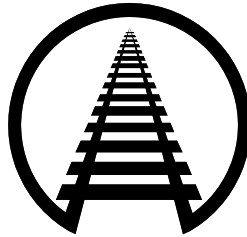


**STATEMENT OF**  
**EDWARD R. HAMBERGER**  
**PRESIDENT & CHIEF EXECUTIVE OFFICER**  
**ASSOCIATION OF AMERICAN RAILROADS**



**BEFORE THE**  
**U.S. HOUSE OF REPRESENTATIVES**  
**COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE**  
**SUBCOMMITTEE ON RAILROADS, PIPELINES AND**  
**HAZARDOUS MATERIALS**  
**HEARING ON THE 35th ANNIVERSARY**  
**OF THE STAGGERS RAIL ACT:**  
**RAILROAD DEREGULATION PAST, PRESENT, AND FUTURE**

**May 13, 2015**

**Association of American Railroads**  
**425 Third Street SW**  
**Washington, DC 20024**  
**202-639-2100**

## Introduction

On behalf of the members of the Association of American Railroads (AAR), thank you for the opportunity to testify on the 35th anniversary of the Staggers Rail Act of 1980. AAR members account for the vast majority of North American freight railroad mileage, employees, and revenue.

From the food on our tables to the cars we drive to the shoes on our children's feet, freight railroads carry the things America depends on. Approximately 570 freight railroads operate in the United States today (only Hawaii does not have at least one) over a network of nearly 140,000 miles. Railroads account for close to 40 percent of our nation's intercity freight ton-miles — more than any other mode of transportation. By linking businesses to each other here and abroad, freight railroads have played a crucial role in America's economic development for more than 180 years. Today, they serve nearly every agricultural, industrial, wholesale, retail, and resource-based sector of our economy.

Every year, railroads' efficiency and service reliability save their customers — and, ultimately, all U.S. consumers — billions of dollars. Today, millions of Americans work in industries that are more competitive in the tough global economy thanks to the affordability and productivity of America's freight railroads. A few years ago, the American Association of State Highway and Transportation Officials (AASHTO) estimated that if all freight rail traffic were shifted to trucks, rail shippers would have to pay an additional \$69 billion per year. Adjusted for increased freight volume and inflation, that figure is probably close to \$100 billion today.

Rail is also *the* environmentally friendly freight transportation option. In 2014, U.S. freight railroads moved a ton of freight an average of 479 miles per gallon of fuel. That's roughly equivalent to transporting one ton from Buffalo to Boston, or Long Beach to Tucson,

on a single gallon of fuel. On average, trains are four times more fuel efficient than trucks. Since greenhouse gas emissions are directly related to fuel consumption, that means moving freight by rail instead of truck lowers greenhouse gas emissions by 75 percent. A single freight train can replace several hundred trucks — enough to replace a 12-mile convoy of trucks on the highways — freeing up space for other motorists while reducing highway wear and tear and the pressure to build costly new highways.

As the Federal Railroad Administration has noted, “By many measures, the U.S. freight rail system is the safest, most efficient and cost effective in the world.” Ours is at or near the top among all countries in terms of miles of freight railroad, the condition of freight rail infrastructure and equipment, the amount of freight carried by rail, rail productivity, and other key rail-related measures. And unlike freight railroads in many parts of the world, nearly all of America’s freight railroads are privately owned and operated. Unlike our trucks, barges, and airlines, America’s freight railroads operate almost exclusively on infrastructure that they own, build, maintain, and pay for themselves.

The global superiority of U.S. freight railroads is no accident. Rather, it is a direct result of a balanced regulatory system, embodied in the Staggers Act, that relies on the marketplace to establish most rate and service standards. This balanced regulation has allowed railroads to improve their financial performance from anemic levels prior to Staggers to much healthier levels today, which in turn has allowed them to plow back hundreds of billions of dollars — again, their own funds, not taxpayer funds — into improving the performance of their infrastructure and equipment. The benefits to rail customers and our economy at large are immense.

We cannot be complacent, though. Looking ahead, our nation's economic prosperity and ability to compete successfully in the global marketplace require vibrant, effective freight railroads. But to be viable and effective, especially in the face of projected increases in freight transportation demand in the years ahead, railroads must be able to both maintain their *existing* infrastructure and equipment and build the substantial *new* capacity required to handle the additional traffic they will be called upon to haul.

Members of this committee have a critical role to play. I respectfully suggest that one of your primary obligations should be to refrain from taking steps that hinder railroads in earning enough to make the investments they need to sustain themselves and provide the current and future transportation capability our growing nation requires.

In this regard, it is crucial that the current balanced railroad regulatory framework embodied by the Staggers Act be retained. If artificial regulatory or legislative restraints are put into place that unnecessarily and unreasonably restrict rail earnings, rail spending on infrastructure and equipment will shrink. Either taxpayers will have to make up the difference or the industry's physical plant will deteriorate, needed new capacity will not be added, and rail service will become slower, less responsive, and less reliable. Why would anyone want an outcome like that?

Today, our nation faces a number of serious transportation-related problems, many of which this committee, to its credit, is working hard to address. It makes no sense to add to that list by trying to fix something that isn't broken. The current rail regulatory system is working well, and because of that our nation's freight rail network is working well too.

To be sure, challenges remain. Foremost among them is the need to find ways to make an already safe rail system even safer. Working with their employees, their customers,

their suppliers, and policymakers at all levels, railroads will continue to seek solutions to their safety challenges while continuing to make the massive private investments needed to meet tomorrow's freight transportation needs.

In my testimony below, I will briefly recap what the Staggers Act did and why it was necessary, outline some of the many ways the Staggers Act has benefited our nation's economy, and discuss why it's so critical for the health of our economy and our standard of living that the current balanced regulatory system Staggers created be retained.

### **The Rail Industry Before the Staggers Act**

In 1887, Congress passed the Interstate Commerce Act, creating the Interstate Commerce Commission (ICC) and making railroads the first major U.S. industry to become subject to comprehensive federal economic regulation. Over the next 93 years, the federal government would come to control broad aspects of rail pricing, service, and asset utilization.

The results were disastrous. Entire books have been written on the subject, but suffice it to say here that by the 1970s, archaic regulations, in conjunction with intense competition from other transportation modes, had driven the rail industry to the brink of ruin. Consider:

- During the 1970s, more than 20 percent of the nation's rail route mileage was accounted for by railroads operating under bankruptcy protection.
- Between 1970 and 1979, the rail industry's rate of return on net investment never exceeded 2.9 percent and was as low as 1.2 percent. Rail investors could earn far more putting their money in a passbook savings account than investing it with railroads.
- Railroads lacked the capital to properly maintain their tracks. By 1976, more than 47,000 miles had to be operated at reduced speeds because of poor track conditions. Deferred maintenance was in the billions of dollars and the term "standing derailment" — when stationary railcars simply fell off badly maintained track — entered the railroad lexicon.
- By 1978, the rail share of intercity freight had fallen to 35 percent, down from 75 percent in the 1920s.

Excessive and oppressive railroad regulation was largely to blame. As the U.S. Department of Transportation noted in 1978, “The current system of railroad regulation ... is a hodgepodge of inconsistent and often anachronistic regulations that no longer correspond to the economic condition of the railroads, the nature of intermodal competition, or the often-conflicting needs of shippers, consumers, and taxpayers.”<sup>1</sup>

The status quo was untenable. Congress had two options: nationalization, at a continuing cost of untold billions of dollars, or deregulation and greater reliance on the free market. Congress wisely chose deregulation and passed the Staggers Rail Act of 1980.

### **Major Provisions of the Staggers Act**

In passing the Staggers Act, Congress recognized that railroads faced intense competition from trucks and other modes of transportation for most freight traffic, but prevailing regulation prevented railroads from earning adequate revenues and competing effectively. Railroad survival required a new regulatory structure that allowed railroads to, in effect, establish their own routes, tailor their rates to market conditions, and differentiate rates on the basis of demand. Congress mandated that, going forward, rail transportation should be governed principally by the marketplace — that is, by private actors making decisions about the use of privately-owned property — though with regulation continuing where railroads did not face effective competition and as a remedy for anticompetitive conduct by railroads.

Consistent with these principles, the Staggers Act eliminated many of the most egregious regulations that prevented railroads from meeting the needs of their customers reliably and efficiently. For example, Staggers:

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<sup>1</sup> U.S. Department of Transportation, *A Prospectus for Change in the Freight Railroad Industry*, October 1978, p. 25.

- Allowed railroads to price competing routes and services differently. Prior to Staggers, rates were set by “rate bureaus,” which recommended general rate increases that applied across the board to all railroads. Rates were equalized over all routes between a given origin/destination pair, without regard to differing costs. The Staggers Act gave railroads freedom to price according to market demand and to operate over their most efficient routes.
- Allowed railroads to enter into confidential contracts with shippers. Such contracts were virtually unknown prior to Staggers because of regulatory restrictions.
- Expanded regulators’ authority to exempt categories of rail traffic from regulation if regulation was not needed to protect shippers from an abuse of rail market power. For example, traffic that could easily be carried by railroads’ trucking competitors could be exempted.
- Streamlined procedures for the abandonment and sale of rail lines. Prior to Staggers, the ICC required railroads to continue service on thousands of miles of rail lines that lacked enough traffic to be operated profitably.
- Directed that the ICC, when it adjudicated the reasonableness of rail rates, had to take into account a railroad’s need to earn adequate revenues.

One of the fundamental principles of the Staggers Act was something that had been essentially ignored for decades prior to it: if our nation is to have a viable, efficient, privately owned freight rail system, someone has to be willing to pay for it, and the market is far superior to the government in determining who should pay. Railroads were given the freedom to utilize their assets and price their services like most other businesses could.

Importantly, the Staggers Act did not completely deregulate railroads. In addition to retaining authority over a variety of non-rate areas, the ICC, and now its successor, the Surface Transportation Board (STB), retained the authority to set maximum rates if a railroad is found to have “market dominance” and to take other actions if a railroad engaged in anticompetitive behavior.

### **The Post-Staggers Era**

The Staggers Act has been one of the most successful transportation-related pieces of legislation in history, yielding tremendous benefits for rail customers and our economy:

- Average inflation-adjusted rail rates (measured by revenue per ton-mile) are down 43 percent since Staggers was passed. This means the average rail shipper can move close to twice as much freight for close to the same price it paid when Staggers was passed (see the lowest line in Figure 1).

- Rail volume today is twice what it was when the Staggers Act was passed (see the dashed line in Figure 1).

- After decades of decline, rail market share has grown. It is now close to 40 percent when measured in ton-miles, more than any other transportation mode.

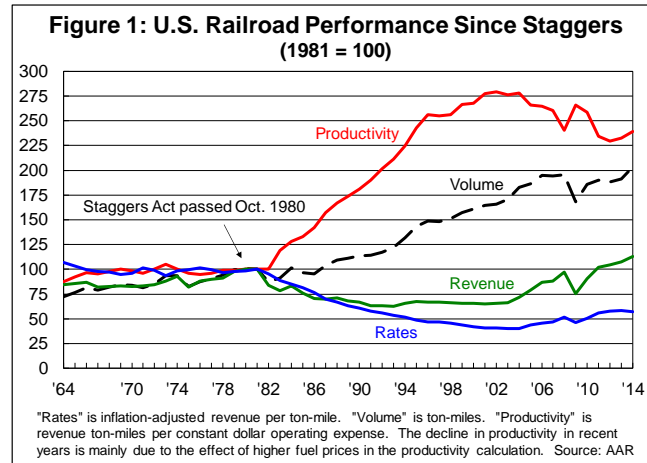
- Railroads are stronger financially. Return on investment, which had been falling for decades, rose to 4.4 percent in the 1980s, 7.0 percent in the 1990s, and 9.4 percent from 2000 to 2014. As discussed further below, improved rail earnings are a positive development because they allow railroads to make the massive investments needed to keep their track and equipment in top condition and help their customers grow in a very competitive global economy.

- Thanks to their improved financial health, freight railroads have been able to reinvest \$575 billion of their own funds back into their operations to create a national freight rail network that is second to none in the world. Railroad spending is discussed in more detail below.

- Railroads are much safer. The train accident rate in 2014 was the lowest ever, and the employee injury rate and grade crossing accident rates were near record lows. Railroads know that the safety challenge never ends and are continuing to find ways to further improve the safety of their operations.

- Since Staggers, railroads have increased their productivity far more quickly than most other industries. Overall rail industry productivity was flat for many years prior to Staggers, but is up nearly 140 percent since then (see the top line in Figure 1).

- Service and reliability have greatly improved as America's freight railroads have become the most efficient and productive in the world.



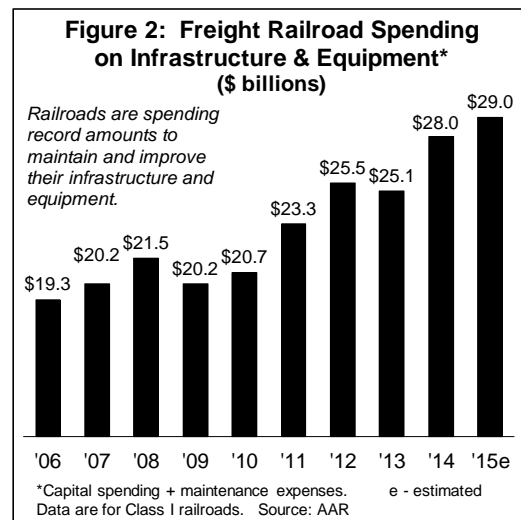
These tremendous gains are exactly the kinds of results that Congress hoped for when it passed the Staggers Act. The challenge for members of this committee and other policymakers is to ensure that those gains are not squandered and that our nation's freight rail system remains the envy of the world.



## Freight Rail Spending on Infrastructure and Equipment

As noted above, prior to passage of the Staggers Act, much of the U.S. rail infrastructure base was in miserable condition, mainly because railroads lacked the funds to properly build and maintain it. This changed with the passage of the Staggers Act. Railroads responded to the act's balanced reforms by rationalizing and upgrading their systems, dramatically increasing productivity, improving service, sharply lowering average rates for their customers, and reinvesting heavily in productive rail infrastructure and equipment.

Indeed, from 1980 to 2014, America's freight railroads have spent \$575 billion on capital expenditures and maintenance expenses related to locomotives, freight cars, tracks, bridges, tunnels and other infrastructure and equipment. That's more than 40 cents out of every revenue dollar, invested right back into a rail network that keeps our economy moving. In recent years, despite weak economic conditions, railroads have been spending more than ever before, including \$28 billion in 2014 and an expected \$29 billion in 2015 (see Figure 2).



Put another way, America's freight railroads today are spending more than \$500 million per week — of their own funds, not government funds — on their infrastructure and equipment. This is an extraordinary level of funding, a clear indication of the remarkable diligence with which railroads approach capacity and infrastructure issues. Railroads know that if America's future freight transportation demand is to be met, they must have the capacity to handle it. They are preparing for tomorrow today, all over the country:

- Norfolk Southern plans to expand its Austell, Georgia intermodal terminal to accommodate an additional 1,000,000 containers by 2022. This \$13.4 million expansion includes new track, three new truck chassis storage lots, and a new state-of-the-art lift crane. The expansion will mean better service for the region's intermodal shippers while removing trucks from the surrounding highways.
- Over the last few years, Genesee & Wyoming's Arizona Eastern Railway has been working on a \$30 million project to upgrade and rebuild its line with new rail, ballast, thousands of new ties, and devices called turnouts that allow railcars to move from one track to another. These and other enhancements have already allowed the railroad's customers to significantly increase their output and capacity, thereby creating additional jobs in southeastern Arizona.
- As part of a multi-year effort to enhance the fluidity of its network, BNSF Railway is laying a second track alongside an existing track over a 150-mile stretch between Minot, North Dakota and Snowden, Montana. This track segment has seen huge volume increases since 2009; the expansion will enhance safety and allow BNSF to serve customers in the region more efficiently and reliably.
- Canadian National may be headquartered in Canada, but about 30 percent of its traffic volume is in the United States, particularly in and around Chicago. Over the past five years, CN has invested well over one billion dollars on its Midwest operations, helping the railroad accommodate increased demand, freeing up rail capacity inside Chicago for other railroads, and helping its customers compete better in their end markets.
- CSX recently added additional tracks and lift cranes to its northwest Ohio intermodal hub to meet growing demand. Thanks to this expansion, the facility, which first opened in February 2011, can now process one million containers annually. That's one million potential trucks off the roads. The facility has provided countless businesses in small- and medium-sized markets throughout the region access to highly efficient intermodal service for the first time.
- Kansas City Southern is spending more than \$18 million on a stretch of track between Laredo and Corpus Christi, Texas to install approximately 80,000 crossties, replace six miles of rail, enhance more than 170 road crossings, and add structural improvements to the International Bridge in Laredo. Together, these projects will expand capacity and enhance safety at a key location for imports and exports.
- Union Pacific is investing in a new rail yard in Hearne, Texas to better connect fast-growing Texas markets with the national freight rail network. The Hearne facility, known as a classification yard, will serve as a sorting facility, akin to a hub airport, helping to move goods to market faster. The new facility will help meet the region's growing need for building materials and consumer goods while removing trucks from congested Texas highways.
- Canadian Pacific (CP) is installing a centralized traffic control (CTC) system across much of its network, with a focus on its corridor from Canada into Chicago. CTC increases available capacity on CP's network by increasing velocity and allowing additional trains per day. It also improves safety by providing centralized notification of rail breaks and misaligned switches.

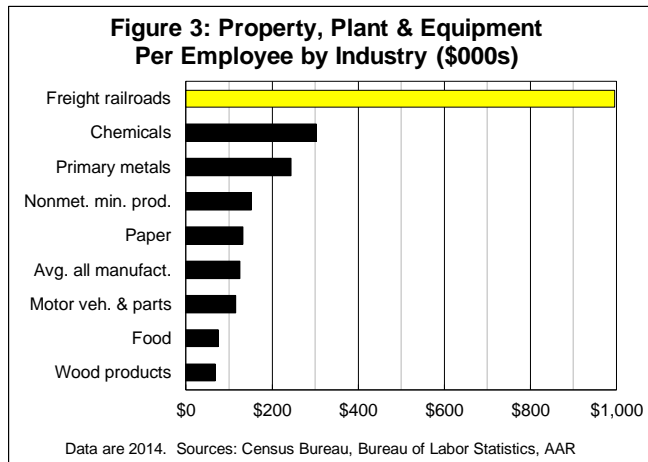
These are just a few examples of the thousands of similar projects that freight railroads undertake each year. Some of these projects cost railroads a few thousand dollars; others cost hundreds of millions of dollars. Whatever their cost, all of the projects are aimed at maintaining and growing railroads' networks so that they are better able to serve their customers and provide the safe, efficient freight transportation service our nation's economy needs. And all of them are far more likely to be undertaken under today's balanced regulatory system than they would be under a system of excessive, needless regulation.

### Financial Realities Facing Freight Railroads

This committee knows well that transportation systems are expensive to build and maintain, whether with private or public funds. Railroads are no exception: to put it bluntly, you don't get a best-in-the-world freight rail network, like the United States has, on the cheap.

By any of a number of measures, the capital intensity of freight railroading is at or near the top among all U.S. industries. For example, in recent years, U.S. freight railroads have spent an average of 19 percent of revenue on capital investment. The comparable figure for the U.S. manufacturing sector as a whole is around 3 percent.

Similarly, railroad net investment in plant and equipment per employee (a measurement that incorporates cumulative capital spending over many years) is far higher than other industries. As Figure 3 shows, the figure for freight railroads for 2014 — \$997,000 per employee — is nearly



eight times the average for all U.S. manufacturing (\$126,000). Finally, firms in different

industries require very different quantities of land, equipment, and other assets to operate effectively. Firms, including railroads, with very high levels of assets require higher profits in order to cover the costs of those assets.

Because U.S. freight railroads are overwhelmingly privately owned and must finance the vast majority of their infrastructure and equipment spending themselves, this spending is accompanied by substantial financial risk. Back in 2006, the Government Accountability Office correctly noted that, “Rail investment involves private companies taking a substantial risk which becomes a fixed cost on their balance sheets, one on which they are accountable to stockholders and for which they must make capital charges year in and year out for the life of the investment. A railroad contemplating such an investment must be confident that the market demand for that infrastructure will hold up for many years. This is in sharp contrast to other modes such as highway infrastructure, which is paid for largely by public funds.”<sup>2</sup>

Accordingly, railroad capacity investments must have a reasonable expectation that they will generate an adequate return over a long period of time. For this reason, adequate rail earnings — again, over the long term — are critical for capacity investment. As the Congressional Budget Office (CBO) noted, also in 2006, “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.”<sup>3</sup>

The GAO’s and CBO’s comments are just as valid today as they were when first made. If a railroad is not financially sustainable over the long term, it will not be able to

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<sup>2</sup> Government Accountability Office, *Freight Railroads: Industry Health Has Improved, but Concerns About Competition and Capacity Should Be Addressed*, Oct. 2006, p. 56.

<sup>3</sup> Congressional Budget Office, *Freight Rail Transportation: Long-Term Issues*, Jan. 2006, p. 11.

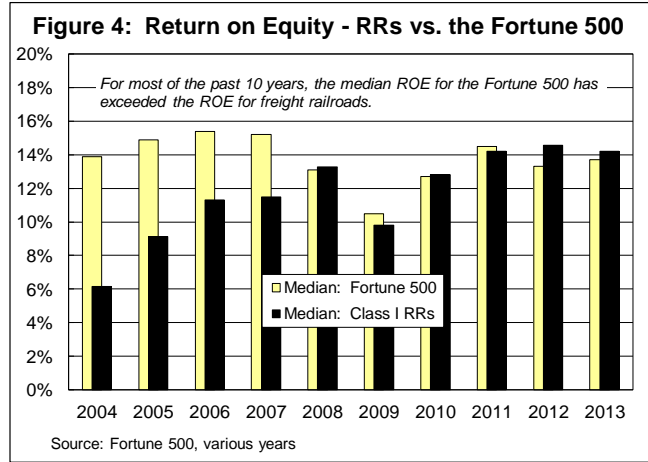
make capacity investments to maintain its existing network in a condition to meet its customers' demands or make additional investments in the replacement or expansion of infrastructure required by growing demand.

Major freight railroads face additional constraints because they are either publicly traded or are subsidiaries of publicly traded companies. As such, they must provide their shareholders a return commensurate with what those shareholders could obtain in other markets with comparable risk. If railroads are viewed as returning less to shareholders (because of misguided regulations or any other reason) than comparable investment opportunities, then capital will flee the rail industry or will only be available at much higher costs than we see today.

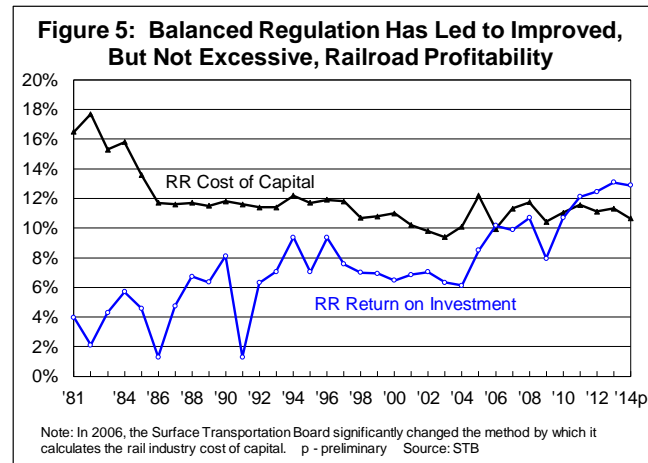
These points — that railroads must be able to earn sufficient revenue that they can invest in and grow their networks, and that, as public companies, they must provide their shareholders with a return that will entice capital providers to invest their money with railroads — are foundational. The ability to invest in their networks allows railroads to improve safety, provide the levels of service that their customers demand, and create the efficiencies needed to help ensure that our economy is competitive in global markets.

Railroads acknowledge that their financial performance in recent years has been much improved compared to earlier years, with some railroads recording “record profits.” Until recently, rail profitability was generally poor relative to most other industries. Thus, an improvement from earlier years may be a “record,” yet may still yield levels of profitability that are only about average compared with the earnings achieved by most of the other industries against which railroads compete for capital.

One example that illustrates this point is return on equity (ROE), a measure of profitability that reveals how much profit a company generates with the money shareholders have invested. Figure 4 shows that the ROE for the rail industry has improved over the past few years, but it is still only about average compared to the Fortune 500. To use a baseball analogy, a hitter with a lifetime batting average of, say, .225 isn't automatically headed to the Hall of Fame when his batting average goes up to, say, .250.

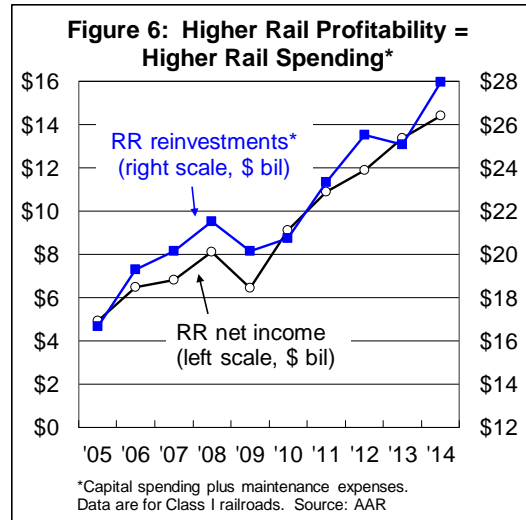


Likewise, Figure 5 shows that there used to be a huge gap between the rail industry's cost of capital and its return on investment. There is hope that this gap will be closed, on a long-term basis, in the years ahead. If America's freight railroads are to fully deliver their potential benefits to the economy, such an outcome should be regarded as one step along the path toward sustainability, not as the final destination.



Make no mistake, the rail industry is encouraged by the improvements in its financial condition in recent years, and they will work to see that those improvements continue. But it would be a tremendous mistake for policymakers to view recent improvements in rail earnings as a reason to cap rail earnings through price controls, artificial competitive

constraints, or by other means. This would encourage capital to flee the industry, threatening railroads’ ability to reinvest in their networks. Higher rail earnings have made it possible in recent years for railroads to plow back record amounts of their own funds on the locomotives, freight cars, tracks, bridges, tunnels and other infrastructure and equipment they need to keep the U.S. freight rail network in world-best condition and to meet our nation’s growing transportation needs. Take away rail earnings today and you limit rail capacity and service capability for tomorrow. As Figure 6 shows, you can’t have one without the other.<sup>4</sup>

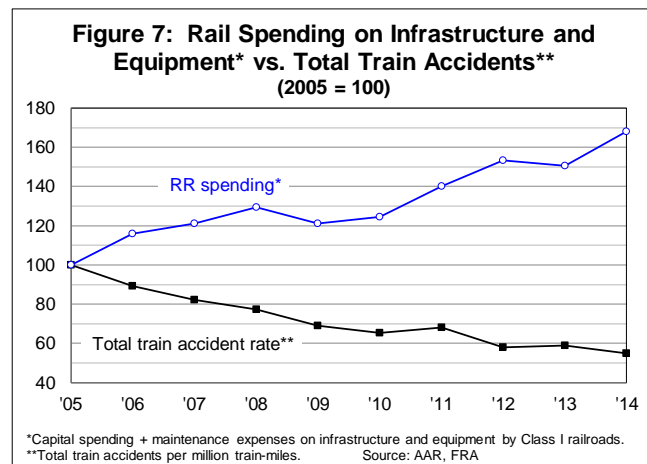


Thanks to the vast sums railroads have poured back into their networks — something that could never have happened without Staggers — U.S. freight rail infrastructure today is in better overall condition than ever before. No other transportation mode can say this. Even more remarkably, rail infrastructure is in the condition it’s in because of private spending, not public spending. Indeed, the term “crumbling infrastructure” applies to many of our highways, waterways, and transit systems, but with few exceptions it does not apply to our nation’s freight railroads. Prior to the Staggers Act, it did. Without appropriate public policies, it could again. We can’t let that happen.

<sup>4</sup> Chemical firms, some of whom are at the forefront of those who want to re-impose onerous regulations on railroads, understand this point well. At a February 19, 2015 conference, the CEO of Air Products and Chemicals, a major U.S. chemical producer, asked, “Why do we deserve to maintain our [pricing] margin? So that we can continue to invest and create new products for our customers... [I]f we don't do that, then our margins will go down. Then in order to keep the investors happy, we would have to cut R&D, we would have to cut development, and as a result five years from now, our customers wouldn't have what they need. So, it's really for the good of our customers that we need to be a viable organization.”

It's also important to note that railroads' infrastructure and equipment spending, made possible by the Staggers Act reforms, play a crucial safety role. Preliminary data indicate that 2014 had the lowest train accident rate in history. Railroads are proud of this fact, but they also know that the pursuit of safety never ends. And they know that virtually every project they pursue to replace existing assets or build new capacity also enhances safety in one way or another. For example, a railroad might replace lighter weight rail with heavier rail made from a higher quality steel that is more durable and can better handle heavy trainloads than the rail it replaced. For many rail investments, improving safety is the primary reason the investments are made in the first place. For example, railroads have installed large quantities of trackside detectors that identify defects

on passing rail cars — including overheated bearings and damaged wheels, dragging hoses, deteriorating bearings, cracked wheels, and excessively high and wide loads — before structural failure or other damage occurs. The correlation is



clear: as railroads' spending on their networks rises, safety improves (see Figure 7).

### Upsetting the Existing Regulatory Balance is Not Consistent With Staggers

From the time the Staggers Act was passed, advocacy groups have sought to amend it or make changes to the regulatory regime it spawned that would fundamentally alter the landscape in which railroads operate. The changes these self-interested groups seek would grievously harm our nation's freight transportation capability and deviate sharply from Congress's intent in passing the Staggers Act.



At their most basic level, proponents of railroad reregulation believe that railroads charge them too much and that the use of differential pricing by railroads is unfair. They seem to discount the notion that a railroad must balance the desires of each customer to pay the lowest possible rate with the requirement that the overall network earn enough to pay for all the things needed to keep it functioning now and into the future. Rhetoric from rail industry critics about “competition” cannot change the fact that railroads must be able to cover their costs or they will not be able to maintain or expand their infrastructure and provide the services upon which their customers and our nation depend.

Indeed, when one looks behind the actions that proponents of reregulation are urging upon Congress and the STB to “reform” freight rail policy, it is clear that “reform” is a euphemism for “force railroads to subsidize us” and that the needs of the railroads and the general public are a distant second to their own narrow desires.

Changes that proponents suggest in the current railroad regulatory regime are based on a fundamental misrepresentation of what the Staggers Act was all about.

First, nothing in the Staggers Act is meant to imply that the only competitive force that matters is rail-to-rail competition, that service to a shipper by a single railroad is equivalent to monopoly power, and that all rail shippers therefore have a right to service by more than one railroad. Rather, Staggers was premised on the understanding that the market — not regulatory or legislative fiat — would determine which markets have sufficient demand to sustain multiple railroads and which do not. Staggers encourages the creation of additional competition through private investment and initiative, but it does not seek to artificially manufacture additional competition through governmental intervention. 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 and Chicago can. A world in which multiple railroads chase every, or nearly every, customer has never existed.

Second, Staggers did not bestow on railroads a special public service obligation, verging on the governmental, to subsidize other businesses, compensate for regional disadvantages or characteristics, or serve as the instrument for advancing other local or national objectives at the railroads' own expense. Thus, Congress did not intend to force railroads to provide service that does not pay its way.

Third, Staggers was not meant to force a railroad to price one shipper's movements at the same rate as another shipper's movements, or to cap rates at some percentage of variable costs. Instead, Staggers explicitly recognized differential pricing as essential for railroads. Only by pricing in accordance with the varying demands for rail service (with reasonable regulatory protections against unreasonable rates) can railroads efficiently recover all of their costs, serve the largest number of rail customers, and maintain the viability of the nation's rail system.<sup>5</sup> Of course, shippers are not always thrilled with the prices they are able to negotiate with the railroads. Virtually every purchaser of goods or services, including railroads, would like to get a better deal than what they have from their suppliers. But there is no question that, since Staggers, the vast majority of railroad rates are market-based and driven by competition — just as Staggers intended.

Fourth, Staggers was not meant to be a vehicle through which one railroad could be ordered to make its facilities available for use by another railroad. Under current regulation, unless a railroad is found to have engaged in anticompetitive conduct, it can determine for itself how to utilize its assets. The experience prior to Staggers, when regulators again and

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<sup>5</sup> For more on why differential pricing is necessary in the rail industry, see <https://www.aar.org/BackgroundPapers/Differential%20Pricing%20in%20the%20Rail%20Industry.pdf>.

again deemed their judgment superior to that of rail management in the allocation of rail assets, with dismal consequences for railroad efficiency, should not be repeated.

The need for efficiency helps explain why railroads strongly oppose efforts to reverse existing policy under which the STB must first find that a railroad serving a terminal area is engaged in anti-competitive conduct before the STB can order the railroad to “switch,” or interchange, traffic to another railroad when such an interchange is not necessary for freight delivery. Adding an interchange to a movement that is currently handled in single-line service adds substantial time, complexity, and costs to that movement. Over the years, railroads have invested tens of billions of dollars and enormous effort into concentrating traffic onto routes that are the most efficient for rail customers as a whole. Part of this effort has been the development of very efficient and streamlined terminal switching. The result has been sharply higher productivity, reliability, and asset utilization, and lower average freight rates for rail customers. Forced switching would destroy these terminal efficiencies, compromise the service improvements they have created for rail customers, and raise rail costs. The added switching activity that would be required, the increased possibility of service failures caused by that new switching activity, and the complex operations that would be required to bring about the new interchanges would disrupt rail traffic patterns, produce congestion in rail yards, and undermine efficient service to customers.

The need for efficiency also helps explain why railroads oppose reversing existing “bottleneck” policy<sup>6</sup> and forcing railroads to prioritize certain types of traffic over other types.

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<sup>6</sup> In “bottleneck” situations, one railroad can move freight from an origin to an intermediate point, and from that intermediate point on to a final destination, and at least one other railroad can also move the freight from that intermediate point to the final destination. For more on the bottleneck issue, see: <https://www.aar.org/BackgroundPapers/Bottleneck%20Policy%20-%20Dont%20Fix%20What%20Isnt%20Broken.pdf>.

In addition to putting at risk several billion dollars in rail revenue each year, reversing existing bottleneck policy would lead to huge disruptions in railroads' physical operations because it would force railroads to route traffic without regard to network efficiency. In essence, a few shippers would be able to disrupt rail operations and raise costs for everyone else. Likewise, forcing railroads to prioritize certain types of traffic over others would force railroads to sacrifice what's good for their customers as a whole for what's good for just a small segment of their customer base.

Fifth, the Staggers Act was not intended to prevent railroads from engaging in practices that improve efficiency or from offering incentives to shippers that make efficiency improvements themselves. Thus, for example, railroads often offer shippers lower rates to move their product in larger shipments. The lower rates result in more efficient movements in the marketplace. Under this system, the market — not railroads — decides whether investments in facilities designed to handle more efficient shipments are appropriate.

Sixth, nothing in the Staggers Act supports efforts to cast aside the fundamental tenet of the economics of competition that says that where competition exists, there should be no regulatory intervention. Because the vast majority of rail freight movements are subject to an array of competitive forces — including competition from trucks and barges, product competition<sup>7</sup>, and geographic competition<sup>8</sup> — the vast majority of rail movements should

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<sup>7</sup> Substituting one product for another in a production process — for example, generating electricity from natural gas (which is not carried by railroads) instead of coal (which is). This is far from a hypothetical example. To illustrate, in an April 29, 2015 earnings call, the CEO of Southern Company, one of the largest U.S. utilities, said “[O]ur diverse generation fleet enables us to quickly adapt to constantly changing market conditions with the ability to utilize the most cost efficient generation resources at any particular point in time. When natural gas prices are low, for example, we are able to take advantage by burning more natural gas and less coal.”

<sup>8</sup> The ability to obtain the same product from, or ship the same product to, a different geographic area. For example, clay is used for taconite pelletization in Minnesota. This clay is available from Wyoming mines served by one railroad and from Minnesota mines served by another. Iron ore producers can play one railroad against the other for clay deliveries.

likewise be free of governmental oversight. Unfortunately, proposals by some rail critics, including the proposals regarding forced switching and “bottleneck” policy noted above, would unjustifiably subject huge swaths of rail traffic to governmental rate and service regulation, putting billions of dollars in rail revenue at risk.

Finally, Congress, through Staggers, has provided (and the ICC and STB have implemented) effective remedies to protect shippers from abuse of market power or anti-competitive behavior. But Staggers was not designed to allow those unhappy with either the rates they are charged or STB decisions in rate cases to simply abandon the use of sound economic principles as a basis for rate decisions or to ignore the fundamental principle that railroads need to earn sustainable revenues.

Remedies for unreasonably high rail rates are available if it can be shown that the railroad does not face effective competition for the traffic at issue. Upon finding a rate unreasonably high, the STB is authorized to award reparations and to prescribe maximum rates for the future.

The STB has recognized that the procedures it uses in large rate cases — when hundreds of millions of dollars might be on the line — are not appropriate in all cases, especially when the amount at issue is relatively small. In response, the STB has instituted for smaller cases new alternatives that are far less expensive and time consuming. Railroads support making the STB rate and service adjudication processes accessible to all shippers, but the procedures used must be based on sound economic principles.

### **Misleading Claims by Rail Industry Critics**

Proponents of additional regulations on railroads claim to have only the best intentions. They don’t want to “reregulate” railroads, they say; they only want more healthy

“competition” that will make railroads stronger, within the spirit of the Staggers Act. They insist they “don’t want to undermine the ability of railroads to function and make needed investments.” They just want to update “outdated policies” that are “not equipped to handle today’s challenges.”

Don’t let them fool you. When one looks at the actual policy changes that proponents of this view are urging upon Congress and the STB, it’s clear that what they seek would substantially increase government control over crucial areas of rail operations in ways that would lead to a loss of efficiency, responsiveness, and potentially billions of dollars in rail revenue each year. It’s unavoidable that rail investments and service would suffer greatly.

It’s an unfortunate reality that, when trying to make their case, rail industry critics sometimes resort to misleading claims. For example, they complain that “railroad rates have surged 98% over the last decade – more than three times the rate of inflation.”<sup>9</sup>

No one disputes that rail rates on average have risen in recent years. But as noted above, America’s privately-owned freight railroads operate almost exclusively on infrastructure that they own, build, maintain, and pay for themselves. Higher rail earnings, made possible in part by those higher rail rates, have enabled railroads to plow back record amounts to keep the U.S. freight rail network in world-best condition.

Putting aside that point, the claim that rail rates have increased “more than three times the rate of inflation” is irrelevant because the overall consumer price index (CPI, the basis for the “three times” claim) does not measure rail input costs. A price index that does is the Rail Cost Adjustment Factor (RCAF). The RCAF is prepared by the AAR under the direction of the STB and is subject to independent outside audit every two years. Since 2001, the RCAF

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<sup>9</sup> This and other statements in this section come from various statements found on the web site of “The Rail Customer Coalition” ([www.freightrailreform.com](http://www.freightrailreform.com)).

has risen much more quickly than the CPI (see Figure 8). That being the case, it would be surprising if rail rates had *not* risen much more quickly than overall consumer prices.<sup>10</sup>

It's ironic that some of the rail customer groups who complain about

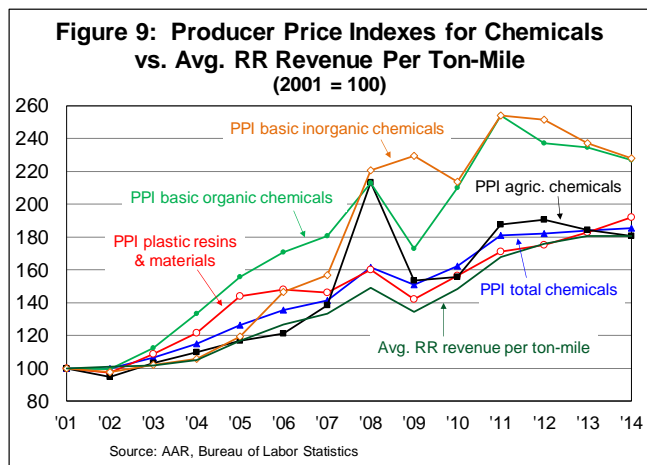
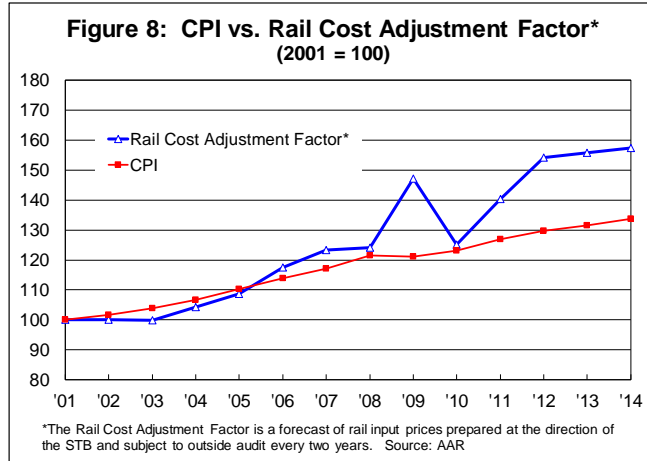
railroad rate increases in recent years have seen the prices they charge increase even faster.

For example, according to data from the Bureau of Labor Statistics, average prices for chemicals, as measured by the producer price index, rose 85 percent from 2001 to 2014;

prices for key chemical subsectors rose even more (see Figure 9). Meanwhile, average railroad revenue per ton-mile, unadjusted for inflation, rose 81% over the same period. In other words, the rail rate increases that the chemical industry is

so upset about are no more than, and usually less than, the chemical industry's own price increases over the same period.

Finally, rail industry critics are wrong when they make the tired claim that "railroad consolidation has led to skyrocketing rates that are shielded from market forces." Like most U.S. industries, freight railroads have consolidated over the past 35 years. Rail mergers have



<sup>10</sup> It should be noted that railroads set their prices based on the value they provide to their customers, not on their input costs. So do firms in virtually every industry, including rail critics who don't want railroads to do what they do themselves.

not, however, reduced intra-railroad competition. Because of conditions placed on every major post-1980 rail merger, shippers that had multiple railroads serving them prior to the merger still had multiple-railroad service following the merger. The precedent that rail customers should not go from two-railroad service to one via a rail merger is so well established that in the most recent major rail mergers (more than 10 years ago), the merging railroads addressed such situations even before applying to the STB for approval.

### **Looking to the Future**

The long-term demand for freight transportation in this country will undoubtedly grow. In fact, the Federal Highway Administration forecasts that U.S. freight tonnage will rise 45 percent by 2040. Railroads are the best way to meet this demand. With highway congestion becoming more acute and with public pressure growing to reduce emissions, conserve fuel, and promote safety, railroads are likely to be called upon to do even more in the years ahead, given their substantial advantages in these areas over other transportation modes. Demands for use of freight-owned track by passenger trains are mounting and will probably continue to grow. And, of course, as our economy evolves — as exemplified in recent years by the growth in rail intermodal traffic, chemicals, crude oil, sand, and other rail commodities — railroads will continue to be called upon to make additional investments in their networks to provide the efficient, reliable, and cost-effective freight transportation service that their customers, and our nation, need to prosper.

For that to happen, there must be appropriate public policies. Policymakers should acknowledge that for reasons of international competitiveness, safety, and economic growth, the United States has a critical and growing need for investment in transportation infrastructure. Private railroad investment in transportation infrastructure should be



encouraged, and regulations and legislation should not adversely affect railroads' ability or willingness to make those investments.

## **Conclusion**

The deregulatory reforms of the Staggers Act have been tremendously successful. The flexibility Staggers provided has enabled railroads to rationalize and upgrade their systems, reinvest well over half a trillion dollars in productive rail infrastructure and equipment, generate higher levels of service, dramatically increase productivity, and improve safety — while, at the same time, sharply lowering average rates for shippers.

These successes could not have happened without a regulatory regime under which competition and market forces are the determining factors in setting rail rates and service standards in most cases, with maximum rate and other protections available to rail customers who truly need them. The current system strikes an appropriate balance between providing railroads the freedom to compete effectively in the marketplace and providing shippers with a regulatory safety net if there is an abuse of railroad market power.

It may well be that particular elements of the current regulatory regime can be improved, and the rail industry is always willing to work with this committee, others in Congress, the STB, and other parties to identify areas where improvement might be made. That said, going forward, railroads need the continued flexibility that deregulation has offered in order to efficiently handle the rapidly expanding transportation needs of our economy. At a time when the pressure to reduce government spending on just about everything — including transportation infrastructure — is enormous, it makes no sense to enact public policies that would discourage private investments in rail infrastructure that would boost our economy and enhance our competitiveness.