An Assessment of North American Container Cabotage Regulations: The Impact on Canadian Operations

FINAL REPORT

Prepared for:

The Province of Manitoba
Transportation and Government Services

Prepared by:

Erica Vido
Dr. Barry Prentice
Jake Kosior

The Transport Institute
University of Manitoba

March 2001
An Assessment of North American Container Cabotage Regulations: The Impact on Canadian Operations

FINAL REPORT

This report has been financially supported by the Manitoba Department of Transportation and Government Services. The views expressed do not necessarily represent those of the Department. The Department provides no warranties as to the validity or accuracy of the information presented herein.
An Assessment of North American Container Cabotage Regulations:  
The Impact on Canadian Operations

TABLE OF CONTENTS

Executive Summary ................................................................. 4  
1.0) Introduction ........................................................................... 6  
2.0) Review and Comparison of Canadian and U.S. Cabotage Regulations .......... 8  
   2.1) U.S. Cabotage Regulations ..................................................... 8  
   2.2) Canadian Cabotage Regulations ........................................... 8  
   2.3) Customs Post Audit System .................................................. 10  
   2.4) Penalties .............................................................................. 11  
   2.5) Summary ............................................................................ 12  
3.0) The Impact on Canadian Operations from Current Regulations ................ 13  
   3.1) Brief Overview ..................................................................... 13  
   3.2) The Effects on Network Efficiency ......................................... 14  
   3.3) Protection of Canadian Industry .......................................... 15  
   3.4) Impact on Freight Rates ...................................................... 16  
   3.5) Government Fiscal Considerations ...................................... 16  
   3.6) Environmental Considerations ............................................. 17  
   3.7) Are the Railways in a Conflict of Interest? ............................. 17  
4.0) Cabotage Liberalization – Some Ideas for Reform .............................. 20  
   4.1) Relaxing Cabotage Restrictions – Impact on Shippers .................. 21  
   4.2) Relaxing Cabotage Restrictions – Impact on Carriers ................. 21  
5.0) Conclusion ............................................................................ 23  
References .................................................................................. 25  
Appendix .................................................................................. 26
An Assessment of North American Container Cabotage Regulations: 
The Impact on Canadian Operations

EXECUTIVE SUMMARY

Cabotage describes a transport activity that was first applied to ocean vessel shipping, specifically the pick-up and delivery of goods along a coastline. These regulations have been a part of North American history from as far back as 1651 with the implementation of the Navigation Acts. Today, the Canada Customs Act regulates the carriage of all domestic cargo by the different conveyances available to shippers. The same is true for the U.S.; cabotage regulations are outlined in customs laws. While these laws are in place to protect domestic carriers from international competition, changes in the global marketplace, resulting from deregulation and shifting trade patterns, justify the need to revisit the effects of cabotage regulations on efficiency and economic growth.

Container cabotage is unique for two reasons. First, the cabotage issues explored thus far include aviation, trucking and marine transportation and involve both immigration and customs regulations. Container cabotage regulations deal only with customs. Second, the current literature on cabotage investigates bilateral relationships between two nations. Container cabotage, on the other hand, is distinct because it affects third party relationships. International ocean carriers that serve North America call on both Canadian and U.S. ports when moving containers around the world. Differences in how the U.S. treats a third party and how Canada treats a third party affects the competitiveness of Canadian goods in global markets.

Canadian shippers could benefit from access to a larger, more diverse pool of intermodal containers and a commercially competitive transportation sector. Under the current regulatory environment steamship companies are dissuaded from positioning empty marine containers to Canada’s interior and are unable to compete in Canadian domestic services. As a result, shippers in Canada, particularly rural or remotely located shippers, have a difficult time accessing intermodal equipment and are thus limited in their flexibility to choose alternative modes and routes. Furthermore, empty repositioning costs are frequently passed on to shippers, reducing their competitiveness in export markets.

Carriers are ill affected by these regulations because they are limited in their abilities to reposition equipment to demand areas, preventing them from operating in the most cost effective manner. As a result, Canadian operations are made less efficient because of container cabotage regulations.

The most challenging problem with the regulations is that they hinder operational efficiency. Consequently, container service is inherently more costly and less flexible, and thus harmful to shippers. With relaxed container cabotage restrictions, steamship companies could operate in a more cost effective manner because they can more ably reposition equipment to demand areas. Shippers will benefit by a reduction in freight
rates, an increase in available rail capacity as well as improved competitiveness among carriers. Furthermore, reducing empty repositionings will decrease the amount of fuel burned by the transportation industry. This can assist Canada in meeting its Kyoto commitment to reduce Greenhouse Gas Emissions.
An Assessment of North American Container Cabotage Regulations: 
The Impact on Canadian Operations

1.0) Introduction

The word cabotage comes from the French verb, *caboter*, which means to coast, and refers to ocean pick-up and delivery of goods along a coastline. In modern practical terms, it refers to the restriction of foreign carriers from entering into domestic services. Many centuries before the airplane was invented, sailors from northern Europe en route to the Mediterranean Sea would stop along the coast of Portugal to drop off and pick up cargo and passengers, making their trips more profitable. In an effort to protect their own sea trade, the Portuguese restricted this practice to vessels that were locally owned and operated. As a result, they were the first to develop cabotage laws.

Cabotage regulations have been a part of North American history since the implementation of the *Navigation Acts* (1651). These acts regulated the shipping of goods in Great Britain and its colonies by restricting this trade to British and colonial ships. It was justified in terms of ensuring a sufficient marine capacity in order to meet defence needs. While cabotage became a regulated activity in ocean vessel shipping through the restrictions of foreign flagged vessels on a particular coastline, the term came to be used in description of all forms of transport activity that took place on sovereign territory by a foreign conveyance. As alternative modes of transport developed, the same protections were transferred to them. Today, both Canada and the United States (U.S.) outline cabotage regulations in their respective *Customs Acts*.

The literature concerning cabotage deals primarily with aviation, trucking and marine transportation. No literature on container cabotage currently exists. The consistent theme among the available literature relates to bilateral relationships between two different countries. The container cabotage issues examined in this study focuses on third party relationships. International ocean carriers that serve North America call on both Canadian and U.S. ports when moving containers around the world. Differences in how the U.S. treats a third party and how Canada treats a third party affects our competitiveness in global markets.

The word “cabotage” does not appear in the *Customs Act* as administered by Canada Customs and Revenue Agency (CCRA). Cabotage activity is, however, duly addressed. The act treats a foreign-based container as an import, albeit a temporary one, under tariff item 9801.10.00. Generally, the purpose of these cabotage regulations is to protect the domestic transportation industry from foreign competition. If domestic transportation were completely restricted to solely domestically owned equipment, shippers in Canada’s interior would be plagued with higher freight costs and access to intermodal equipment would be dismal. However some cabotage moves are acceptable. Current legislation permits carriers and container operators to reposition containers within Canada while
carrying a payload, providing them with opportunities to generate revenues on their assets.

Cabotage restrictions on international containers are subject to ambiguities that make compliance difficult. Misinterpretations of these regulations are a source of economic inefficiency and have important affects on all players in Canada’s transportation system. This paper outlines the legislation in both Canada and the U.S. that govern cabotage activity for foreign-based intermodal containers. An analysis of these regulations on Canadian operations in a Canadian, North American and global context follows. Finally, some possible cabotage reforms and their expected market impacts are considered.
2.0) Review and Comparison of Canadian and U.S. Container Cabotage Regulations

2.1) U.S. Container Cabotage Regulations

Containers in the U.S. are designated as “instruments of international traffic” and are exempt from the application of customs laws as laid out in Title 19 of the U.S. Code (Customs) in section 1322 (a). Foreign-based containers designated as instruments of international traffic can enter the U.S. without payment of any duties or taxes and remain there for a period not exceeding 365 days from the date of their importation. The container is deemed to remain in international traffic during this time and may engage in unrestricted point-to-point domestic moves. If the container remains in the U.S. for a period exceeding 365 days it will be deemed to have been diverted from international traffic and the appropriate duty and taxes must be paid.

Containers must also follow the coastwise laws of the U.S. A U.S. flagged vessel must carry a foreign-based container loaded with domestic U.S. goods for point-to-point moves along a U.S. coast or river. The coastwise laws, in this case, regulate the carriage of the goods, not necessarily what is containing the goods. The mode of transport moving the container determines which regulations apply. The container simply “goes along for the ride.”

In the case of failing to export the container after 365 days or of failing to report its diversion from international traffic, the penalty imposed is a sum equal to the value of the container plus the duties and taxes. Should the container be imported, the rates of duty are low – free for most countries. According to U.S. customs officials, the sheer number of containers moving goods into and out of and around the U.S. makes it impractical to track the movements of every container. Effectively, there are no restrictions concerning cabotage moves. The only real restriction is a 1-year time limit.

2.2) Canadian Container Cabotage Regulations

In Canada, foreign-based containers, including any ancillary equipment, are provided for under tariff item 9801.10.00. Containers imported under tariff item 9801.10.00 may enter Canada without payment of duties or taxes. This duty free status is conditional upon the following circumstances: (1) the container is owned or leased and imported by a person who is not a resident of Canada; (2) in normal operations, the container leave from and return to the foreign country; (3) main control of the container is from the foreign country; and (4) the container must leave Canada within 30 days from the date of its importation. This 30-day grace period may be extended, under extraordinary circumstances and at the full discretion of the customs official, to up to 24 months. Extraordinary circumstances include adverse weather, equipment breakdown, legal action involving the conveyance and delays in the delivery of goods to be loaded into the container.
If a foreign container enters Canada for the purpose of import-export moves and fails to leave Canada within 30 days, its duty-free status is forfeit. For integration into the Canadian economy, containers can be imported under tariff item 8609.00.90 and the appropriate duty and taxes paid. Chapter 98 of the Customs Tariff contains provisions for goods that have been previously imported. If it can be proven that a particular container had been previously imported and the duty paid, the provisions in Chapter 98 will permit the re-importation of the container without the payment of any additional duties. Then, each imported container not originating in Canada can exit the country for the purposes of international commerce and can re-enter Canada under tariff item 9814.00.00 duty free, as long as it has not been advanced in value or improved in condition while abroad and CCRA is satisfied that a similar quantity of containers has been exported. Tariff item 9813.00.00 refers to containers that originate in Canada and are used for the international transportation of goods. Containers entering Canada under tariff item 9813.00.00 or 9814.00.00 can leave and re-enter Canada duty-free at any time and move all goods throughout Canada freely and without restrictions. These provisions outlined in Chapter 98 of the Customs Tariff may involve considerable internal controls for container owners and many may not consider employing them.

A foreign-based container may engage in domestic “incidental” operations during its maximum 30-day duration in Canada. The incidental domestic operation must take place totally within Canada’s boundaries over a route that is consistent with the international route, and only minor deviations off this route are acceptable. As well as being incidental to the international traffic of the goods, the transportation service of the domestic goods must not, at any time occur outside the territorial limits of Canada. Additionally, the container must not have entered Canada for the purpose of an in-transit movement through Canada to a point outside Canada.

The act defines transportation “incidental to the international traffic of the goods” as the transportation of goods between points in Canada that occur immediately before or after the container is used for international commercial transportation. It must move in the general direction of the delivery point and follow a route that is similar and consistent with the international load. While “similar and consistent” is subject to interpretation, acceptable cabotage practices are at the full discretion of customs officials.

To elaborate further on these concepts, between import load drop-off point (A) and export load pick-up point (B), the repositioning move must occur with only a minor deviation off of the A to B direct line and the repositioning drop-off need not be anywhere near B, generally it just has to be in direct line (collinear) to it and point A. One can also conclude that “transportation incidental to the international route” will require that the export load to be picked up at point (B) must have been scheduled prior to undertaking any cabotage activity. Furthermore, it can be deduced that doubling back is not allowed, meaning the export load pick-up point (B) must be reached with the repositioning drop-off point in between point (B) and point (A). Furthermore, the length of the move is unrestricted. Also, the direction of the repositioning move is unrestricted so long as doubling back is not occurring. By and large, container-repositioning moves will follow east-west patterns.
Only one point-to-point domestic move is allowed throughout the containers maximum 30-day duration in Canada, because a cabotage move must occur immediately before or immediately after the transportation of the international load.

A foreign-based container entering Canada empty may be used in domestic services on the inward leg of an international journey, provided it enters Canada to pick up a load for export. The export load to be picked up, however, must have been scheduled prior to the time the container enters Canada. As well, the incidental domestic use must follow a route that is both similar and consistent with the destination of the container where the export load will be picked up. Again, the container will be restricted to one such movement during and international journey. The movement of an empty foreign-based container between two points in Canada is not considered transportation incidental to the international traffic of the goods and can be moved to any location in Canada freely and without restrictions.

Another type of cabotage move is the “sufferance warehouse pick-up” sanctioned by CCRA. Frequently, carriers operate terminals, warehouses, or drop yards as intermediate points to consolidate or deconsolidate shipments and to pick-up or deliver goods. After international goods have been delivered to one of these facilities to wait for customs release, any foreign-based container entering Canada in accordance with tariff 9801.10.00, may be used to pick-up or deliver goods from that location, to any location, for the remainder of the 30-day period permitted in Canada. This is allowed provided the container is being used exclusively to complete deliveries of other international goods previously unloaded at the warehouse, or to pick-up and deliver export goods to the warehouse.

Canadian regulations also permit equipment switching for any reason. During transportation, international goods may be transferred from one conveyance to another. There are no limits to the number of times international goods may be transferred to other foreign-based containers. Additionally, there are no limits to the number of times domestic goods may be transferred to other foreign-based containers, so long as each container follows the cabotage regulations set out in the Customs Act. Meaning, during its maximum 30-day duration, the movement must be incidental to the international load and only one such movement is undertaken.

2.3) Customs Post Audit System

All foreign goods entering Canada must be reported at the border and any relevant duties and taxes must be paid before the goods can proceed into Canada. Carriers can apply for Customs Post Audit Carrier status to defer the payment of duties. Several conditions must be met and a bond must be posted. Post Audit Carriers must still report the goods entering Canada at the border but the payment of duties and taxes can be deferred to a later date upon the arrival of the goods to an inland destination in Canada. The Customs Post Audit System allows qualifying companies to transport goods in bond under limited
physical control as long as there exists suitable records for audit by customs officials to ensure the cargo was disposed of according to the regulations set out in the *Customs Act*. The result is faster release times at the border.

A firm that maintains an inventory of containers for shippers to use in international service may be designated as a post audit container operator or container pool operator, provided the company maintains records of containers under its ownership or control from which CCRA auditors can track their movements in Canada.

A cargo container operated under the Customs Post Audit System must follow the same rules as all other foreign-based containers entering Canada under tariff 9801.10.00. That is, they may make one domestic move under load, en route to a repositioning of the container for export. The domestic load must be incidental and must follow a route that is similar and consistent with the international load. This does not apply to a transcontinental or other movement under which a container pool in one part of Canada is merely being supplemented by containers from another pool.

Repositioning a container that is operated by a container pool operator over a route outside the territorial limits of Canada is permitted on condition that: (1) at the time of the containers entry into Canada, it was being used to ship imported goods; (2) the container is being repositioned to pick-up an export load; (3) the route taken is incidental to the repositioning; (4) the equipment used to move the container is of Canadian origin or has been fully duty-paid in Canada; and (5) the container is under the control of the Customs Post Audit System. Containers in Canada under the control of post audit container operators and pool car operators may remain in the country for up to six months (but are still only allowed one point-to-point domestic move for each international load).

All containers are nevertheless subject to the coastwise laws of Canada as well as other regulations that outline the acceptable practices of foreign-based carriers operating in Canada. The origin-destination of the cargo, as determined by the bill of lading, is the principle for cabotage regulations, rather than just the nationality of the container used in the transport.

### 2.4) Penalties

Currently, the maximum penalty for an illegal cabotage move is a fine of an amount equal to the market value of the container. However, CCRA is currently reviewing a proposal to increase penalties for contraventions of the *Customs Act*. A new Administrative Monetary Penalty System (AMPS) is being proposed as part of a modern sanctions program for CCRA. The purpose of this program is to promote compliance with Canada’s customs legislation. As a result, penalties for customs contraventions will increase through a graduated response to non-compliance. Additionally, increased penalties would apply to repeat violators.
2.5) Summary

Canadian legislation limits the amount and type of cabotage moves that may be undertaken by a foreign-based container. Two specific types of cabotage moves are allowed: the repositioning move – solely domestic transport between an import move and an export move; and the sufferance warehouse pick-up – equipment switching at sufferance warehouse stations. The U.S., on the other hand, has no such restrictions on foreign-based containers. The only real restriction imposed by U.S. legislation is a 1-year time limit for completion of its services. These regulations are outlined in the Customs Acts of both countries. For Canada, a foreign-based container is considered a temporary import and no duty is charged during the first 30 days of cabotage activity. It is governed under tariff item 9801.10.00. The U.S. also considers a foreign-based container a temporary import, but for a maximum period of 1 year. No other restrictions are placed on foreign-based containers with respect to acceptable cabotage moves. In both countries, foreign-based containers are subject to their applicable coastwise laws.
3.0) The Impact on Canadian Operations from Current Regulations

Attitudes on the effects of container cabotage regulations in Canada were solicited from industry representatives. Telephone inquiries and a faxed out questionnaire were used to gather information. The specific goal was to determine whether Canadian cabotage rules are viewed as an advantage or disadvantage to Canadian industry. Respondents were asked for their experiences with the current regulatory environment, and to provide some insight on how these regulations affect Canadian operations. In addition, they were asked to consider the U.S. situation and postulate how differences in these regulatory environments may affect operations in Canada.

The respondents can be classified into four different groups: (1) shippers, (2) ocean carriers, (3) container pool operators, and (4) government officials. The views of Canada’s two major railways, CN and CP, are not represented in this analysis. Although they were contacted, they chose not to respond. Many issues raised in this consultation were common to the majority of firms, and differing views were not divided along stakeholder lines. For example, a particular opinion expressed by one shipper may have been shared by some carriers, but not all other shippers and vice versa. What follows is mostly the anecdotal views on several related issues that were expressed by the bulk of the firms involved in this process.

3.1) Brief Overview

Participants were asked to identify the benefits stemming from current cabotage laws. The perceived benefits to firms were modest, but significant. The current regulatory environment enables carriers to reposition containers in Canada while carrying a payload, helping them generate revenues on their assets. In addition, repositioning containers from import points to other areas helps steamship companies take better advantage of export bookings.

Most firms face numerous difficulties in the current environment. All respondents feel the current regulations are overly restrictive, and compromise the ability of ocean carriers to reposition containers to demand areas. The 30-day maximum is viewed as too restrictive. For example, a container pool operator observed that long-term storage beyond 30 days is usually required. In addition, more than one repositioning move should be allowed. A single movement in the vast expanse that is Canada does not allow for triangular or quadrangular strategies that could reduce costs significantly. The inability to re-divert containers in order to take advantage of market variations inhibits the ability of steamship companies to offer competitive rates.

Many steamship companies charge or build empty repositioning moves into their freight rates. Repositioning charges add costs for shippers and consequently reduce their competitiveness in export markets. Shippers also face implicit costs because their flexibility to move goods by containers is limited. Flexibility is lost when shippers are
limited to specific routes, or the required equipment is not available at the desired location in a timely fashion.

Participants were asked to consider U.S. cabotage regulations and speculate how these rules may affect Canadian operations. Generally, differences in U.S. and Canadian legislation are considered to be harmful to Canadian shippers. International container shipping lines are granted the opportunity to move their containers, with multiple use from place to place and without limitation to the means by which the unit is transported, or the place idled. This flexibility in U.S. regulations provides a competitive advantage to remotely located U.S. shippers when moving their freight, because headhaul and backhaul are not strictly discreet between international and domestic movements. U.S. shippers enjoy lower container costs, making U.S. export goods more price competitive in global markets.

3.2) The Effects on Network Efficiency

All participants believe that cabotage regulations are a source of network inefficiency. Regulations that inhibit equipment from being efficiently located to demand areas are a principle cause of the imbalance in equipment availability in several regions of Canada. These regulations increase the magnitude of empty mileage because many containers must be repositioned without carrying a payload. Moving empty equipment consumes capacity and wastes fuel and other resources. If rail carriers were able to reposition marine containers while carrying cargo, it is expected that their available capacity would increase as cargo is diverted from other means, depending on the specific needs of shippers. Administrative costs are another source of network inefficiency. Monitoring and recording the movements of each foreign-based container in Canada is cumbersome and creates additional “red tape” costs.

Current regulations do not reflect the needs of the North American market. The foundations of an efficient transportation network involve a pricing system based on supply and demand. Where containers are needed and how they are moved as instruments of international commerce is supported by landside positioning strategies, which may require multiple movements over a period longer than 30 days. In addition, carriers must have more opportunities to supply empty containers in the locations as they are needed. An efficient and reliable supply chain requires the right equipment to be available at the appropriate time for scheduled export moves. A continual shortage of 20-foot containers exists on the prairies while an excess supply is found in eastern Canada. Under current Canadian regulations, the steamship companies can only reposition containers to demand areas when they have booked export loads. Allowing containers to be used in domestic services would give the steamship companies the means to position appropriate equipment to demand areas in advance of export bookings.

Rural or remote shippers in Canada may benefit most from relaxing the cabotage rules. As long as this market is protected, they are forced to find alternative means to move goods to the seaports (Vancouver, Montreal or Halifax) where the transloading
(“stuffing”) of international containers takes place. More immediate access to equipment in remote locations can avoid the transloading costs at the port and the incidence of shrinkage and damage. Shippers of more fragile cargo are particularly affected by these practices. Accordingly, the closer the equipment supply can be made available to shippers, the better their cost competitive access to international trade lanes will be. An empty container would not have to be positioned from port locations if the international and domestic traffic flows can take container equipment into the vicinity of the shipper.

Relaxing cabotage restrictions can benefit both shippers and carriers. If steamship companies are given the opportunity to generate revenues on their assets by repositioning containers that carry a payload, they will operate in a more cost effective manner, and it is expected that cost savings will be passed on through improved competition to shippers.

Besides the obvious capability of providing a more gainful provisioning of equipment in an otherwise imbalanced market, a more cost effective means of positioning equipment will enhance carrier competitiveness vis-à-vis other shipping origins. Differences in U.S. cabotage regulations have a significant effect on the efficiency of Canadian operations. Steamship lines call at both Canadian and U.S. ports when delivering containers worldwide. If their U.S. operations are more profitable because they have the opportunity of positioning their equipment close to demand areas, empty containers from Canada will flow to U.S. destinations.

3.3) Protection of Canadian Industry

Participants believe that Canadian regulations do protect the domestic container market from foreign competition, but the degree of protection afforded to any other Canadian carriers is negligible. Policies designed to protect the Canadian domestic container market do nothing to advance and maintain the health of Canada’s domestic freight transport system. Furthermore, the group also feels that cabotage restrictions on international containers are unnecessary in protecting Canadian interests, and they present impediments to better and more economical service.

According to several respondents, cabotage restrictions inhibit competition in Canada’s transportation industry. Customs regulations restrict the ability of international carriers to compete for all traffic, limiting the number of operations and alternatives to choose from. A freight forwarder indicated that competitive behavior is hindered because Canada Customs “insert yet another tier of pointless regulation” and several shippers allege that competition is scarce because the playing field among stakeholders is not level to begin with.

When considering the differences in U.S. and Canadian legislation, the affect on Canadian carriers is ambiguous. Domestic container lines enjoy a protected market on goods of Canadian origin, free of any competition from U.S. or international carriers. However, rail transport in the U.S. is more competitive than in Canada. U.S. rail carriers
provide more access to international container equipment for domestic movement. Consequently, Canadian rail carriers’ Canadian operations are less competitive.

The efficiency of Canadian operations is diminished because international carriers are effectively prohibited from competing in Canadian domestic services. As noted by one steamship operator, there are more costs, controls and restrictions associated with Canadian movements than there are in the U.S. Ultimately, these cost differences are passed on to Canadian shippers.

### 3.4) Impact on Freight Rates

A very important issue to consider is the resultant affect on freight rates. Although it was not unanimously agreed that freight rates are directly affected by cabotage restrictions, for many shippers empty repositioning costs are calculated into the rates offered by steamship companies. If these expenses can be mitigated through deregulation, cost savings can be passed on to shippers in the form of lower rates. In addition, domestic freight rates may also be affected. Economic theory dictates that an influx of previously underutilized equipment supply, which becomes available to the shipping public, would put pressure on domestic rates and service to adjust.

### 3.5) Government Fiscal Considerations

Finally, participants shared their perception on the degree of enforcement by CCRA. Enforcement of container cabotage regulations is moderate at best, and many also believe they are unevenly enforced. One foreign-based steamship company openly admitted that containers sometimes undergo 2, 3 or 4 repositioning moves while carrying domestic cargo before arriving at the export pick-up point, and most containers remain in Canada beyond 30 days. Furthermore, their last audit by CCRA was more than 10 years ago. Considering the ever-increasing amount of container traffic in Canada, it is possible that CCRA may have limited resources for this type of enforcement.

The problem in enforcement may be directly related to tracking movements of each individual container. For example, the containers move from mode to mode throughout Canada and may be interchanged between different carriers at a variety of different locations. In many instances no financial transaction may take place between the different carriers. Factor in a number of freight forwarders, container service contractors and other groups that may be involved in container movements, as well as the number of times that the containers are in storage, the task may be quite daunting.

In many cases the return on investment for CCRA may not make it viable to enforce these regulations. Equipment tracking and enforcement requires extensive auditing and oversight, yet operators/stakeholders have access to creative means by which to operate at the fringes of the regulations. In addition, most head offices for international container carriers are not based in Canada, and the regulations may not be known to many of these
companies. Consequently, equipment audits cannot be consistently scrutinized by CCRA. At the end of the day the level of enforcement is the key to whether the regulation is merely a “paper tiger”, or a real rule to be followed.

3.6) Environmental Considerations

Repositioning empty containers uses up more fuel and energy. As a consequence, the Canadian transportation industry produces higher fuel emissions levels. This is an environmental concern and affects all Canadians.

The Kyoto Protocol to the United Nations Framework Convention on Climate Change negotiated in December 1997, establishes a commitment period between 2008 and 2012 in which industrialized nations are to reduce Greenhouse Gas Emissions (GHE’s) to 94.8 percent of 1990 levels. Canada is to reduce its emissions by six percent. The Kyoto Protocol is just one of a series of promises to reduce GHE’s made by the federal government. “Unless steps are taken now to begin to coordinate municipal, provincial, federal and even trans-national matters in transportation, we will likely fall considerably short of the mark”. Reducing GHE’s will almost certainly mean substituting to more efficient engines and improved fuel technology; there are, however, other avenues that could be pursued to the benefit of societies as a whole. One example is eliminating regulations that prohibit efficiency.

3.7) Are the Railways in a Conflict of Interest?

Foreign steamship companies that operate in Canada rely on Canadian surface carriers or freight consolidators to move their freight and reposition their equipment. Current cabotage laws permit Canadian carriers and freight consolidators to load domestic cargo into empty international containers for repositioning. However, rail companies own domestic intermodal equipment that they utilize for the same market. Given these facts, are the railways in a conflict of interest?

International containers owned and operated by foreign steamship lines are usually placed under the management of a Canadian carrier or freight consolidator to move import and export freight within Canada. Upon delivery of the import load, the steamship company has several options. They can attempt to locate export freight in the vicinity to load into the container. This is an ideal situation because there is a quick turn around time and the shipping lanes are easily balanced. If they are unable to locate an export load they can move the empty container back to the port or within Canada to an export load pick-up point. This situation is costly and inefficient because the containers may have to travel great distances without carrying a payload.

---

1 Email correspondence by UMTI staff with industry official regarding container cabotage, March 2001.
The steamship company can offer the container to the railways to reposition it on their behalf. The railway can reposition this equipment with domestic cargo, if they wish. For example, a foreign-based container laden with import goods will enter Canada at a Canadian port (usually Vancouver, Montreal or Halifax). A Canadian carrier assumes custody of the container and delivers it to the import load drop-off point (A). The steamship company instructs the carrier to reposition the container to the export load pick-up point (B) by a certain date. During this time the carrier is responsible for the container. If the carrier has a domestic load to move between A and B they can load the container with this domestic cargo. Presumably, both parties benefit under this scenario. The steamship company gets their container repositioned for free, or at a reduced fee. The carrier benefits because they receive revenue from the domestic movement using another company’s assets. The export shipper may benefit if the repositioning charges for that container are reduced or waived. This cooperation between the steamship company and the carrier can be beneficial to all parties involved.

Rail companies’ intermodal equipment competes with international containers for domestic traffic. A conflict for Canadian railways lies with the utilization of international versus their own domestic containers. Both sets of equipment can be used to move the same goods. Consequently, an empty international container may sit in a rail yard that could be used for domestic traffic and reduce costs for shippers and carriers alike. The current regulations give the railways the option of selecting either international or their own containers to move domestic freight without having to consider the consequences of their decisions on shippers and other carriers.

In certain situations, the railways do not have this luxury. For example, merchandise of some Canadian shippers cannot be easily transported in domestic containers. Steel for example, is a heavy commodity and marine containers are ideally suited to this cargo. In fact, carriers and freight forwarders have built shipping programs around this type of movement. By utilizing foreign equipment for domestic services the number of empty repositioning moves are reduced. This facilitates efficiencies in the transportation network and helps to reduce costs for carriers and shippers.

Empty international containers move from Toronto to Vancouver that could be used for westbound domestic traffic. Several possible reasons explain why they are not being employed. First, there may be no export traffic for them in Vancouver due to the current import/export imbalance on the Asia-Pacific trades. Second, there may be no suitable domestic freight with which to reposition these containers. Finally, the overall supply of domestic and international equipment dictates which containers are employed in domestic traffic. For instance, international marine containers are usually employed only when the overall supply of available domestic containers is low. When the domestic freight market for the railways is sluggish more international containers are repositioned empty, resulting in higher revenues for the railways. Revenues from repositioning empty containers supplement domestic freight revenues when the market is in decline. Furthermore, the costs for repositioning the empty equipment are paid by ocean carriers and ultimately passed on to shippers.
Ultimately, to determine whether or not the railways are in a conflict of interest depends on what operating strategy they choose to employ. When moving domestic traffic, rail carriers have the option of utilizing their domestic fleet or employing the containers owned by steamship companies. This decision has an affect on both shippers and ocean carriers, suggesting that they may be in a conflict of interest. In order to explicitly determine this, traffic flows under differing cabotage scenarios should be measured and compared, but it is impossible to determine the potential traffic flows under a hypothetical cabotage environment. Indeed, if the railways are not in a conflict of interest position, they should have no objections to removing the cabotage restrictions.
4.0) Cabotage Liberalization – Some Ideas for Reform

Presumably, Canadian cabotage laws are in place to protect domestic container carriers from foreign competition and mirror the restrictions that other countries impose on Canada. Steamship companies can switch ports, railways or trucking companies, but their relationships with the trucking industry are the most tenuous. Immense competition exists among truckers, which allows steamship companies to change carriers quickly.

The railways, on the other hand, have more market power. Canada has only two national rail carriers, CN and CP, with similar service levels and rates. Many foreign companies perceive Canada’s railways as a homogeneous service. Consequently, the steamship companies take a more long-term approach with the railways than they do with trucking companies. When the time comes to renew service contracts, the railways may feel a threat by the steamship companies to switch to other carriers. A service contract between a steamship company and CN and CP is worth millions of dollars and substantial revenue losses to the railway result if the steamship company chooses to switch to another surface carrier. Large international steamship companies can more easily induce competition between Canadian rail carriers than shippers can. Considering this, it may be in the railways’ interests to aid the steamship companies to operate more cost consciously.

Intermodal is the fastest growing freight market in Canada and growth in international traffic is expected to outpace growth in domestic traffic. The railways have important equipment investment decisions to accommodate the increasing demand for intermodal services. They could use existing foreign-owned equipment to increase capacity in order to accommodate this growth, rather than domestic assets. This reduces the movement of empty international containers.

Both the period of time that containers can remain in Canada duty free as well as the number of allowable domestic movements should be extended. Specifically, Canadian laws should parallel those to our southern neighbor. Triangulations or other diversions of containers, as it makes its way back to international commerce is an opportunity for Canadian shippers, carriers and intermediaries. Enhancing the efficiency of the total network, especially in the areas of transportation and supply chain management, contributes more broadly to improving the competitiveness of export goods.

Three possible cabotage scenarios are considered here. The first scenario is status quo, meaning no change to Canada’s current environment. The second scenario is one identical to U.S. laws, called “unlimited cabotage liberalization.” Finally, “limited cabotage liberalization” is a combination of these two regimes, which sanctions relaxing the restrictions to allow for triangulation. The objective is to determine which scenario would best suit the needs of shippers and carriers and what the expected outcomes might be.
4.1) Relaxing Cabotage Restrictions – Impact on Shippers

Shippers can most benefit from unlimited cabotage liberalization. Domestic traffic in Canada is primarily East-West movements. The opportunities for North-South movements, from or to the most northerly populations, can be enhanced if the more complete liberalization of a whole North American regime were established, rather than just advancing a merely incremental adjustment to the current regulations. Given that shipping lines could take advantage of multiple moves over an extended period of time, container equipment of specific sizes and types would be more readily available to remote shippers. Furthermore, carriers could operate in a more cost effective manner, and pass along efficiencies to shippers. The potential to reduce both domestic freight costs and international import and export freight costs is enhanced under the more complete liberalization.

Relaxing cabotage restrictions could improve the supply of containers in Manitoba, but it may not be sufficient to alleviate completely the current supply imbalance. Shippers must develop shipping alliances to strengthen their market power. Manitoba’s hay exporters have done this and appear to be happy with the results. Allied shippers have the influence needed for ocean carriers to better appreciate their needs and are more likely to have the required equipment repositioned in a timely fashion.

During the 30-day window, containers are likely to be limited for domestic use. The 180-day window improves the possibility of improving shippers’ transportation efficiencies, but may not be sufficient to improve the supply of containers in Manitoba. The U.S. allows a 1-year period of entry of the equipment, and as an example, Argentina has a 270-day window. Argentinean customs officials diligently enforce this time frame and levy heavy fines on violators. Again, the level of enforcement determines whether the regulation is de jure or de facto.

Some U.S. container depots have containers that had been idle and available for export for more than 5 years. The import – export imbalance led to such a state of affairs. The U.S. situation suggests that the one-year time period is ample, but this still may not be sufficient as increasingly specialized equipment requirements make management of an idle fleet more difficult. Even if all containers were fully interchangeable between carriers, transport operators or agents, there will always be a headhaul and a backhaul where surpluses of equipment build up due to lack of demand.

4.2) Relaxing Cabotage Restrictions – Impact on Carriers

Canadian ocean and surface carriers could benefit from relaxing container cabotage restrictions. However, some carriers would be more inclined to prefer limited cabotage liberalization. This community would like to maintain protection of the equipment supply advantage they currently enjoy, and thus seek to maintain this subtle protectionism.
It makes more sense to have only one set of rules because of the volume of intermodalism between the U.S. and Canada. Unlimited cabotage liberalization would give carriers more opportunities to reposition equipment to demand areas. Furthermore, their load factors and empty mile ratios would improve more substantially than with the more restrictive scenario. Capacity available to domestic shippers could increase. Given that surface carriers could use equipment belonging to container pool operators and steamship companies, this could be achieved without any significant investments in new infrastructure.

Internationally based carriers would most benefit from the complete cabotage liberalization. They could operate more cost effectively, allowing them to pass along efficiencies to their customers. For these carriers, the ability to most economically operate a fleet of intermodal equipment relies on the opportunities to generate multiple revenues and to minimize positioning times and costs. Ocean carriers spend close to $10 billion a year operating container assets, including ships, containers and trucks. It is estimated that about 16 percent of that gross expenditure is directly attributable to the cost of repositioning empty equipment.³ By minimizing the time and numbers of units that sit idle and cost effectively positioning units toward demand areas these repositioning costs can be mitigated.

Canadian long-haul over-the-road carriers can be potentially harmed from relaxing container cabotage restrictions. The addition of previously unused capacity would inherently reduce rates. This may be detrimental to some carriers because the market is immensely competitive with slim margins.

5.0) Conclusion

The most difficult problem with the regulations is that they hinder operational efficiency. Container operations in Canada are inherently more costly and less flexible than in the U.S. The significance of the reform proposals is that they allow for greater flexibility. Thus the real gain is equipment utilization rather than explicit cost savings.

These regulations are costly to Canada’s transportation network. With containerization and trade significantly rising, carriers, shippers and intermediaries are in a position to take advantage of the increase in shipping opportunities afforded in a deregulated environment. The tangible rewards from cabotage liberalization include a reduction in freight rates, an increase in rail capacity as well as reducing empty mile ratios for carriers. Furthermore, it can be expected that service levels would improve given that shippers would have better access to equipment. Imbalances in equipment availability could be mitigated because carriers would enjoy more freedom to position equipment toward demand areas. Both shippers and carriers alike can profit from this.

Containers are instruments of international commerce. They allow diverse goods to be loaded inside standard-sized units that could be handled and transported with greater efficiency. In essence, they are simply reusable packaging. Imposing restrictions on using containers constrains the efficient flow of goods. This is harmful to shippers and reduces their competitiveness in global markets.

Most cabotage regulations deal with both immigration and customs issues. Container cabotage regulations deal only with customs. Furthermore, most cabotage issues involve bilateral and reciprocal arrangements between two trading partners. Container cabotage, on the other hand, is distinct because it affects third party relationships. The U.S. is Canada’s largest trading partner and regulations on container cabotage are not reciprocal. Differences in how the U.S. treats a third party and how Canada treats a third party affects the competitiveness of Canadian goods in global markets.

Canada is the second largest country in the world and covers a landmass of over 9 million square kilometers. The population however, is a mere 31 million people spread over a small number of cities from one coast to the other. The distances covered in moving products nationally are so great that domestic transportation costs are generally 5 to 10 percent higher than our American counterparts. Considering this, it does not seem sensible to retain such restrictive cabotage laws for international containers.

The tight restrictions placed on foreign-based containers in Canada are a source of economic inefficiency that cannot be discounted. This policy causes containers to accumulate in certain areas of the country and to move empty, taking up rail capacity, burning fuel and costing shippers when carriers charge, or build in their rates, the empty repositioning moves. These policies may have been designed to reduce cabotage and protect domestic Canadian container carriers, but at considerable cost to the Canadian importer / exporter community.

Transportation facilitates trade and represents a transaction cost that exists regardless of the removal of tariff barriers on goods. Free trade has the effect of easing trans-border movements and has triggered Canadian trade volumes to rise to over 80% of GDP in 1999, up from 50% of GDP ten years earlier. Canada has made great strides toward becoming a free trade zone; it has yet to achieve modes of trade that would reduce this transaction cost associated with the international movement of goods.

---

References:


APPENDIX

Canadian and U.S. Container Cabotage Legislation

<table>
<thead>
<tr>
<th>CUSTOMS RULES</th>
<th>CANADA</th>
<th>UNITED STATES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customs Act:</strong></td>
<td>• Definition of imported good and container and applies duties</td>
<td><strong>Title 19 United States Code (Customs):</strong></td>
</tr>
<tr>
<td><strong>Customs Tariff:</strong></td>
<td>• Item 9801.10.00 provides a zero rate of duty on conveyances that enter Canada for international commerce.</td>
<td>• Section 1322 (a)</td>
</tr>
<tr>
<td><strong>Memorandum D3-3-3</strong></td>
<td>• Customs Cargo Control Procedures</td>
<td>• Allows for vehicles and other instruments of international traffic to be exempt from the application of the customs laws.</td>
</tr>
<tr>
<td><strong>Memorandum D3-1-5</strong></td>
<td>• International Commercial Transportation</td>
<td><strong>Title 19 United States Code of Federal Regulations:</strong></td>
</tr>
<tr>
<td><strong>Memorandum D3-1-6</strong></td>
<td>• Customs Post Audit System</td>
<td>• Section 10.41a</td>
</tr>
<tr>
<td><strong>Memorandum D3-7-1</strong></td>
<td>• Cargo Containers Used in International Service</td>
<td>• Regulations</td>
</tr>
</tbody>
</table>