



Railroad productivity and competitiveness

Notes for remarks by

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(Please check against delivery)

Thank you for inviting me to address the Canadian Club. Today I want to talk about competitiveness — what it means, and the role the railroads play in making Canada competitive.

Last week, the Paris-based Organization for Economic Co-operation and Development said Canada's standard of living may fall behind those of other countries — in part because of poor productivity.

The House of Commons Finance Committee also released its pre-Budget consultation report. One of the issues it addressed: the urgent need to improve productivity.

The issue of productivity and competitiveness is rising to the top of the national agenda. Improving productivity carries some short-term costs. You read about them every day as companies restructure to become leaner and more efficient. But the reality of the 1990s is that we compete in a global economy, and we must improve productivity to compete.

Canada should be one of the big winners in the global economy. We're one of the world's great trading nations, and have built an infrastructure to promote trade. In fact, freight exports account for 35 per cent of Canada's Gross Domestic Product. Compare that to the United States, where freight exports account for about 9 per cent of GDP.

How important is rail transportation to Canadian exporters? Rail moves 40 per cent of all Canadian export products — more than any other transport mode.¹

Canada's low-cost and highly competitive rail transportation supports the competitiveness of Canadian industry. If our railroads are not competitive, Canadian shippers are profoundly affected.

An era of consolidation

Rail is even more important when you look at how our customers are consolidating to improve their productivity and take advantage of economies of scale. More than ever, they turn to the transportation service industry to sharpen their competitive edge.

A good example of this is the automotive companies. They spend billions of dollars on transportation budgets, and they don't intend to waste a dime.

¹ Source: Railway Association of Canada.

The industry has restructured around just-in-time delivery of parts and components. This requires highly reliable transportation, and parts suppliers and transportation providers worked together to deliver in-bound shipments just in time.

Now the automotive sector is revolutionizing its out-bound shipments as well. Automobile assemblers, such as Ford and General Motors, are creating huge vehicle distribution centers capable of serving customers across the continent. Many cities compete to become the distribution center for a major assembler. Their success depends, to a large degree, on the ability of transportation services to deliver across the continent.

Other industries have been going through a similar process of consolidation and restructuring. They are looking for ways to improve productivity and reduce costs by relying upon transportation services.

In the forest products sector, single mills in the forest towns used to provide products for single markets. Now the industry is rationalizing on a North American basis. Companies are using distribution centers to draw products from a network of mills across the continent, and ship them to customers everywhere in North America.

Large chemical producers have complexes in several major producing areas, such as Alberta, Ontario, and the Gulf of Mexico. They work on complex logistics to decide which facilities should produce what chemicals for which consuming markets. Among the factors they consider: the cost of the feedstock, the location of end markets, and the safest and most reliable way to move products from their plants to destination. Transportation is crucial.

Rail consolidation

Our customers have become more aggressive competitors through their consolidations. The same process has been happening in the North American rail industry. A few years ago, there were seven big railroads in the United States. Now, after consolidations, there are four. The largest are bigger than CN and CP combined. Even the smallest is bigger than either of us.

The American rail system is already the most efficient in the world. When they have finished digesting their recent mergers and consolidations, the Big Four will become the strongest railroads in North America.

Consequences

This has consequences for shippers and for CN.

The new efficiency of the Big Four will help their customers compete in new markets. We're already seeing this, for example, in the competition that Quebec paper mills now face in the northeastern United States.

Canada's ports also have a very large stake. On both the Atlantic and Pacific coasts, shippers can choose among port facilities that compete against one another on the basis of cost and efficiency. Rail transportation to the interior is a critical factor. Canadian ports need railroad partners as efficient as those in the U.S.

It is no wonder, then, that the past few years has seen a remarkable growth in the productivity and efficiency of Canadian railroads. We've raced to try to catch up to the most efficient rail service in the world. The resurgence of a competitive rail industry has been one of Canada's great success stories of the 1990s.

Our cost efficiency has improved dramatically. When I joined CN, our operating costs were over 97 cents for each dollar of revenue. In the most recent quarter, they were only 73.3 cents to earn a dollar.

Our productivity, measured in the revenue per ton moved one mile per employee, has improved by almost 70 per cent in the past five years. This is impressive, but we still lag behind the American railroads by 30 per cent.

And this is the critical point: as impressive as the Canadian improvements have been, they are still not enough to keep us in the competitive race with the American railroad system. It keeps getting better. And so must we.

What is required

To help our customers compete, Canada's railroads need to do three things.

First, provide quality service at competitive rates.

Second, maintain an infrastructure that improves service and extends reach.

Third, keep the cost structure low.

As for service, railroads must understand that we are in business to serve shippers and help them compete. Running trains is only a means to this end. I recently issued a Customer Bill of Rights for CN. Summed up, it means service with no secrets, no surprises, and no excuses.

As for prices, Canadian railroad freight rates are very competitive — among the lowest in the world.

Infrastructure

Maintaining a rail infrastructure that helps our customers compete means two things.

First, we must invest the capital required to operate our lines efficiently. CN has projected capital spending of over \$2 billion by 2001.

Second, we must increase our customers' reach. By reach, I mean efficient transportation that enables customers to get to markets more easily. In the NAFTA environment, this means, more than ever, moving goods north-south. Traffic between Canada and the United States is growing at more than 10 per cent a year, compared to about four per cent for traffic moving east-west.

We are extending the reach of our customers through a merger we've signed with the Illinois Central, and a marketing alliance involving CN, Illinois Central and the Kansas City Southern Railway Company.

Illinois Central runs down the center of the United States from Chicago to the Gulf of Mexico, with two of the Big Four on one side, and two on the other.

Kansas City Southern extends the reach further west to cities like Dallas. With Kansas City Southern's affiliates, our customers will have access to all three NAFTA nations.

We're creating a new CN — a CN built like a giant "Y", transecting North America from east to west and north to south. Years ago, Canada needed a rail line that reached the Pacific. Now it is just as important to reach the Gulf of Mexico, the gateway to Central and South America.

Where traffic warrants, we can now provide intermodal service between Toronto and Dallas, for example. We can offer Ontario's auto parts manufacturers easier access to assembly plants in St. Louis.

The merger is subject to approval by American regulators, which we anticipate in the spring. The marketing alliance is already in effect.

Low cost structure

Now I want to talk about the third requirement to help our customers compete.

Providing quality service and competitive rates is not enough. Nor is maintaining an infrastructure that improves service and extends reach.

For any of this to take place, we need the third element: a low cost structure. Let me tell you about what we've done to keep our costs down.

First, we negotiated with the unions the elimination of antiquated work rules. There were provisions, for example, that gave full employment security for life to employees with eight years' experience. We could no longer afford such generous provisions in the 1990s.

Second, we negotiated more flexibility in operating rules. Some rules had been designed for an earlier era, and had no place in a modern railroad.

Third, we implemented smarter procurement policies, working with our suppliers to maximize the savings available throughout the supply chain.

Fourth, we sold or abandoned under-utilized branch lines, and concentrated on strong rail corridors. Many of the branch lines are now run profitably by short-line railroads.

And fifth, we began making better use of our assets. This is a continuing process. We run longer trains, use fewer locomotives, and use better technology to monitor shipments, and improve the reliability of our service. We reduce our car cycle times so we will need fewer rail cars to carry our customers' goods. For every day we take out of our car cycle time, we can save 3,000 cars from our fleet.

In short, we'll carry more freight and use fewer resources. These are real productivity gains, and they help lower our costs.

Human impact

Of course, these measures have a human impact. I am very sorry that increased productivity means that we do not need as many people on our payroll.

We prepared for this when we negotiated with our unions to provide severance packages that are among the best in Canadian industry.

Let me give you an example. A clerk earning \$45,000 with eight years service can elect to take a lump sum payment of \$65,000; or go on employment security and collect annual payments of about \$40,000 for up to six years.

But let there be no misunderstanding: we can afford to negotiate generous severance packages precisely because we are now running a profitable railroad.

And let there be no mistake: we cannot stop our efforts to improve our productivity. We owe it to our customers. We owe it to their workers, whose jobs depend on our competitiveness. We owe it to our own employees whose future depends upon CN's success in meeting the competition head on.

And we owe it to Canada. This country needs efficient, productive, competitive railroads.

The human cost of improving productivity in our sector is high. But the cost of not taking action would be much higher. We would pay it in lost competitiveness, lost business, and even more lost jobs.

What is required next

We have moved aggressively to give our customers the kind of railroad they need to compete. We've made tough decisions in the process. We're doing everything in our power to improve competitiveness.

But we can't do it all alone. We need a policy environment that lets us compete with the Americans on as level a playing field as possible.

What do we need?

Equitable taxation

First, a level playing field in taxation. We pay 14 per cent of gross revenues in taxes, compared to just eight per cent for U.S. railroads and eight per cent for U.S. and Canadian truckers.

We build our own lines on our own rights-of-way. We maintain and police our lines. We erect our own traffic signals and control the traffic flow. And we pay taxes for the privilege of doing all this.

The federal Capital Cost Allowance is another problem. American railroads can depreciate equipment in as few as eight years. Canadian railroads must wait as long as 30 years.

Regulatory framework

Second, we need a regulatory environment that encourages competitiveness.

Progress was made in 1996 with the Canada Transportation Act, the CTA. It has created economic and social benefits for Canada, including safer rail transportation, and the emergence of a vibrant short-line railroad industry.

Deregulation has its critics in Canada. When the CTA comes up for review next year, some of the shipping community will speak against it.

But they will have a difficult argument to make when you consider Canadian rail freight rates are among the lowest in the western industrialized world, and that we are an industry that still does not recover its cost of capital.

Rail competitiveness is inseparably linked to regulations. We must continue to deregulate.

Conclusion

I've been speaking about the role of railroads in the highly competitive global economy of the 1990s. But in fact, CN is playing a role we have always played: helping create value for the Canadian economy by moving shippers to their end market.

The CN of today is a private company, but we serve a public policy need in Canada by building a more competitive economy that creates opportunities for all Canadians.

Canada's competitiveness cannot be separated from the competitiveness of its transportation system. CN is moving boldly to be competitive in North America. That's good for shippers. It's good for Canada.

Thank you.



News

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Rail productivity central to shipper competitiveness and urgent need for improvements in overall productivity of Canadian economy, says Canadian National's Paul M. Tellier

TORONTO, Dec. 7, 1998 — The Canadian rail industry – a key player in Canada's export-driven economy – has made huge strides in boosting productivity but requires public policy changes to accelerate productivity gains that are essential to the competitiveness of the Canadian economy, says Canadian National President and Chief Executive Officer Paul M. Tellier.

Tellier, speaking to The Canadian Club of Toronto today, said the issue of productivity and competitiveness is rising to the top of the national agenda. The Paris-based Organization for Economic Co-operation and Development warned last week that Canada's productivity has fallen. The OECD urged Canadian governments, among others, to take decisive steps to reverse this trend, a trend that threatens the living standards of all Canadians, he said.

In another report last week, the House of Commons Standing Committee on Finance in Ottawa urged the adoption of a "Productivity Covenant", which would focus government action to ensure that it supports improving the productivity of the Canadian economy.

Tellier said rail productivity and competitiveness are vital to Canada's economy because freight exports account for 35 per cent of Canada's Gross Domestic Product, and rail moves 40 per cent of all Canadian export products – more than any other mode of transport.

"Canada's low-cost and highly competitive rail transportation supports the competitiveness of Canadian industry. If our railroads are not competitive, Canadian shippers are profoundly affected."

Tellier added: "Rail is even more important when you look at how our customers are consolidating to improve their productivity and take advantage of economies of scale. More than ever, they turn to the transportation service industry to sharpen their competitive edge."

Tellier said CN has taken, and continues to take, initiatives to improve its productivity – and the competitive standing of its customers:

- CN has signed a definitive merger agreement with Illinois Central Corporation and established a marketing alliance with IC and Kansas City Southern Railway Company. The merger and alliance – making CN like a giant "Y" transecting North America from east to west and north to south - - will position CN and its customers to take advantage of fast-growing trade opportunities flowing from the North American Free Trade Agreement. Traffic between Canada and the U.S. is growing at more than 10 per cent annually, compared with about four per cent for traffic moving east-west. CN remains optimistic that the proposed CN/IC merger will be approved by U.S. regulators in March 1999;

- CN is projecting capital expenditures of more than \$2 billion by 2001;
- CN has taken far-ranging steps to lower its cost structure by eliminating antiquated work rules, ending life-time employment security benefits, pursuing smarter procurement policies, abandoning and selling under-utilized trackage and making better use of its assets.

Improved asset utilization is a continuing process, Tellier said. "We run longer trains, use fewer locomotives and use better technology to monitor shipments and improve the reliability of our service. We reduce our car cycle times so we will need fewer rail cars to carry our customers' goods. For every day we take out of our car cycle time, we can save 3,000 cars from our fleet."

Tellier said these tough, expensive decisions to improve productivity and competitiveness – some of which have a human cost – were essential, but are not enough. Moreover, CN cannot do it all alone. While CN's productivity, measured in revenue per ton moved one mile per employee, has risen by almost 70 per cent in the past five years, the Company's productivity performance in certain key measures still lags that of the U.S. rail industry by 30 per cent.

Tellier said the Canadian rail industry requires a public policy environment – fairer taxes and less restrictive regulation – to ratchet up productivity gains so it can compete effectively against U.S. rail giants whose size, efficiency and extended North American market reach are posing an increasing challenge to CN and the shippers who rely on it.

Canadian railroads have a tax handicap. They pay 14 per cent of gross revenues in taxes, compared with eight per cent for U.S. railroads and eight per cent for U.S. and Canadian truckers. Canada's Capital Cost Allowance is another barrier to competitiveness, Tellier said, pointing out that U.S. railroads can depreciate equipment in as few as eight years, while Canadian rail carriers must wait as long as 30 years.

Tellier said productivity and safety gains posted by Canadian railroads in recent years, along with the emergence of a vibrant short-line rail industry, are inseparably linked to reforms introduced by the *Canada Transportation Act* of 1996. But Tellier said greater deregulation is necessary, and he warned against policy changes that would erode key provisions of the CTA.

Tellier acknowledged the CTA has its critics in Canada, and predicted some of them will speak against the Act when it is subject to a statutory review in 1999. But he said the CTA's critics "will have a difficult argument to make when you consider Canadian rail freight rates are among the lowest in the western industrialized world, and that we are an industry that still does not recover its cost of capital.

"Rail competitiveness is inseparably linked to regulations. We must continue to deregulate."

Tellier said some of initiatives to improve CN's competitiveness "have a human impact. I am very sorry that increased productivity means that we do not need as many people on our payroll. We prepared for this when we negotiated with our unions to provide severance packages that are among the best in Canadian industry."

For example, a clerk earning \$45,000 with eight years service can elect to take a lump sum payment of \$65,000; or receive employment security and collect annual payments of about \$40,000 for up to six years.

Tellier said: "Let there be no mistake: we cannot stop our efforts to improve our productivity. We owe it to our customers. We owe to their workers, whose jobs depend on our competitiveness. We owe it to our own employees, whose future depends upon CN's success in meeting the competition head on.

“And we owe it to Canada. This country needs efficient, productive, competitive railroads. The human cost of improving productivity is high. But the cost of not taking action would be much higher. We would pay it in lost competitiveness, lost business and even more lost jobs.”

Canadian National Railway Company serves all of Canada and the U.S. Midwest, including the ports of Vancouver, Montreal and Halifax and key cities of Toronto, Chicago, Detroit and Buffalo, with connections to all points in North America.

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