The Provision of Rail Service: 
The Impact of Competition

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This paper is an abridged version of “Railways, Competition and the Hold-Up Problem” presented at the conference The Economics of World Wheat Markets: Implications for North America sponsored by the Trade Research Center at Montana State University–Bozeman, May 29–June 1, 1997.

Grain transportation is one of the most important economic issues for grain producers in the Northern Plains. The reliance on export markets and the long distances to port position means that transportation costs have a significant effect on the price received by farmers.

In the prairie region of Canada, rail transportation is undergoing a major transformation that will affect the competitive positions of agriculture in both the United States and Canada and influence the direction of grain flows between the two countries. Rail rates are no longer legislated (although a cap is still in place), restrictions on branch line abandonment have been lifted, and further deregulation of price and car allocation is being considered. Some parties, including the railways, argue that a completely deregulated system, similar to the U.S. system, is the only way to achieve transportation efficiencies. Other groups, supporting the status quo, argue that the regulation of rates is essential to control the monopoly power of the railways. There has been very little discussion of other policy options, with the exception of a limited discussion of nationalized railbeds.

The U.S. experience provides a stark view of the likely outcome of deregulation. When railways are not faced with competition from other railways or from other forms of transportation such as barges, the evidence suggests railways will price freight services at or near truck competitive rates. Freight rates in Montana, where no effective rail and/or barge competition exists, are approximately twice those at Kansas City and Denver/Commerce City, where such competition exists.

The current cost-based regulated rates in Western Canada are similar to those at Kansas City and Denver/Commerce City. Given similar distances to port and the existence of only two railways (and no likelihood of new entrants), deregulation in Western Canada is likely to result in freight rates closer to those in Montana than to the current regulated level. The increase in freight costs will result in transfers from producers to the railways, distort production incentives, and create losses elsewhere in the economy.

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While maintenance of a regulated freight rate structure would address the freight rate issue, other problems would result. The lack of price signals reduces incentives for industry participants to perform. Branch lines are less likely to be maintained in a regulated environment because railways may be unable to charge the extra amount necessary to make them viable. Railways may also disrupt the system—as a form of bargaining—to create pressure for deregulation.

This report explores the option of the government encouraging entry into rail service provision. Just as telecommunication companies are required to allow competitors to use their phone lines, existing railways could be required to make their track and switching equipment available to rail operators who wish to run train service on a line, on the condition that the access price covers the infrastructure cost. The paper examines the case of the British railway system where the ownership of the track has been separated from the operation of the rail equipment and the provision of service, and explores the applicability of this model to grain transportation on the Great Plains. In Britain, ownership of the track rests with a company called Railtrack (although Railtrack was government-owned, it has been privatized). Railtrack leases access to thirty train operators for fees that are regulated by the Office of the Rail Regulator to cover maintenance costs and provide a return on investment. The thirty rail operators then compete to provide service to customers.

This model and others similar to it need to be developed and articulated before they can be considered in the public policy forum. Nevertheless, given the importance of rail transportation to the grain industry in the Northern Plains, it is imperative that options such as these be investigated to address the very thorny issue of freight rate and entry regulation.
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Introduction

Grain transportation is one of the most important economic issues for grain producers in the Northern Plains. The reliance on export markets and the long distances to port position mean that transportation costs have a significant effect on the price received by farmers.

In the prairie region of Canada, rail transportation is undergoing a major transformation that will affect the competitive positions of agriculture in both the United States and Canada and influence the direction of grain flows between the two countries. Rail rates are no longer legislated (although a cap is still in place), restrictions on branch line abandonment have been lifted, and further deregulation of price and car allocation is being considered. Some parties, including the railways, argue that a completely deregulated system, similar to the U.S. system, is the only way to achieve transportation efficiencies. Other groups, supporting the status quo, argue that the regulation of rates is essential to control the monopoly power of the railways. There has been very little discussion of other policy options, with the exception of a limited discussion of nationalized railbeds.

The purpose of this paper is to explore some policy options for providing competition in the rail industry. The paper begins with a description of the rail industry in Canada and the United States. An analysis of the market structure of the industry indicates that lack of competition is a concern in rail transportation in certain geographical locations. At the same time, it is shown that regulation results in inefficiencies. The result is a policy dilemma: Although some sort of regulation is required, regulation also has costs.

The solution proposed in this paper is to examine types of regulation other than those traditionally used. The option examined here is to require railways to make their track and switching equipment available to anyone who wishes to run train service on a line. This encouragement of entry into rail service provision follows similar efforts in the telecommunications and electrical generation industries. The paper examines the case of the British rail system, where the ownership of the track has been separated from the operation of the rail equipment and the provision of service, and explores the applicability of this model to grain transportation on the Great Plains.

The Rail Industry in Canada

Regulation of grain transportation in western Canada began in 1897 when Canadian Pacific Railways agreed to move western grain at the predetermined statutory “Crowsnest Pass Rates” in exchange for a number
of important concessions. These statutory rates were extended to all railways in 1925. By the 1970s, Canadian Pacific (CP) and Canadian National (CN) were losing substantial amounts of money hauling western grain at the statutory rate and were no longer investing in transportation infrastructure (see Vercammen [1996] for more detail on the material in this section).

In response to this lack of infrastructure, the federal government purchased hopper cars (provincial governments in the Prairies also participated in this purchase), rehabilitated branch lines, and helped finance construction of a grain terminal at Prince Rupert. As well, the federal government passed the Western Grain Transportation Act (WGTA) effective August 1, 1984. The main goals of the WGTA were to preserve the basic features of the Crowsnest Rates (distance-based and equitable freight rates), ensure that the railways would earn a fair return for hauling western grain, and provide a mechanism whereby producers and the federal government would share the total freight cost.

Under the WGTA, the federal government paid a share of the annual total freight cost directly to the railways; the remainder was paid by farmers. The annual Crow Benefit—or the amount paid by the federal government—was initially set at $658.6 million. This value changed over time. In 1988–1989, the government payment to the railways was $695.1 million (72.3 percent of the total freight charge); in 1994–1995, the government’s contribution was $528.5 million (51.5 percent); and in 1995–1996, the government’s share declined to 48.3 percent of the total freight charge.

The WGTA was eliminated effective August 1, 1995. The removal of the WGTA was due to at least two reasons. First, under the recent General Agreement on Tariffs and Trade (GATT), the WGTA was viewed as an export subsidy and was subject to volume restrictions. Second, the transportation subsidy represented a sizable financial commitment for a cash-strapped federal government that, during the latter part of the WGTA era, was no longer able or willing to maintain its financial commitment to grain producers.

After the removal of the WGTA, the Canadian Transportation Act (CTA) was passed and it contains all the relevant legislation concerning the transportation of western grain. An important element of the CTA is the introduction of a Maximum Rate Scale, which effectively caps the level of freight rates for the transportation of western grain. The CTA also contains provisions for a review of the legislation in 1999 to “determine the efficiency of the grain transportation system and [review] the sharing of efficiency gains between shippers and railway companies” (CTA, section 155).

A final element of the grain transportation system in western Canada is the allocation of cars to various shippers. The Car Allocation Policy Group is responsible for allocating on a weekly basis the railcar fleet between Canadian Wheat Board (CWB) shipments and open market shipments and
for specifying the precise allocation of cars by elevator company and location.

**The Rail Industry in the United States**

Regulation of U.S. railways began in 1887 with the formation of the Interstate Commerce Commission (ICC). A major factor in the regulation of the rail industry in the United States was a concern about monopoly practices. The formation of the ICC was primarily a reaction against price discrimination that targeted specific people, companies, and geographical areas. Interestingly, however, the ICC sanctioned commodity price discrimination in its acceptance of value-of-service pricing (Friedlaender 1969).

By the early 1970s, the U.S. railways were experiencing financial problems as a result of business lost to the trucking industry and because the regulatory environment prevented the railways from introducing pricing flexibility and from abandoning unprofitable rail lines (see Wilson 1994 and the references therein). These financial problems led to the passage of the Staggers Rail Act in 1980 which reduced the degree of regulation in the system. The impact of deregulation for the period up through the mid-1980s has been estimated using a number of different approaches (see MacDonald 1989; Fuller, et al. 1987; and Wilson 1994). The conclusion is that deregulation reduced freight rates in the Great Plains region of the United States where intermodal competition was limited; deregulation appeared to have little effect on rates in eastern Corn Belt areas where barges provided competition. The general conclusion is that prior to the Staggers Act the railways were able to use regulations to form an effective monopoly and to raise prices to the level the market would bear.

The passage of the Staggers Rail Act resulted in a significant change in the U.S. railroad system. The system became much more market-based for many aspects of railroad operations including rate setting, line abandonment, and car allocation. The ICC was also given the responsibility to protect captive shippers from excessively high freight rates (see Wilson 1994 and the references therein). On January 1, 1996, the ICC was removed and replaced with the National Transportation Agency and the Surface Transportation Board.

Prior to the Staggers Rail Act, cars were allocated under “common carrier obligations” (i.e., cars were essentially allocated on a “first come, first served” basis), and shippers were not assessed penalties if they canceled the cars. At the current time, railcar allocation is predominantly controlled by the railroads, with shippers having some input. Approximately half the hopper car fleet is railroad-owned. The railroads also control up to 40 percent of the privately owned fleet giving them control of the placement of 65 to 70 percent of the total available fleet. Railroads use various approaches to allocate cars to individual shippers. Burlington Northern, Union Pacific, and Canadian Pacific-Soo Line use a market-based approach for the allocation of their cars. This approach involves the
shippers bidding on cars to secure guaranteed placement at some future date.

As an example, Burlington Northern (BN) uses three different approaches to allocate their cars. The first method uses Certificates of Transportation (COTs), which guarantee grain cars. Shippers bid for COTs in an auction-type setting. Shippers who do not buy COTs at auction have the opportunity to purchase them in a secondary market, which allows those who previously ordered but no longer need COT cars to dispose of them. Usually 30 percent of BN’s fleet is allocated to this use.

The second method allows shippers to place their own cars into BN’s Guaranteed Car Pool (GCP) program. This program guarantees them a claim on an equal number of cars in the future. During periods of low demand for railcars, BN may refuse to allow shippers to use these private cars on their tracks in order to increase demand for their own cars. Users of the GCP have no guarantee on the rate (as they would with the COT program). GCP users also carry a car cancellation fee of $200 per car. The GCP program accounts for approximately 25–30 percent of BN’s total fleet.

Finally, shippers may place orders for railcars under the ordinary tariff system called the General Car Order (GCO) program. Cars are assigned to various corridors based on historical usage and are awarded to individual shippers according to demand; when the number of car orders exceeds the supply, a lottery is used for allocation. This program accounts for approximately 40 percent of BN’s fleet.

**Market Structure of the Rail Industry**

The rail industry in the Northern Plains region of North America is highly concentrated. In Montana and the western portion of North Dakota, BN has a monopoly. In Canada, the Prairie provinces of Manitoba, Saskatchewan, and Alberta are served by a duopoly—the two railways are CN and CP. However, the areas served by CN and CP are often geographically distinct so that in many areas the market structure is a monopoly. Figure 1 shows the rail network in Saskatchewan in 1998. Although there is a corridor running from the southeast to the northwest in which farmers have reasonable access to both CN and CP, outside of this corridor most farmers have reasonable access to only one railway.

In addition to facing a highly concentrated industry, grain shippers have few other options available when it comes to shipping grain for export. West Coast ports are 600 to 1,600 miles from grain production on the Canadian Prairies, making trucking a very expensive option. Exporting grain via the East Coast or Gulf ports requires trucking several hundred miles plus significant waterway costs.

The presence of a duopoly—and in some cases a monopoly—raises concerns about monopoly pricing should the Canadian rail industry be completely deregulated. There are empirical and theoretical reasons to
Figure 1. Saskatchewan Rail Network, 1998

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suggest these concerns are valid. From a theoretical perspective, high levels of concentration are a problem in an industry if the threat of entry is low (an industry is highly concentrated if the largest four firms have more than 70–75 percent of the market). Without the threat of entry, existing firms can raise price without fear of losing market share to new entrants. To be a real threat, however, potential entrants must be able to enter and exit an industry without much cost.

Although new firms can and do enter industries such as the grain handling business, this ease of entry is not present in the rail industry. Indeed, the cost to a new firm of entering the rail industry and building new rail lines is likely to be prohibitive. The need to meet environmental regulations and the expenditures required to acquire land are two reasons for this prohibitive cost.

The CTA includes provisions that are designed to stimulate competition such as confidential contracts, interswitching, competitive line rates, and final offer arbitration (Vercammen 1996). However, the high concentration in the industry and the geographic location of the rail lines reduce the effectiveness of these provisions. Simply put, the CTA provisions will lead to competitive prices if the railways are willing to actively compete with each other. If the railways are aware of the market influence they possess and act accordingly, the effectiveness of the CTA provisions will be limited.

The empirical evidence also suggests that monopoly pricing is a concern. Figure 2 shows the freight rates from four different delivery points in the United States and Canada to the closest port. Three of these delivery points are in the United States, and one is in Canada. The delivery points were chosen based on the level of competition among railways and between railways and other modes of transportation, the ability to handle a 52-car spot, and the types of crops handled by the elevators and produced in the local area. Where possible, delivery points were chosen with similar distances to port. However, since the analysis is based on a per 1,000-ton-mile basis, the distance to port is not a critical factor. The values in Figure 2 are in Canadian dollars per 1,000-ton miles. Since the points selected for comparison are roughly 1,000 miles from their respective ports, the values represent the total amount paid per ton for grain shipment (see Government of Saskatchewan [1997] for more detail on the material in this section).

The Canadian point is Moose Jaw, Saskatchewan. Moose Jaw is approximately 1,190 miles from Vancouver and was chosen because of the presence of a large inland terminal and its location on the CP mainline. The rate shown in Figure 2 reflects average railway costs. The rate does not include an ownership charge for the government-owned hopper cars and thus likely understates the actual costs.

The three points chosen in the United States are Shelby, Montana; Denver/Commerce City, Colorado; and Kansas City, Kansas. These points
Figure 2. Freight Rates for Wheat, Selected U.S. and Canada Points, 1990–1995

Rail freight rates are considerably higher in Montana than in other locations where effective competition exists.

were chosen because of their differing levels of competition between railways and other modes of transportation. The destination ports (that is, the ports served by the three originating stations) were chosen because of the direct connections on Burlington Northern (BN) lines from the originating station to the port.

Shelby, Montana, to Portland, Oregon, is approximately 782 miles and is served by only one railway, BN. Portland was chosen as the destination point because the majority of the grain from the Shelby area is exported via ports in the Pacific Northwest. Denver/Commerce City, Colorado, to Galveston, Texas, is approximately 961 miles and is served by three major Class 1 railroads (BN, Union Pacific, and Southern Pacific) and one small carrier (Denver and Rio Grande Western Railroad Company). Galveston was chosen as the destination point because it is a major port for wheat from this area destined for the Gulf ports. Kansas City, Kansas, to Galveston, Texas, is approximately 861 miles and is served by numerous Class 1 and small railway companies. In addition, Kansas City is served by barge on the Missouri River system. The common destination point for Denver/Commerce City and Kansas City can be used to determine if the presence of barge transportation at Kansas City is reflected in rail freight rates.

At least three observations and conclusions can be made from the data in Figure 2. First, freight rates from Kansas City and Denver/Commerce City are significantly lower than rates from Shelby, suggesting the presence of effective rail and/or barge competition has a direct effect on the rates charged by BN. Second, the Kansas City and Denver/Commerce City freight rates have remained relatively constant over time, although there have been some relatively small changes from month to month. This price pattern suggests a relatively competitive market in which the price is
determined by the cost of providing the service. Third, the Shelby freight rate has changed considerably over time, rising from just under Can $40 dollars per 1,000-ton miles in 1990–1991 to about Can $55 dollars per 1,000-ton miles in late 1995, a value that closely reflects the cost of trucking. This freight rate pattern suggests that in Montana BN is operating in a market where considerable latitude is available for setting prices.

The Policy Dilemma in the Rail Industry

The concern about monopoly pricing in the rail industry is mirrored in other areas such as power distribution, telephone systems, pipelines, and rail service. These activities are often described as natural monopolies and have been either allowed to operate as regulated monopolies or operated as monopoly enterprises owned by government. Transportation corridors such as waterways, ports, roadways, and railways have also been largely claimed for operation as monopolies through the public domain.

Government creation and regulation of these monopolies has been based on the argument that these industries have economies of scale; one firm can provide the good or service at lower cost than can two or more firms. Although there are undoubtedly some economies of scale in the provision of these services, these industries have had another more important characteristic in common: the need to secure the right of access to a continuous corridor to provide these services. The necessity of acquiring an uninterrupted corridor meant landowners along the route could hold out for a share of the potential profits, resulting in land acquisition costs outweighing the returns that could be earned by a company wishing to provide the service.

The historical use by governments of their power of eminent domain to acquire land (including expropriation when necessary) suggests this entry barrier is very large and that government action is required to facilitate the entry of even a single firm. Providing entry to one player, however, creates another problem: The monopoly that has been created is now free to raise prices. Governments have historically reacted to this threat by instituting public ownership and regulation of these industries.

The history of the rail industry in both Canada and the United States is a good example of this pattern of government interest and involvement. For example, in Canada, the railways were initially established through government land grants. The rail industries in both countries have been heavily regulated since the last decade or two of the 1800s. The evidence on railroad pricing presented earlier also suggests that concerns about monopoly pricing are real and need to be addressed.

The traditional form of regulation focuses on controlling price. Price regulation, however, has its own costs. In both the United States and Canada, regulation of the rail industry resulted in financial problems, lack of investment, and poor maintenance of infrastructure (e.g., some branch lines) that was no longer cost effective. More generally, the lack of price signals inherent in regulatory environments reduces the incentive for

In both the United States and Canada, price regulation of the rail industry resulted in financial problems, lack of investment, and poor maintenance of infrastructure.
industry participants to perform. Rail companies may also disrupt the system—as a form of bargaining—to create pressure for deregulation. Finally the uncertainty created by the possibility of switching to a deregulated system discourages industry participants from making investments that rely on regulated freight rates.

The unique structural characteristics of industries such as rail transportation create a dilemma for policymakers. The prohibitive cost of entry means monopoly pricing is a real concern and regulation is required. At the same time, traditional price regulation is costly and creates inefficiencies.

The solution is to examine types of regulation other than those traditionally used. One option is to use regulations to encourage entry into rail service provision. Traditionally, entry into an industry has been thought to require investment in new facilities and infrastructure. Since this route is effectively blocked in the rail industry, attention needs to be focused on encouraging entry into the provision of service.

Entry regulation has been introduced in industries outside of transportation. For instance, in the field of telecommunications, regulations have been introduced to force local companies to carry long-distance services from other companies. This has resulted in a dramatic reduction in the cost of long-distance services. Similarly, electrical utilities are being forced to carry current from other suppliers to their customers, which has eliminated their monopoly over their customers and has given them an incentive to find lower-cost technologies (Joskow 1997).

These options are available for the rail industry. Just as telecommunication companies are required to allow competitors to use their phone lines, existing railways could be required to make their track and switching equipment available to rail operators who wish to run train service on a line, on the condition that the access price covers the infrastructure cost. The next section examines the case of the British rail system in which the track ownership has been separated from the ownership and operation of the rail equipment, and hence the provision of rail service. The applicability of this model to grain transportation on the Great Plains is also explored.

**Rail Service Provision Entry—The British Rail System**

The British rail system has historically been operated by British Rail, a government-owned enterprise. In 1993, the British Railway Act was introduced. Its objective was to create a system that operates in the public interest by enhancing the competitive forces in the British railway system. A government agency called the Office of the Rail Regulator (ORR) is supervising the process of transition from the previously government-owned and controlled system to the new system.

The rail infrastructure is currently owned by a company called Railtrack which leases access to thirty independent rail operators. These rail operators compete to provide passenger and freight service to the public. Up until the fall of 1997, Railtrack was owned by the government. With the
access agreements and the regulatory framework in place, the ORR developed a business prospectus for Railtrack, which was then sold in a public share offering. The ORR continues to regulate the rate of return for Railtrack. The ORR also monitors contracts for rail and passenger service, along with other responsibilities. Figure 3 contains a schematic representation of the set of public and private institutions involved in the reform of the British Railway system. See Appendix for a description of the British railway system.

**Figure 3. The Operation and Control of the British Railway System**

In addition to the actions and responsibilities mentioned in the policy statement, the ORR is also involved in a variety of activities designed to facilitate more efficient operation of the railways, including working with industry to develop standard codes of practice, insurance and safety standards, and so on. During 1996 the ORR examined a merger between two rail operators and also investigated claims of unfair ticketing practices.
The ORR has been very proactive in creating a new set of institutions and contractual agreements within the evolving British railway system. The ORR seems to clearly recognize where a legitimate monopoly problem may exist and then moves to improve contractual design to provide the proper incentives. It also acts as a mediator when disputes arise.

**Applicability to the Great Plains**

In theory at least, something like the British railway model could be adapted for use in the Great Plains region. Existing rail companies could be required to let other operators run trains on their rail track. This would effectively introduce competition into the industry, with the result that freight rates should drop to competitive levels. Railway companies would likely specialize, with some concentrating on the provision of railway infrastructure and others concentrating on train operations. If both Canada and the United States adopted such a model, train operators would likely operate in both countries and freight rates would equalize. If only one country adopted this policy, competition in that country could be expected to increase, resulting in relatively lower freight rates. Train operators from both countries would likely enter the more competitive market, whereas the restricted market would continue to have railway service and rail infrastructure provided by the same company.

Major shifts in the rail industry would be required for this policy change to be implemented. At the operational level, switching devices would need to become much more automated and train location determination would need to be improved. As is the case in the electrical industry where electricity generation and transmission are being separated, train operation logistics would likely have to be turned over to independent system operators who would coordinate train movement. These system operators would require a unique ownership structure that provides both infrastructure owners and rail operators a say in the operations. Although most rail infrastructure investment decisions could be left with the infrastructure owners, some investment decisions may have to be made on an industry-wide basis. Electronic “markets” may have to be created to allocate demand across the various train operators (see Joskow 1997 for an excellent discussion of the organizational changes required in the electrical industry). Finally, an organization something like the ORR would have to be formed to establish access terms and rates.

Since railways operating in the Great Plains region of the United States and Canada haul much more than grain, this new regulatory environment would have to apply to all the commodities handled by the railways. Also, because the impact of a regulatory change would affect other carriers such as trucking, changes to other transportation systems would be required and would have to be coordinated.

Although this new regulatory model would generally improve the economic performance of the rail system, some problems would emerge. One of the most important is likely to be the impact of low demand.
volume on certain railway lines. The ability to provide rail service to low demand areas may hinge on the ability of producers and shippers in these areas to provide rail infrastructure at rates that make rail operation profitable. Thus, mechanisms that allow effective local ownership also need to be developed.

Although these changes are substantial, changes of this magnitude are occurring in the electrical industry. If anything, the separation of electricity generation and transmission is much more difficult than the separation of rail infrastructure provision and railway service provision. Nevertheless, a great deal of thought and research needs to take place before this type of regulatory reform could occur in the rail industry.

Summary and Conclusions

The unique structural characteristics of industries such as rail transportation create a dilemma for policymakers. The prohibitive cost of entry means monopoly pricing is a real concern and regulation is required. At the same time, traditional price regulation is costly and creates inefficiencies. The solution is to examine types of regulation other than those traditionally used.

One option is to use regulations to encourage entry into rail service provision. Traditionally, entry into an industry has been thought to require investment in new facilities and infrastructure. Since this route is effectively blocked in the rail industry, attention is focused on encouraging entry into the provision of service. Regulations that facilitate entry have been introduced in industries outside of transportation. For instance, in the field of telecommunications, regulations have been introduced to force local companies to carry long-distance services from other companies. This has resulted in a dramatic reduction in the cost of long-distance services. Similarly, electrical utilities are being forced to carry current from other suppliers to their customers, which has eliminated their monopoly over their customers and has given them an incentive to find lower-cost technologies.

These options are available to the rail industry. One example is the British railway system. In Britain, the ownership of the track has been separated from the operation of the rail equipment and the provision of service. Ownership of the track rests with a company called Railtrack. Railtrack leases access to thirty train operators for fees that are regulated by the Office of the Rail Regulator to cover maintenance costs and provide a return on investment. The thirty rail operators then compete to provide service to customers.

This model and others similar to it need to be developed and articulated before they can be considered in the public policymaking framework. Nevertheless, given the importance of rail transportation to the grain industry in the Northern Plains, it is imperative that options such as these be investigated to address the very thorny issue of freight rate and entry regulation.
REFERENCES


Railtrack's 1995-1996 Network Management Statement outlines their role in the overall structure.

Railway Industry Framework. The reform of the railway industry structure in Britain is based on separating the management of the railway infrastructure from the operation of trains, stations, and other railway transport services.

Railtrack, which took over the network in April 1994, owns the infrastructure and manages it within the new railway industry framework. It operates approximately 32,000 km of track and associated signaling equipment and leases approximately 2,500 stations and approximately 90 depots to operators. Investment in maintaining and expanding the network encompasses expenditure on track, structures, train control systems, and stations.

Trains are currently run by some thirty operators. They provide international, intercity, regional, and commuter passenger services and freight services. Passenger service operations are initially being franchised with the opportunity from April 1, 1999, progressively to introduce direct competition. Freight services are already open to competition. Over the period of this statement, the number and nature of network users is likely to change as the new railway structure develops and the market changes.

Operators who use the network and contractors who help to maintain or develop the infrastructure must demonstrate that they can operate safely and must provide Railtrack with acceptable safety cases which document their ability to discharge safety responsibilities.

Railtrack, a government-owned company (it has since been privatized), is a commercial undertaking which provides services to its customers under contract. The contracts set out standards of service to be delivered by Railtrack and provide performance incentives for their achievement. Railtrack sets its priorities for network management and expenditure plans to enable it to meet these contractual obligations and improve the performance of the network.

Railtrack derives the majority of its revenue from charging passenger train operators for using the network.

Since 94 percent of income is earned from charges to passenger and freight operators, Railtrack’s investment plans are to a large degree concerned to protect or enhance the income from passenger and freight operations by ensuring that it delivers against the terms of the access contracts. Access agreements set out:
• specified routes that the train operator may use;
• the number and timetable parameters of trains using a route;
• the type of trains and rolling stock that may be operated;
• standards of service, which are designed to encourage punctuality and reliability of trains;
• the charges for use of the network.

With the exception of fourteen of the largest stations, which continue to be operated by Railtrack, nearly all stations and depots that are owned by Railtrack are leased to and operated by train operators.

When determining passenger track access charges for the next five years, the Regulator took the extent of Railtrack’s proposed renewal program into account, so that Railtrack would be able to undertake renewals without seeking to raise additional charges on passenger train operators. Charges were set to remunerate Railtrack’s total expenditure, including major renewal projects, across the entire network rather than as incurred on a particular route.

The access conditions also set out the processes by which changes to the network and the layout of stations are to be made. Railtrack and train operators may both propose changes, but each has the right to object if the proposed investment were not economic or if there were major disruptions to other services that were not compensated for.

Access agreements are subject to the approval of the Rail Regulator who aims to ensure that their terms will operate in the public interest as set out in Section 4 of the Railways Act. The Regulator has published criteria on the basis of which he will decide whether to approve, reject, or modify such agreements. If a train operator cannot reach agreement with Railtrack on acceptable terms, he can ask the Regulator to direct Railtrack to enter into an agreement.

. . . The Regulator is now consulting train operators on the broad structure of the profit sharing mechanism. The key feature of the proposed mechanism is that 25 percent of additional net income, over and above the levels already taken into account in setting access charges, should be passed back to train operators through a rebate of access charges, with Railtrack retaining the other 75 percent. . . .

_Tendering for Maintenance and Renewal Work_. Railtrack has developed a maintenance and renewal expenditure forecast for the next ten years. Detailed rolling programs are being developed, setting out the way in which the forecast work will be undertaken. Railtrack contracts out the maintenance and renewal work of its network. Initial maintenance contracts require the contractor to deliver efficiencies and open competitive tendering will come into force as existing contracts expire.
Closure Procedures. With the exception of a station or service designated by the Franchising Director as experimental, any proposal to close a part of the passenger railway network or stations would be subject to statutory closure procedures. . . .

. . . Railtrack has no proposals to close any part of the passenger network to passenger services and nor does it anticipate initiating any proposals for such closures in the period covered by the Network Management Statement.

The Office of the Rail Regulator
A recent press release of the ORR outlined the major areas of activity for the ORR during 1995-1996.

- Access to the railway system: Over the year ORR completed the process of approving the initial track and station access agreements.

- Railtrack: In preparation for the flotation (the selling of stock) of Railtrack, the Regulator published a detailed statement, for inclusion in the prospectus, on the general principles he has adopted in the regulation of the railway industry and the approach he intends to take following the flotation of Railtrack.

- Licensing and consumer protection: Over the year the focus of the Regulator’s role has begun to change from facilitation, guidance, and setting standards to monitoring and enforcing compliance with obligations and contractual arrangements.

- Consultative Committees: The Rail Users’ Consultative Committees, which are sponsored by the Regulator, have recently undergone a review aimed at maximizing the effectiveness of the Committees in representing the interests of railway users, whilst making the best use of resources. The results of the review, which was carried out by PA Consulting, are currently being discussed with the Committees.

In March 1996 the ORR released a policy statement which sets out the approach he intends to take in the following areas:

- The contractual framework, access arrangements and the allocation of capacity: The general presumption is that capacity should be shared fairly, and in accordance with the public interest, between all operators wishing and able to use the facility.

- Charging arrangements for access: The Regulator expects that owners of facilities, such as Railtrack, will carry out enhancement investment where they receive an appropriate return through access charges. This should cover at least avoidable costs plus a share of the benefits from investment depending on the relative risks being taken by the parties involved.
• Licensing arrangements: Generally operation of new facilities will be covered by licensing arrangements designed to protect the public interest and consistent with those covering existing facilities.

• Implementation of projects: Contracts giving train operators access to track, stations, and depots contain procedural rules designed to facilitate enhancement investment. The Regulator anticipates keeping these under review to ensure that this objective is achieved and he is willing to give informal guidance as to the approach he would take in respect of specific investments.

• Sharing of information about investment plans: The Regulator emphasizes the importance of sharing and coordination of investment plans and the document outlines the various arrangements that are in place to achieve this.

_The Regulator will keep these arrangements under review to ensure that they facilitate beneficial investment in the enhancement of the infrastructure._