TESTIMONY OF

THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

BEFORE THE

SUBCOMMITTEE ON RAILROADS
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON

THE STATUS OF THE SURFACE TRANSPORTATION BOARD
AND RAILROAD ECONOMIC REGULATION

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THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

Before the
Subcommittee on Railroads
Committee on Transportation and Infrastructure
U.S. House of Representatives

Presented by

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The National Industrial Transportation League

Concerning

The Status of the Surface Transportation Board and Railroad Economic Regulation

The National Industrial Transportation League is one of the nation's oldest and largest national associations representing companies engaged in the transportation of goods in both domestic and international commerce. The League was founded in 1907, and currently has approximately 600 company members. These members range from some of the largest users of the nation's transportation system, to smaller companies engaged in the shipment and receipt of goods. League members use all forms of transportation for the shipment and receipt of goods of all kinds, to literally thousands of points in the United States.

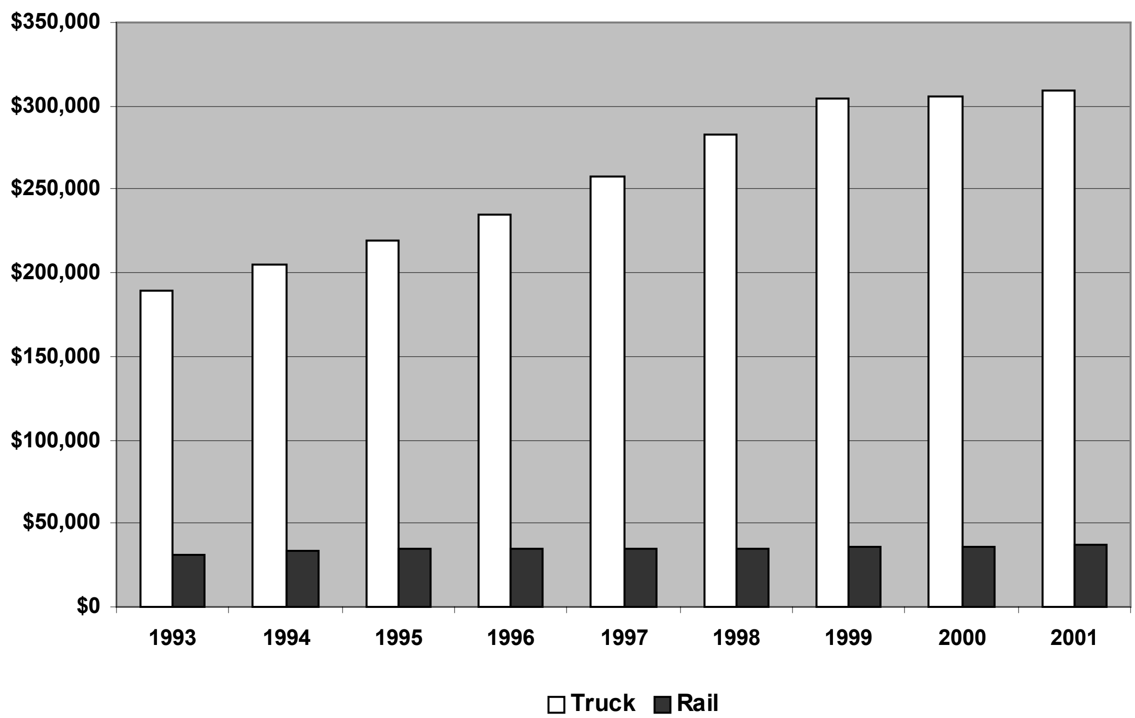
Many members of the League utilize rail transportation, and thus have a very substantial interest in federal policies relevant to rail carriers, including the status of the Surface Transportation Board and railroad economic regulation. Indeed, many League members are dependent on rail carriers to move their goods, and therefore need a safe, secure, efficient and financially healthy rail industry. For this reason, over the years the League has been a staunch supporter of the rail industry. Many League members are eager to increase their utilization of this vital industry, in order to meet their own and the nation's transportation needs. In fact, the ability of American manufacturers to compete in a world economy and the creation of jobs in the United States, depends in substantial part on the existence of a competitive and efficient rail industry. Rail transportation is thus not simply a matter of private interest between rail carriers and shippers, but appreciably contributes to our nation's overall economic health. Rail transportation also helps to alleviate congestion on our highways, and thus adds to the overall efficiency and safety of our nation's entire transportation system.

Moreover, the League well understands the capital-intensive nature of the rail industry and its large capital needs. Rail shippers depend on those infrastructures for the safe and efficient transportation of their goods. Almost exactly one year ago, the League appeared before this Subcommittee and urged the Congress to take steps to provide funds to improve the nation's rail infrastructure and to reduce the amount of taxes that the nation's rail carriers pay so that additional monies can be directed toward improving rail infrastructure.

Shippers will utilize the transportation modes that best meet their business needs. Shippers who have the option to choose between rail transportation and other modes will utilize the mode that provides them the best combination of service and price. Even shippers who are served by a single rail carrier and who must, because of the nature of their commodity or their situation, use rail in the short to medium term, if service or price is unsatisfactory may reduce their use of rail service by shifting production overseas or redesigning their manufacturing or distribution processes. Although the nation absolutely needs an expanding and vital rail industry, there are signs that the rail industry has not kept up with the nation's growing transportation needs.

The chart below shows one aspect of the situation. In 1993, according to data published by the Association of American Railroads ("AAR"), railroads intercity freight revenues were $30.7 billion. In that same year, trucks' intercity freight revenues were $189.7 billion. By 2001, trucks intercity freight revenues had grown to $309.4 billion, an increase of 63%. In contrast, by 2001, railroads intercity freight revenues had grown to $36.7 billion, an increase of just 19.5% over the same time frame.[1] In other words, in the 1993-2001 timeframe, the trucking industry's percentage of intercity freight revenue had grown over three times faster than that of the rail industry.

Modal Revenue Growth 1993-2001



Moreover, between 1993 and 2002, U.S. Class I railroads' dependence upon a single commodity – coal – grew from 38.2% of all tons carried to 44.4% of all tons carried, a 16.4% increase.[2]

Another aspect of this situation is shown in the growth of rail carriage compared to the growth in U.S. industrial production. According to AAR figures, between 1993 and 2002, the number of carloads originated by Class I railroads grew by 28.6% and tons originated grew by 26.5%. Yet, in this same period, U.S. industrial production grew by 36.8%.[3] In other words, over an entire decade, U.S. industrial

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1 Source: "Railroad Ten Year Trends 1993-2002," Volume No. 20, Policy and Economics Department, Association of American Railroads, p. 26 ("Railroad Ten Year Trends").

2 Id. p. 51.

3 Id. pp. 43 and 44.

production grew about twenty-five percent faster than railroads' traffic.[4] Even using ton-miles, the measure of production most favorable to railroads (which measures not only the number of tons transported but also how far those tons are carried), railroads' growth still had not kept pace with U.S industrial production.[5] In other words, today railroads are carrying things – primarily coal – farther than they carried those things ten years ago, but the number of carloads they carry is failing to keep pace with the growth in the U.S. industrial economy.

As mergers took place over the decade from 1993 to 2002, the number of Class I railroads declined from twelve carriers to just seven carriers. These mergers reduced routing options and a variety of other forms of competition for shippers. Yet, these mergers do not seem to have produced the dramatic improvements in service promised: according to AAR figures, the average freight train speed of Class I rail carriers in 2002 was lower than the average freight train speed of a decade earlier.[6] Nor have these mergers apparently produced the financial results hoped for: according to AAR figures, the rail industry's rate of return on net investment in 2002 (7.0%) is almost precisely where it was a decade earlier (7.1% in 1992) and its return on equity was lower (8.3% in 2002 versus 9.4% in 1993).[7] In fact, on average, both the railroads' rate of return on net investment and their return on equity were higher in the first five years of the decade than they were in the most recent five years of this ten-year period.[8]

Shippers need railroads to provide proven, reliable, consistent freight service, and they will pay for such service. This is because value consists of consistent service, competitive pricing, market innovation, and competitive choices. In a global economy, shippers are becoming more demanding of their transportation suppliers -- even more timely freight service, at even more consistent levels, at an

4 Id. U.S. industrial production grew 27.8 percent faster than carloads originated by Class I rail carriers, and 22.2% faster than the tons originated by Class I railroads.

5 Id. p. 44. In the ten-year period from 1993 to 2002, U.S. industrial production grew by 36.8%, and Class I railroads' ton miles grew by 35.9%.

6 Id. p. 132. The AAR reports that the average freight train speed in 1993 was 23.1 miles per train hour, while the average freight train speed in 2002 was 20.9 miles per train hour.

7 Id. p. 86, 90.

8 Id. p. 86, 90. Between 1993 and 1997, rate of return on net investment averaged 8.1%, while between 1998 and 2002, ROT averaged 6.8%. Return on equity from 1993 to 1997 averaged 10.3%, while from 1998 to 2002 it averaged 8.5%.

even more competitive price. They are becoming more demanding of their freight transportation suppliers because shippers' <u>customers</u> are becoming ever more demanding in an increasingly competitive global economy.

While the economic and services bar is being raised higher, the data suggests that, though the freight railroad industry is in far better financial shape than it was in the 1970s, it has not been able to maintain or expand its share of intercity freight transportation. Freight transportation overall is expected to grow significantly over the next decade. According to the report entitled "Freight – Rail Bottom Line" published by the American Association of State Highway and Transportation Officials (AASHTO) in 2000, freight volume is expected to grow fifty percent between 2000 and 2020. Freight railroads need to be part of that growth. But if the trends of the past ten years discussed above are projected into the nation's future in 2020, trucking activity will more than double, while the railroads' share of intercity freight revenues will grow only slowly. Such a situation would result in a massive challenge to the nation's existing highway infrastructure. The status quo thus does not appear to be a model that will result in a rail industry that will fully participate in the growth required to meet the nation's increased transportation needs.

This leads to the issue of this hearing – the status of the Surface Transportation Board and railroad economic regulation, including the impact of the current railroad regulatory environment on railroads and shippers. The League believes that a national transportation policy should recognize the inherent value of each mode of transportation; provide incentives to all modes to improve efficiencies and productivity, and encourage not only competition between and within modes, but also cooperation to take advantage of the inherent advantages of each mode.

In all other modes of transportation, shippers have service providers competing for their business. The public roads over which trucks travel are open to all trucks, and the trucking companies strongly compete between themselves for the business of shippers. Indeed, one of the major benefits of the *Motor*

Carrier Act of 1980 was to free the trucking industry from unnecessary federal regulation, and to permit more competition between trucking companies over the public roads. The trucking industry's strong competition for shippers' business has, the League believes, strongly benefitted both motor carriers and shippers, as the industry has become increasingly efficient and customer-focused.

But this competitive model also promotes cooperation between shippers and carriers. In the operational arena, shippers and motor carriers work together to figure out ways to reduce costs and drive efficiencies. And in the public policy arena, reliance on a thoroughgoing competitive model has also meant that the trucking industry and shippers are on the same "side" when it comes to public policy. Instead of fighting each other, shippers and motor carriers have increasingly cooperated in the public policy arena to fight for improvements needed to make the industry stronger. For example, shippers and motor carriers have cooperated in the Department of Transportation rulemaking reforming the industry's hours of service rules.

The League strongly believes that federal economic policy should similarly encourage and promote rail-to-rail competition, and that there should be legislative changes to bring about increased rail-to-rail competition. The reason for this is directly linked to the nation's overall transportation needs and the extremely favorable experience that has come about through increased truck competition as a result of the Motor Carrier Act. Unlike the trucking industry, the vast majority of League members, and indeed rail shippers in general, are only served by a single railroad. A significant portion of the nation's shippers must use rail service for at least a portion of their transportation needs. If a shipper is unsatisfied with the rail service that it receives or the price, it cannot use another railroad, sometimes for even the portion of the move for which another railroad could provide competitive rail service.

Competition drives efficiencies and innovation. It leads to a fundamental shift in thinking, away from a static and ultimately counterproductive effort to protect a "franchise," toward a positive effort to grow business opportunities and eliminate costs. Competition promotes cooperation between transportation providers and their customers as both become partners in an effort to eliminate inefficiencies and improve their market opportunities. The result of these efforts is increased demand for the service – that is, growth.

In her opening statement to the Surface Transportation and Merchant Marine Senate Subcommittee last October, Senator Kay Bailey Hutchison of Texas said, “There is a severe shortage of competition in the freight railroad industry.”

It is because the League believes so strongly in the benefits of competition that it has endorsed H.R. 2924 and its companion bill in the Senate, S. 919, the “Railroad Competition Act of 2003.” While the League believes that there is room for shipper and carrier interests to discuss and arrive at points of common ground for instituting beneficial changes to this vital industry, the League sees three key provisions of the bill. These are: the modifications to existing STB rules on competitive switching; the requirement of rail carriers to quote a rate to and from any point on its system, and a provision for mandatory, expedited arbitration of rail rate and service disputes. These provisions in particular represent sound steps that can be taken to improve rail-to-rail competition consistent with national transportation policy.

In 1980, the Staggers Act amended the law to provide that the Interstate Commerce Commission could require rail carriers to require competitive switching where it finds such switching to be “practicable and in the public interest” or where such switching was “necessary to provide competitive rail service.”[9] Yet, in the more than twenty years since the passage of the Staggers Act, the ICC and the STB have never ordered competitive switching when requested by a shipper. On the contrary, the agency, through administrative interpretation, has as a practical matter written this broad pro-competitive provision out of the statute through the use of a “competitive abuse” test found nowhere in the law. H.R.

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9 See 49 U.S.C. §11102(c)(1).

2924/S. 919 would eliminate this "competitive abuse" test to restore the effectiveness of the statutory language promulgated by Congress in 1980.

H.R. 2924/S. 919 would also require a rail carrier to quote a rail rate to a shipper from and to any point on the rail carrier's system. Under the agency's current interpretation of the law, a rail carrier may lawfully refuse to quote a rate to a shipper from the shipper's facility to an interchange point with another rail carrier that may provide competitive rail service over at least a portion of the total movement. The STB's interpretation has the paradoxical effect of eliminating possible rail-to-rail competition even where it is now physically possible.

Litigation under the agency's administrative processes is slow, complex and expensive. H.R. 2924/S. 919 would provide for mandatory, expedited arbitration to resolve rail rate and service disputes quickly and efficiently.

Railroads claim that these changes are "re-regulatory" and they would devastate the rail industry economically as rail carriers would compete themselves into financial distress. But these changes are not "re-regulation" and they don't cap rates at any level. Rather, they would permit competition to determine service and set rates – not regulation. These three provisions are similar to the regulatory model that exists for railroads today in Canada. Canadian carriers, far from suffering under this competitive model, have prospered.[10] Most importantly, the League believes that these changes would move the industry toward a competitive model in which railroads completely focus on their growth and the growth of their customers, rather than an attempt to protect their piece of an existing pie.

The League believes that Chairman Nober of the Surface Transportation Board has taken very positive steps at the Board to open the regulatory process, and to begin to streamline the processing of

[10] For example, the operating ratio of both Canadian carriers in 2002 was better than the operating ratio of the U.S. Class I freight railroads by significant margins. The operating ratio for U.S. Class I railroads in 2002 was 83.77%, according to the AAR. Railroad Ten Year Trends, p. 65. The operating ratio of Canadian National Railroad in 2002 was 76.0% and Canadian Pacific was 76.6%. See 2003 CN Annual Report, p. 8; CP 2003 Annual Report, p. 6.

cases. At a League's meeting last week, Chairman Nober told League members that the STB's "top priority" in the coming year will be to reexamine the agency's "small rate case" rules, both from a substantive and a procedural standpoint. The League believes that substantial changes in those rules and standards are necessary. It welcomes the re-examination mentioned by Chairman Nober, and looks forward to participating in the administrative process. But while administrative changes are indeed necessary, Congress itself needs to set a more pro-competitive policy for the U.S. rail industry, to provide both substantive changes to the governing statute and policy direction to the agency.

Finally, the League recognizes that the best solutions are reached through a collaborative effort that includes all freight industry stakeholders. Over the course of the last 25 years we have all witnessed the benefits that enhanced competition has brought to the highway, air and ocean industries. And while rail transportation is different in some ways from these modes, the underlying principles are constant. Competition enhances efficiency and this can occur without reducing the revenue needed to maintain investment in infrastructure. Users as well as service providers have an important interest in that objective. But none of this may be accomplished without a free and open dialogue. We would welcome the assistance of this sub-committee to help facilitate private sector discussions. The League is ready, willing and able to enter into serious discussions with representatives of the nation's rail carriers to develop positive, pro-competitive changes to the economic model that will serve the freight needs of our country.