The Heritage Foundation Backgrounder UPDATE
214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202)546-4400
1/8/88 Number 63

H.R. 1393--A HIGH COST THREAT TO AMERICA'S RAILROADS

(Updating *Issue Bulletin* No. 129, "The Consumer Rail Equity Act: Returning to the Dark Days of Regulation," June 5, 1987.)

The House Energy and Commerce Committee is due soon to take up a bill, H.R. 1393, sponsored by Democrat Thomas Luken of Ohio, to increase federal regulation of the nation's railroads. Supporters claim that the bill merely will fine-tune the 1980 Staggers Act, which partially deregulated the railroads. In truth, H.R. 1393 could inflict a serious setback to the railroad industry, which has just begun to revive and to become more competitive with other modes of transportation thanks to the 1980 law. Most at risk with the Luken bill, of course, will be the shippers and American consumers who have benefited by deregulation.

Under the Staggers Act, service and rates for the vast majority of rail shipments were deregulated. The result: a general improvement in service and an overall decline in rates. To protect a small number of so-called captive shippers, those deemed to be dependent on a single railroad, the Staggers Act retained a small degree of regulation. The Luken bill approved on November 5 by the Transportation, Tourism and Hazardous Materials Subcommittee of the House Energy and Commerce Committee would expand these regulations, as well as impose new restrictions on railroads. These changes, at first glance, appear innocuous, technical alterations of current law. Many, however, would have a significant and damaging effect on railroads and their customers, reversing much of the gain from deregulation. Examples:

The burden of proof in regulatory cases concerning rates for captive shippers would be shifted to the railroad when the rate charged was more than 220 percent of the "variable," or incremental, cost of the service. Since the burden of proof is a crucial element in the typical rate case, this provision would make it difficult to uphold any rate over 220 percent. This could have a substantial impact on railroads. Because railroads have such high fixed costs of operation--which do not vary by use--they must charge rates well above variable costs to operate profitably. Had the railroads charged no rates above the 220 percent figure in 1984 (the latest year such data are available), their total revenue would have been an estimated $668 million lower--over 17 percent of their pre-tax net income for that year and over 73 percent of that for 1986.

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The Railroad Cost Adjustment Factor, or inflation index, upon which many regulated, as well as nonregulated, rates are based, would be adjusted downward to reflect increases in productivity. Such a change could reduce a railroad's incentive to make investments to increase productivity, since the gain from such investments would be wiped out. What is worse, since the adjustment would be retroactive to 1980, it would impose an automatic and unexpected decrease in rates estimated at more than 13 percent.

Railroads would be forced to permit other railroads to use certain of their terminals, tracks, and equipment at unspecified rates. This would apply regardless of whether the shippers affected were captive. Forcing a private company to open up its property for the use of others would violate basic principles of fairness.

Among its other provisions, the bill would:

Forbid the Interstate Commerce Commission (ICC) from considering certain types of competition when deciding if a shipper is captive.

Change the standards for determining whether a railroad is earning adequate revenues.

Make it more difficult to sell or abandon money-losing rail lines.

Looming Deterioration of Quality. The overall effect of H.R. 1393 would be to reduce revenues significantly for U.S. railroads. The railroad industry, despite improvements since deregulation, still earns a very low rate of return. The railroads' options thus would be limited. They could try to increase rates for noncapitive shippers. Yet these shippers easily could take their business elsewhere, transporting their goods by truck or barge. More likely, the quality of railroad service would resume the decades-long deterioration that was halted only by deregulation. The result: railroads, captive and noncaptive shippers, and consumers would all be worse off.

The regulatory changes proposed in H.R. 1393 are not only apt to be detrimental to railroads and shipppers, but they are also unnecessary. Under the current provisions of the Staggers Act, captive shippers have adequate protection. In the two years since the ICC put its new coal rate guidelines into effect, it has granted rate relief in several major cases. Commission officials estimate that rate reductions in coal rate cases alone total over $150 million--even without counting the settlements reached without litigation and thus not reported to the ICC.

The 1980 Staggers Act is working. The greater flexibility made possible by the legislation has enabled America's railroads to move back from the brink of bankruptcy, while improving service and cutting rates. Moreover, remedies are in place, and being used, that address the complaints of captive shippers who feel they are paying too much. The changes proposed in H.R. 1393 would simply threaten the benefits gained from partial deregulation--hurting shippers and consumers, as well as railroads.

James L. Gattuso
McKenna Senior Policy Analyst
in Regulatory Affairs