

Why the Rail Reregulation Debate Is Important

Summary

The partial deregulation of U.S. freight railroads via the Staggers Rail Act of 1980 sparked a rail industry transformation. It has led to hundreds of billions of dollars of reinvestment in rail infrastructure and equipment, better rail service, more rail traffic, and safer railroads — in addition to sharply lower average rail rates.

Despite these tremendous successes, some groups want Washington to take a far more intrusive role in rail operations and force railroads to cut their rates to many customers to below-market levels. Rail reregulation would be disastrous. It would prevent railroads from earning enough to maintain their existing systems in top condition and from building the substantial new capacity needed to handle future freight transportation demand. Reregulation would mean less rail capacity when we need much more.

The Staggers Rail Act of 1980 Partially Deregulated U.S. Freight Railroads

Beginning with passage of the Interstate Commerce Act in 1887, regulators in Washington eventually came to control numerous key aspects of U.S. freight railroad operations. By the 1970s, the cumulative effect of decades of stifling government regulation, along with growing competition from trucks and barges, had nearly crippled the rail industry. Rates and rail accidents were rising, rail infrastructure was crumbling, many major railroads were bankrupt, and the industry's return on investment (a key measure of profitability) averaged 2 percent — less than a child could earn on a savings account.

The status quo could not continue, so Congress had two choices: nationalize the railroads, at a cost to the government of untold billions of dollars, or give railroads the opportunity to compete in the free market. Congress wisely chose the free market and passed the Staggers Rail Act of 1980.

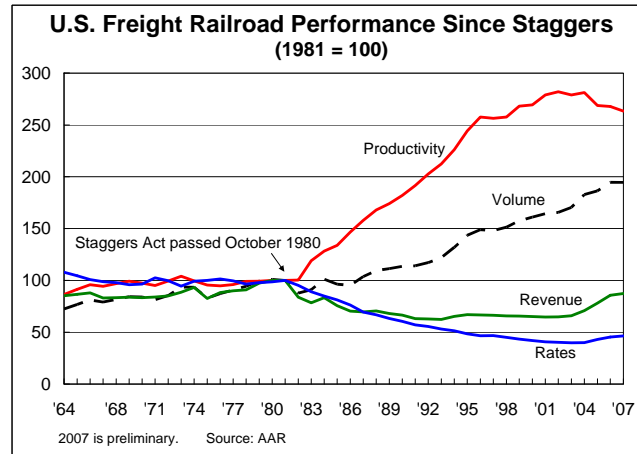
By passing Staggers, Congress recognized that railroads needed a new regulatory system that largely allowed them to decide for themselves what routes to use, what services to offer, and what rates to charge. A primary goal of Staggers was to allow railroads to act much like other businesses in managing their assets and pricing their services.

The Staggers Act did not completely deregulate railroads. The Surface Transportation Board, an independent agency within the U.S. Department of Transportation, still has the authority to set maximum rates or take other actions if a railroad is found to have “market dominance” or to have engaged in anti-competitive behavior. Thus, the Staggers Act established a safety net, which still exists, to protect rail shippers from unreasonable railroad behavior.

Rail Deregulation Works

The performance of U.S. freight railroads since Staggers proves that rail deregulation works — for rail customers, railroads, and our economy at large.

- Fueled by massive productivity gains passed along to rail customers, average U.S. freight rail rates plunged 54 percent in inflation-adjusted terms from 1981 to 2007, saving shippers billions of dollars per year and greatly enhancing U.S. global competitiveness. These rate reductions mean that the average rail customer today can move two railcars of freight for the price of moving one in 1980.
- Railroads have reinvested \$420 billion since 1980 — more than 40 cents out of every revenue dollar — back into their infrastructure and equipment. Today, the U.S. freight rail network is in better overall condition than ever before.
- Railroads are healthier financially. Return on investment rose from an annual average of 2.0 percent in the 1970s to 7.4 percent from 2000 to 2006. Rail industry profitability is still lower than most other industries, but the gap has narrowed.
- Railroad market share has trended slowly upward after decades of steady decline.
- Railroads are much safer. From 1980 to 2007, the train accident rate was reduced 71 percent and the employee injury and illness rate was reduced 81 percent.



Proposals to Reregulate Railroads Should Be Rejected

Despite the severe harm caused by excessive regulation prior to Staggers and the huge benefits that have resulted from deregulation, some rail critics want to again give Washington control over crucial areas of railroad operations.

The most recent proposal to reregulate railroads is S. 953/H.R. 2125, the so-called “Railroad Competition and Service Improvement Act of 2007” in the 110th Congress. Like similar bills offered from time to time since Staggers (all of which Congress has rejected), S. 953/H.R. 2125 includes a variety of provisions that would, in one way or another, force railroads to lower their rates to below-market levels for certain favored shippers at the expense of other shippers, rail employees, and the public at large. Billions of dollars in rail revenue could be lost each year.

Those calling for reregulation often claim that excessive market power exists whenever a rail customer is served by a single railroad. This claim ignores the fact that railroads face extensive competition for the vast majority of their business, including when a customer is served by a single railroad.

Multiple-railroad service exists where market demand justifies it. In fact, claiming that every market can sustain two railroads just because some markets can is like saying that every city can support two major league baseball teams just because New York can. Trying to mandate

more competition than the marketplace will support would ultimately reduce competition, not enhance it, because it would prevent railroads from earning enough to cover their costs and build the huge amounts of new capacity that will be needed to meet our freight transportation demand in the years ahead.

Earnings Today Mean Investments For Tomorrow

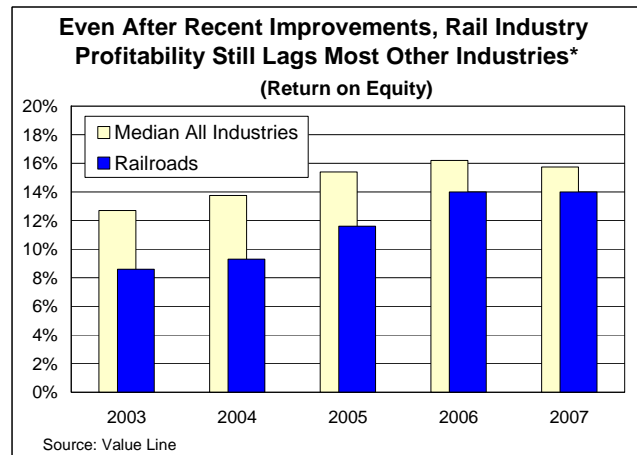
Unlike trucks and barges, which travel on heavily-subsidized highways and waterways, freight railroads must pay for nearly all of their infrastructure and equipment investments themselves, either from earnings or by borrowing from outside investors.

Reregulation, though, would take railroads away from the financial sustainability they need to pay for those investments. Artificially-lower rates brought about by reregulation would translate directly into lower rail earnings. This, in turn, would lead to lower spending on rail infrastructure and equipment; a deteriorating physical plant; and slower, less responsive, and less reliable rail service — outcomes that are incompatible with a growing, healthy economy.

Proponents of reregulation ignore the fact that rail investments in infrastructure and equipment, like most private investment decisions, are driven by expected returns. In order to expand infrastructure and service, railroads must — like every other business in a free market economy — obtain from their customers the resources necessary to support the growth their customers want and need

Railroads' financial health has improved over the past couple of years. But even in recent years, when railroads hauled more freight than ever before, their "record" earnings were still below most other industries. In other words, the best financial performance in decades for railroads is no better than ordinary when compared to other industries.

Improved rail earnings were a primary goal of deregulation in the first place. The success of deregulation in this regard should not lead anyone to conclude that it is no longer needed. That would be like a doctor telling a patient who had ingested poison that the antidote for the poison worked, so now the patient should have more poison.



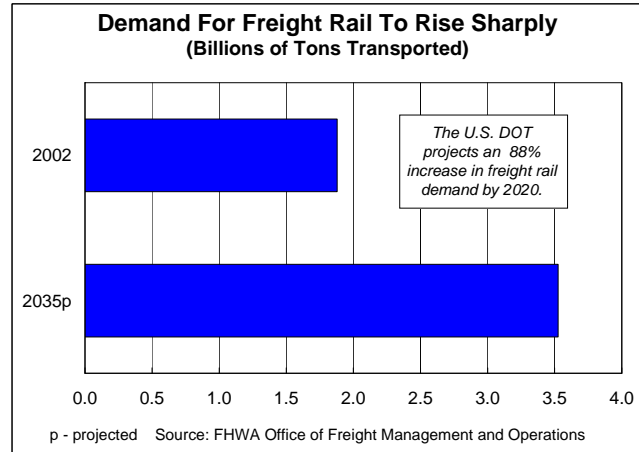
Railroads Need More Capacity, Not Less

Over the past few years, U.S. railroads have been moving more freight than ever before. Consequently, at many locations on the rail network, the days of excess rail capacity are over.

Moreover, demand for freight transportation is expected to grow sharply in the years ahead as our economy and population grow. According to the U.S. Department of Transportation, freight railroad demand will rise 88 percent by 2035. To meet this growing demand, railroads will have to concentrate increasingly on building new capacity in addition to maintaining and replacing their existing capacity.

The magnitude of the looming rail capacity issue was borne out by a recent study by Cambridge Systematics, a prominent economic and transportation consulting firm. The study, which focused on 52,000 miles of key rail corridors, was designed to estimate the cost of the capacity expansion necessary for railroads to handle the 88 percent traffic increase forecast by the DOT for 2035.

The study found that, if capacity needs are not properly addressed, by 2035 some 16,000 miles of primary rail corridors — nearly one-third of the 52,000 miles covered in the study — will be so congested by 2035 that a widespread service breakdown environment would exist. (Today, less than 1 percent of rail miles are that congested.) Because our rail system is interconnected, this outcome would mean that the entire U.S. rail system would, in effect, be disabled.



The Cambridge study estimated that an investment of \$148 billion (in 2007 dollars) will be necessary for infrastructure expansion to keep pace with economic growth, meet the DOT’s forecast demand, and maintain rail’s current market share. That’s in addition to the hundreds of billions of dollars necessary to maintain and replace existing rail infrastructure over the same period, and in addition to hundreds of billions of dollars needed to maintain and replace locomotives, freight cars, and other rail equipment.

Even without reregulation, railroads will be unable to pay for socially-optimal rail capacity entirely on their own. With reregulation, they would be able to fund far less. As the Congressional Budget Office recently noted, “As demand increases, the railroads’ ability to generate profits from which to finance new investments will be critical. Profits are key to increasing capacity because they provide both the incentives and the means to make new investments.”

Reregulation Would Mean Reduced Rail Efficiency, Higher Costs, and Poorer Service

Proponents of reregulation claim that, by forcing railroads to lower their costs, improve their efficiency, and improve their service, their proposals would actually lead to more traffic on railroads. They claim that this would keep rail profits high enough that rail disinvestments would not occur.

This implausible claim relies on the false assumption that today’s railroads are inefficient. In fact, the empirical evidence since passage of the Staggers Act supports the opposite view. Over the past 20 years, railroad productivity growth has exceeded the vast majority of other U.S. industries. Most of these productivity improvements have been passed through to shippers in the form of sharply lower average rates. Rail investment, already extremely high, has been growing, and rail innovations continue apace.

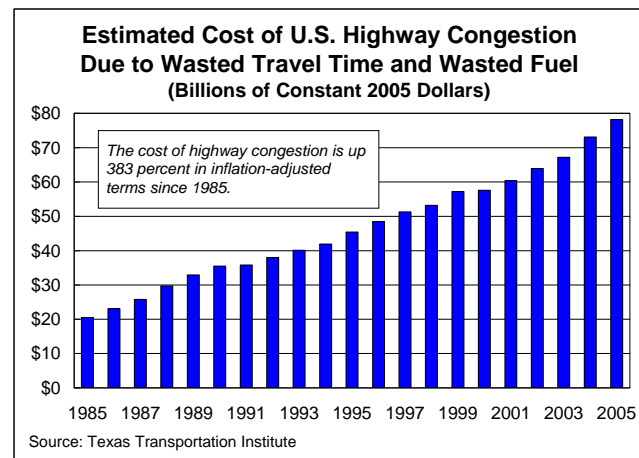
Nor would reregulation lead to improved rail service. Major service improvements and building new service-enhancing capacity are extremely expensive. Railroads would find it extremely difficult to maintain existing service levels — much less improve them — in the face of the capital shortfalls and disinvestment that reregulation would entail. Rail profits would inevitably fall, not rise. Traffic would divert from railroads, not be drawn to them.

Reregulation Would Threaten the Huge Public Benefits That Freight Railroads Offer

Our economic prosperity depends on the continued viability and effectiveness of our freight railroads. Railroads account for more than 40 percent of intercity freight ton-miles (more than any other transportation mode), and connect businesses with each other across the country and overseas. And as the former World Bank railways adviser explained, “Because of a market-based approach involving minimal government intervention, today’s U.S. freight railroads add up to a network that, comparing the total cost to shippers and taxpayers, gives the world’s most cost-effective rail freight service.”

Railroads provide huge public benefits beyond their cost-effectiveness:

- On average, railroads move a ton of freight 436 miles per gallon of fuel. Because railroads are, on average, three or more times more fuel efficient than trucks, every ton-mile of freight that moves by rail instead of truck reduces greenhouse gas emissions by two-thirds or more.
- A typical train takes several hundred trucks off our highways. Railroads thus help reduce highway congestion, the costs of maintaining existing roads, and the pressure to build costly new roads. According to the Texas Transportation Institute’s 2007 Urban Mobility Study, the annual cost of highway congestion in the United States is \$78 billion just in wasted travel time (4.2 billion hours) and wasted fuel (2.9 billion gallons).
- According to the EPA, a typical locomotive is far cleaner than a typical truck in terms of pollution per unit of freight moved.



Thus, deregulation has not only allowed railroads to compete more effectively in the transportation marketplace, it has also improved our environment and enhanced our mobility.

Conclusion

Any policy — especially a return of heavy-handed regulation — that endangers future rail revenue and cost recovery also threatens the sustainability of our rail system, and therefore must be avoided. Under reregulation, rail spending on infrastructure and equipment would shrink; the industry’s physical plant would deteriorate; needed new capacity would not be added; and rail service would become slower, less responsive, and less reliable. Eventually, either the government would have to make up the shortfall in rail earnings via subsidies, or railroads would have to cut the size of their networks and/or the services they offer.

Both of these outcomes can be avoided if policymakers reject calls to reregulate the rail industry.