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Response of the American Chemistry Council
to
Surface Transportation Board Docket No. EP 752
Solicitation of Information on AAR Petition for Rulemaking

January 31, 2020

The American Chemistry Council (ACC) is pleased to respond to the Surface Transportation Board's request for information on whether and how particular cost-benefit analysis approaches might be more formally integrated into its rulemaking process. ACC represents the leading companies in the business of chemistry. Our members apply the science of chemistry to provide innovative products and services that make people's lives better, healthier and safer. As a \$526 billion enterprise, the business of chemistry is a key element in the nation's economy and one of the largest customers of the U.S. freight rail system.

As a general matter, ACC supports the use of cost-benefit analysis or, more specifically, regulatory impact assessments in appropriate rulemaking proceedings. Such assessments can enhance the transparency of the regulatory process, create a consistent framework for data collection and the identification of data gaps and uncertainties, allow for a useful comparison of alternative approaches, and establish a basis for the measurement of net benefits. For the Board, such assessments can be particularly useful to understand the broader impacts of railroad market power over captive shippers upon the U.S. economy, including impacts on service and deadweight economic losses resulting from the dearth of competition for the transportation of bulk commodities, including chemical traffic.

ACC nevertheless supports the Board's decision to defer action on the petition filed by the Association of American Railroads (AAR) to adopt procedural rules that would require a cost benefit analysis in Board rulemaking proceedings. CBA requires significant human, financial, and data resources. It is important that the Board acquire the resources along with the expertise to conduct proper and meaningful analyses. Therefore, we support the Board's consideration of practices used by other agencies and appreciate the solicitation of stakeholder input on specific approaches that the Board could use going forward.

As stated in our previous filings, the Board should not delay pending rulemaking proceedings while it considers how to conduct CBA and acquires the necessary resources to do so. The Board is considering a range of proposals, including rate case reforms that are critical to fulfilling the Board's statutory objectives. The Staggers Act requires the STB to balance competing goals of ensuring that rates for captive shippers are "reasonable," allowing railroads to earn "adequate revenues," and providing "expeditious handling and resolution" of all

proceedings. While the Board should continually seek to improve its regulatory decision-making processes, such efforts should not impede fulfillment of the Board's core mission. Regardless of how it may address CBA in the future, the Board has ample information to complete its current pending rulemakings.

Framework

ACC supports a general framework for regulatory impact assessments that includes the following key steps:

- 1) Assess the problem the agency is trying to solve;
- 2) Identify alternative solutions; and
- 3) Define and estimate the benefits and costs of each alternative;

The problem assessment step is a critical element of assessing potential Board rulemaking actions. Under Executive Order 12866, a covered agency is directed to:

...identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new agency action) as well as assess the significance of that problem.

Much of the Board's regulatory authority relates to rates and market competition within the rail industry. The "problem" for the Board to assess hinges on the degree of market power that railroads hold over captive shippers, the extent to which railroads should be permitted to exercise that power to charge differentially higher rates on captive traffic, and the extent to which such power should be reduced through pro-competitive policies. Below, ACC discusses specific approaches that the Board could use to inform policy in this area.

The alternatives assessment phase should consider multiple approaches. The favored approach should be compared with other possible alternatives, including a base-case of no action. This step will help to explain the basis for the Board's selection of its preferred alternative and allow stakeholders to evaluate and comment on the Board's proposal.

In considering the benefits and costs of alternative proposals, ACC suggests that the STB adhere to accepted best practices for benefit-cost analysis, including those outlined in OMB Circular A-4. Benefits from fair rail rates and greater competition could include lower prices and better service to customers, resulting in higher production and economic activity. Costs could include changes to railroad operations and investment schedules. At the heart of any analysis of economic regulation is the consideration of transfers from one group to another. To the extent that potential regulatory actions (e.g., reforms to STB rate review procedures or competitive access rules) lead to lower rail rates, these impacts would generally be considered a transfer. Because such transfers have impacts on real economic variables such as production and

investment, they are relevant to a Board analysis. However, they should be treated separately from social/economic costs and benefits.

The STB should incorporate into its analysis global competitiveness impacts, in particular how transfers from shippers to railroads could negatively impact competition and the subsequent impacts on jobs and payrolls of U.S. firms. While jobs are generally not considered a “cost” in traditional benefit-cost analysis, research¹ is looking at including the negative transitional impacts of unemployment as a cost. In fact, EO 13563 directs departments and independent agencies to “protect public health welfare, safety and our environment while promoting economic growth, innovation, competitiveness, and job creation.” In addition, STB should consider impacts on consumers’ surplus (via higher prices). On the other side of the coin, STB should look at the benefits of lower rates on consumers’ surplus. The Board should also provide a discussion of the distributional effects of monopolistic profits that railroads may require for their long-term viability.

Methods

The Board has requested information on specific methods that would assist in the qualitative or quantitative analysis of proposed rules. In this section, ACC discusses potential models with which it has some knowledge or experience.

Rate Benchmarking Models

Rate benchmarking methodologies, including those developed by the Transportation Research Board² and by ACC, can be used for analyses of Board proposals addressing rail rates and market competition within the rail industry. The clearest indication of railroad market power is the degree to which captive shippers pay differentially higher rates than shippers in competitive markets. This is precisely the question that benchmarking methodologies are designed to answer.

As discussed extensively in comments on the STB’s proposed Final Offer Rate Review process (EP 755) and in testimony on Railroad Revenue Adequacy (EP 761), ACC has presented a prototype benchmarking model for the U.S. rail sector. ACC developed this model from information in the Confidential Costed Waybill Sample and publicly-available sources. ACC’s model yields information that could be useful in Board analysis. This includes data on the ratio of waybill shipments meeting competitive screens, the average differential between non-competitive and competitive rates, and the stratification of these rate differentials. The model could be used in CBA to estimate the revenue impacts of proposed rules that would increase access to competitive service or drive rates towards competitive levels.

¹ Jonathan Masur and Eric A. Posner, “Regulation, Unemployment, and Cost-Benefit Analysis”, *Virginia Law Review* (May 2012).

² Transportation Research Board, *Modernizing Freight Rail Regulation*, Special Report No. 318 (2015), <https://www.nap.edu/catalog/21759/modernizing-freight-rail-regulation>.

In a Verified Statement submitted with ACC's testimony, Dr. Kevin Caves provides illustrative results. Based on limited access to masked Waybill data for 2006 through 2013, the model shows:

- Approximately 76% of shipments meet competitive screens.
- On average, non-competitive rates exceed competitive rates by 48%.
- For 12% of potentially noncompetitive sample, actual rate was more than double the predicted competitive rate.
- For 4% of potentially noncompetitive sample, actual rate was more than three times the predicted competitive rate.

Dr. Caves also provides results for individual commodity groups (by 2-digit STCC). Such data can help assess the extent of railroads' market power over groups of captive shippers, a critical step in developing a regulatory impact assessment.

To conduct analysis in support of a specific rulemaking, the Board could run the benchmark model with the most current, unmasked Waybill data. The Board could conduct additional benchmarking analysis to provide more granular data on specific shipment categories. Moreover, the Board can modify the assumptions underlying the prototype model to best fit the proposals it desires to test. ACC has previously provided the Board with all of Dr. Caves' work papers and instructions for re-running the model. In addition, the Board could make modifications to ACC's model that it deems appropriate

Assessment of Rate Differentials and Railroad Revenue Adequacy

Building on his econometric model for rate benchmarking, Dr. Caves' testimony provides a mechanism to determine how much of the rate differential paid by captive shipments is necessary for a railroad's long-term revenue adequacy. This Benchmark Method involves establishing a "competitive threshold," meaning the ratio a challenged rate is permitted to exceed the competitive benchmark rate predicted by the model. As discussed in our testimony, ACC asks the Board to implement this approach as an alternative rate reasonableness methodology with equal standing to Stand Alone Cost. If the Board moves forward to consider this proposal, the methodology would provide specific data needed to prepare a regulatory impact assessment. Dr. Caves' Verified Statement includes illustrative results showing potential rate reductions for captive shippers that would limit differential pricing without threatening the railroad's long-term revenue adequacy. The Board could conduct sensitivity analysis using different "competitive threshold" levels.

Aside from its potential implementation as a rate standard, the Board could use ACC's Benchmark Method to inform other regulatory proposals. Specifically, it can identify the

universe of rail rates potentially subject to the Revenue Adequacy Constraint of the Board's Coal Rate Guidelines.

Economic Models

The STB may benefit from the development of new analytical tools and models to assess a broader portfolio of economic impacts of proposed rules that affect rates and competition. Such models could include computable general equilibrium (CGE) and partial equilibrium models that would provide insight on how rate changes affect competitiveness (via trade flows), supply chain impacts, and other final demand variables. Such modeling could quantify the extent of market failure from excessive rail rates. For example, the United States International Trade Commission (USITC) supports several partial equilibrium (PE) models to examine tariff impacts.³

In an ideal world, the STB could develop CGE models to explore dynamic adjustments of regulatory proposals upon railroads and the industries they serve. Such models, however, are resource intensive to build and maintain. Partial equilibrium models could be built and/or modified for use in evaluating the potential impacts of rail rates on demand (via price elasticity of demand). Using historic data on output and product price trends, STB can create simplistic models. Further refinements could be made to examine export demand, in particular, for certain trade-exposed industries. Aggregated industry-level data is generally available from the Census Bureau or Federal Reserve Board. Price trend data is available from the Bureau of Labor Statistics. Export statistics and pricing data are available from the USITC.

Data

The STB has requested suggestions regarding data that the Board collects or could collect to assist with CBA. The Board already collects a trove of valuable data in the Confidential Costed Waybill Sample. That is the foundational data source, for example, in the Benchmarking Model described above.

A substantial portion of the data needed to perform CBA on proposed regulations is likely to be in the possession of the rail industry. There is no general category of railroad data that ACC believes would be sufficiently beneficial across most rulemaking proposals to warrant reporting to the Board as a routine matter. Rather, a case-by-case approach may be more appropriate. Pursuant to 49 U.S.C. 11163, the Board can and should make relevant cost data available for the purpose of performing CBA on proposed rules. This will permit more comprehensive quantitative CBA by the Board and serve as a check against the selective sharing of information by railroads.

³ USITC PE Modeling Portal: https://www.usitc.gov/data/pe_modeling/index.htm

There is a significant gap in data available to assess both economic impacts and transfers relevant to analysis of potential policies to promote greater rail competition. One analysis cited in the record is work by Grimm and Winston.⁴ Using 1998 data, Grimm and Winston analyzed the higher rates paid by captive shippers (21% on average) and estimated the annual aggregate transfer to railroads to be \$1.3 trillion. At the same time, they found a relatively small “deadweight loss.”

However, the rail market has changed significantly since 1998. In 1998, the UP/SP merger was very recent, the Conrail split had not yet been proposed, and the CN/IC merger was years away. That consolidation dramatically altered the rail landscape and ushered in an era of constrained rail capacity that continues to define the competitive landscape. In addition, many of the industries served by rail have also changed, as globalization has accelerated and competition has increased for many shipper industries.

Overall, from 2000 to 2017, real freight rail rates for all commodities increased by more than 30%.⁵ Furthermore, as noted above, ACC’s rate benchmarking analysis suggests that non-competitive rates exceed competitive rates by an average of 48%. Therefore, the Board should not presume that the social benefits of rate relief or increased access to competitive rail service would be small. Benchmarking analysis discussed above provides a sound basis for developing updated estimates of the aggregate transfers to railroads from captive shippers. The Board should also consider updating Grimm and Winston’s analysis on the deadweight loss from non-competitive rail rates. This would provide relevant data for further evaluation of the Board’s competitive switching proposal (EP 711) and Bottleneck Rule reforms discussed in the Rate Reform Task Force report.

Threshold

The Board should adopt a threshold for determining the rulemaking proceedings to which any cost-benefit analysis procedures should apply. Meaningful benefit-cost analysis requires time and resources. Where the costs and benefits are significant, it is appropriate to undertake the effort. Where costs and benefits are relatively small, the cost of delay due to the time to conduct benefit-cost analysis may make it inappropriate to do such an analysis. Section 6 of Executive Order 12866 appropriately requires departments and agencies to conduct a regulatory analysis of proposed regulations that are determined to be “economically significant.” This applies specifically to rules where the economic impacts are expected to exceed \$100 million per year. A potential regulation would also be considered significant if it

⁴ Grimm, Curtis, and Clifford Winston. “Competition in the Deregulated Railroad Industry: Sources, Effects, and Policy Issues.” *Deregulation of Network Industries: What’s Next?*, edited by Sam Peltzman and Clifford Winston, Brookings Institution Press, Washington, D.C., 2000, pp. 41–72.

⁵ American Chemistry Council calculations based on data from Association of American Railroads’ [Railroad Facts – 2018 Edition](#)

would “adversely affect in a material way a sector of the economy, productivity, competition, jobs, the environment, public health or safety.”

Clearly, the Board should consider conducting a cost benefit analysis for any regulation expected to result in societal costs above the \$100 million/year threshold. A CBA might be justified for other regulatory proposals where the expected “transfers” (e.g., from rate reductions) are expected to be substantial enough to threaten railroad revenue adequacy or to impose comparable material harm to rail customers and/or other sectors of the economy. However, to require benefit-cost analysis for less consequential rules would be an inefficient use of resources and inappropriately delay Board efforts to modernize its regulations and fulfill its statutory obligations.

Application of CBA

The Board requests information on how it could apply a cost-benefit analysis to a hypothetical rulemaking lowering the threshold R/VC percentage from 180% to 165%. While ACC is not in a position to provide a detailed discussion of this hypothetical rulemaking, we offer these general comments following the regulatory impact analysis framework discussed above.

Problem assessment

For the Board’s hypothetical rulemaking, the problem assessment should address the extent to which 180% R/VC threshold shields potentially “unreasonable” rates from Board oversight. The current threshold precludes shippers from challenging rates that are below 180% R/VC and limits the relief that can be pursued on rates that can be challenged.

ACC’s benchmark model provides a useful tool for the Board to better understand the scope of this problem. Specifically, the Board could run the model with the most current unmasked Waybill data, to:

- Identify a sample of potentially captive shipments with R/VC percentages between 165 and 180;
- Calculate competitive benchmark rates for these shipments; and
- Determine the extent of differential pricing for these shipments by comparing the actual rates to the benchmark rates.

This analysis would indicate the universe of shippers that could potentially gain access to the Board’s rate oversight procedures from the proposed rule change, and estimate the magnitude of differential pricing paid by these captive shippers.

The Board could also run a similar analysis on shipments with R/VC’s above 180%. The model could estimate the extent to which non-competitive rates could be reduced below 180%

R/VC under the proposal, assuming rates could be prescribed at the competitive benchmark or 165% R/VC, whichever is higher. This could help the Board to understand the extent to which the current threshold shields non-competitive rates from Board oversight.

Identifying Alternatives

The Board's hypothetical rulemaking focuses on one of many barriers that shippers face in challenging potentially unreasonable rates. In a regulatory impact analysis, the Board should evaluate its proposed approach against an alternative such as allowing rail-to-rail competition to work where it exists through alternatives such as competitive switching.

Assessing Costs and Benefits of Alternatives

To quantify the impacts of the Board's hypothetical proposal, the Board would need to estimate the following:

- *Additional rate relief expected in cases brought to the STB.* The Board could look at past cases where rate relief was granted. The record should indicate whether a rate below 180% R/VC would have been supported, but for the statutory threshold. It should be fairly straightforward to calculate the expected impact of the proposed rule change on this small group of cases.
- *Change in number of expected rate complaints.* This presents a more significant challenge because it requires the Board to predict uncertain human behavioral responses. The Board would need to consider potential challenges to rates with RVC's between 165% and 180%. In addition, the Board would need to consider whether the potential for winning a lower proscribed rate would lead to additional challenges on rates that are above 180% RVC. This would necessarily be a qualitative assessment due to a dearth of rate case data from which to employ a quantitative statistical analysis. However, given the large number of rates that are significantly above 180% RVC and the small number of challenges brought to the Board under the current rules, it seems unlikely that the proposal would drive many new cases, particularly for carload shippers.
- *Economic impacts and transfers.* Once the Board estimated the number of expected rate cases and the expected rate reductions, it could apply economic models discussed above to estimate certain societal costs and benefits of these changes. However, the hypothetical rulemaking would be unlikely to result in impacts over \$100 million per year, and would not likely be determined to be an "economically significant" rulemaking under EO 12866.

Thank you for your consideration of these comments. If you have questions, please contact Jeffrey Sloan at 202-249-6710 or jeffrey_sloan@americanchemistry.com.