

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 705
COMPETITION IN THE RAILROAD INDUSTRY

COMMENTS OF THE
U.S. DEPARTMENT OF AGRICULTURE

Edward Avalos
Under Secretary
Marketing and Regulatory Programs
U.S. Department of Agriculture
Washington, D.C. 20250

Date: April 12, 2011

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.

INTRODUCTION

The Department of Agriculture (USDA) commends the Board for holding this hearing to explore the current state of competition in the rail industry and possible policy alternatives to facilitate more rail-to-rail competition. The U.S. railroad industry has changed significantly since the Board's competitive access standards were adopted in the mid-1980s. These changes make it appropriate for the Board to consider means of increasing competitive access in the U.S. railroad industry.

In the comments below, we discuss the importance of rail transportation to agricultural producers, the importance of rail-to-rail competition, and the need today to increase rail competition. In the comments, USDA urges the Board to use reciprocal switching agreements as one means to increase rail-to-rail competition.

USDA COMMENTS

Rail Transportation Is Important to Agricultural Producers

Agricultural producers are dispersed over the entire country. Because these

producers' operations are tied to the land or specific climatic conditions, they are unable to move their operations. Because they are tied to the land, they must be able to transport their products to markets, many of which are located long distances from the farms.

Because there are many agricultural producers with operations that are relatively small in size, and their products are homogeneous, 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 cost increases forward to buyers. Instead, these producers tend to absorb cost increases, especially in the short-run. 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.

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.

During 2007, railroads moved 153 million tons of grain and oilseeds, which is 33 percent of all grain and oilseed shipments. Railroads are even more important for the movement of wheat, moving 66 percent of all wheat during 2007.

The Importance of Rail-to-Rail Competition

Despite the initial success of the Staggers Act, agricultural producers and shippers continue to express concern about decreased rail-to-rail competition, rapidly increasing rail rates, poor rail service, rail capacity constraints, and the fair allocation of rail capacity. Within the agricultural sector, grain producers and shippers in regions with more transportation competition have benefited the most from rail deregulation.¹

Producers with few transportation options, such as wheat farmers, have the highest rates.

Consequently, many shipper groups have supported increased rail-to-rail competition as a means to preserve the benefits of railroad economic deregulation in comments prepared for various Board proceedings. Competition requires businesses to become efficient and effective in providing the kinds and quality of goods and services the consumer desires. Competitive markets reduce market distortions and result in the efficient allocation of resources, providing a basis for economic development.

Furthermore, Harvard professor Michael Porter observes that industries sheltered from competition are less vigorous and successful than industries subject to competition.²

Greater rail market concentration has increased the need for stronger rail-to-rail competition. The top four railroads originated 84 percent of the grain and oilseed traffic

¹ Bitzan, John, 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.

² Porter, Michael, *The Competitive Advantage of Nations*, 1990, pp. 117-20, 225-238, 416, 708.

during 2009, compared to 53 percent during 1980. The top four railroads transported 94 percent of the wheat during 2009, compared to 80 percent in 1994.³

In addition, the level of rail-to-rail competition for grains and oilseeds decreased significantly between 1992 and 2007. Almost 75 percent of agricultural crop reporting districts lost rail competition from 1992 to 2007, and the crop reporting districts in which a railroad had a monopoly in transporting grain and oilseeds increased from 10 to 15 percent.⁴

USDA Supports the Use of Mandatory Reciprocal Switching

In the past, the Board has ruled that reciprocal switching is not required unless there is competitive abuse. In such cases, the complaining party must show that the railroad has used its market power to extract unreasonable terms or—because of its monopoly position—has disregarded the shipper’s needs by providing inadequate service. Due to increased railroad concentration resulting from numerous rail mergers, this policy no longer adequately serves the needs of the Nation.

Railroad termination of reciprocal switching services and rapid increases in reciprocal switching fees have precluded rail-to-rail competition in many instances. Reciprocal switching fees, when the service is available, typically exceed \$500 per railcar and have a variable cost near \$100. As a result, the marketing opportunities for many agricultural shippers have been limited to only those locations on the railroad serving the shipper.

³ Association of American Railroads, *Railroad Transportation of Grain*, 2010.

⁴ U.S. Departments of Agriculture and Transportation. *Study of Rural Transportation Issues*. <http://www.ams.usda.gov/AMSV1.0/RuralTransportationStudy>. April 2010.

USDA urges the Board to use mandatory reciprocal switching agreements as one means to increase rail-to-rail competition.⁵ These mandatory reciprocal switching agreements should be for a distance up to about 30 miles and for a fee of up to 180 percent of the Uniform Rail Costing System variable cost.

Because the costs for switching should not be significant to the total cost of the movement, USDA believes the distance should not be greater than about 30 miles. If substantially greater than 30 miles, the issue could become more of a line haul situation and could have unintended consequences for railroad profitability and investment incentives. Canada limits its reciprocal switching to 30 km or about 18 miles.

USDA recommends a fee up to 180 percent of variable cost because it assures coverage of fully allocable costs in most cases and allows for a profit. A fee of up to 180 percent of variable costs is reasonable because fees in recent trackage rights cases have been set as low as 130 to 145 percent of variable costs.

The Board report on rail competition in 2008 estimates that reciprocal switching will have a small effect on railroad profitability and investment incentives.⁶ In addition, the report identifies reciprocal switching as one of the methods most likely to result in shipper gains.

Prior Interstate Commerce Commission (ICC) and Board regulatory decisions affecting the degree of rail-to-rail competition were made when railroads were financially weak. Today, railroads are financially strong and market concentration has increased.

⁵ When—for a fee—a railroad transports traffic over its own track on behalf of a competing railroad, it is called reciprocal switching. Reciprocal switching enables the competing railroad to offer its own single-line rate, even though it cannot physically serve the shipper's facility.

⁶ Laurits R. Christensen Associates, Inc. *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition*. November, 2008. P. ES-39.

Although no Class I railroad attained revenue adequacy during 2009, several Class I railroads have reported record profits during 2010.

CONCLUSION

USDA urges the Board to use mandatory reciprocal switching agreements as one means to increase rail-to-rail competition. USDA believes such reciprocal switching agreements should be for a distance of up to 30 miles, and for a fee up to 180 percent of the variable cost. USDA believes this would nominally increase rail-to-rail competition in some areas, while enhancing the marketing opportunities for some agricultural shippers and would not substantially affect overall rail profitability and investment.

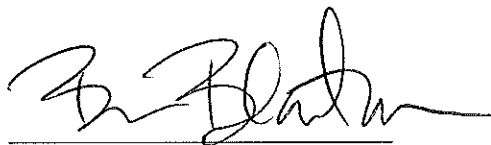
Respectfully submitted,

A handwritten signature in black ink, appearing to read "Edward Avalos", is written over a horizontal line.

Edward Avalos
Under Secretary
Marketing and Regulatory Programs
U.S. Department of Agriculture
Washington, D.C. 20250

CERTIFICATE OF SERVICE

I, Bruce Blanton, certify that on this 12th day of April, 2011, 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. 705.

A handwritten signature in black ink, appearing to read "Bruce Blanton", written over a horizontal line.

Bruce Blanton
Director
Transportation Services Division
U.S. Department of Agriculture
Washington, D.C. 20250