RAIL AND POLITICS —
Managing Expectations in a Shifting Landscape

Henry Posner III
Chairman, Railroad Development Corp. (www.RRDC.com)

While railways and politics are generally considered inseparable from a passenger perspective, what is more subtle is the interaction of politics with the rail freight sector. RDC at this point has substantial and diverse experience as result of our investments in a wide variety of railways, ranging from the formerly abandoned national railway in Guatemala to the heavy-haul Estonian Railways. Our experience is therefore of potential value as countries consider policy options, not only for railways but also for general investment.

The prime example of the influence of policy on freight railways is probably best demonstrated by the U.S. experience, where an industry that was 25% bankrupt by mileage in the mid-1970s is now arguably at its busiest and most profitable, thanks almost exclusively to deregulation. That being said, profitability is a relative term and the industry is still struggling with how to fund the capacity increases required to meet projected demand. Ironically, recent years have seen a small but vocal backlash calling for reregulation: this would be best labeled as populism were it not heavily weighted by industrial companies substantially larger than the rail industry itself; an extreme example of this is the recent "small shipper" regulatory challenge of tariffs by a tiny U.S. company by the name of DuPont.

But despite the conflicts described above, it is with good reason that the North American model has been exported to places ranging from Latin America to, in the case of Estonia, Europe. The body of experience of the last decade is now both broad and deep enough that conclusions may begin to be drawn as to the impact of both economic and regulatory policy, as well as to how the two interact. One unsurprising conclusion is that politics heavily impacts the outcome.

In the case of Guatemala, the results are quite easy to judge. The abandoned national railway was restored to operation by RDC in 1999 without any public funding and run as a freight railway until 2007, at which point it was forced to suspend operations due to, on the surface, a change in government policy in which it was determined that, retroactive to 1999, the privatization was against the interests of the country. While this is highly debatable in and of itself, the facts concerning the case go deeper and suggest that the real agenda was that, like most railways worldwide, Guatemala's railway was "worth more dead than alive" and that the privatization and restoration of the railway served to isolate a nugget of value (in this case, real estate) in a manner that was more easily susceptible to confiscation. While this is a subject of ongoing binding arbitration under the Central American Free Trade Agreement (CAFTA), it does serve to highlight that there was in fact value created…unfortunately, not in a manner consistent with the original objective of restoring the railway to operation.

In contrast with Guatemala, Estonia's railway, which was privatized in 2001, was a fully functioning, heavily trafficked extension of the Russian railway system and was therefore the beneficiary of incremental improvements as a way of creating value, with the stated objective of making Estonia's ports more competitive in an intensely competitive transit market. It is ironic that for this major railway the outcome was the same as with Guatemala's abandoned railway: namely, the isolation of an asset, whose value had been significantly increased, in a manner that made it more susceptible to confiscation through regulation. In the case of Estonian Railways, the value was in fact in the railway, and the method of hijacking much of the value involved changing the regulatory scheme to benefit customers—specifically, the imposition of below-cost access charges by the new government under the guise of accession to the EU. The results of the binding arbitration process were such that the company was ultimately renationalized, at a substantial premium, ironically five (5) months before the railway lost half of its traffic due to political events beyond its control. But like Guatemala, it highlighted that value created is value at risk.

Finally, Africa's Nacala Corridor, which consists of Mozambique's Nacala port and railway and Malawi's railway, offers one of the few examples of a complete investment cycle in Africa. Specifically, Malawi's railway was privatized in 1999 and the Nacala port and railway followed in 2005. But in this case, the investors were able to sell their interests as result of appreciation in the railway's long-term potential. The prospect of a significant increase in traffic, thanks to the line's survival and stabilization, positioned the company to take advantage of the long-anticipated development of the Moatize coal deposits in northern Mozambique.

All of the above serve to reinforce a single theme, which is that while there is value to be created in the restructuring and development of freight railways, that value is largely subject to, and constrained by, regulatory policy. Further, regulatory policy is an easy way of implementing corruption. Ironically, RDC's experience was that corruption was just as easily found in Europe as in Third World countries, albeit done in a more professional and subtle manner.

Consideration of RDC's experience is therefore offered to both the public and private sectors as examples of how value can be created and, depending on your perspective, confiscated or protected. In this respect, we are not only proud of our achievements, but especially proud that in each case we have stood our ground against sovereign governments and achieved results disproportionate to our size.

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Henry Posner III *is a founding principal of Railroad Development Corporation (RDC) (www.RRDC.com) in Pittsburgh, Pennsylvania (USA). Mr. Posner entered railway service at Conrail, where he served in various Operating, Marketing, Planning and Sales positions.*

Mr. Posner serves as Chairman of RDC, a railway investment and management company with interests in the USA, Argentina, Peru and Guatemala. RDC was also a shareholder in Eesti Raudtee (Estonia) until its renationalization in January 2007; and a shareholder in the Nacala Corridor in Malawi and Mozambique until the sale of its shares in September 2008. In March 2009, France's Secretary of State for Transport announced the formation of a joint venture with RDC to help revive that country's wagonload freight business.

A graduate of Princeton University (BS – Civil Engineering), Mr. Posner also holds an MBA in Finance from the Wharton School. He also serves as Chairman of Iowa Interstate Railroad; Chairman of Ferrovías Guatemala; a Director of América Latina Logística–Central (Argentina); and Vice Chairman of The Hawthorne Group.

Mr. Posner serves as a member of the Association of American Railroads' Security Working Group, member of the Advisory Council of Princeton University's Institute for International and Regional Studies, member of the Transportation Research Board's Local and Regional Rail Freight Transport Committee, member of the Board of

Advisors of the University of Pittsburgh's Center for Latin American Studies, Board Chair of the Winchester Thurston School, and Chairman of the Estonian Railway Culture Foundation.

He has lectured and published extensively on railway matters, with a particular emphasis on developing countries. He is active in welfare programs for the Jewish community in the Former Soviet Union and is the recipient of a Paul Harris Fellowship from Rotary International for his civic work in Guatemala.

Mr. Posner speaks Spanish, Portuguese, French and Russian.