

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 665
RAIL TRANSPORTATION OF GRAIN

REMARKS DURING OPEN HEARING
BY THE
UNDER SECRETARY OF AGRICULTURE
FOR MARKETING AND REGULATORY PROGRAMS

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Date: November 2, 2006

AUTHORITY AND INTEREST

I wish to thank the Surface Transportation Board (Board) for the opportunity to present the views of the Department of Agriculture (USDA) regarding issues related to the rail transportation of grain. I believe the Board is providing a valuable service to the public by initiating this proceeding and I am pleased to present USDA's concerns for the Board and all other interested parties to consider.

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 shippers and producers in improving transportation services and facilities by, among other things, initiating and participating in Board proceedings involving rates, charges, tariffs, practices, and services.

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

BACKGROUND

On October 6, 2006, the United States Government Accountability Office (GAO) released a report that included observations on rates, competition, and capacity issues in the U. S. rail freight industry.¹ GAO found that most rail rates have declined since 1985, but that grain rates diverged from the trends of other industries. In addition, the GAO reported that the amount of grain traffic with comparatively high markups over variable cost increased notably between 1985 and 2004.

¹ Freight Railroads, United States Government Accountability Office, GAO-07-94, October 2006.

The Board is holding this hearing to obtain views and information about the market conditions that led to these observations by GAO and about grain transportation markets in general. Because U.S. grain producers compete in a broader North American, and global, marketplace, the Board also requested information regarding the interplay between the American and Canadian wheat markets, how the Canadian regulatory system differs from the United States system, and what impact these differences might have on grain production in the United States.

AGRICULTURE AND RAIL TRANSPORTATION

An affordable and reliable transportation network is necessary to maintain the strength and competitiveness of American agriculture and our rural communities. Rail service is a particularly important part of that network for U.S. agriculture, and it is virtually the only cost-effective bulk shipping alternative available in many rural areas. Several states - including Arizona, Kansas, Montana, North Dakota, Ohio, Oklahoma, Texas, and Utah - rely heavily on rail services for the transportation of grains. More than 50 percent of corn, wheat, and soybeans produced in these states are moved by rail (Figure 1--Appendix).

BENEFITS OF THE STAGGERS ACT

The Staggers Rail Act of 1980 (Staggers Act) significantly reduced regulation in all phases of railroad operations. Among other reforms, the Staggers Act encouraged greater reliance on competition to set rates and gave railroads increased freedom to price their services according to market conditions, including the freedom to use differential

pricing. Thus, railroads are in a position to recover a greater proportion of their costs from rates charged to shippers with a greater dependency on rail transportation. At the same time, the Staggers Act gave the Interstate Commerce Commission, and later the Board, the authority to establish a rate appeals process so that shippers could obtain relief from unreasonably high rail rates.

Shipper benefits from railroad deregulation include preservation of railroad service, rate savings, and, in many cases, improved service. Short line railroads have been able to operate profitably on many rail lines abandoned by the major railroads and have generally provided more individualized service to shippers.

Benefits, however, have not been distributed uniformly across or within commodities or communities. The distribution of benefits has tended to favor grain producers in regions with higher levels of intermodal competition.² GAO also noted that rates have not declined uniformly and that rates for some commodities are significantly higher than rates for others. Despite the overall success of the Staggers Act, agricultural shippers continue to express concern about decreased rail-to-rail competition, increased rail rates, poor rail service, rail capacity constraints, and the fair allocation of rail capacity.

RAIL COMPETITION CONSTRAINS MARKET POWER ABUSES

One of the key assumptions underlying the deregulation of the rail industry was that there would be sufficient competition to constrain the abuse of railroad market power. Thus, the authors of the *Staggers Act of 1980* and the *Interstate Commerce*

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

Commission Termination Act of 1995 (ICCTA) included the preservation of effective competition as one of the rail transportation policy goals of the United States. Not only does effective competition promote reasonable rates and minimize the need for regulatory control, but it also encourages efficient management of railroads.

RAIL-TO-RAIL COMPETITION

Since enactment of the Staggers Act, rail consolidation has reduced rail-to-rail competition. Rail consolidation has led to a sharp decline in competitive routes and options for agricultural shippers. In some cases connecting gateways to other markets have been closed by railroads. In other cases, the differential prices charged by railroads have limited economic access to less distant markets and markets on the lines of other railroads. As a result, many farmers have lost the benefits of geographic competition.

Also, a large proportion of some commodities are often hauled by one railroad. BNSF, for example, originates 53 percent of all wheat shipments transported by rail (see figure 2). The reason for this large market share is because BNSF has very limited rail competition in the Northern Plains states, which is a major wheat production region.

Rail rates

Agricultural producers of grain and oilseed crops are considered “price-takers.” That is, they have little or no ability to influence the price they receive for their products, and therefore, are unable to pass increases in costs forward to buyers of their products. Instead, these individual agricultural producers tend to absorb any cost increases because of their lack of market power. Consequently, increases in transportation costs typically result in decreased producer incomes. In turn, lower producer incomes can adversely

affect the ability of individual producers to borrow funds or purchase inputs such as fertilizer and machinery, potentially reducing economic prosperity in rural areas. Higher transportation costs also hinder the competitive position of U.S. agricultural products in highly competitive export markets.

GAO's analysis states that although many rates have decreased, rates have not declined uniformly, and rates for some commodities are significantly higher than for others. In fact, since 2003, rail rates for grain shippers have increased much more rapidly than rail rates for other products. The average freight revenue per carload for major grains has increased 27 percent since 2003 while the average freight revenue for all commodities (including grain) increased only 13 percent since 2003. Rates on corn, sorghum, soybeans, and wheat have gone up 25, 23, 39, and 25 percent, respectively, since 2003 (see figures 3 and 4).

Grain shippers are shouldering greater responsibility for car supply and other functions railroads formerly provided. Grain shippers now incur additional costs to obtain guaranteed car service, provide many of their own railcars, and pay increased demurrage penalties. Also, due to railroad emphasis upon unit-trains, shippers have had to make significant capital investments in sidings, inventory, storage capacity, and loading facilities to retain cost-effective rail service.

Rail service

Railroad consolidation has resulted in railroads having the ability to dictate the terms of rail service – even though those service terms do not meet the present and future needs of many agricultural shippers. Class I railroads, for example, encourage unit-train

movements of grain, even though the emergence of specialty markets will require specialized handling in much smaller quantities.

Another example of Class I railroads dictation of service terms involves their obligation as common carriers. Despite the retention of the Common Carrier Obligation in the Interstate Commerce Commission Termination Act of 1995 (ICCTA), many shippers have lost reliable and timely carload service while others have been required to meet railroad-determined volume requirements to receive rail service. Other changes have required substantial investments by agricultural shippers.

Due to the lack of adequate rail-to-rail competition, the quality of service provided by Class I railroads has not been sufficient for some agricultural shippers. Captive shippers, even though paying the highest rail rates, often receive the worst rail service because Class I railroads may choose to first serve those shippers having competitive options. This may result in captive shippers losing equal access to markets – particularly during those critical periods when the prices for grain are rising.

Rail capacity

Rail capacity for agricultural products has been extremely tight during the last three years, for a number of reasons, both agricultural and non-agricultural. Non-agricultural factors include general economic expansion, increased international trade, increased demand for coal due to high natural gas prices, high fuel prices forcing truck traffic to railroads, and new hours of service (trucking) regulations increasing rail intermodal demand. Agricultural factors include strong grain export demand, high prices for agricultural crops, and back-to-back record or near-record grain harvests.

Allocation of rail capacity

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

ABILITY TO COMPETE WITH CANADIAN PRODUCERS IN WORLD MARKETS

The U.S. wheat industry has long complained that the special, government-enforced privileges afforded the Canadian Wheat Board (CWB), including significant transportation subsidies, have provided western Canadian wheat and barley competitive advantages in both export markets and the Canadian domestic market.

The CWB has operated in tandem with the two major Canadian railroads, Canadian National and Canadian Pacific, to the benefit of Canadian grain exports. For over 100 years, Canada has subsidized rail rates for agricultural products moving to export and certain domestic positions. For many years, the subsidies took the form of a fixed cap on rail rates, which were much below market rates, and direct subsidies to the railroads. About a decade ago, as a result of the Uruguay Round Agreement on Agriculture, Canada removed the cap, raised rail rates considerably, and compensated grain producers with offsetting direct payments. But Canada continues to subsidize rail rates through a cap on revenue from shipping grain. In addition, the CWB's grain exports have benefited from preferential access to subsidized rail transportation.

The United States government, as well as private industry, has pursued various actions to address the subsidies and other trade-distorting practices associated with the CWB and the grain transportation system. These trade actions have been complicated by the lack of transparency surrounding both CWB activities and the extensive government regulation of the Canadian rail system. The United States pursued a WTO challenge against the CWB and certain aspects of the Canadian treatment of imported grain, including the revenue cap for grain shipments. The U.S. wheat industry brought a countervailing and antidumping case against the CWB and other wheat subsidies, including the rail revenue cap and provision of government-owned rail cars. Both actions only met limited success, but made clear the distorting nature of the western Canadian grain marketing and transportation system. The United States continues to pursue meaningful disciplines for state-trading enterprises in the WTO negotiations.

OPEN ACCESS TO INFORMATION

The GAO report noted that the STB Waybill Sample³ fails to ensure consistent and accurate reporting of railroad revenues, including revenue from fuel surcharges. GAO also noted that railroads reporting data for the STB Waybill Sample should have consistency in the methods used to report revenues and other information. It would be helpful if railroad revenue reporting in the Waybill Sample reported revenue from fuel surcharges, sale of guaranteed freight, demurrage, and other accessorial charges. In

³ The Waybill Sample is a statistical sampling of railroad waybills that is collected and maintained for use by the STB and by the public. A Waybill could be described as the railroad version of a Bill of Lading. All freight shipments require a Bill of Lading (Waybill in the case of railroads) as it serves as a document of title, a contract of carriage, and a receipt of goods. The Waybill contains information regarding each shipment including the forwarding and receiving stations, the miles hauled, total revenue, all railroads handling the shipment, description and weight of the commodity, number of cars in the shipment, etc.

addition, USDA has noted errors in the Waybill data that result in questionable revenue-to-variable cost ratio calculations.

It is ironic that while the consolidation of Class I railroads has resulted in the rise of new mega-carriers capable of exercising market power over shippers, the amount and quality of data available on these carriers has fallen dramatically. Because of the many mergers and consolidations in the U.S. railroad industry over the past twenty years, and the past five in particular, most localities have service from at most two railroads. With railroad competition now essentially determined by interaction between pairs of firms, an increasing amount of oversight is needed so that the pricing and service behavior of these firms can be monitored. Railroads should be required to provide greater clarity on their reported shipping rates. The public needs information that can identify possible abuses of market power and the common carrier obligation.

CONCLUDING REMARKS

USDA, STB, and all interested and affected parties should continue to work together to ensure that rail transportation is an affordable and reliable option for the nation's grain shippers. USDA believes that healthy competition is essential for encouraging railroads to improve customer service, preserving the economic vitality of the railroad industry, and for protecting shippers from the abuse of railroad market power and unfair rail rates. Finally, any system used for determining and reporting rail shipping charges should be fair, transparent, and easily accessible to the public.

Respectfully,

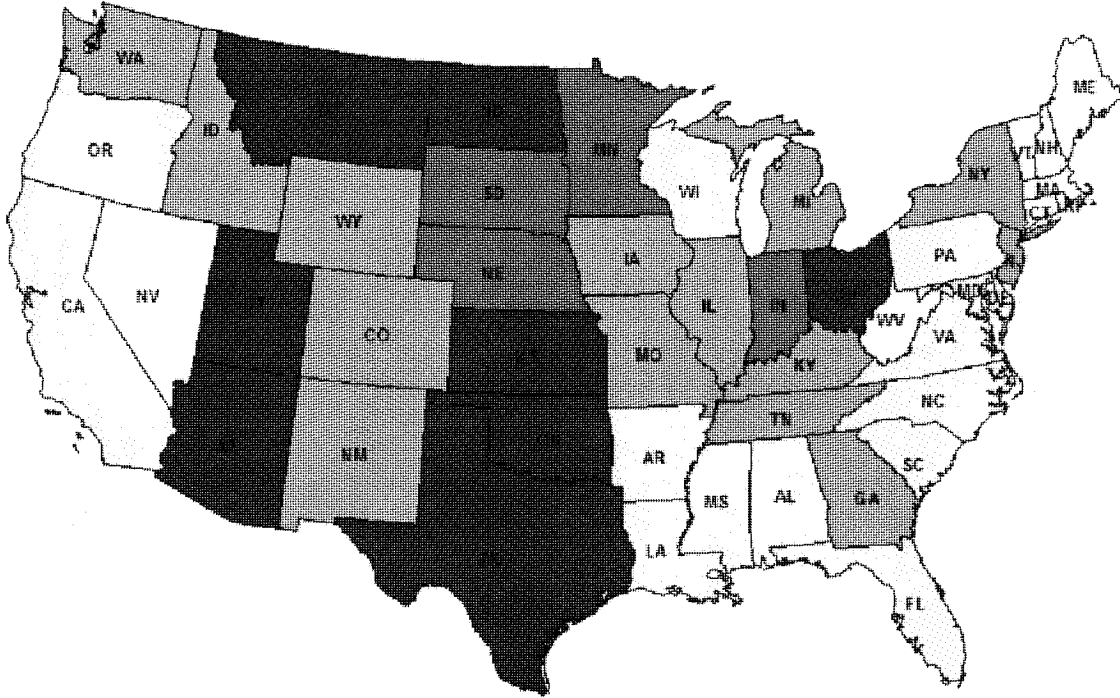
A handwritten signature in black ink, appearing to read "Bruce I. Knight". The signature is fluid and cursive, with a large initial "B" and a long, sweeping underline.

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APPENDIX

Rail/Production Ratio

Ratio includes corn, wheat, and soybeans



Source: U.S. Department of Transportation; U.S. Department of Agriculture, 2004

Rail Shipments as a
Percent of Grain Production

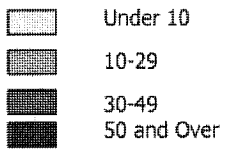
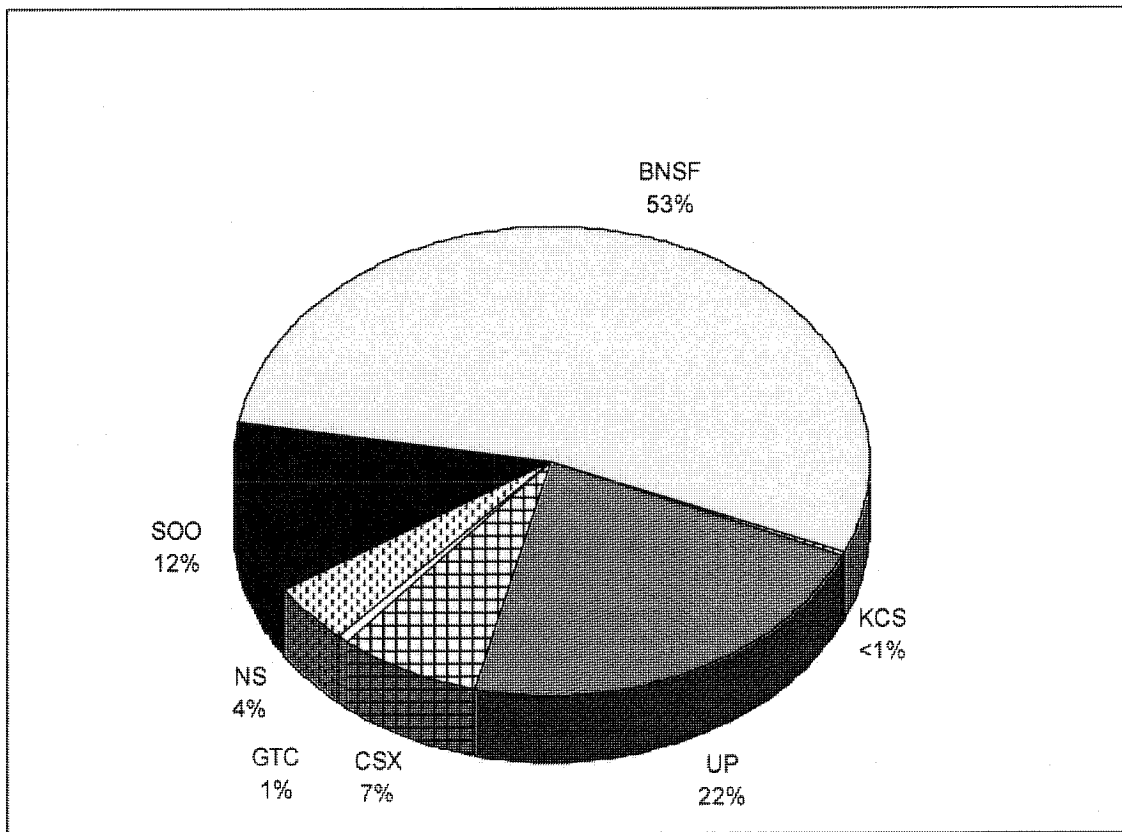


Figure 2 – Percentage of Total Class I Railroad Carloads of Wheat Originated by Railroad—2004



Source: Association of American Railroads

Figure 3

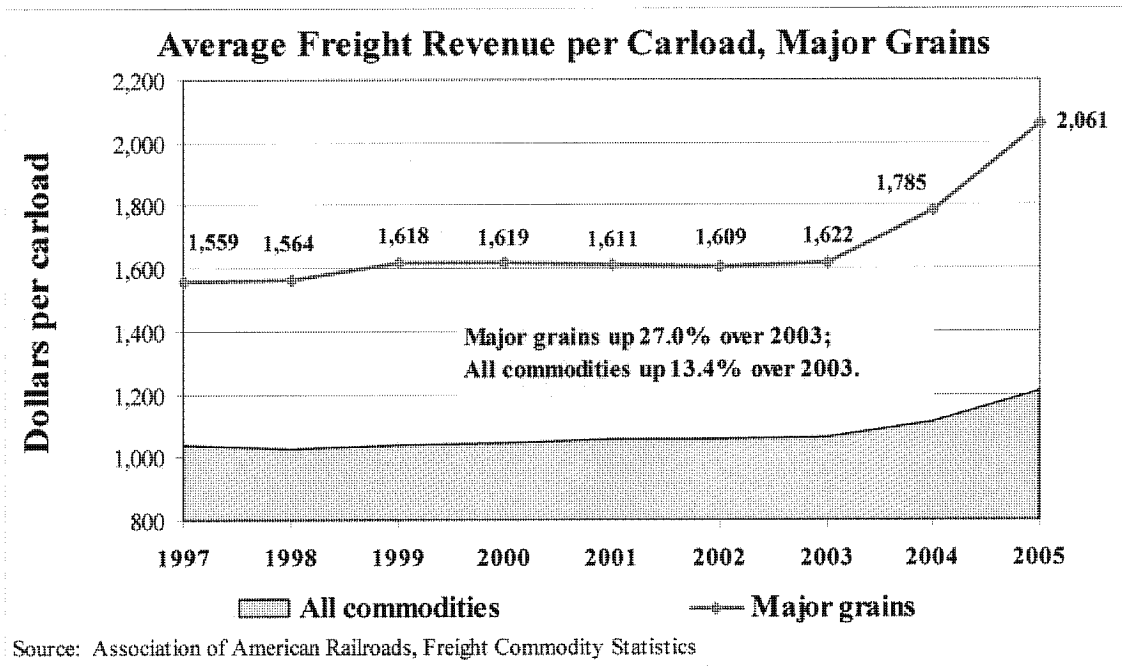


Figure 4

