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Highlights

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# FREIGHT RAILROADS

# Preliminary Observations on Rates, Competition, and Capacity Issues

## Why GAO Did This Study

The Staggers Rail Act of 1980 largely deregulated the freight railroad industry, giving the railroads freedom to price their services according to market conditions and encouraging greater reliance on competition to set rates. The act recognized the need for railroads to use demand-based differential pricing in the deregulated environment and to recover costs by setting higher rates for shippers with fewer transportation alternatives. The act also recognized that some shippers might not have access to competitive alternatives and might be subject to unreasonably high rates. It established a threshold for rate relief and granted the Interstate Commerce Commission and the Surface Transportation Board (STB) the authority to develop a rate relief process for those "captive" shippers.

This testimony provides preliminary results on GAO's ongoing work and addresses (1) the changes that have occurred in the freight railroad industry since the enactment of the Staggers Rail Act, including changes in rail rates and competition in the industry, (2) the alternative approaches that have been proposed and could be considered to address remaining competition and captivity concerns, and (3) the projections for freight traffic demand over the next 15 to 25 years, the freight railroad industry's projected ability to meet that demand, and potential federal policy responses. To fulfill these objectives, GAO examined STB data, interviewed affected parties, and held an expert panel.

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To view the full product, including the scope and methodology, click on the link above. For more information, contact JayEtta Z. Hecker at (202) 512-2834 or heckerj@gao.gov.

## What GAO Found

The changes that have occurred in the railroad industry since the enactment of the Staggers Rail Act are widely viewed as positive. Railroad industry financial health improved substantially and rates generally declined between 1985 and 2000, but increased slightly from 2001 through 2004. Concerns about competition and captivity remain because traffic is concentrated in fewer railroads and some shippers are paying significantly higher rates than others. It is difficult to precisely determine the number of shippers that are "captive" because proxy measures can overstate or understate captivity. However, GAO's preliminary analysis indicates that while captivity may be dropping, the share of potentially captive shippers that are paying the highest rates—those substantially above the threshold for rate relief—has increased.

A number of alternative approaches have been suggested by shipper groups and others to address remaining concerns about competition and captivity; however, any alternative approaches should be carefully considered. Two areas are particularly integral to further improvement. First, while STB has broad authority to investigate industry practices and has assessed competition—generally in railroad merger cases—there has been little assessment by any federal agency of the state of competition and of where specific areas of inadequate competition and the inappropriate exercise of market power might exist. Such an assessment would allow decisionmakers to identify areas where competition is lacking and to assess the need for and merits of targeted approaches to address this situation. These approaches include requiring reciprocal switching arrangements, which allow one railroad to switch railcars of another railroad, and/or terminal access agreements, which permit one railroad to use another's terminals. Second, a number of different approaches have been suggested that could make the rate relief process less expensive and more expeditious, and thus potentially more accessible, such as arbitration and increased use of simplified guidelines. Each of the proposed approaches has both advantages and drawbacks. Any alternative approach to address competition and captivity should be carefully considered to ensure that the approach will achieve the important balance set out in the Staggers Rail Act of allowing the railroads to earn adequate revenues while assuring protection for captive shippers from unreasonable rates.

Significant increases in freight traffic over the next 15 to 25 years are forecasted, and the railroad industry's ability to meet future demand is largely uncertain. Investments in rail projects can produce benefits for the public--for example, shifting truck freight traffic to railroads can reduce highway congestion. As a result, the federal and state governments have been increasingly participating in freight rail improvement projects—for example, Congress provided $100 million to the CREATE project in 2005 to improve the rail network in Chicago. Congress is likely to face additional decisions in the years ahead regarding federal policy toward the nation's freight railroad system. GAO would note, based on past work, that federal involvement should occur only where demonstrable public benefits exist, and where a mechanism is in place to appropriately allocate the cost of financing these benefits between the private and public sectors, and between national, state, and local interests.