

Statement before the Surface Transportation
Board

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Public Interest Comment on Railroad Revenue Adequacy, Docket No. EP 761

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Please find two documents I have written which I request to be entered into the record. They are reprinted here for ease of inclusion. The key points are the revenue adequacy proceeding is not necessary as the freight rail market is competitive. Moreover, the Surface Transportation Board engaging in such a proceeding is a dangerous trend of re-regulation which contravenes Congress' goal of deregulation. There is simply no reason for price regulation of the rails in 2019 when shippers have multiple modes of transportation.

1. In An Era Of Deregulation, Why Is The STB Re-Regulating The Freight Railroads?, Forbes, December 10, 2019 <https://www.forbes.com/sites/roslynlayton/2019/12/10/in-an-era-of-deregulation-why-is-the-stb-re-regulating-the-freight-railroads/#17bd875f71d7>
2. The Signs and Symptoms of Regulatory Obsolescence in Network Industries, American Enterprise Institute. October 25, 2019. <https://www.aei.org/research-products/report/the-signs-and-symptoms-of-regulatory-obsolence-in-network-industries/>

In An Era Of Deregulation, Why Is The STB Re-Regulating The Freight Railroads?

Over two days, the little-known Surface Transportation Board (STB) will convene a [closed-door hearing](#) with a litany of special interest groups asking to regulate shipping prices to favor their business. This is Washington at its worst: industry making backroom deals with bureaucrats and politicians. In a free and open marketplace, companies are not favored by government regulation; they serve their customers and face the force of competition. But when the STB signals they're open for business, industry will sign up to serve the regulators.

President Trump made a campaign promise to break the power of special interests which use the bureaucracy to win favorable regulation. His administration has [removed](#) some of the worst regulations, particularly those which have the opposite of their intended effects. Moreover, the Office of Management and Budget has made a bold plan to [reshape](#) government for the 21st Century, with common sense proposals such as merging the Departments of Education and Labor into a single entity, the Department of the Workforce.

However, when we look at the federal budget now approaching \$5 trillion (almost one-third of the entire gross domestic product of the country), sadly, this administration has fallen short of the goal of reducing government. While some regulations may be gone, the *regulatory agencies* that make them are still around. Indeed, many of these agencies are trying to make new regulations, many of which have little to do with protecting the American people.

The STB began its life as the Interstate Commerce Commission (ICC) in 1887, the result of agricultural interests to consolidate their power over the railroad industry. For example, if given the opportunity, a grain supplier would prefer that the government to set the shipping price as close to zero as possible instead of engaging in the market. Thus, began the tortured history of the regulator deciding the prices that railroads could charge with brute attempts to find prices that covered the actual cost of building the railroad. This proved quite inefficient, so much so that the U.S. did not have adequate rail infrastructure needed to ship munitions for World War I. In the meanwhile, new forms of transportation emerged that proved more convenient and flexible than regulated rail, such as trucks. By the 1970s, when the ICC reached its height of over 2,000 employees, Congress began the long overdue process of deregulation.

Unsurprisingly, freight railroad investment, safety, and quality surged. Congress continued further de-regulation in 1996, and the organization was renamed the Surface Transportation Board.

Over its life, different industrial constituencies have paid tribute to the STB with the hope of getting preferred rates, whether chemicals, lumber, fertilizer, or even corn refiners. On the flip side, other industries choose different solutions to ship their goods, especially energy providers which want to control their distribution by building pipelines. Others use barges/ships, planes, trucks, or drones, or a combination. That any company or industry gets its preferred regulator is at odds with the modern market economy and information technology which improves parties' ability to transact. There is no reason to have an STB in 2019, at least not one with its broad powers.

My recent [paper](#) "**The signs and symptoms of regulatory obsolescence in network industries**" describes what's going on. In an effort to live beyond its useful life, The STB is looking for something new to regulate and spins a yarn that there is dire problem that only it can remedy. To cater to new constituencies, it rolled out a [new website](#) and updated its filing system. And to give the its closed door hearing the veneer of credibility, it set itself up in NASA's headquarters to welcome the parade of well-capitalized trade associations asking for favors. Many of the companies represented by the American Chemistry Council, Freight Rail Customer Alliance, the Fertilizer Institute, and National Grain and Feed Association have a larger capitalization than the total freight industry itself. These actors speak in a code on esoteric topics such as "revenue adequacy" which is a fancy way to say the government is taking your property. As economist Jerry Ellig [notes](#), "Given the troubled history of rate regulation in the pre-Staggers era and the difficulty of making credible commitments to limit price regulation, the STB should exercise extreme caution in regard to any proposal for more extensive general rate regulation." While the Constitution guarantees the freedom of association—like-minded people are allowed to organize, communicate, and petition, it [does not provide the right to rent seek](#) on the public dollar.

The STB was created to regulate *only* in uncompetitive markets, which is the exception in the freight rail market. Yet the Board wants to make this the rule regardless of the facts. The Trump Administration needs to deliver on making government smaller. Rationalizing a small agency such as the STB into the larger Department of Transportation, its logical home, is a reasonable suggestion and would make a salient proof point for the election.

The Signs and Symptoms of Regulatory Obsolescence in Network Industries

Roslyn Layton

Key Points

- The Surface Transportation Board (STB) and the Federal Communications Commission (FCC) exert significant power over small slices of larger industries, which industrial competitors attempt to capture to win preferable operating conditions.
- Many regulators, wanting their agencies to remain relevant past their useful life, may cater to new constituencies by grabbing new regulatory turf or fabricating crises.
- Reflecting the dynamic competition in the transportation and communications sectors, Congress should consider rationalizing the two small agencies (folding the STB into the Department of Transportation and the FCC into the Federal Trade Commission), thereby reducing incentive and opportunity for regulatory capture.

The telecommunications and transportation industries were supposedly deregulated during the 1980s and 1990s, but there has been a parallel track of re-regulation—for example, the reimposition of common carriage (or policies delivering the equivalent) on industries earlier deemed competitive. In some respects, the US regulates these industries more heavily than other countries.¹

This report presents a preliminary, modest, and logical analysis of regulatory obsolescence in the telecommunications and transportation industries. Using a schema developed by Jonathan Macey to study the Securities and Exchange Commission (SEC),² I examine agency obsolescence at the Federal Communications Commission (FCC) in 2015 and the Surface Transportation Board (STB) in recent years, which both trace their roots to the Interstate Commerce Commission (ICC) established in 1887.³

Macey outlined four features of agency obsolescence:

1. Agency imperialism or turf grabbing,
2. Agency capture by special interest groups,
3. Distortion of information flow to the public, and
4. Manufactured or fabricated crises.

Both the FCC and the STB have shown signs of these four features, which I outline in the following sections.

Agency Obsolescence and Its Symptoms

The notion of obsolete products and industries is well-known. When a better product comes on the market, consumers switch, and the original product is phased out. Similarly, entire industries can become obsolete. For example, the automobile made the buggy whip industry obsolete. It would not be tenable to continue the Buggy Whip Regulatory Authority in the age of the automobile. As such, Macey asks a reasonable question:

What happens when technological change, market processes, or other exogenous variables cause the basic purposes of an administrative agency to cease to be relevant from the perspective of the public policies that originally led to the creation of the agency?⁴

Communications have evolved not just in the devices (telegraph to telephone to smart device) but in the system logic, from circuit-switched to packet-switched networks. Similarly, the railroad industry of today operates in a more competitive environment than when it dominated long-haul transportation. But substantial legacy regulations remain for both, and many stakeholders would rather extend or reinvent the regulatory mission (whether it is legal is another question) than decommission the organization and return the resources to the federal budget.

Perpetuating agencies beyond their useful life can have profound consequences—notably, the waste and misdirection of scarce resources, the creation of barriers to market entry, the promulgation of misguided policy, and the private inurement of regulatory employees and associated stakeholders. For one, the proliferation of multiple regulatory agencies wastes real resources and creates overregulation. Had regulation been held at the 1980 level, America's economy today would have \$4 trillion more in gross domestic product.⁵

Consider the Rural Electrification Administration, established in 1936 to bring electricity to farms, which

continues to this day. It achieved its goal of electricity to all farms and was redirected to bring telephone service to all farms.⁶ Both goals have long ago been achieved, but the agency remains.⁷

Macey examined the four features of agency obsolescence at the SEC in the 1990s. He found evidence of turf grabbing between the SEC and the Commodities Futures Trading Commission and that the SEC's policies favored constituencies such as analysts, institutional investors, brokerages, and securities professionals.⁸ Following George Stigler's study of the SEC showing how it generated disinformation,⁹ Macey also found evidence of the SEC generating dubious "proof" of "thieves and incompetents in the securities industry" to justify the need for new agency initiatives.¹⁰ Macey found the abuse pernicious because the SEC, having authority over capital formation, not only disrupts the process but creates a downstream impact to other industries that rely on capital inputs.

The SEC, one of many authorities that regulate the financial industry, remains a powerful regulatory institution with a \$1.7 billion budget and more than 4,000 employees. The agencies examined in this report (the FCC and STB) are significantly smaller in budget and head count, but they still have an outsized impact on the economy and consumers. The symptoms of obsolescence for the STB and the FCC are summarized in Table 1.

Table 1. Symptoms of Obsolescence for Rail and Communications Regulations

	Rail	Communications
First Iteration	Interstate Commerce Commission (1887)	Federal Radio Commission (1927)
Second Iteration	Surface Transportation Board (1996)	Federal Communications Commission (1934)
2019 Budget	\$37 million	\$333 million
Employees	142 (average \$183,000 compensation per employee)	1,448 (average \$168,000 compensation per employee)
Turf Grabbing	Pushing the boundaries of rate regulation to price caps; revenue adequacy (2019)	Net neutrality including Title II classification (2009-2015)
Capture by Special Interest Groups	Variety of industry groups that ship goods by rail; National Industrial Transportation League (2011); reciprocal switching (2011); consideration to revoke exemptions for rate regulation for specific commodities (2016); Rate Reform Task Force report with a variety of shipper-favored policies (2019)	Silicon Valley companies represented by the Internet Association
Distorted Information Flow to the Public	Incomplete analysis of competition, defined generally by rail shippers without considering other market forces; imposition of price regulation with a subjective definition of market dominance	“Virtuous circle” theory; imposition of price regulation without finding market power; redefining engineering concepts on a whim to suit predetermined political outcomes (e.g., claiming the telephone network is equivalent to the internet)
Manufactured Crises	Competition is vibrant, but the STB insists on regulating prices.	The “openness” of the internet is at stake. The natural character of the internet will not be preserved unless the FCC regulates it.

Source: Author.

Turf Grabbing

Institutional territory or “turf” can refer to resources and jurisdiction. For obsolete agencies, their regulated industry, territory, or jurisdiction shrank, and simultaneously, competing industries grew in its place, industries over which the regulators do not necessarily have the same authority. At the end of the period, the agency’s turf is significantly smaller both relative to other industries and as a percentage of gross domestic product.

If the agency wishes to be relevant to a new set of stakeholders, then it must revise, redeploy, or reinvent its activities to win the new group’s political favor. As such, it grabs new “turf.” For instance, in the 2015 Open Internet Order, the FCC asserted that its authority to regulate the plain old telephone network translated to regulating the price and traffic of a different network, the internet. It did this through a lawyerly sleight of hand that claimed the “interconnected service” on the telephone network is the same as a service “interconnected with the public switched network” of internet protocol. At the STB,

regulators are considering pushing the boundaries of rate regulation to go beyond mere concepts of revenue adequacy (ensuring the industry can attract investors and provide for safety upgrades) to price caps, de facto ceilings on what railroads can charge based on the lobbying of corporate rail customers. Many service substitutes have emerged outside the regulated industry, so the obsolete agency needs to invent a *crise du jour* to deny its obsolescence and create a new reason for being, frequently the re-regulation of a deregulated or at least partially deregulated industry. Regulatory advocates frequently prefer that new services from the deregulated industries are so popular and important that they need to be regulated, and they invoke old paradigms such as common carriage to justify it.

Common carriage is a regulatory concept characterized by four features: (1) the duty to serve all who apply, (2) the transport of people or property with responsibility for loss, (3) transmission from place to place, (4) and a reasonably adequate service for a reasonable price. Common carriage conflicts with free-market principles and private carriage, or negotiated, personalized service.

Information technology has brought a boom in private carriage in telecommunications and transportation. Consider ridesharing, which people increasingly choose over regulated taxis, public buses, and transit rail. The many advantages of ridesharing services are the antithesis of common carriage: dynamic pricing, multiple payment methods, integration with customer loyalty programs, rating the driver and experience, and dozens of ways for consumers to tailor their experience to their preferences such as vehicle type or size.

The following describes turf grabbing with the STB and the FCC.

Rate Regulation. The STB, whittled down from the once gargantuan ICC with 11 commissioners and more than 2,000 employees, now seeks to reinvent itself through the Rate Reform Task Force after decades of a deregulation focus.¹¹ The first major reform was the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act),¹² enacted on the realization that the regulatory paradigm perpetuated a moribund industry of some 70 Class 1 railroads, most financially distressed and many bankrupt. As the current STB observes of the 4R Act and the subsequent Staggers Rail Act of 1980, which further deregulated the rail industry,

given the level of competition that had developed within and among the modes for most traffic, the impetus behind both laws was a desire to give railroads more leeway to operate in the marketplace like other industries. Recognizing that markets generally function effectively as a result of competition rather than regulation, Congress expected that, along with its relaxation of regulation, railroads would compete, where possible, for traffic. . . . The ICC's implementation of those laws, the railroads' own business decisions, and an improved business climate have transformed the railroad industry, which is now safer, more productive, and in better financial health.¹³

These acts are purported to have allowed easier entry and exit into the rail industry, ended the regulation that enabled collective rate making (a legal form of collusion), and allowed more flexibility between railroads and shippers to make contracts. Most important and in stark contrast to common carriage, the deregulation allowed the railroads to use, to some extent, differential or flexible pricing based on the customer's unique needs.

However, rate regulation did not go away completely. Limited to situations in which a railroad is shown to be market dominant, the STB can hear a complaint that a common carrier rate is "unreasonable." The

STB generally attempts to estimate a competitive market outcome in such cases by hypothesizing that the market is contestable—that is, free from barriers to entry and exit. The stand-alone cost test to do so is complex and time-consuming. As a result, the STB has established two simplified methodologies for challenging market-dominant common carrier rates. The STB’s staff report also details half a dozen proposals to further simplify its methodologies and offers yet another methodology, called Incumbent Network Cost Analysis.

The STB is directed to encourage railroads’ ability to achieve adequate revenues, defined as the level of revenue necessary to attract and retain capital.¹⁴ The report’s recommendations would use a finding that a railroad had earned adequate revenue on a firm-wide basis to justify capping rates on the transportation of specific commodities. In this way, the agency would turn a price floor into a price ceiling. This demonstrates how inefficient regulation can become.

Revenue Adequacy as a Shortcut to Rate Regulation. Congress requires the STB to assess the rail shipping industry’s financial health and report it to Congress. The notion is meant to ensure that the railroads earn enough revenue to attract investors and invest in safety. However, the exercise to determine an acceptable minimum profitability for the industry easily becomes an effort to cap the industry’s maximum revenue. In a free market, the rate of return would be the result of the interplay of supply and demand for risk among investors, the railroads, and their customers. However, this process is disintermediated by the STB, which is assumed to have better knowledge than the actors themselves.

To expand its turf, the STB can look for stakeholders that would like it to play a more active role to regulate the industry, to exploit the minimum that Congress stipulates. Indeed, if the STB can find a group of stakeholders (notably shippers) to whom it can curry favor, then the STB can ensure its longevity. Whether it is legal or economically efficient is a different matter.

Evidence that the STB is moving in this direction comes from a September 2019 hearing notice on the definition of long-term revenue adequacy in which it offers members of the public to submit their comments and testify to the board.¹⁵ Naturally, those stakeholders that would like to have reduced shipping rates will participate to provide justification to the STB. Stakeholders can comment on the time period over which revenue adequacy is to be considered (notably, a longer-term time horizon provides a more accurate description of a railroad’s financial health), adding limitations to how railroads can price their services to differentiate and simplifying the process to determine whether the rate is reasonable.

What constitutes a “reasonable” rate is subjective. Naturally, a shipper would like a price of zero, while the railroad would like the highest possible price without losing the shipper as a customer. Left alone, markets would find the optimal efficient price for the shipper to use the railroad (in lieu of finding a different solution to produce and distribute its goods) and the railroad to provide the shipment. Notably, many variables could influence the decision, including availability, time, fitness for purpose, payment terms, quality, and quantity.

Reciprocal Switching. Shippers have never enjoyed so many options to distribute their products as they do today, including multiple alternatives to rail. While the rail industry has some advantage in that a customer can ship large quantities of goods on one train instead of multiple trucks, there is immense competition in the freight market. And this competition is defined on multiple levels, not just railroad versus railroad, but also across modes, geographies, and product types.

While coal once sustained the baseline revenue of the freight rail sector, changes in US electrification patterns and regulatory policy limited the use of coal. This had ripple effects in railroad regulation (as rail prices were based in part on coal) and incentivized shippers to choose trucks over trains. The market for shipping has also become global, forcing America's railroads to compete with not only planes, drones, and ships but also international transport logistics providers, which build bespoke transport solutions that select individual transport elements and repackage them as end-to-end service solutions.

These many shipping solutions reflect both the growth in products that American producers ship to market and the need for shipping customization. Some producers create their own shipping network, such as Amazon Prime's logistics solutions of planes, trucks, and vans to guarantee two-day delivery. Most producers can choose where to establish their industrial operations, whether near a Class I line or on a secondary railroad line. Moreover, railroads engage in voluntary switching when exchanges are mutually beneficial.¹⁶

Yet some shippers, predominately in the chemical and agricultural sectors, are not satisfied with the outcomes of bilateral negotiations with railroads. While they could often avail themselves to other modes of delivery, they can coordinate their efforts and lobby the regulator—the STB—to mandate the switching terms between railroads. Beginning in 2011, the National Industrial Transportation League (NITL) petitioned the STB to regulate the price of the secondary railroad, essentially requiring the Class I railroad to switch its traffic to the secondary line at an STB-regulated rate, whether at or below cost.

By statute, the STB is chartered to regulate in the case of harmful market power. It needs to first establish a market failure before it regulates. The STB declined to do that (reneging on its statutory authority). It issued a notice of proposed rulemaking in 2016 and instead sought a workaround known as “competitive switching,” an opaque standard of how and when it decides to impose regulation.

American folklore alludes to the 19th-century railroads as justification for regulatory agencies, but the creation of the ICC itself was a product of rent seeking, reflecting the political prioritization of powerful agricultural interests over that of transport, not consumers.¹⁷ As long as the regulator can be an intermediary, rail industry policy will be more a product of special interest groups than the natural market interplay of supply and demand.

Net Neutrality. As the FCC's traditional domain (telephony) has declined, net neutrality has given the FCC a reason for being. The number of households with common carrier fixed-line telephone subscriptions continues to fall while wireless-only households rise.¹⁸ This demonstrates that people prefer the services and flexibility of private carriers. But that does not stop elite lawyers and advocates, who, together with Silicon Valley firms, lobby the FCC to impose common carriage on the internet. This so-called nondiscrimination regime, or net neutrality, amounts to Silicon Valley getting its data delivered for free while consumers bear the cost of transit and last-mile infrastructure, regardless of whether they access the services of the Silicon Valley firms. Under this quasi-common carriage,¹⁹ consumers and Silicon Valley's competitors are barred from contracting for any kind of service that deviates from the mandated status quo, and the FCC is empowered to impose taxes on internet access to generate revenue for municipal broadband and traffic controls to restrict individual contracts for quality of service, content, priority, and so forth. Moreover, the net neutrality rules effectively regulate speech, creating First Amendment concerns.²⁰

The internet is already a poor fit for common carriage by virtue of its packet-switched design and because paths and destinations are not known in advance, but autonomously and dynamically generated.

The internet and its applications, such as Voice over Internet Protocol and email, have provided zero-cost substitutes to the telephone and post, effectively making the latter obsolete. Consumers can get access to the internet in many ways, with multiple competing firms offering ever-increasing speeds on DSL, cable, fiber, mobile (including 5G²¹), Wi-Fi, and satellite (now launching 100 Mbps service²²). These innovations have been achieved under the specific policy determination that internet access would not be common carriage (Title II of the Communications Act). Indeed, common carriage in the telecom industry led to usurious prices, prohibitions on attaching devices to networks, reduced innovation, and ultimately the breakup of Ma Bell monopoly because of collusion between the FCC and Ma Bell.²³

Based on the pressure from internet companies, regulatory activists, and President Barack Obama himself, the FCC applied Title II telephony regulation to the internet in 2015. Following documented declines in internet investment and other problems, the FCC vacated the Restoring Internet Freedom Order in 2017.²⁴ The order returned jurisdiction of broadband to the Federal Trade Commission (FTC), while sharing with the FTC the ability to regulate the transparency of broadband subscriptions. Following the change, the FCC has documented an increase in speeds, investment, and network diversification.²⁵ However, internet companies sued the FCC for removing the rules, and many state legislatures and governors have tried to promulgate the 2015 rules to their own states, a clear violation of federal preemption and supremacy clause.²⁶ This restoration of a light-touch approach was upheld unanimously in *Mozilla v. FCC*, though a split decision allows state to pursue regulation subject to FCC conflict preemption.²⁷ Until Congress clarifies the statutory mandates for these agencies, turf grabbing will continue to animate these agencies' policies, including the disruptive flip-flop of classification every time the majority party changes at the FCC.

Capture by Special Interest Groups

Because of their sector-specific nature, the FCC and STB are subject to capture from discrete constituencies that become fluent in arcane, sector-specific regulation. Powerful industrial network users lobby the regulator for favorable price regulation, as is demonstrated with the NITL and the Rail Customer Coalition at the STB and the Internet Association at the FCC.

Nobel economist George Stigler's idea of "regulatory capture," the observation that regulation is acquired by industry and operated for its benefit, has been documented across a range of industries: telecommunications, airlines, oil and gas, and so forth.²⁸ Stigler describes how the regulated party colludes with the regulator to create a mutually reinforcing regime. Capture allows regulators to exert authority to retain support and maintain power even though the industry has become obsolete. Samuel P. Huntington explored this further,²⁹ and Marver H. Bernstein extended Huntington's analysis and capture perspective to six additional agencies: the FTC, the Federal Power Commission, the Civil Aeronautics Board, the FCC, the National Labor Relations Board, and the SEC.³⁰

It is not only corporate lobbyists that can capture the regulator, but special interest groups. Mancur Olson described the "collective action" that can succeed to win favorable outcomes in policy.³¹ Olson notes that special interests tend to be overrepresented, as the diffuse majority is costly to organize.³² This is particularly the case in telecom and transportation policy, topics that are sufficiently arcane to a general audience, making it even more susceptible to abuse by special interests. Although the public can benefit from good telecom and transportation policy, the technical nature of these policies means they attract only a minority of interest from scholars, advocates, and policymakers.

Stanford economists Roger Noll and Bruce Owen described the predictable opposition to regulatory reform in *The Political Economy of Deregulation* (1983).³³ Noll and Owen observe that regulation is not

neutral; it benefits certain firms at the expense of others and helps and hinders different interest groups. Importantly, they observe that consumers and taxpayers are the parties least likely to be represented by special interest groups. Noll and Owen observe that many law firms and consumer groups claim to operate in the public interest, but regulatory process gives them a source of power they do not have otherwise. As such, they are biased in favor of regulation over market solutions, a typical response of the policy entrepreneur whom James Q. Wilson described as seizing an opportunity to “serve as a vicarious representative of groups not directly part of the legislative process.”³⁴

While the internet could increase the ability of poor and low-income individuals to engage in the political process by lowering information and transaction costs, digitization has increased the power of special interests.³⁵ The creation and promotion of digital advocacy platforms require skills and socialization that tend to reside with educated, or at least experienced, users. As advocacy has become digital, those without skills and those not online (particularly the elderly who might not find the internet relevant) are also less likely to participate in digitized advocacy.³⁶

Macey describes that agencies will seek new constituencies to replace old ones that have disappeared and will look for constituencies that have powerful congressional allies.³⁷ Indeed, Macey observes that these allies evolve “in such a way that their survival depends on the continued success of that agency.”³⁸ In fact, law firms and consultancies build their practice around a particular agency. He notes:

The ability of administrative agencies, their allies, and their constituents to generate and control information relevant to that agency makes it difficult to design systems that can reliably identify obsolete agencies and respond to that obsolescence in a constructive way.³⁹

Indeed, the STB believes that deregulation was a success and that the rail industry today is more safe, solvent, and attractive to investors. It should follow then that the agency has fulfilled its objective and therefore should be decommissioned. But, as Macey describes, the agency seeks a new constituency. In the case of the STB, this new constituency is reportedly “aggrieved” shippers. Tellingly, the STB notes:

Many shippers find railroads largely uninterested in their business; many shippers feel that they have little bargaining power with respect to the contracts they are offered; and while inter-modal and intramodal competition for much traffic remains vibrant, many captive shippers have no realistic avenue for relief from what they view, as their ancestors did in 1887, as abusive practices by powerful, dominant railroads.⁴⁰

Yet so-called captive shippers are hardly small companies, at least not uniformly. After the board reformed its simplified rate cases in 2007, the first shipper to file cases under the new rules was chemical giant DuPont. While the STB often cites small farmers as well, the reality is that large firms and trade associations consume much of the board’s time and attention. To characterize these actors as helpless, small rail shippers is misleading at best.

The chemical sector, which spearheads the Rail Customer Coalition, is perhaps the most vocal. Yet as Cal Dooley, CEO of the American Chemistry Council, said, “The US remains the most attractive place in the world to invest in chemical manufacturing.”⁴¹ If this is the case, then the shipping conditions are such that they do not distract from the US being the most attractive place to invest.

Why then, if STB declares that competition is “vibrant” for both inter- and intra-modal competition, does the agency have to compensate for companies that choose to locate their facilities in remote

places? Is it the federal government's job to reward a class of major corporations? Finally, is it empirical that certain practices are "abusive," or is this just the view of a self-interested firm that would like to pay zero transmission costs? Indeed, conflict is inherent in any market, but could these disputes be resolved more efficiently and with less cost under a general competition authority such as the FTC, or even the courts themselves?

A similar dynamic is at play with the FCC and the largest Silicon Valley companies, which are lobbying for free transmission of their traffic under the guise of net neutrality.

Distorted Information Flow to the Public

To ensure that price regulation is justified, Congress mandates that each agency perform a market power assessment, an economic exercise to show that a dominant firm can or has raised prices above competitive levels such that it stifles demand or generates losses. In the case of reciprocal switching and net neutrality, both agencies declined to perform these assessments.

When the STB formally adopted a rulemaking process to begin the reciprocal switching exercise, it was at the NITL's request, not by STB's own independent assessment that there was such a need.⁴² NITL waged a political information campaign preceding the rulemaking, and the Rail Customer Coalition has loudly occupied the space since.⁴³

In the case of the FCC, a series of distorted events led to the net neutrality order. For one, the FCC stopped determining whether the market was competitive in its periodic reports to Congress during the Obama administration. It also spontaneously changed the speed definition of broadband on a partisan vote.⁴⁴ And then in promulgating the order, it imposed the rules on every broadband internet access service provider, essentially pronouncing thousands of internet service providers (ISPs) in America as having market power, but never performing the market power assessment for a single firm. Moreover, the FCC engaged in dubious engagement with interest groups to spur millions of comments to be submitted in support of the FCC's predetermined outcome.⁴⁵

Manufactured and Fabricated Crises

Social and political problems are created by official misinformation. Macey notes that an obsolete regulatory agency has strong incentives

to disrupt and distort the creation and flow of information to the public regarding the firms it is supposed to regulate. . . . Indeed, administrative agencies can only justify their huge staffs and significant budgets if they can persuade people that they are dealing with problems of significant proportions.⁴⁶

The 2015 FCC claimed that unless the internet is regulated with an obscure 1934 statute, its very "openness" will be compromised. It invented a facile theory purporting to explain how innovation on the internet works, the path it follows, and the actors involved—in advance. As the Restoring Internet Freedom (RIF) Order correctly notes:

The economic analysis in the [2010] *Open Internet Order* and *Title II Order* was at best only loosely based on the existing economics literature, in some cases contradicted peer-reviewed economics literature, and included virtually no empirical evidence.⁴⁷

The Title II Order declared that internet innovation is predicated on a "virtuous circle"⁴⁸ that operates in

clockwise fashion: (1) “Edge providers” create services and applications that users demand, (2) users purchase broadband to access the apps and services, and finally, (3) broadband providers invest in networks to facilitate the other two processes. Without any source of authority or evidence, the Title II Order pinpoints the essential actors, their inherent motivations, and an unwavering chronological process that moves in a clockwise direction.

This is a presumptuous statement to make with little to no academic or empirical support for a market as large and complex as America’s internet-enabled information technology economy. Indeed, network engineers in *Verizon v. FCC* testified that ISP investment frequently precedes innovation, noting that the presumed “virtuous circle” could turn both clockwise and counterclockwise and that ISP investment could also spur edge provider service development.

Given that the “virtuous circle” theory and its associated regulatory regime has no justification in the academic literature, no empirical test or proof, and no independently verifiable measure of its efficacy, the RIF Order properly rejected the virtuous circle as the basis for regulation.

The same dynamic occurs at the STB: The agency pronounces market competition as “vibrant” but then conducts hearings to justify more rate regulation. The STB, endlessly lobbied by rail shippers, is intent on market “fixes” without any clear definition of market failures.

Policy Solutions

In the past, a network offered a single technology to provide a single service. Classic examples are voice delivered over the copper-based telephone network or the commodity cargo delivered over a railroad. The rules governing today’s high-tech communications and transportation industries are predicated on a 19th-century technology framework.

The historical silo-based approach to network regulation is inapposite to modern ecosystems. In communications, different technologies and facilities compete to deliver the same service: broadband. Consumers can get broadband via DSL, cable, fiber, mobile, Wi-Fi, and satellite, but each of these facilities is subject to different regulations, many of which conflict. Similar asymmetries characterize the shipping industry. Goods can be shipped by rail, truck, barge, plane, drone, or other means, but different regulatory regimes distort competition and allow arbitrage.

The current administration has initiated many important and long-overdue reforms at major federal departments, organizations that have tens of billions of dollars in budget and tens of thousands of workers and fall directly under the executive branch’s authority.⁴⁹ The STB and FCC are relatively small players in comparison and are so-called independent agencies, not subject to the executive branch requirements. But the need for both macro- and micro-level reform is evident.

Notably, FCC Chairman Ajit Pai has been aggressive to make important reforms at the FCC (notably by repealing the common carriage regulation imposed in 2015), including removing burdensome regulation that deters investment and innovation, drastically reducing regulatory and paperwork costs, creating transparency to the FCC’s activities, and formalizing a rigorous evidence-based approach to decision-making by setting up the Office of Economics and Analytics.⁵⁰ However, more work remains to be done.

The regulatory structures for these industries are a patchwork of outdated laws and overlapping, redundant agencies. Congress should eliminate the silo-based regulatory structures and replace them with

technology-neutral, competition-oriented approaches. Concurrent with this process, Congress should rationalize duplicative regulatory agencies, apportioning their functions and resources to their sister agencies or relevant cabinet department.

Most notably, the FCC's competition and consumer-protection functions (\$333 million budget) are duplicative of the FTC (\$312 million budget). The FTC already regulates internet platforms, the competitors of the telecom industry. Having two different regulators for firms that provide the same services distorts competition and creates incentive for capture. The distortion is also evident considering that the total annual revenue of the telecom industry that the FCC regulates is less than the market capitalization of any one of the internet giants: Amazon, Apple, Facebook, Google, and Microsoft.

The case is similar in transportation, in which freight rail is subject to price regulation under the stand-alone STB (\$37 million budget) but its competitors in other transportation industries are not. Meanwhile, the freight rail industry complies with safety regulations administered by the Department of Transportation (DOT) (\$72 billion budget). DOT houses a number of agencies overseeing the safety and other features of transportation, including the Federal Aviation Administration, which regulates air travel; the Federal Railroad Administration, which regulates rail safety; the Maritime Administration, regulating seaborne traffic; the Federal Motor Carrier Safety Administration, regulating the safety of trucks; and the Pipeline and Hazardous Materials Safety Administration.

Fortunately, the Trump administration has resisted advocating for yet another regulatory agency to oversee Unmanned Aircraft Systems (UAS), known as drones. While drone operators must register with the Federal Aviation Administration, they are covered under a pilot program in which the DOT makes agreements with state, local, and tribal governments to establish innovation zones for testing complex UAS operations and to attempt different models for integrating drones into local airspace.⁵¹ DOT's openness to pilot projects suggests this could be a helpful model to experiment with modernized forms of regulation—for example, allowing rail freight to operate under the same technologically neutral laws with a focus on competition and safety.

Industries already compete across silos. It is only logical that regulation should be modernized to reflect reality. The industry expertise and capabilities of sector-specific regulators (the FCC and STB) should be combined with the appropriate larger department (the FTC and DOT).

The White House Office of Management and Budget recognizes this.⁵² It has offered valuable recommendations to merge the Departments of Education and Labor into an entity focused on developing the workforce, restructure the Post Office and Office of Personnel Management, and consolidate the myriad of disparate federal programs under a single roof for their respective goal, whether it is nutrition assistance, environmental cleanup, fisheries management, military cemeteries, and so on. Importantly, these efforts are necessary to ensure that the US can prepare fiscally for new threats and opportunities, whether it is attracting top talent to work in cybersecurity functions or appropriating a sufficient budget for NASA to conduct research.

Ultimately, Congress should adopt technologically neutral regulatory frameworks that recognize convergence and embrace network competition across now-obsolete silos. The important functions and resources currently housed in these stand-alone agencies can be redeployed—not eliminated—to yield a more coherent and streamlined regulatory edifice that more effectively reflects the rule of law and the will of the people.⁵³

About the Author

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