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Agricultural Transportation Challenges for the 21st Century

The Long-term Viability of Short Line and Regional Railroads

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Issue

Smaller railroads are an important part of the U.S. railroad system, especially to agricultural and rural shippers. By offering an alternative to the abandonment of low-traffic-density, rural branch lines, regional and short line railroads have preserved rail service to many rural communities. Yet, the long-term survival of many of these lines is questionable. Among the factors affecting the viability of short lines are the dependence upon connecting Class I railroads, changes in the railroad industry due to recent mergers and technology, and the poor track condition of the lines on which short lines operate.

Background

Since the 1970's, many short line railroads have been created that operate on track previously abandoned by Class I railroads. Since Class I railroads were unable to operate these lines profitably, many doubted whether these lines would be successful under new management. In fact, many short lines have successfully provided better service at lower cost than the previous Class I operator. In 1996, more than 500 short line railroads operated 47,214 miles of road, approximately 27 percent of the U.S. rail network.

Short line railroads provide the labor-intensive services on low-density branch lines that Class I railroads often cannot profitably provide. Short lines and Class I railroads work closely together — in return for a portion of the freight revenue, short lines often gather, sort, and forward railcars to the Class I railroad. Yet, because Class I railroads have greater bargaining power relative to short lines, the rate splits between the Class I and the short line are often set at levels that cannot adequately support short line track investment. These contracts also can disadvantage short lines by setting a flat rate per railcar that fails to account for the effects of inflation over time. This complicates the ability of short line railroads to survive and lessens the level of rail service available to agricultural shippers.

In addition, the contracts short lines have with Class I railroads often limit their ability to interchange traffic with other railroads. These “paper barriers” limit the market access of short line customers and restrict intramodal competition. Limitations on market access interfere with the ability of agricultural producers and shippers to obtain the best price for their production and

increase their transportation costs. Some Class I railroads have closed route options either by pricing the movements on the route at high levels, by forcing the movement over other routes less desirable to the shipper, or by canceling joint-line rates. In addition, some short lines have complained of shipments sitting for unreasonable lengths of time after interchange. These delays discourage future traffic from those shippers who have incurred the additional costs of delay.

Typically, short lines are totally dependent upon one Class I railroad for railcar supply. Many short lines have contracts with Class I carriers that prevent them from leasing railcars from outside sources. Many short lines have complained that they have not received an equitable railcar supply from their Class I “partner.” Because the most important factor affecting the profitability of short lines is traffic density, the lack of railcars, or even the unpredictability of their supply, undercuts the ability of short lines to develop the traffic base needed for survival.

Should a short line purchase its own railcars, the default *per diem* rates for the use of the railcars, set by the Class I railroads as a group, are so low that they are often not compensatory. This also prevents many short lines from obtaining financing to purchase their own railcars. In addition, those small railroads having their own railcar fleet allege that their cars are not returned in a timely fashion because Class I railroads divert those cars for their own use after they have been unloaded. As a result, many short lines owning railcars will not allow their railcars to go off-line, thereby forcing agricultural shippers to choose between inadequate railcar supply via the short line to off-line terminals or the limited number of market destinations on the short line. Although the railcar supply may be adequate to on-line market destinations, the bid prices offered at those terminals are often lower.

Recent rail mergers may also affect the long-term survival of short line railroads. As Class I railroads increase in size, gaining more control over all the railroad shipping points in large geographic areas, they are much less likely to be constrained by the ability of producers to haul to shipping points on competing railroads. Due to increased dominance over large geographic areas and the ability to compel unit-train shipping, the need of Class I railroads for the gathering function provided by short lines has decreased. Moreover, because agricultural producers must travel greater distances from the farm to the first rail shipping point, or use truck transportation entirely, overall transportation costs are increased. The increased truck traffic also results in much higher maintenance costs on local roads, resulting in either higher taxes or reduced public services for those living in more remote rural areas.

Short lines also have a different customer focus than Class I carriers. Although one-third of U.S. agricultural production is exported, Class I railroads focus on the export market and appear reluctant to serve domestic markets that involve smaller individual movements over shorter distances. Indeed, there have even been reports of Class I railroads setting local rates so high as to discourage the construction of domestic processing facilities. In contrast, short line railroads generally focus on serving domestic markets.

The increasing size of railcars could constitute the single biggest technological threat to the long-term viability of short line railroads. The use of these larger cars reflects vehicle-size economies that are available to Class I railroads but that are not as available to short line railroads that

generally operate on tracks having much lower traffic densities and worse track conditions. For example, the new super jumbo covered-hopper railcars, having loaded weights of 286,000 to 315,000 pounds, are much larger than most of the short line track was designed to handle.

Due to the lower traffic densities and marginal profitability of their lines, many short line railroads will be unable to upgrade their track to handle these larger cars without assistance. A conservative estimate is that more than one-third of the current rail network operated by short lines is unable to handle 286,000-pound cars. This is based on the weights of short line rail, the condition of the ties and ballast on many of these lines, and the slower operating speeds of present short line road. Much of the short line track that is able to handle these larger cars can do so only at greatly reduced speeds.

The condition of short line track is another factor affecting the long-term survival of many short lines. In more recent sales or leases of track to short lines, Class I railroads have tried to complete the transaction before the track condition deteriorated too far. Prior to the late 1980's, most Class I railroads, in an attempt to obtain as much return on the original investment as possible, deferred maintenance for years prior to abandonment. Thus, much of the track that short lines operate was in extremely poor condition at the time of purchase or lease. Due to the marginal profitability of short line railroads and the limited access of the smaller independent short lines to capital markets, a great deal of this track is still in poor condition. The worst of this track can only be operated at slower speeds, with higher operating costs and less reliable service. In addition, as discussed above, the poor condition of the line generally precludes the handling of larger railcars.

Holding companies that own and operate more than one short line railroad have grown in importance in recent years. The key advantage of this organizational form is its lower risk profile, thanks to product and geographic diversification. As a result, holding companies can more readily obtain large amounts of low cost capital through the issuance of stock or bonds. Another distinguishing feature of the holding company is its ability to optimize the allocation of equipment and managerial talent across several short line railroads. This is done not only through the seasonal transfer of locomotives and railcars among affiliated firms, but by virtue of the fact that economies of scale often permit holding companies to purchase specialized rail equipment that can be employed by all its affiliated roads.

Implications

The long-term survivability of the small railroads that provide railroad service in many rural areas is in question for a number of reasons. Because much agricultural production occurs in these rural areas, the viability of short line railroads is a long-term transportation issue of vital importance to U.S. agriculture. Should these lines fail, transportation costs for producers and agricultural shippers would rise. Many producers would shift to truck, limiting the number of markets that these agricultural shippers could access, and greatly increasing the rural road and bridge maintenance burden on local and state governments.

Information Sources

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