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COOPERATIVE EXTENSION SERVICE

# Economics Newsletter

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## The Role of Railroad Contracts in Shipping South Dakota Grain

by
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The Staggers Act of 1980 deregulated many of the activities of the nation's railroads. A primary reason for deregulation was the belief that technological change had created trucking and barge industries which provide close market competition for the railroads. Consequently, shippers could be protected from monopolistic railroad exploitation by the natural operation of competitive market forces. Such protection would be more effective and efficient than protection provided by government regulation of railroads.

### Individually Negotiated Rail Contracts

One of the provisions of the Staggers Act allowed railroads to contract with individual shippers to provide transportation. Prior to 1980, rates and conditions under which a railroad would provide service had to be made public through published tariffs; the same rates and conditions applied to all shippers. Since 1980, shippers and receivers of grain have been allowed to contract with railroads individually, creating terms applicable only to that shipper/receiver. In addition to rates, terms of such contracts often include conditions on commodities, minimum volumes, origins, destinations, responsibility for car supply, and length of contract.

By the end of 1986, nearly 48,000 such contracts had been negotiated and filed with the Interstate Commerce Commission. More than 8,000 of those contracts (17%) covered the movement of grain by rail. Since such contracts are confidential agreements between private parties, it is not possible to completely assess their terms or impact. Various individuals and organizations have, however, cited what they believe to be some of the effects of rail contracting. Contracts provide a certainty of rates and volumes which allow better planning and more efficient utilization of railroad equipment and shipper/receiver grain handling facilities and equipment. These efficiency gains are often credited with lowering rail rates for the movement of grain and increasing investment in grain handling capacity.

### Impacts of Individually Negotiated Rail Contracts

Grain rates have decreased since rail contracts have become legal. Investments in grain handling capacity have been made, with an increased share of grain traffic moving in unit trains. Two broad questions, however, have been raised. First, are the lower rates and greater investment due to contracting or would they have occurred anyway in a market with excess transportation capacity and large volumes of lower priced grain? If the reduced rates and greater grain handling capacity are at least partly due to rail contracts, the second question is: how are the benefits of such cost reductions distributed? Depending upon the conditions in several market sectors, such benefits could be passed on to consumers; retained by railroads, grain receivers by rail, or grain shippers by rail; or, passed back to grain producers.

To learn the extent to which South Dakota grain shippers use rail contracts and how those shippers view the impacts of contracts, a survey was undertaken in December 1986. All 177 elevators with rail service were surveyed. Of these, 92 (52%) responded. Only 32% of the respondents had never shipped grain under terms of a rail contract, 36% had shipped under their own contract, while 68% had shipped under their own contract or that of another shipper or receiver.

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About 61% of the elevators shipping under individually negotiated rail contracts indicated a belief that the contracts had increased their volume, 26% thought contracts had had no impact on their volume, and only 11% thought contracting had reduced their volume. Of those which had never used contracts, only 3% thought contracting had increased their volume, 34% believed contracts used by others had decreased their volume, and 38% did not think contracting had affected their volume.

With respect to their ability to compete in the grain market, 67% of the contract users thought contracts had made them more competitive while only 3% of those not using contracts thought they were more competitive. Competitiveness was thought to be negatively affected by 48% of those not using contracts and only 13% of those using contracts.

Shippers were also asked whether rail contracts had affected the prices they paid to grain producers. Of those using rail contracts, 85% said they had passed benefits back to farmers through higher prices and 6% thought contracts had lowered prices paid to farmers. Of those shippers which did not use contracts, only 7% thought they had been forced by others' contracting to pay higher prices while 24% thought contracting had reduced prices paid to farmers.

## Interpretation of Findings

The responses to this short survey are consistent with those in several other states. Rail contracts tend to be used by shippers which can take advantage of large volumes. Such shippers often ship grain under contracts negotiated by their customers, large grain buying firms. This observation is consistent with the claim that large firms are capable of negotiating more advantageous contract terms because they can spread negotiating costs over a larger volume of purchases and can offer railroads guaranteed large volume traffic. It is not clear whether the existence of a rail contract increases a shipper's volume as most respondents reported or if it is only the ability to ship a large volume which makes a rail contract feasible.

Since significant economies of scale exist in the handling of grain, it is also not clear that contracts have reduced the cost of shipping grain as respondents suggest. Lower rail rates made available during this period may only be a market response to the scale economies available to large volume shippers, the excess covered hopper car capacity, and the availability of truck and barge transportation at historically low rates.

Whether lower transportation costs are attributable only to efficiencies due to large volume, or also to efficiencies introduced by contracting or recent market circumstances, it appears that a significant share of such gains has been passed back to producers.

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