



**Before the
SURFACE TRANSPORTATION BOARD
Washington, D.C. 20423**

**In the Matter of
Competition in the
Railroad Industry**

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**Docket No. EP 705
FR Doc. No. 2011-774**

**COMMENTS OF THE COMPETITIVE ENTERPRISE INSTITUTE
IN REPLY TO INITIAL COMMENTS OF
CONSUMERS UNITED FOR RAIL EQUITY (CURE)**

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On behalf of the Competitive Enterprise Institute (CEI), a non-profit public policy organization that specializes in regulatory issues, I respectfully submit this letter in reply to the initial April 12, 2011, comments of Consumers United for Rail Equity (CURE) in the matter of *Competition in the Railroad Industry*.¹

This comment letter develops the following points:

1. CURE ignores 49 U.S.C. § 10101(6) and fails to show that current “rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital.”
2. CURE’s case for forced access does not consider the economic literature on the peculiarities of network industries and the dangers of overregulation.
3. CURE and the firms it represents have long engaged in a pattern of rent-seeking behavior in which they have heavily criticized adequate rate-setting in the railroad industry.

1. CURE ignores 49 U.S.C. § 10101(6) and fails to show that current “rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital.”

CURE admits in its initial comments that “the rail customer bears all burdens of proof” in challenging rates set by railroads.² Yet the organization has not met these burdens and offer little in terms of evidence that railroads are engaging in excessive rate-setting due to increased market power or that railroads are setting rates in order to “provide [themselves] with revenues which exceed the amount necessary to maintain the rail system and to attract capital.”³ Under 49 U.S.C. § 10101(6), this must be established and proven before any rate-corrective regulatory action is taken that is intended to increase “effective competition and coordination between rail carriers”⁴ in the presence of “undue concentrations of market power.”⁵

CURE cites “the various L.R. Christensen and Associates reports to the Board”⁶ in a manner that seems to imply that the L.R. Christensen findings support the CURE contention that railroads have engaged in anticompetitive behavior and/or that the current railroad industry lacks the nebulous quality of “effective competition.” This would be a mistaken conclusion. In fact, the latest L.R. Christensen report to the Surface Transportation Board (hereafter STB or Board) found that “while shippers have been exposed to increasing RPTMs after 2004, it appears that costs rather than markup factors are largely the culprits”⁷ and that this in turn was “driven

¹ Surface Transportation Board, *Competition in the Railroad Industry*, January 14, 2011, Docket No. EP 705, FR Doc No. 2011-774.

² Initial Comments of Consumers United for Rail Equity (CURE) in before the Surface Transportation Board in the matter of *Competition in the Railroad Industry*, April 12, 2011, Docket No. EP 705, Filing ID 229235, p. 4.

³ 49 U.S.C. § 10101(6).

⁴ 49 U.S.C. § 10101(5).

⁵ 49 U.S.C. § 10101(12).

⁶ Initial Comments of CURE, p. 6.

⁷ Surface Transportation Board, “An Update to the Study of Competition in the U.S. Freight Railroad Industry,” Final Report, prepared by Laurits R. Christensen Associates, January 2010, p. 6-17, <http://www.stb.dot.gov/stb/docs/CompetitionStudy/Final/January%202010%20Report.pdf>.

primarily by the spike in fuel prices in recent years.”⁸ In other words, the generic costs faced by railroads have increased, which in turn drove rates higher, rather than this recent uptick in rates being the result of an increased exercise of market power on the part of the railroads.

As the degree to which carriers have exercised market power has not changed, there is no way to apply the rate “reasonableness” criteria contained in 49 U.S.C. § 10701(d) in a manner consistent with statutory intent. Given the lack of evidence to support action under the statutory conditions, CURE’s subsequent claims fall apart.

2. CURE’s case for forced access does not consider the economic literature on the peculiarities of network industries and the dangers of overregulation.

As we noted in our supplemental comments filed with the Board on April 12, 2011, the dangers of reregulating railroads to require forced access arrangements are numerous and severe.⁹ The U.S. economy has changed a great deal over the past 30 years. If the current *ex parte* proceeding is resolved in CURE’s favor, the STB would be ignoring lessons learned at its own—and the nation’s—peril.

Viewing the railroad industry through the lens of the basic, textbook industrial organization and antitrust analyses are fundamentally flawed. In recent years—coinciding with the amazing growth of high-tech network industries—a growing body of academic economic literature on competition policy and evolving networks has found that typical modern antitrust and regulatory views are woefully inadequate, and the current corrective and enforcement tools clumsy and counterproductive.

George Priest, John M. Olin Professor of Law and Economics at Yale Law School, has argued that while most “[a]ntitrust analysts and courts are presumptively suspicious of the possession or extension of market power,” this suspicion “[i]n the context of a network industry” is “inappropriate” because it ignores “positive externalities generated by network participation.”¹⁰ “Thus, many of the traditional presumptions with respect to industrial practices and industrial structure are not available and are even counterproductive in the context of networks.”¹¹ Professor Priest goes on to call for a complete reorganization of contemporary antitrust understanding with respect to network industries.¹²

An error often made when analyzing the efficiency of markets is the assumption that, due to market failure or other perceived market imperfection, public policy can easily be implemented in a manner that corrects these claimed deficiencies. Unfortunately, in the real world, the net social costs of government failure in attempting to remedy suboptimal market outcomes frequently outweigh the costs of market failure itself. As New York University economist

⁸ Ibid.

⁹ Comments of the Competitive Enterprise Institute before the Surface Transportation Board in the matter of *Competition in the Railroad Industry*, April 12, 2011, Docket No. EP 705, Filing ID 229233, pp. 4-5.

¹⁰ George L. Priest, “Rethinking Antitrust Law in an Age of Network Industries,” John M. Olin Center for Studies in Law, Economics, and Public Policy, Yale Law School, Research Paper No. 352, November 2007, p. 7, available at: <http://ssrn.com/abstract=1031166>.

¹¹ Ibid., p. 9.

¹² Ibid., pp. 39-42.

Lawrence Wright has astutely noted, “governments are not omniscient”¹³ and they “may not be the benevolent neutral entities of textbooks.”¹⁴

On the contrary, regulatory bodies are frequently captured by commercial interests, which then drives socially harmful, anti-market policy. As a result, “the efforts of government to fix the potential problems of networks may well go awry.”¹⁵ This is not to suggest that the Board currently finds itself in such a predicament, but regulations enacted now would have long-run consequences that are beyond the control of the present STB.

While much of the literature examining the impact of post-Staggers deregulation found that railroads, shippers, and consumers broadly benefited, very little research has been done on the effects on specific sectors or subsectors. Shippers have challenged the discrimination among firms in freight rate-setting by arguing that these practices undermine social welfare. However, economic historian Marc Levinson challenges these claims, and he argues that this sort of discrimination in the railroad industry is not only welfare-enhancing, but that “the end of the ban on discrimination was the most important result of the deregulation of freight transport.”¹⁶

3. CURE and the firms it represents have long engaged in a pattern of rent-seeking behavior in which they have heavily criticized adequate rates in the railroad industry.

Since the Staggers Act was enacted, a minority of shippers—including those represented by CURE—have complained about rates that they perceive as “unreasonable” and have called on the STB to be more heavy-handed with the railroad industry.¹⁷ In reality, it is these very shippers who are unreasonable and their continued attempts to convince the Board to take drastic action are little more than rent-seeking.

Brookings Institution Senior Fellow Clifford Winston for years has called on these shippers to stop engaging in such unproductive behavior. Absent STB intervention, “shippers and railroads could extend the benefits they have already achieved through contractual negotiations by achieving efficiencies as partners, instead of quibbling over a small pie as adversaries.”¹⁸

Virtually every academic economic analysis of the post-Staggers railroad industry has found that “the net effect ... was to reduce rates for all commodities, increase competition, and improve factor (e.g., labor, capital) productivity.”¹⁹ Given that rail carriers seem to be losing interest in

¹³ Lawrence J. Wright, “U.S. Public Policy Toward Network Industries,” *Reviving Regulatory Reform* conference, American Enterprise Institute, January 16-17, 1996, p. 20, available at: <http://ssrn.com/abstract=164500>.

¹⁴ *Ibid.*, p. 21.

¹⁵ *Ibid.*, p. 22.

¹⁶ Marc Levinson, “Two Cheers for Discrimination: Deregulation and Efficiency in the Reform of U.S. Freight Transportation, 1976-1998,” *Enterprise & Society* Vol. 10 No. 1, March 2009, p. 178.

¹⁷ See, e.g., Fritz R. Kahn, “Railing at Railroads,” *Transportation Law Journal* Vol. 28 No. 1, Fall 2000.

¹⁸ Clifford Winston, “Deregulating the rails: A rare win-win for public policy,” *The Washington Examiner*, December 8, 2005, p. 19. See also, Curtis Grimm and Clifford Winston, “Competition in the Deregulated Railroad Industry: Sources, Effects, and Policy Issues,” *Deregulation of Network Industries: What’s Next?* Eds. Sam Peltzman and Clifford Winston, Washington, D.C.: AEI-Brookings Joint Center for Regulatory Studies, 2000.

¹⁹ Brian A. Weatherford, Henry H. Willis, and David S. Ortiz, *The State of U.S. Railroads: A Review of Capacity and Performance Data*, Santa Monica, Calif.: RAND Supply Chain Policy Center, 2008, p. 4, http://www.rand.org/content/dam/rand/pubs/technical_reports/2008/RAND_TR603.pdf.

serving many low-volume shippers,²⁰ perhaps the ongoing, wasteful political efforts of groups such as CURE will convince the railroads to abandon some of these shippers altogether?

Conclusion

We again urge the Surface Transportation Board to exercise extreme caution when considering the requests of shipping interests such as CURE. The railroad industry must invest hundreds of billions of dollars in the coming decades to accommodate freight traffic growth and to remain competitive with other modes of freight transportation.²¹ As CURE fails to sufficiently establish that rates are excessive under Title 49, lacks an understanding of the underlying economics of network industries, and has continually engaged in frivolous complaint-filing over rates, the Board should ignore calls in this current proceeding to reregulate the United States railroad industry.

²⁰ Ibid., p. 41.

²¹ Ibid., p. 42.