

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 658
THE 25TH ANNIVERSARY OF THE STAGGERS RAIL ACT OF 1980:
A REVIEW AND LOOK AHEAD

COMMENTS OF THE
U.S. DEPARTMENT OF AGRICULTURE

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AUTHORITY AND INTEREST

The Secretary of Agriculture is charged with the responsibility under the Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Surface Transportation Board (Board) proceedings involving rates, charges, tariffs, practices, and services.

USDA represents U.S. farmers and agricultural shippers, and the vitality of their livelihood is our primary interest. Our interest is in preserving an efficient and competitive transportation sector that serves U.S. agriculture effectively.

BACKGROUND

The Department of Agriculture thanks the Board for initiating this public hearing to provide a forum for the expression of views on the impact, effectiveness, and future of the Staggers Act.

By 1976, one-third of the railroads in the United States were bankrupt or nearly bankrupt, due in part to decades of industry regulation. As a result, railroads were unable to efficiently manage their operations and effectively compete with waterway and emerging air and motor carrier transportation.

The Staggers Rail Act of 1980 (Staggers Act) significantly reduced regulation in all phases of railroad operations. Since enactment of the Staggers Act, economic and market conditions affecting the rail industry have changed greatly. Instead of 33 major railroads competing in the early 1980s, the rail industry has consolidated to only 7 major railroads

operating in the United States. Rather than bankruptcy, the major railroads are now financially healthy. And, recent demand for rail transportation has been robust and has set records for several years in a row.

Today, the future facing the major railroads is dramatically different than when Staggers was passed:

- The Department of Transportation's (DOT) Federal Highway Administration Office of Freight Management projects an increase in freight traffic of 69 percent from 1998 to 2020 for rail carriers.¹
- Today, major railroads are constrained more by insufficient capacity than by the excess capacity they faced before Staggers.
- Current and expected future demands on railroads, capacity constraints, as well as greatly increased fuel costs give railroads much more incentive to increase rates – to support needed investments in infrastructure, or face rationing service to their customers.

In view of the changing circumstances of railroads, now is an appropriate time to evaluate the future of the Staggers Act and its ability to be the sole vehicle for all issues and all parties in rail industry transportation. The railroad industry, shippers, and competing transportation modes now face quite different challenges than when the Staggers Act was enacted. All transportation modes are increasingly congested and in need of major capacity investments. The funding of these transportation investments likely will require creative

¹ Department of Transportation, Federal Highway Administration, Office of Freight Management, Freight News: Freight Analysis Framework, October 2002.

solutions. Fuel prices have risen to extremely high levels and likely will remain high for the foreseeable future. Therefore, the most fuel-efficient transportation modes, such as railroads and waterways, will remain critically important in the movement of agricultural commodities. And, concerns about the environment will favor more environmentally-friendly transportation modes such as rail and water.

OVERALL BENEFITS OF THE STAGGERS ACT

Economists generally agree that railroad deregulation has been successful in a broad overall context. Economic analysis also has shown that both railroads and shippers have realized significant economic benefits since enactment of the Staggers Act.

The Staggers Act allowed railroads much greater freedom to meet the competitive pressures placed on them by other freight modes, expedited rail abandonment procedures, and reduced the time required to process merger applications. The Staggers Act also permitted railroads to enter into contracts with shippers and enabled railroads to invest in plant and equipment with a greater degree of certainty that such investments would be profitable.

Railroads have been able to innovate in ways that were previously stifled by regulations. As a result, shippers now benefit from the cost savings due to the use of double-stack intermodal movements and shuttle trains.

Finally, railroads were able to cut costs much more rapidly due to more managerial freedom. This cost-cutting was achieved by abandonment and spin-off of rail lines, reduction of excess labor, longer hauls, and more aggressive use of technologies to obtain efficiencies.

As a result, railroad profitability has increased through efficiency and productivity, resulting in better maintained infrastructure, which in turn increased service reliability and safety.

Shipper benefits from railroad deregulation include preservation of railroad service, rate savings and, in many cases, improved service. Short line railroads have been able to operate profitably on many rail lines abandoned by the major railroads and have generally provided more individualized service to shippers. Benefits, however, have not been distributed uniformly across or within commodities or communities. The distribution of benefits has tended to favor grain producers in regions with higher levels of intermodal competition.²

AGRICULTURE RELIES HEAVILY ON RAIL SERVICE

Due to their numbers (many), size (small), and the nature of their products (homogeneous with many substitutes) individual agricultural producers of grain and oilseed crops are considered “price-takers.” That is, they have little or no ability to influence the price received for their products, and therefore, are unable to pass increases in costs forward to buyers. Instead, these producers tend to absorb cost increases. Consequently, increases in transportation costs typically result in decreased producer prices and, ultimately, lower incomes as producers absorb the increased transportation cost. In turn, lower producer incomes can adversely affect the ability of individual producers to borrow funds and potentially reduce economic prosperity in rural areas.

² John Bitzan, Kimberly Vachal, Tamara VanWechel, and Dan Vinge, The Differential Effects of Rail Rate Deregulation: U.S. Corn, Wheat, and Soybean Markets, Upper Great Plains Transportation Institute, June 2003.

To compete effectively in increasingly competitive world markets, U.S. farmers must have access to efficient, reliable and cost-competitive transportation. The rates agricultural shippers pay for rail transportation must be at a level that promotes, rather than penalizes, American competitiveness in world agricultural markets. High transportation costs hinder the competitive position of U.S. agricultural products in highly competitive export markets. Because U.S. farmers produce more than our country can consume, the ability to export surplus production is extremely important. The ability to export excess production supports domestic grain and agricultural product prices, enhancing the vitality of rural economies.

USDA research shows that transportation often comprises about 40 percent of the final landed cost of commodities at destination. Thus, transportation is critical to maintaining a competitive position in global markets. This point has been illustrated vividly in the past six weeks as the United States experienced what is bound to be declared as one of the worst natural disasters in its history, with hurricane Katrina followed by hurricane Rita in the Gulf. The interconnectivity of rail with barge transportation became amplified within a matter of days following these events, and continues to challenge our ability to move grain just as this fall's harvest begins to get underway.

AGRICULTURAL SHIPPERS' CONCERNS

Despite the overall success of the Staggers Act, agricultural shippers have concerns regarding decreased rail-to-rail competition, the declining rail share of grain transportation, rail capacity constraints, the allocation of rail capacity, and rail rates.

Rail-to-rail competition

One of the key assumptions underlying the deregulation of the rail industry was that there would be sufficient competition, which would improve allocative and technical efficiency. Thus, the authors of the *Staggers Act of 1980* and the *Interstate Commerce Commission Termination Act of 1995* (ICCTA) included the preservation of effective competition as one of the rail transportation policy goals of the United States. Not only does effective competition promote reasonable rates and minimize the need for regulatory control, but it also encourages the efficient management of railroads.

In many agricultural production regions of the Nation, truck and barge transportation provide adequate competition to constrain rail prices. However, barge transportation is not available to those agricultural producers located in the western portions of the Plains States, and truck transportation is not cost-effective due to the long distances to market. Thus, for agricultural producers located in those regions, competition -- including rail-to-rail competition -- must be preserved and promoted for effective competition.

Since enactment of the Staggers Act, rail consolidation has reduced rail-to-rail competition. Even though a large majority of grain shippers have never had access to more than one railroad, the loss of access to nearby grain shippers located on competing railroads and increased geographic reach of the remaining railroads means that many farmers have lost the benefits of geographic competition.

Rail consolidation also has led to a sharp reduction in competitive routes and options for agricultural shippers. In some cases connecting gateways to other markets have been

closed by railroads. In other cases, railroads have limited economic access to less distant markets and markets on the lines of other railroads through differential freight prices.

Declining railroad share of the grain transportation market

Agricultural producers are concerned about the declining railroad share of the grain transportation market. In 1980, railroads hauled nearly 50 percent of grain to market. By 2000, the railroad share of grain hauled to market was down to only 32 percent.³ Most of the loss in market share went to trucks. Yet rail continues to be particularly important in the Plains States of Montana, North Dakota, Kansas, Oklahoma, and Texas, where more than 50 percent of the grain produced is hauled by rail.⁴

Rail capacity

Rail capacity for agricultural products has been extremely tight during the last three years, for a number of reasons, both agricultural and non-agricultural. Non-agricultural factors include increased demand for most commodities due to economic expansion, the expansion of international trade, increased demand for coal due to high natural gas prices, high fuel prices, and new hours of service (trucking) regulations increasing rail intermodal demand. Agricultural factors include strong grain export demand, high prices for agricultural crops during 2003, and back-to-back record or near-record grain harvests. In addition, railroads have faced capacity constraints, internal operational issues related to congestion and labor, and retirement of sizeable portions of their workforce.

³ Nick Marathon, Tamera VanWechel, and Kimberly Vachal, Transportation of U.S. Grains: A Modal Share Analysis, 1978-2000, U.S. Department of Agriculture, October 2004.

⁴ United States Grain Transportation Guide, U.S. Department of Agriculture, forthcoming.

Agricultural producers need enough rail capacity to assure adequate rail service during moderate surges in rail transportation demand. This requires adequate investment in facilities and equipment as well as an adequate return on investment by the railroads. Investment for the long term, of course, requires the likelihood of continued demand to justify the investment in order to provide the return on the investment. The major railroads today appear to fall into two categories: (1) those that have invested in capacity and are now reaping the benefits and (2) those whose delayed investments in capacity have left them unprepared to adequately meet increases in demand for their services.

Problems in rail car investment are illustrated with the issues facing privately-owned covered grain rail cars. On January 1, 2004, 65 percent of these covered hoppers were privately-owned (including leasing companies), and only 35 percent were owned by railroads.⁵ Although many of these cars are privately-owned because of reluctance of the railroads to invest, privately-owned rail cars are treated differently than those owned by the railroads. Specifically, the owners of those rail cars bear the risks and uncertainty of ownership, as well as the costs, and also must meet the requirements of the railroads. These are the burdens the railroads would have carried had they continued to own and operate the cars. Now, however, in addition to private ownership, many shippers also are being asked to share in the investment of track infrastructure to be assured of service. Looking forward, we must consider what can be done to encourage adequate investment in transportation infrastructure by *both* the railroads and private investors. The present example is just one illustration of a situation that is only

⁵ Railroad Equipment Report, 2004, Association of American Railroads.

contributing further to tensions between shippers and carriers in a capacity-constrained industry.

Allocation of rail capacity

USDA believes that all agricultural shippers, even the smallest, should have reasonable access to rail capacity. Agricultural shippers have often complained to USDA regarding grain car allocations that seemingly favor shuttle shippers. The lack of adequate rail service to smaller grain shippers could reduce competition among grain shippers as well as place heavier costs on rural road systems. The common carrier obligation remains and should continue to be enforced.

Rail rates

While deregulation did contribute to an overall decline in rates, as demand for service continues to increase and capacity is constrained railroads will be faced with limited choices in the near term. They can either raise rates, or ration service. Neither will be appealing to any of their customers. But those results -- higher rates or rationed service -- are economic realities of a market place where rates are not regulated, and the ability to appeal excessive rates is hampered by small shippers' inability to effectively use the Board's appeals process.

The ability of agricultural shippers to cost-effectively appeal excessive rail rates is particularly important for agricultural producers because of the characteristics of the market in which they operate. Only coal shippers have been able to cost-effectively use the Stand-Alone Cost rate appeals procedures. Although the Board established small shipper rate appeals procedures ten years ago, they have not been used until this year. Smaller shippers have been

reluctant to use them due to uncertainty regarding how the rules would be applied, which would affect the cost-effectiveness of those appeals.

Tariff rates on approximately 30 percent of farm product shipments exceed the jurisdictional threshold, which is a revenue-to-variable cost (R/VC) ratio of 180 percent. In regions of the country that are highly dependent upon rail service, many agricultural shippers consider their rail rates to be excessive because the R/VC ratio is much higher—sometimes exceeding 300 percent—than the 180 percent jurisdictional threshold.

Today's economic demands on the railroad industry are likely to only add to the frustrations of shippers because of a lack of transparency in the rate appeals process and the costliness of the rate appeals procedures for small shippers. USDA urges all parties to cooperate in finding mutually agreeable solutions to these issues before they become irresolute problems that invite unnecessary intervention in the form of regulation or other compulsory requirements that would turn back progress that has been achieved in the market by Staggers.

CONCLUSION

On the whole, the Staggers Act has been positive for both railroads and shippers. A dying rail industry revitalized itself and helped preserve rail service to many shippers that otherwise would have lost rail service. USDA recognizes the value of deregulation, which allows businesses with a financial interest, rather than government, to make economic decisions. But while deregulation has many benefits, it is not without costs.

USDA has commented on several rail service issues that concern agricultural shippers. Although deregulation is beneficial in the long run, it has not been the successful vehicle to

address all of shippers' issues with respect to rail service. Neither can legislation solve all problems in the market place. USDA does not advocate a return to the pre-Staggers regulation era. USDA supports its agricultural constituents as well as an effective and efficient transportation system. USDA encourages a careful and prudent review of the Staggers Act because many agricultural producers in the United States rely on rail transportation to move their products to market. Even when agricultural producers have a choice of cost-effective transportation modes, rail remains an integral part of moving products to market. It is extremely important that rail rates not be excessive and that rail service is available to even the smallest agricultural rail shippers.

For all of the good that deregulation through Staggers has brought – to the economy, to local communities, to rail carriers and shippers, and to agricultural producers – the issues facing railroads and our agricultural producers and shippers today is manifested in considerable conflict that appears to be worsening as time goes by. Thus, USDA believes this 25-year review and look forward of the Staggers Act is critical. The issues that face railroads, shippers, and producers, and the business relationships among them, require an insightful, innovative, and vigorous approach -- just as the Staggers Act was 25 years ago.

Respectively submitted,

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CERTIFICATE OF SERVICE

I, Barbara Robinson, certify that on this 12th day of October, 2005, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, on all parties of record in STB Ex Parte No. 658.

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