments in 2005 compared to $305 billion the previous year. Over 2,500 firms operate in FTZs in the United States, employing 340,000 people. In addition to the United States, there are over 500 FTZs worldwide, yet Canada does not have one of it own.

Instead, Canada has the Export Distribution Centre (EDC) and the Duty Deferral programs. Each program has its own benefits but even combined, they do not make a true FTZ program. Canada Revenue Agency's EDC program allows participating companies to import input materials duty and tax free but restricts value-added manufacturing to 10 percent. The Duty Deferral Program under Canada Border Services Agency (CBSA) allows participating companies to defer duty and certain taxes on imported goods until they are exported. And like the EDC program, the amount the imported goods can be changed by the valued-added manufacturing process is restricted. The duty relief option of CBSA's program gives more flexibility to value-added manufacturing but participants can only defer the duties, not the taxes. And each of these programs is administered through a separate department requiring an interested company to file each program separately.

Canada's programs do have key strengths and they should be leveraged to put in place a comprehensive FTZ program. For example, the EDC program's application process is seen as user friendly, taking on a more administrative approach rather than the lengthy governor in council or legislative process adopted by the U.S. government. Secondly, the EDC programs enforcement mechanism follows an auditable accounting system that keeps track of imported materials. Users then have the flexibility to move production and process facilities to the most effective spot.

The federal government should merge the EDC and Duty Deferral programs to form a comprehensive FTZ program and tweak them to provide users with the ability to source input materials, defer duties and federal sales taxes, encourage valued-added manufacturing to take place, and allow for domestic and re-export opportunities.

A comprehensive FTZ programs meets the objectives of the *National Transportation Strategy*. FTZs could increase Canada's competitiveness in global markets and attractiveness as a gateway for inbound and outbound trade by encouraging valued-added manufacturing and the use of our transportation system. All ports of entry including inland ports could benefit from a globally competitive FTZ program. An effective FTZ program will ultimately increase Canada's competitiveness in the global supply chain.

Recommendation

- The federal government should put in place a comprehensive foreign trade zone program that:
    - Merges the EDC and Duty Deferral programs into one FTZ program,
    - Follows the EDC's administrative approval process and auditable accounting enforcement mechanism, and
    - Removes the restrictions on valued-added manufacturing within the FTZ.

Conclusion

For the transportation sector to be effective and for it to be a competitive gateway to and from North America, it needs an infrastructure platform that can handle the demand placed on it by businesses and travellers. Pillar #2, *A Multimodal Transportation Infrastructure Investment Strategy*, put forward specific recommendations for strengthening Canada's transportation infrastructure platform. But for the benefits of those to be realized, Canada's transportation system needs a competitive fiscal and regulatory environment to operate within. The Canadian Chamber's *National Transportation Strategy* is meant to bring the infrastructure and regulatory components of transportation together to benefit business and all Canadians.

Recommendations

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Putting in Place Foreign Trade Zones

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- Merges the EDC and Duty Deferral programs into one FTZ program,
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