THE STAGGERS RAIL ACT: IMPACT ON RATE STRUCTURES AND SERVICES

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PREFACE

The Motor Carrier and Staggers Rail Acts of 1980 have led to substantial change in the federal regulation of transportation, and the implications of these changes have caused concern in rural areas. Carriers have made some initial adjustments that have increased some of these concerns.

But these regulatory changes are not the only source of uncertainty in the transportation sector of the economy. Railroad bankruptcies and abandonments, declining public support for the rural road construction and maintenance, deteriorating inland waterway facilities, and grain sales surges or embargoes all have contributed to the need for information or education programs in the area of agricultural transportation. Lack of such knowledge can delay or even prevent desirable developments in transportation, thereby impeding achievement of agricultural policy or rural development policy goals.

This is the third of eight papers in the Transportation Deregulation and Agriculture series, John O. Gerald and Ken L. Casavant, general editors, published by the Western Rural Development Center. The series deals with the nature and potential impacts on agriculture of the Motor Carrier and Staggers Rail Acts of 1980. These acts in part removed federal regulation of the trucking and rail industries.

For a recent empirical evaluation see the report, *An Assessment of Impacts on Agriculture of the Staggers Rail Act and Motor Carrier Act of 1980*, a study conducted by USDA's Office of Transportation, published in August of 1982. The "Assessment Study," while narrower in scope than this series of papers, does describe developments in agricultural transportation since the passage of the two acts and provides recommendations for continued monitoring and/or regulatory change.

INTRODUCTION

Two difficulties arise when one tries to predict the impacts of Staggers Rail Act on rail services and corresponding rate structures for moving bulk agricultural commodities. One difficulty is deciding how to determine the limitations of the act itself—that is, to define or to speculate what is and is not permitted under the new economic regulatory environment created by the act. For instance, what is just and reasonable and what is considered discriminatory under the new act? Thus, the outer boundaries of economic behavior which are considered legal and permissible by the legislation must be defined.

The second and more difficult task is to try to predict how railroad management will react to the new-found managerial discretion provided by the act. Even assuming rational economic behavior, it is still difficult to determine what managerial decisions might be forthcoming from rail management concerning services and rate structures for agricultural commodities. However, an attempt must be made to foretell the economic behavior, taking into account the motives of profit maximization and loss minimization.

The implications of long run versus short-run goals and decisions are inherent in such predictions and must be dealt with as well. One can assume that railroads will maximize their profits or minimize their losses to the best of their abilities in the short-run—if this does not prevent or put in jeopardy achievement of long run corporate objectives. In the situation in which short-run profit-maximizing policy conflicts with long run profit objectives, the conflicts will have to be recognized and may override such short-run decisions.

Provisions of the Staggers Rail Act Affecting Rates

Intended purposes of the Staggers Rail Act include providing a means for railroads to recoup inflationary cost increases quickly; increased railroad revenues; and protecting captive traffic. These objectives are to be achieved largely through the rate-making provisions of the act.

The act broadly defines three types of rates: those rates which apply to commodity movements when market dominance does not exist and therefore are exempt from Interstate Commerce Commission (ICC) regulation; those rates for movements for which the railroads have market dominance and therefor are subject to ICC jurisdiction in accordance with the provision of the Staggers Act; and contract rates.[1]

The test for market dominance can be based on qualitative evidence, quantitative evidence, or a combination of both. The criteria for determining market dominance, established prior to 1980, have been reviewed by the Interstate Commerce Commission in Ex Parte No. 320, Sub. 2. The order is currently under appeal in the courts.

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[1]Market dominance is a concept concerning the market power that a railroad might have over a shipper, e.g., if a single railroad firm has 100 percent of a shipper's traffic and the shipper has no reasonable alternative, then the railroad might be considered to have market dominance over that particular commodity movement. Market dominance means an absence of effective competition from other carriers, or modes of transportation to which a rate applies, or competition from other products or other geographic producing areas.

The Staggers Rail Act itself states that a retail carrier does not have market dominance when revenue is less than:[2]

1. 160 percent of variable cost from October 1, 1980 to September 30, 1981
2. 165 percent of variable cost from October 1, 1981 to September 30, 1982
3. 170 percent of variable cost from October 1, 1982 to September 30, 1983
4. 175 percent of variable cost or a cost recovery percentage specified by ICC from October 1, 1983 to September 30, 1984
5. The cost recovery percentage for each year after September 30, 1984 but not less than 170 percent nor more than 180 percent of variable cost.[3]

Rates which are found to have a revenue/variable cost ratio above these threshold levels are not presumed to be evidence of market dominance, nor is there a presumption that rates in excess of these ratios exceed a reasonable maximum. If the revenue/variable cost ratio is above the threshold, a shipper or the ICC may challenge the railroads having market dominance; however, the ICC does not have to find that those rates are unreasonably high, even if the ICC determines that market dominance exists. The ICC has indicated that the determination of market dominance will be made on a case-by-case basis.

[2]Revenue-to-variable cost is defined as a ratio obtained when the rate (or total revenue) for a movement is divided by the variable cost (or total variable cost) for the movement, with the cost being determined by procedures prescribed by the ICC.

[3]Cost recovery percentage is defined as the lowest revenue/variable cost ratio which would produce revenues sufficient to cover total accumulated variable and full costs, including a return on investment subject to certain conditions.

All rates in effect on October 1, 1980 other than contract rates, are considered base rates and are subject to the rate flexibility provision of the Staggers Act. Base rates can be increased quarterly by the percentage of increase in costs incurred by the railroads, and such increases cannot be challenged. In addition to being able to increase rates by the amount of cost increases, railroads can also increase their base rates up to 6 percent per year for 4 years not to exceed a cumulative total of 18 percent. Such increases cannot be attacked unless the resulting rate is greater than the lesser of: 20 percent above the applicable revenue/cost ratio or a revenue/cost ratio of 190 percent.

Rates which are not market-dominant are immune from ICC regulations and can be raised and lowered at will so long as they contribute to the ongoing concern value of the railroad and they do not exceed the lesser of 20 percent above the effective revenue cost ratio or 190 percent of variable cost.

Contract rates are encouraged by the Staggers Act and a degree of rate flexibility can be obtained by utilizing a contract. In the case of contract for agricultural commodities, essentially the same contract has to be made available to those shippers in the same area for the same commodity willing and able to enter into such contracts on the same terms.

Impact on Rate Structures

The impact of the Staggers Act on agriculture rate structures can probably best be assessed by assuming that railroads are long run profit-maximizing firms with different types and degrees of intensity of intramodal and intermodal competition. Other considerations are ICC jurisdiction and contracts.

Rate structures on agricultural commodities from producing territories were originally based on what the traffic would bear. Rates among major markets were generally more competitively based because of more intensive price competition among railroads serving the same major markets. As viable alternative modes developed, such as the inland waterway system and long-distance trucking, railroads were subjected to intermodal price competition also. This competition resulted in some changes in rate structures.

The rates on agricultural commodities, where competition from other modes or intramodal price competition was weak or nonexistent, will be affected by the Staggers Act only if the rates are found to be unjustly and unreasonably high by the ICC. It is generally thought that there are relatively few movements where the railroads have such a monopoly. In those cases where railroads do have a monopoly, there will probably be no apparent change in the rate structure unless affected shippers protest and the ICC takes positions regarding market dominance and the justness and reasonableness issues that result in rate reductions.

Under the Staggers Act, many of the agricultural commodity movements by rail are subject to long-distance truck competition, and the railroads will have more flexibility to meet this competition than they did in the past. However, before railroads will meet this competition, the traffic must be profitable to them at competitive rates. Rail rates in the long run may be based on truck costs or other competitive forces influencing production and market locations. Railroads can be expected to set rates sufficiently below truck costs or somewhere around truck costs, depending on shippers' preferences, to capture a profit-maximizing share of the traffic. The rate-flexibility clause of the act should allow the railroads to adjust these rates as necessary to retain traffic without fear of interference from the ICC. This may result in railroads capturing nearly all of the traffic profitable to them that was subject to long haul truck competition.

Short-haul rate structures may not be affected nearly as much as the act, unless it is through the contract provisions of the act. However, some of these rates may now be below variable costs, and the act requires that these be equal to or greater than variable costs.

Railroads will be able to react more quickly to a shortage of transportation capacity in the future where truck competition exists. Trucks have traditionally raised their rates during periods when the demand for transportation has exceeded supply. Railroads have either been prevented from or were reluctant to raise rates on a short term basis under the provisions of the Interstate Commerce Act. However, in the future, railroads may implement a pricing strategy that will more nearly maximize revenues during periods of transportation shortage.[4]

In instances where water competition or a combination of truck/barge competition exists, railroads may implement innovative pricing which ties the traffic to the rail mode or they may engage in efficiency-oriented pricing (e.g., unit train rates) resulting in reduced rates and costs. Innovative pricing may take the form of through rates from origin territory to final destination bypassing traditional rate-break market points such as Minneapolis, Chicago, and Kansas City. Railroads will also have a great deal more

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[4]Although the Staggers Rail Act repealed the peak period and seasonal pricing provisions of the 4-R Act, it also provided the railroads the type of pricing flexibility that permits them, in effect, to implement peak period pricing as a means of rationing equipment and maximizing revenue as long as market dominance does not exist.

flexibility to meet the fluctuating barge rates on the inland waterway system and will probably react much more quickly to such changes. Where barge competition or truck/barge competition is such that competitive rail rates are marginally profitable to the railroads, an effort to achieve greater efficiency may make this traffic attractive. Pricing in such cases will be made with an eye towards gaining efficiencies wherever possible, and this may result in unit train rates, limited free loading and unloading time, and a reduction in the nonviable branchline network.

Estimating future changes in rail rate structures for agricultural commodities subject to intramodal competition such as intermarket and market-to-port movements is highly speculative. Any impact on rates will, in part, be a result of changes in the Interstate Commerce Act affecting rate bureaus. As a result of the diminished rate bureau activity concerning the setting of single and even joint line rates, price leadership by one railroad firm may result where intramodal competition exists. Such pricing appears to be preferable to predatory pricing or marginal profitability in industries having only a few dominant firms; these industries may provide pricing examples that competing rail carriers adopt.

Shippers whose rate structures are characterized by very high revenue/cost ratios may benefit from the Staggers Act if the ICC prescribes reduced rates in such cases. How ICC will view such rates is unknown, and in any event, rate reductions will not accrue unless the shipper or shippers take a very active role in seeking reductions.

Contract rates which are encouraged by the Staggers Act initially seem to be more applicable to intermarket movements of products than to movements directly from country points. Such intermarket movements are more predictable and seem to lend themselves to contracting. Contracting for rail services on agricultural commodities moving between origin territories and terminal markets is more difficult because of the variability and uncertainty of production—which makes it difficult to guarantee a given level of movement. But contract movements from country points may be possible if they encompass a large geographic gathering territory, thereby reducing the uncertainty of supply conditions.

Demand-sensitive and peak period rates for agricultural commodities authorized in the 1976 act were repealed by the Staggers Act. Thus, agricultural commodities will no longer be subject to demand-sensitive rates. However, as was pointed out earlier, flexible pricing may occur within the limitations of the concepts of market dominance and justness and reasonableness in cases where cycles in the supply of or demand for transportation occur.

The Staggers Act contains a section called the "efficient marketing provision," which amends the statutory time limits for publishing changes in rates. Rates may now be increased on 20 days' notice and reduced on 10 days' notice, as compared to 30 days' notice before the act was passed. The implications of this reduction in notice time pertain mostly to areas where commodity marketing contracts are entered into considerably in advance of movements of the commodity. A rate increase on a 20-day notice could result in losses to grain merchandisers, who have no means of recovering rate increases on grain they have purchased from producers and hedged on a "to-arrive" contract or a "futures" contract. Grain which is not hedged is, of course, "speculative grain" for which profitability is subject to many factors. In a similar manner, rate decreases, occurring after marketing contracts are made could result in windfall gains.

The Staggers Act mandates that states may exercise authority over intrastate rates only if it is done in accordance with the provisions of the Staggers Act. Thus, intrastate rates on agricultural commodities will also be subject to the act. In cases where rate increases proposed by state regulatory agencies may have been held down, rates will likely be increased more promptly in the future.

Although the Staggers Act does not directly address market competition or geographic competition, it may influence how railroad firms react to the presence of such competition by allowing more pricing freedom. It is questionable whether such pricing freedom was allowed under the Interstate Commerce Act as amended in 1976; however, the perception of rail management seems to be that no such freedom existed. The Staggers Act will have the effect of removing any doubts about the legality of rates made to meet such market and geographic competition. Therefore, railroads may be more aggressive hereafter in providing shippers with rates which meet market and/or geographic competition. Such rates may result in broader markets for agricultural commodities. However, it could result in "balkanization" of agricultural markets along the lines of railroad systems.

Impacts on Rail Services

Rail services may improve for some and deteriorate for others as a result of the Staggers Act. Unit trains, contract rates, and the potentially reduced number of loading stations may well result in better rail service for those firms shipping commodities from those points that are accessible to such rates. However, those points that are not accessible may suffer reduced service.

Up to 40 percent of a car type may be allocated to contract service for the movement of agricultural commodities. Car service orders will not apply to cars in contract service. This may or may not reduce the level of service for those shippers not having contracts, depending in part on the level of efficiency created by contract service. Those firms with a contracted level of service will be in a much better position during periods of car shortage to market the contracted agricultural commodities than will be those without rail service contracts. Conversely, firms with contracts may not be able to take advantage of reduced rates during periods of surplus equipment.

Surcharges on uneconomical branchlines and noncompensating joint line rates also may produce impacts on shippers and receivers of agricultural commodities. The Staggers Act permits railroads to apply surcharges on light-density branchlines, to the extent of allowing rates to rise to 110 percent of variable cost of delivering to and from the lines plus full recovery of the reasonable expected costs of continuing to operate a line. Similarly, a railroad can apply a surcharge to its portion of a joint rate that is noncompensatory and may increase it to 10 percent of variable cost. The impact of this change would apply to those commodities and routes which have very low rates.

CONCLUSION

The impacts of the Staggers Act on agricultural rate structures and service are highly speculative. However, the intent of the legislation is to create adequate revenue for the railroad industry. If productivity does not increase, there is only one alternative remaining. Rates paid by shippers must increase at a pace faster than that of inflation, if revenue adequacy is to be achieved by the nation's railroads.

The Staggers Act contains two strong implications—the railroad system in the United States will remain in the private sector, and the railroad system will be profitable. Intra-industry price competition may occur as a result of rate flexibility and reduced rate bureau influence and activity for a period of time, but eventually a system of price leadership might emerge as a result of efforts to stabilize or increase rail revenues. Efficiencies in rail operations may be realized as a result of the Staggers Act; who benefits from those efficiencies—the railroads, the merchandisers, the shippers, or the producers—is dependent on many factors.