Competitive access would transfer capital to customers

"I won't be coming back here again," said Henry Posner III in a recent interview as he boarded a train from Tallinn, Estonia, to Moscow. US shippers and railroads could learn a lesson from Posner's experience in Estonia.

Posner and his partners in Baltic Rail Services had invested in the privatized Estonian railroad in 2001 only to see it renationalized this year. For the record, BRS was bought out by the state at a price that ensured it a profit, although not nearly as much as they had expected to earn by operating the eastern European railroad. Posner told an Estonian business journal that his group could have invested in real estate in the capital of Tallinn and done better than it did with the railroad.

After only a short period of private operation marked by improvements in the railroad's safety record and the replacement of Russian-built locomotives with US-built power, Estonian Railways was the most efficient carrier of its kind anywhere in Europe.

Estonian Railways handles more than 44 million tons of freight annually, more than the total freight tonnage handled by the much larger French national railroad SNCF. Much of the traffic is Russian oil moving in solid tank car trains.

Posner is not merely a rail fan or investor. He is the chief executive of Railroad Development Corp., a Pittsburgh investment company that owns the Iowa Interstate Railroad and, with local partners, a number of privatized rail concessions throughout Africa and Latin America. What Posner and his partners, who include Ed Burkhardt, founder of Wisconsin Central, ran into was a government mandate that it allow free access to anyone who wanted to use the system. Access fees were capped by government mandate. To suggest that corruption played a part in the manipulations that led to re-nationalization is to put it kindly.

The cap on fees that could be charged for access to the Estonian Railways lines made it impossible to earn the kind of return on investment that would justify further capital investment and infrastructure development. "We bought Estonian Railways under certain economic conditions. Once the government got our money, the terms of our operations were changed completely," Posner told the Estonian publication as he departed for the economic and physical safety of Russia. "The state basically confiscated the majority of our company's value, for which we paid."

There is a lesson for US carriers and their customers in this experience in distant Estonia. Competitive access may sound attractive, especially to shippers who believe they are paying too much for their transportation service, but ultimately it will result in a transfer of the carrier's capital to the customer.

Customers may get less expensive service in the short run because competition does result in lower prices, but in the long run a carrier that cannot earn a market-competitive return on investment will not invest in its property or its expansion, which will result in consumption of capital or gradually going out of business.

The situation in Estonia is similar to that in the United States, except that no one here is proposing outright government ownership of rail facilities — yet. In Estonia, free access was forced on the railway by the dominant customer. Estonia, formerly a Soviet state, still is influenced strongly by Russia, which is in a position to throw its considerable economic weight around.

In his "exit" interview with the Estonian journal, Posner was asked if Russian influence now would increase in Estonia. "I don't see that they will grow now, as the Russian influence has always been huge," he replied.

If the Estonian Railway had been able to charge a fully allocated cost including an amount to reflect the opportunity cost of capital, open access might not have been quite so bad. But then the rate for shipping Russian oil no doubt would have been considerably higher. After all, what is the purpose of free access if you cannot have lower rates? So the government capped the amount that could be charged.

Posner is the thinking man's railroader.

"Clearly, what we are seeing, at least in part, is a global trend because railways are simply being valued more than before," he said. "Fuel prices are rising and railway transport is more efficient than road transport. And with that, there's the temptation to slap on more regulations–something we're seeing in America as well."

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Fortunately for both US railroads and their customers, Congress has shown little inclination to re-impose regulation, at least not the kind that carriers were forced to deal with prior to the deregulation statutes of 1976 and 1980. Rail service in the US under regulation was pretty bad and railroads had no incentive to invest in improving it, while customers moved as much traffic as possible to highway transportation, leaving railroads with mostly those cargoes that could move only by rail.

If shippers were able to persuade Congress to amend the Staggers Rail Act of 1980 to create mandatory competitive access, the self-respecting capitalists who own and run railroads — and all of them who I know qualify — would expect to be compensated fully for the use of their property. But if the rental rate included full-cost recovery, including the opportunity cost of the capital invested in the business, potential "tenant" users would not rush to take advantage of competitive access. This would lead then to a government system of setting usage fees – effective reregulation.

Ironically, before railroads were deregulated, Congress informally considered nationalizing the railroads on the assumption that they could not earn enough to justify reinvesting in improving service. Perhaps a congressional delegation accompanied by executives from the corporations and trade associations most vociferous in calling for competitive access should make a trip to Estonia. The experience of that small Baltic country could be instructive.

Larry Kaufman's Rail Trends column appears twice monthly exclusively in Argus Coal Transportation*. A writer and industry consultant, Kaufman has worked for* Business Week *and the* Journal of Commerce *and he was an executive with the Association of American Railroads. Kaufman's views as expressed in Rail Trends are his own and are included to provide Kaufman's unique insights into the rail industry.*