



TRANSCONTINENTAL TRAFFIC — WHY EUROPE IS VERY DIFFERENT FROM NORTH AMERICA



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Good afternoon. The most important message that I can leave with you today is that I bring a different perspective to this conference as someone who has been a direct investor in railways on four continents—the USA, Latin America, Africa, and until three weeks ago, Europe, when RDC was one of the shareholders of Estonian Railways.

RDC is a small company and most of our businesses are joint ventures with other shareholders, which we believe is a very important way to do business successfully. We have operated in seven countries and it is usually your partners that make or break the business.

RDC Businesses

Country	Entity	Length		Employees	Tons Y. 2005 (in millions)
		Km.	Miles		
USA	Iowa Interstate	1,005	623	185	6.2
Argentina	ALL Central	5,350	3,324	1,012	3.4
Argentina	ALL Mesopotamica	2,740	1,703	313	1.4
Guatemala	Ferrovias Guatemala	322	200	100	0.13
Peru	Ferrocarril Central Andino	490	304	169	1.7
Malawi	Central East Africa Rwys	797	495	487	0.24
Mozambique	Nacala Corridor	872	523	227 Rail	0.27
Estonia	Eesti Raudtee*	693	431	2,389	44.3

*Re-nationalized Jan. 2007

Differences between North America and Europe

So what does someone from North America have to offer a European audience? Many characteristics of Europe and North America are completely different and Table A shows my top choices in terms of why the railways are different.

Table A
Physical Differences between North America and Europe

	North America	Europe
Distances	Long	Short
Traffic Patterns	Concentrated	Fragmented
Competition	Other Rail	Truck
Capacity Constraints	Line Capacity	Clearances
Orientation	Freight	Passenger

But one thing to think about is that the Chinese Railways and the Russian Railways are much more like North America than they are Europe. So when you are talking about transcontinental traffic, keep in mind that if your partners are going to be China and Russia in the transcontinental land-bridge, you are dealing with two countries that have the same fundamental characteristics as North America, at least according to the list in Table A. So perhaps North America does have experience of value to Europe despite the physical differences.

I would like to focus, however, on another type of difference which is not often discussed—the institutional differences; but don't confuse these with the physical differences. In some respects Europe is even more different institutionally than it is physically. Why do I say that? Look at Table B. In North America the driver is competition, whereas in Europe it is regulation which, in my opinion, explains in part why we have such a successful freight business in North America while Europe is struggling.

Table B
Institutional Differences between North America and Europe

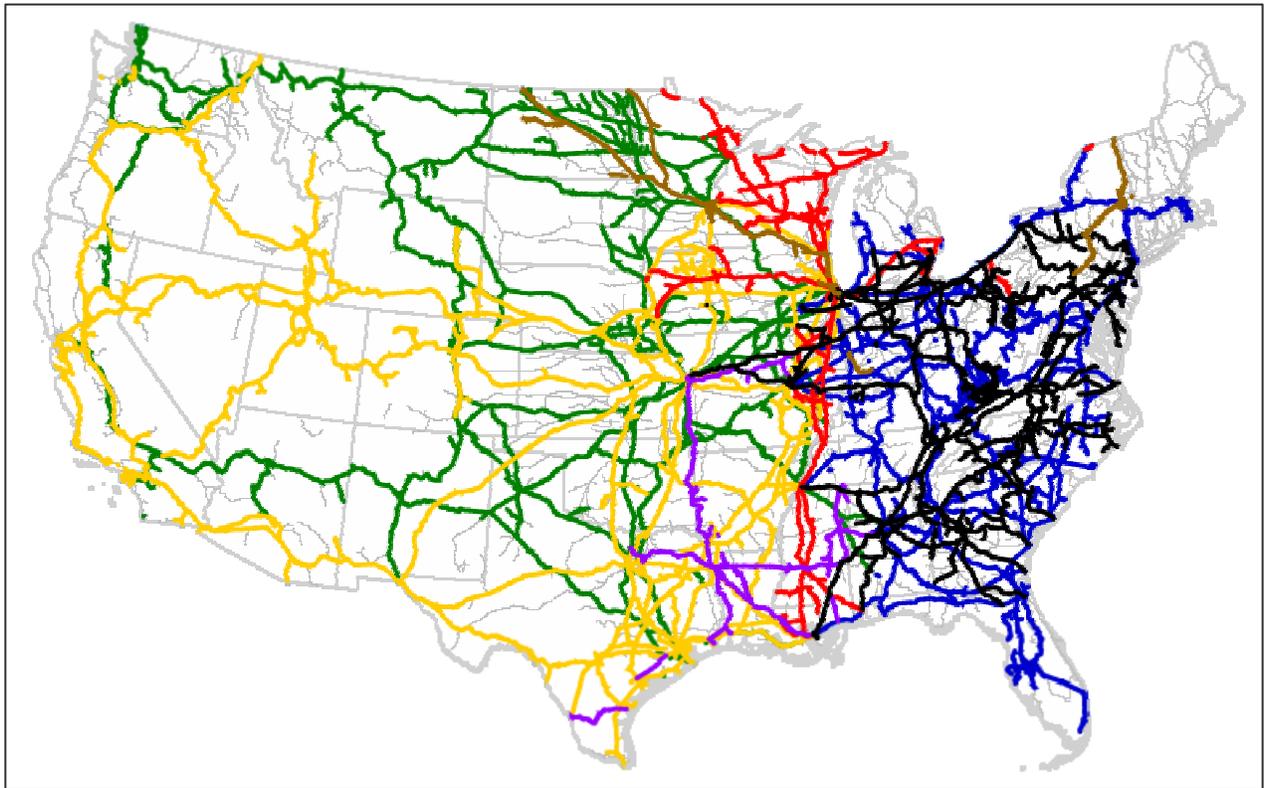
	North America	Europe
Traffic Driver	Competition	Regulation
Rail Competition	Parallel Rail	On-Rail
Infrastructure Control	Operator	Regulator
Funding	Private	Public

In North America rail competition is usually railways running in parallel with each other, competing imperfectly for the same market, which allows each railway to make a profit in certain niches. In contrast, in Europe the focus has been on providing perfect on-rail competition; thus no operator in the long run is going to be able to make a profit, much like the airline industry in North America. As somebody who was told in 1977 that he was stupid for going into the regulated rail industry when other people were going into the glorious, high-technology airline industry, my how the world has changed! I am just happy to be in a position to be talking about this today.

Finally, note that in general in North America the funding is private and in Europe it is public.

Next, let's look at a map of the North American network; please note that in most markets there are railways competing with each other. Each of these colors represents one of the major North American railways, and for the most part, these are parallel railways competing for the same market.

North America — Parallel Competition in USA



Freight Business Drivers

But what really drives the freight business? Table C shows, in descending priority, a list of what I see as driving the business. This is listed first for customers, who are the most important; and second, comparing customers' priorities with those of the railways in North America and Europe.

Table C
Freight Business Drivers (descending priority)

	CUSTOMERS	NORTH AMERICA	EUROPE
Priorities	Worldwide	Competition as Result of <u>Deregulation</u>	<u>Regulation</u> Forces Competition
1	Rail as Option	Rail as Option	Rail as Option
2	Capacity	Capacity	Competition
3	Service	Service	Service
4	Competition	Competition	Capacity

Please note that, in my opinion, the first thing that customers want is rail as an option. If the rail option doesn't exist, then everything else is academic. Where the differences occur, is that in North America there is competition as a result of deregulation, whereas in Europe, you are trying to force competition through regulation. This is an extremely important institutional point because it has nothing to do with engineering, signaling systems or axle loads. It is an institutional fundamental of the European environment, and I think it is the single biggest problem.

The origin of deregulation in North America was primarily the result of the many bankruptcies in the late 1970s. Twenty-five percent of the rail mileage in the USA was in bankruptcy and it really was a question of whether there was going to be a rail industry or not. The government's response was, 'Too bad; there's no money for you; fix your problems. But we will allow you to go out of business if you choose. We will allow you to price your business without regulation if you choose. And we will give you complete freedom to exit markets or restructure yourselves to serve those markets.' The end result was that we have a smaller industry but an industry that is more profitable than it's ever been. We still can't fund all of the capacity that we need, but this is a far cry from the time that I entered the rail industry in 1977. So this is why I say that the most important factor is making sure that the rail exists as an option.

The second most important factor is providing the capacity, or in some cases adjusting the capacity to the market. Once you have the capacity, then you can talk about service. And after that, only then can you talk about competition.

In Europe, in my opinion, the focus has been more on having competition even before considering service or capacity, so the priorities have been reversed and I think that explains much of the results. From an overall perspective, in order for rail competition to exist, there must be capacity and service before a customer can, for example, start playing block train companies (in North America we call these "unit trains") against each other.

Trends in the Freight Business

Using wagonload traffic as an example (Table D), we have a stable business in North America and a declining business in Europe. I say "stable," while some of my colleagues in the USA prefer the term "growing." Yes, it is growing but it is still not enough to pay for all of the capacity that we need. So yes, it is successful but it could be more successful.

Table D

	North America Trends	European Trends
Wagonload Traffic	Stable	Declining
Operator Focus	Common Carrier	Customer-Specific
Financial Performance	Stable	Declining
Market Share	Increasing	Declining
Ownership	Private	Public

But I think that the most important line is the second line. In North America we are common carriers, meaning the freight railways handle containers, coal, wagonload traffic, etc. By contrast, in Europe the trend is toward customer-specific block trains. This is not a healthy sign, and I think that is reflected in the financial performance where the freight business is being shrunk to what in the long run may end up just as a block train business.

Some Final Thoughts

Let me leave you with some final thoughts, which are at least indirectly connected with what I have just said. RDC now has European experience through our 5+ years of shareholding in Estonian Railways. I would argue that, based on our experience, EU Accession increases the power of the regulators at the State level but without the oversight. So when the railway regulations were changed in Estonia, the EU response was that it was legal and that it was certainly within Estonia's powers; and when we noted that the laws were unfair, the EU said that they had nothing to say about that.

Second, regulation is an invitation not only for political interference but also an invitation for corruption. Whenever you have increased power through a regulator of something that is valuable, and the rail freight business in Estonia is a valuable and profitable business, you are inviting corruption.

Third, regulation does very little to stimulate rail traffic; it merely redistributes it. A good example of that is the UK, which is seeing the same coal movements being fought over by different open access companies.

The underlining message of all of the above is that the private sector cannot compete with the public sector, and that the power of the public sector is actually increased as result of the presence of the EU. So whatever the problems were before, they may be getting worse.

This is a pessimistic message so I want to close with some positive contributions. I would therefore like to make three suggestions:

1. For these types of conferences, it would be very important to have customers here as part of the dialogue and in particular, wagonload customers. The block train customers don't have to be here because their hidden hand is behind each and every block train movement that train operators are competing for. Maybe it already exists, but if there could be some sort of a group of wagonload customers sitting at the table of some of these conferences, I think that would be extremely helpful to all concerned.
2. I think as an industry, if you focus on the wagonload business, it's like the "canary in the coal mine." In countries where the wagonload traffic has disappeared or almost disappeared, you know that it is sicker than in other countries like Sweden where they have held on to much of the wagonload traffic. The problem with converting customers from wagonload traffic to, for example, intermodal, is that you are teaching them how to use trucks. You are also converting them into a business where, if you are successful, some other guy is going to start an intermodal business and take it away from you.

3. And finally, I would like to offer that even though that I have spent the last ten minutes telling you why it is different, I think that there are still some very valuable lessons to be learned from the North American wagonload business. I would like to extend a welcome to anybody who would be interested in coming to the USA to see why it is completely different but that there are still some aspects of it that could be useful to you and I'm certainly available for that.

Thank you for your time and have a safe day.

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