



**Statement for the Record
of the
National Corn Growers Association**

Hearing to Review Rail Competition and Service

**House Transportation and Infrastructure Committee
Washington, D.C.**

September 25, 2007

The National Corn Growers Association (NCGA) represents more than 32,000 members from 25 state associations and 22 state checkoff associations as well as the hundreds of thousands of growers who contribute to state checkoff programs nationwide.

Agriculture is notorious for its uncertainty. Crops and farm income are dependent like no other industry on weather, politics and market trends beyond our control or ability to estimate. No matter the current market price, the cost to harvest and market this year's crop is on the minds of all corn growers, and consequently, we appreciate the House Transportation and Infrastructure Committee for taking a serious look at rail transportation, competition and service issues.

U.S. Corn Industry

America's corn producers continue to make a significant and important contribution to our nation's economy. From 2001 to 2006, the nation's corn crop has averaged 10.3 billion bushels resulting in an annual average farm gate value of almost \$22 billion. The relatively stable production over the past ten years, made possible by innovation in production practices and technological advances, has helped ensure ample supplies of corn for livestock, an expanding ethanol industry, new biobased products and a host of other uses in the corn industry. Moreover, investments by the American taxpayer in our nation's agriculture programs have helped to produce a more stable financial environment for production agriculture and a brighter future for our rural communities. In our view, reliable, abundant, affordable and safe supplies of grain for the food on our tables to the fuel in our cars are generating benefits many times over for our national economy.

Higher production yields have created back-to-back record or near record harvests, and this year we are on par to harvest the largest corn crop in history. The U.S. Department of Agriculture (USDA) recently reported that corn producers are expected to harvest 13.3

billion bushels (26 percent above the 2006 crop). Yields are expected to average 155.8 bushels per acre; 6.7 bushels higher than in 2006.¹

However, agricultural trade is hypersensitive to changes in transportation cost. Frequently, these costs are a large portion of the delivery price, particularly for raw, unprocessed commodities, like bulk corn. USDA research shows that nearly half the cost of U.S. grain at its final destination is accounted for by the cost of transportation from the farm gate to the final consumer. The accessibility and cost of transportation affects the ability of our farmers to keep and expand foreign markets.

Exportation of excess production supports domestic grain and agricultural product prices, enhancing the vitality of rural economies. Yet, our competitors in South America have a geographic advantage over us. In the U.S., points of production and consumption often are separated by long distances. The leading Corn Belt production areas are located 1,000 miles or more from the ports that serve our export customers. While we have sat idle, our major competitors – Argentina, Brazil and China – have made investments in their transportation systems and are dramatically reducing their costs for moving grain. The leading grain producing areas in Argentina and Brazil are located within 200 miles of their ports – in some cases as close as 50 miles – and with significant investments in their transportation infrastructure, they are better able to compete in the global marketplace. As a result, the U.S. advantage in world grain markets has weakened.

Growing Demand for Transportation

The Department of Transportation's (DOT) Federal Highway Administration Office of Freight Management projects a 69 percent increase in freight traffic from 1998 to 2020 for rail carriers.² In many agricultural regions of the country, trucks and barges compete with rail, keeping prices in check. However, barge transportation is not available to producers in the western Corn Belt, and truck transportation is cost-prohibitive for longer hauls to market. To agricultural producers located away from barge transportation, effective competition – including rail-to-rail competition – must be preserved and promoted.

Rail transportation demand has been strong and has set records for several years running – a trend that will likely continue due to several factors including: increased demand for commodities due to economic expansion; increasing intermodal demand; expansion of international trade; increased demand for coal due to high natural gas prices; high fuel prices; and new hours of service regulations on the trucking industry. Railroads are also facing internal operational issues (congestion and labor) and retirement of their workforce in substantial portions.

Compared to other commodities, corn has the highest transportation requirements due to volume. Total shipped grain tonnages increased 63 percent in 26 years – from 242 million

¹ World Agricultural Supply and Demand Estimates, Approved by the World Agricultural Outlook Board, United States Department of Agriculture, ISSN: 1554-9089, September 12, 2007.

² Department of Transportation, Federal Highway Administration, Office of Freight Management, Freight News: Freight Analysis Framework, October 2002.

tons in 1978 to 394 million tons in 2004.³ Of that total, 61 percent was corn.⁴ In 2004, rail moved 33 percent of U.S. corn to export locations and 32 percent to domestic processors, feed lots and dairies.⁵

During the week ending September 15, 2007, U.S. railroads originated 24,582 carloads of grain. This is a ten percent increase over the previous week (22,271 carloads) and a fourteen percent increase from the same week one year ago (21,528 carloads), and an eleven percent increase over the 3-year average.⁶

Additionally, demand for the most fuel-efficient modes of transportation – railroads and waterways – will remain strong as fuel prices continue at their high levels for the foreseeable future. Likewise, concerns about the environment will support more environmentally friendly transportation – rail and waterways.

Capacity Limits Have Led to Poor Service

A 1998 USDA report stated that “...for the first time in a century there is too little rail capacity available to satisfy the demand of shippers.”⁷ Rail capacity concerns are not a new phenomenon, yet as a nation we are only now recognizing it as a problem.

All modes of transportation are facing serious capacity constraints. The Department of Transportation has estimated that “by 2020 the nation’s freight tonnage is projected to increase nearly 70 percent” from 2003 levels, making the potential for additional problems in the next 15 years staggering.

We only need to look back on 2005 as an example of the catastrophic problems created by a major failure of our transportation system. The history books will declare Hurricane Katrina as one of the worst natural disasters on record. Additionally, Hurricane Katrina amplified the interconnectivity of rail with barge transportation. The inability to move grain just as the 2005 fall harvest was underway more than proves that fewer transportation alternatives mean higher transportation costs as agricultural producers lost over \$1 billion in just four months.

There is very little slack in our nation’s transportation system, particularly in agriculture. According to USDA’s Agricultural Marketing Service (AMS), the number of railroad revenue-ton-miles increased 69 percent while route miles decreased 40 percent between 1980 and 2003.⁸ As a result, each mile of rail line handles nearly three times as much volume on average as in 1980. This leads to constrained rail capacity which causes

³ Transportation of U.S. Grains, A Modal Share Analysis, 1978-2004, Prepared by Nick Marathon, Tamara Van Wechel, and Kimberly Vacal for the Transportation Services Branch of the Agricultural Marketing Service, U.S. Department of Agriculture, October 2006.

⁴ Ibid.

⁵ Ibid.

⁶ Grain Transportation Report, Agricultural Marketing Service, U.S. Department of Agriculture September 27, 2007

⁷ Agricultural Transportation Challenges for the 21st Century – A Framework for Discussion, The National Agricultural Transportation Summit, Kansas City, MO, July 27-28, 1998.

⁸ Feedstuff magazine, “In 60 Seconds,” November 11, 2005.

railroads to raise prices and/or apportion capacity to those shipments that are the most lucrative. Thus, agricultural shippers pay more while experiencing deteriorating service.

Various segments of the industry report complaints regarding availability of rail cars, late arriving cars, long cycling times and other service issues. Service predictability is a huge issue. Determining when rail equipment will arrive at origin for loading, when it will be furnished locomotive power and when it will reach destination are increasing uncertainties. It is common to hear reports from agricultural shippers who experience wait times for rail cars exceeding 30 days. In a world of “just-in-time” delivery, a 30-day wait for your product to be picked up is often unacceptable to your customers.

Interestingly, the trucking and barge industry have been able to better adjust to fluctuations in grain movement demand. As the cost of grain transportation increases, these industries see that as a sign for additional short-term capacity. Under similar conditions, the rail industry lessens its service options available to small rural shippers.⁹ Shuttle trains are an option that moves grain efficiently. However, not all grain and grain products can be moved by shuttle shipments because either the volumes will not justify it or the shipping and receiving infrastructure cannot handle shuttles.

While railroads continue to have a common carrier obligation under the law – meaning reasonable service on a reasonable request – it seems to be redefined each year as rail service capacity becomes more limited. For example, intermodal is the fastest growing sector of rail traffic and competes with grain for limited rail capacity. By October, the fall corn harvest is in full swing. However, this is also the peak month for intermodal traffic with Christmas merchandise coming into the U.S. In this situation, grain does not have the same status as intermodal, both in the rates and the willingness to haul, which increases the cost of freight to grain shippers and undercuts the efficient marketing of grains.

As price takers and not price makers, these costs come directly from a producer’s bottom line. We have little or no ability to influence the price received for our corn and are unable to pass cost increases on to buyers. Higher transportation costs result in producers receiving lower prices for our grain, which results in reduced producer income and potentially reduced economic prosperity in rural areas.

The Ethanol Dynamic

Agricultural products, particularly with respect to biofuels, have opportunities for growth with new and growing markets. Since 1976, no new oil refineries have been built in the U.S., yet over 120 ethanol production facilities have been built during this time – supplementing the gasoline market.

As of August 29, 2007, there were 128 ethanol plants with an annual production capacity of 6.78 billion gallons. An additional 85 plants are under construction. The U.S. ethanol

⁹ Agricultural Transportation Challenges for the 21st Century – A Framework for Discussion, The National Agricultural Transportation Summit, Kansas City, MO, July 27-28, 1998.

industry is expanding rapidly and is expected to exceed 13 billion gallons per year by early 2009.¹⁰

Our ability to take advantage of these opportunities will be severely constrained if transportation capacity is not available. Currently, ethanol production is centered in the Midwest but 80 percent of the population, and therefore the ethanol demand, lives along the coastlines. Rail was the primary mode of transportation for ethanol in 2005, shipping approximately 60 percent of ethanol production (or 2.9 billion gallons). Rail freight is expected to increase from 1,879 million tons in 2002 to 3,525 million tons by 2035 – approximately an 88 percent increase even before ethanol production expansion is considered.¹¹

Corn growers are very concerned that the current rail infrastructure appears ill-equipped to handle the potential volume increases expected to be generated by ethanol and its co-products. When ethanol production reaches 13 billion gallons, demand for rail transportation of ethanol could grow to an estimated 245,000 total ethanol carloads per year – three times the amount of ethanol shipped in 2005.¹²

With little excess capacity, all modes of transportation become hyper-sensitive to sudden changes in transportation demand and distribution patterns. Issues that could impact rail network performance include: potential shifts in grain rail transportation, location and demand changes from terminal markets, increased transportation demand for agricultural inputs, and volumetric increases of dried distillers grains (an ethanol co-product). As ethanol production expands, the consequences of these changes over a relatively short period could result in disruptions to rail service.

Increasing Rail Rates and Small Rate Case Challenges

Without question, the Staggers Act allowed a floundering rail industry to dig its way out of debt while preserving rail service to many shippers that otherwise would have lost access. The agriculture industry depends heavily on a strong and financially viable railroad system. Likewise, the availability of rail transportation at a fair price is critically important to corn growers. Unfortunately, rates have not declined uniformly since enactment of the Staggers Act and captive shippers are paying significantly higher rates than those with access to competition.

Agricultural products have been subjected to an increasing number of double-digit rate increases in the past few years, which magnifies the need for agricultural shippers to have access to an expeditious, cost-effective and fair regulatory process for challenging

¹⁰ Ethanol Transportation Background: Expansion of U.S. Corn-based Ethanol from the Agricultural Transportation Perspective. Transportation Services Branch, Transportation and Marketing Programs, Agricultural Marketing Service, U.S. Department of Agriculture, September 2007.

¹¹ U.S. Department of Transportation, Federal Highway Administration, Office of Freight Management and Operations, Freight Analysis Framework, 2006.

¹² Statement of Bruce I. Knight, Under Secretary, Marketing and Regulatory Programs, U.S. Department of Agriculture, before the Surface Transportation Board, STB Ex Parte No. 672, Rail Transportation of Resources Critical to the Nation's Energy Supply, July 12, 2007.

unreasonable rates. In a 2006 study, the Government Accountability Office (GAO) found that the increases that have characterized rail rates for agricultural products since 1985 were atypical from the rate reductions that have occurred for coal, motor vehicles and other non-agricultural shipments. The GAO study, updated in 2007, found that the greatest increases in the percentage of rail tonnage shipped at rates exceeding 300 percent of a railroad's revenue-to-variable cost were occurring in rural areas where grain shipments are prevalent.¹³

Industry experts have stated that current and expected future demands on railroads, capacity constraints and greatly increased fuel costs give railroads even more reason to increase rates. For these reasons, corn growers participated in two joint-filings with respect to the STB's small rate case proposals.¹⁴

The STB issued new simplified rate guidelines in September 2007, modifying its procedures for small rail rate cases. The STB retained its proposed three-tiered approach for small, medium and large rail rate cases. The Stand-Alone Cost (SAC) methodology, which continues to be the Board's preferred approach, will apply to large rate cases of the type normally involving coal shipments. The Board has adopted, with some modifications, its proposal for a new Simplified-SAC for medium rate cases— an approach that is still very unworkable. Finally, the Board has retained a modified version of its three-benchmark approach for small cases.

Although the new rules are now in effect, we are digesting their implications and considering a petition to reconsider several of the decisions made that are either unfavorable for smaller shippers or unnecessarily complicated.

Even the STB's own proposal states that regulatory relief to challenge unreasonable rail rates would be limited to a small percentage of a carrier's traffic. Furthermore, these proposals are designed to improve processes available to shippers *after* they have been charged a rate they consider to be unreasonable. From the start, the rates paid for grain shipments should be at levels that promote, rather than punish, our competitiveness in the global marketplace.

Fuel Surcharges

While recovery of unanticipated fuel expenses by railroads is justifiable, fuel surcharges have hit agriculture particularly hard. We are concerned that the calculation many

¹³ Report to Congressional Requesters by the U.S. Government Accountability Office (GAO), "Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed," GAO-07-94, October 2006 (Updated in 2007).

¹⁴ Joint comments filed on Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases, by Andrew P. Goldstein, legal counsel on behalf of the National Grain and Feed Association and other Agricultural Organizations referred to in the comments as "The Agricultural Commenters." Joint Written Comments filed on Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases, by Nicholas DiMichael and Andrew Goldstein, counsel on behalf of the American Chemistry Council and other interested parties. Supplemental filings were also submitted on our behalf by Gerald W. Fauth III and Thomas D. Crowley. October 24, 2006.

railroads used to establish their surcharges are unreasonable and provide revenue beyond recovering their costs of fuel.

Earlier this year the STB adopted a rule which stated that it is an “unreasonable practice” to compute a fuel surcharge as a percentage of the base rate in addition to applying a fuel surcharge (a practice known as “double dipping”). We appreciate this ruling; however, the STB has yet to finalize rules for the rail industry to report revenues raised from fuel surcharges. We urge the Committee seek a final decision from the STB which would mandate that fuel surcharges must be reasonably related to additional fuel costs and rail carriers must be transparent in their actions.

Increasing Importance of Short lines

The GAO report touched on the hundreds of short line railroads that have come into being since enactment of the Staggers Act. Short lines provide rail service for numerous rural communities that otherwise would have lost service as a result of rail abandonment, and in many cases, short lines also provide greater customer service with lower rates. According to USDA, short line and regional railroads now operate nearly 30 percent of our railroad network and originate about 25 percent of the carloads.¹⁵

However, what began as a financing scheme for small railroad purchase of rail lines has turned into prohibited restrictions on competition. While railroads have partial antitrust immunity, there is concern that existing paper barriers may violate the Sherman Act,¹⁶ which prohibits restraint of trade, because they limit the market access of shippers and restrict rail-to-rail competition. Paper barriers limit the ability to interchange traffic with other railroads, restricting our access to markets which impacts our ability to obtain the best price for our products due to increased shipping costs. Furthermore, the rates are split between Class I railroads and short line railroads. As a result, short line railroads cannot adequately support track investment or maintenance.

Paper barriers are usually confidential. Shippers are not aware of their existence until they attempt to ship products and are faced with the penalties in the paper barrier. The selling or leasing railroad should recover the fair market value of the sold or leased rail lines at the current cost of capital. However, when the fair market value of the line is inflated by accounting for the value of traffic that will travel over the lines, producers pay tariff rates higher than warranted.

We would support a comprehensive review of paper barriers that could be used to develop guidelines for reasonable paper barriers that would satisfy antitrust laws or remove them altogether. We do not believe a prohibition of unreasonable paper barriers would result in desertion of rail lines. It would still allow railroads to profit by selling or leasing lines and remove the ability to extract monopoly rates.

¹² Statement of Chuck Lambert, Acting Under Secretary, Marketing and Regulatory Programs, U.S. Department of Agriculture, Before the Surface Transportation Board on Ex Parte No. 575 – Review of Rail Access and Competition Issues: Renewed Petition of the Western Coal Traffic League, March 10, 2006.

¹⁶ Sherman Act; 15 U.S.C. §1

Infrastructure Investment

Transportation infrastructure improvements expand the number of marketing options available to producers which means greater farm income. To corn growers the answer is simple: improving transportation infrastructure should be a national priority that deserves urgent attention – sooner rather than later. We can no longer stand idle, taking our transportation infrastructure for granted. Capacity constraints, structurally deficient bridges and mediocre roads, and locks and dams long past their expected useful life require our full attention as a nation.

In 2006, the rail industry reported an expected \$8 billion investment in infrastructure – a 21 percent increase over 2005. However, some of this is focused on maintenance or renewal of existing capacity as opposed to capacity expansion. This only maintains the status quo and makes no long-term commitment to infrastructure investments. As the 2006 GAO report states, “Railroads do not prepare long-term capacity plans because of concern about the potential for significant economic changes.”

We are appreciative that the rail industry faces the highest percentage of fixed costs when compared to all other modes of transportation. The rail industry provides its own roadbed, tracks, terminals and other facilities which are subject to depreciation, property taxes and maintenance expenses regardless of traffic value or volume.

Additionally, corn growers welcome the investment commitment by the rail industry to improve capacity, but as one industry expert has pointed out, individual railroads will concentrate their limited funds on what they perceive to be their most profitable market segments.¹⁷ Our concern is how well corn growers compete for rail service, and in turn, rail infrastructure improvements with other sectors of the economy. Grain and grain products have not proven to be a high priority for service with the rail industry. We question whether or not these investments will be a response to the demands of Wall Street investors or reflect public benefits in terms of economic development, energy use, safety and congestion.

H.R. 2125 – A Step in the Right Direction

The Railroad Competition and Service Improvement Act of 2007 (H.R. 2125) is a big step in the right direction toward addressing many of the rail transportation problems facing agriculture as discussed in this testimony. This legislation will improve access to competitive rail service, protect those without competition from being subjected to unreasonable rates and/or practices and re-establish the reliability of rail service. In particular, this legislation provides key improvements to issues important to agriculture including the removal of paper barriers and the use of final offer arbitration.

¹⁷ Statement of Carl D. Martland, Senior Research Associate & Lecturer, Department of Civil & Environmental Engineering, Massachusetts Institute of Technology, Before the Subcommittee on Railroads, Committee on Transportation and Infrastructure, U.S. House of Representatives, April 26, 2006.

We look forward to working with the Committee to see that this legislation moves quickly through the congressional process.

Conclusion

Our competitive advantage is slipping due to a myriad of troublesome transportation issues. Strained capacity in all modes, increasing rates for rail service, declining barge efficiency because of outdated locks and dams and congested roadways are just a sampling of the issues that significantly affect our ability to market corn and corn by-products.

If we are to remain competitive in a very dynamic domestic and world market and be in a position to capture new market opportunities, we must have reliable, cost-effective and efficient transportation - whether by barge, truck or rail. Competition among these modes of transportation helps farmers receive their farm inputs, meet their customers' demands for timely delivery of products and successfully compete with foreign producers. Even when producers have cost-effective transportation alternatives, rail is an integral part of moving products to market.

Without investment in our transportation system, the promise of expanded trade and commercial growth is empty, job opportunities are lost, and we will be unprepared for the challenges of this new century.

This Committee has been very responsive to our nation's infrastructure needs. We value your efforts in seeking solutions that will establish a nationally-focused, comprehensive transportation strategy. Corn growers appreciate the opportunity to serve as a resource and provide input for the hearing record.