RAIL PRICE ADVISOR

First Quarter 2004
Volume 13, Number 1

Are High Captive Rail Rates Contributing to the Flood of Imports and the Loss of U.S. Jobs?

Railroads are allowed to use differential pricing which means they can charge captive movements more than twice the rate of competitive movements. High captive rail rates put many rail shippers at a competitive disadvantage with other domestic producers as well as with global companies, which import their products into the United States (U.S.). Imports into the U.S. are increasing dramatically and displacing domestic production for many products, and causing an increase in the trade deficit and the loss of U.S. jobs. Based upon the flood of imports into the U.S. and that more freight moves by rail than any other mode of transportation it is logical to ask the following question about the railroad's differential pricing policy.

Are the railroad's pricing practices contributing to the flood of imports flowing into the U.S.?

Domestic producers that are captive to one railroad are not competing on a level playing field with imports as they can have rail rates that are more than 200% higher than comparable rates for imported products. The reason for this is that imports normally come into ports where they have access to more than one transportation option. This enables imports to get rail rates, which are substantially, less than the rates from domestic facilities with no rail competition. High captive rail rates are therefore helping to price many domestic producers out of markets.

The Table 1 on page 2 demonstrates the increase in imports for major commodities over the first three quarters of 2003 versus the first three quarters of 2002. Figure 1 shows the increase in imports for several commodities over the longer time period of 1998 to 2003 (import numbers are for the first three quarters of each year).

This data demonstrates that imports of products like chemicals and coal that primarily ship in bulk by rail are exploding. Railroads and bulk rail shippers must come to grips with the fact that imports are taking business away from US manufacturing facilities and high captive rail rates contribute to this loss of business. The extent to which domestic producers' high rail rates contribute to the glut of imports is unknown. However, many shippers we have talked to said that their rail rates make it almost impossible to compete against imports in some markets while in other markets they continue to lose market share because of their lack of success in reducing high transportation expenses.

Table 1

Increase in Imports Between the First Nine Months of 2002 and the First Nine Months of 2003

(in million of dollars)

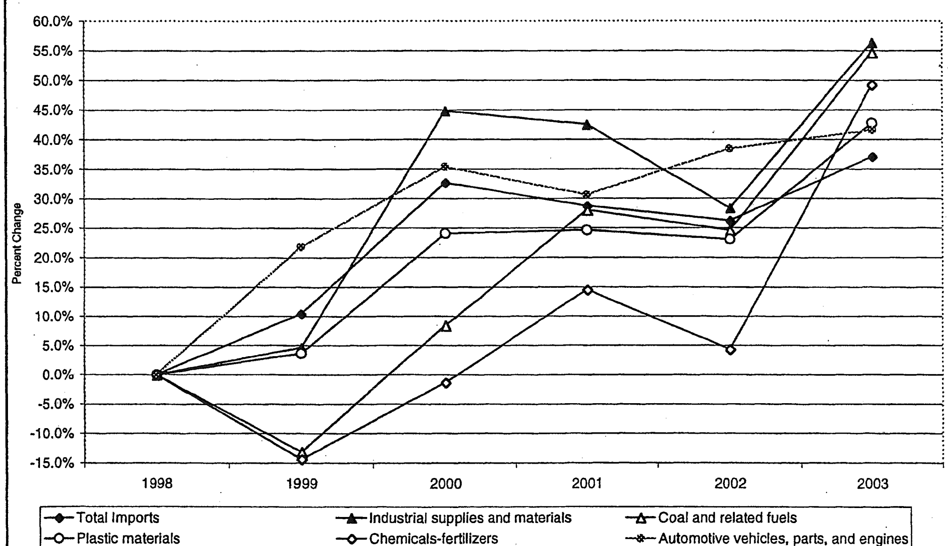
	2002	2003	Increase	Percent Increase
Industrial Supplies & Materials	**$125,326**	**$157,011**	**$31,685**	**25.2%**
Chemicals - Organic	$9,227	$10,230	$1,003	10.9%
Chemicals - Fertilizers	$2,698	$3,861	$1,162	43.1%
Chemicals - Inorganic	$2,925	$2,927	$3	0.1%
Plastic Materials	$5,443	$6,316	$873	16.0%
Chemicals - Other	$4,028	$4,233	$205	5.1%
Paper & Paper Products	$4,487	$4,766	$279	6.2%
Glass - Plate, Sheet, etc.	$629	$709	$79	12.7%
Coal	$724	$899	$176	24.2%
Natural Gas	$7,592	$16,430	$8,837	116.4%
Crude Oil	$55,357	$74,495	$19,138	34.6%
Capital Goods, Except Automotive	**$211,893**	**$217,860**	**$5,967**	**2.8%**
Automotive	**$151,397**	**$154,812**	**$3,415**	**2.3%**
Consumer Goods	**$227,193**	**$245,930**	**$18,737**	**8.2%**
Foods & Feeds	**$36,695**	**$41,245**	**$4,551**	**12.4%**
TOTAL	**$859,122**	**$933,076**	**$73,953**	**8.6%**

Source: U.S. Census Bureau

Figure 1

Percent Increase in All Imports and Selected Commodities Between 1998 and 2003

(Imports are over the first nine months of each year)



Source: U.S. Census Bureau

Our survey of many rail shippers demonstrates that the loss of domestic business to imports is intensifying and that imports will become a much bigger drain on domestic production in the future. The reason for this is that up until now, in order to fight imports many companies continually cut their margins. Margins are now to the point that they can not be cut any further. During the time that rail shippers have been cutting the margins on their products the railroads have continued to increase the rates for their captive movements. For many of these companies, it is now do or die time. Railroads must either join the fight in the battle against imports or the battle will be lost for many companies in numerous markets. Many rail shippers believe that they cannot win the battle against imports without the cooperation of their railroads.

Fighting the battle against imports seems like it should be a no brainer for railroads. After all, when domestic production loses out to imports, railroads also lose out to imports. When railroads give lower rates to imports they not only lose the higher rate on domestic producer's outbound movements they also lose the inbound raw material rail movements associated with this business. When finished products are imported the railroads' loss is much greater. They can lose all the inbound and outbound movements at each domestic facility involved in each stage of processing for the finished product. Between raw material shipments, intermediate product shipments and finished product shipments railroads could lose more than six separate movements in exchange for the one movement from the port where the imported product arrives. In reality, it might be a better business decision for the railroad to move the domestic final product for free in exchange for all the other movements in the supply chain for this type of domestic finished product.

Railroads have a lot to lose from the increase in imports but many rail shippers say that it is hard to convince them of the magnitude of the problem. The reason for this is that railroads want to maintain their high captive rail rates for as long as possible. This means they are reluctant to participate in preserving business by cutting their rates until they see concrete proof, e.g. a big drop in volumes in a market. Shippers counter that this is a prescription for failure, because by the time they lose large volumes to imports in a market it is already too late! Once international companies invest capital, build infrastructure and establish customers in an area it is much more difficult to compete against them. Shippers claim that the actions of railroads to preserve domestic business tends to be too little and too late.

What is unnerving to U.S. companies that export their products is that they are always at a transportation disadvantage in other countries. In other countries the indigenous railroad helps protect domestic business by giving higher rail rates to imports. In the U.S., however, imports are given preferential treatment because of the railroad's differential pricing policies, which result in imports receiving lower transportation expenses than domestic producers with captive rail movements.

The railroad's reluctance to change their philosophy of high rates for captive movements in order to compete with imports is shortsighted. Rail shippers are not however without blame because in many cases they are not providing the information railroads need to understand what they are competing against in the market place. Rail shippers need to do more to show railroads:

1) Why their current rate structure is bad for both companies, and
2) The rate structure that is needed to win the battle against imports.

Railroads and rail shippers need to have a very good understanding of each others' businesses in order to establish rates that will help win the battle against imports and maximize profit for both companies. There is a war going on for US markets between domestic and global producers. The sooner railroads and rail shippers work together to win this war the more success they will have in increasing volumes, revenue and profits for both companies while preserving U.S. manufacturing jobs.

The government must also recognize that by allowing railroads to charge high rates for captive domestic movements, it is responsible for giving U.S. companies the incentive to import products. The recent Surface Transportation Board (STB) decisions in the Norfolk Southern (NS) versus Duke Energy (Duke) and Carolina Power & Light (CP&L) versus NS rate reasonableness cases are disappointing as they are classic examples of how the government is encouraging imports. In these STB decision, it is estimated that NS will be allowed to increase its captive rates for coal movements by 20% to 50% more than what it was previously receiving. Many rail shippers believe that through these decisions the STB has essentially broadcast loud and clear that railroads may increase rates on all captive shippers, not just coal shippers, by a huge increment without fear of regulatory intervention. The STB does not agree with this contention, but from a rail shipper's standpoint, the STB's actions speak much louder than its words.

The Duke/NS decision will reportedly cost Duke $40 to $50 million annually and provide Duke, and other utilities in a similar situation, with a lot of incentive to invest capital to try and avoid the railroads high captive rates, by being in a better position to purchase imported coal. The higher the rail rates the STB allows at captive plants, the greater the advantage imports have in U.S. markets. In order to effectively fight imports, the STB needs to be an active participant in the battle. The Duke/NS and

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The *Rail Price Advisor* is published by Escalation Consultants, Inc.
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Subscription rate $260 U.S. ($290 outside U.S.)

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CP&L/NS decisions unfortunately indicate that the STB is far from being an ally in the battle against imports.

Conclusion

Railroads were allowed to use differential pricing under the Staggers Act of 1980. The world is much different now as U.S. companies buy and sell in a world economy to a much greater degree than they did in 1980. Being as twenty-three years have passed since the enactment of the Staggers Act it seems logical for the government to review the positive and negative implications of differential pricing on the trade deficit and on the loss of jobs in the U.S.. No one is certain of the actual impact the railroad's differential pricing practices are having on the loss of U.S. business and the loss of jobs in the U.S.. The large jump in imports indicates that it's time to find out! □