BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO 677

COMMON CARRIER OBLIGATION OF RAILROADS

222449

SUPPLEMENTAL WRITTEN SUBMISSION OF ARKANSAS ELECTRIC COOPERATIVE CORPORATION

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Dated May 27, 2008

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Introduction

This document answers a question that Arkansas Electric Cooperative Corporation (AECC)[1] was asked during the April 25, 2008 public hearing in this matter Vice Chairman Mulvey asked AECC's representative, Steve Sharp, Principal Engineer-Fuels & Civil, whether a reference in AECC's written submission to "economies of scale" should instead have referred to "economies of density" Mr Sharp, who is not an economist, was unable to answer that question A brief answer to that question follows

Definition

AECC's written submission responded to railroad industry arguments that seek to excuse service deficiencies because traffic volume increases have used up, or are using up, excess capacity AECC Written Submission, at 6-7. AECC commented that "railroads possess economies of scale" (i e , average costs decline as volume increases)," and therefore, "railroads benefit from, and are well-suited to handle, volume increases" Id., at 7

1 AECC's interests in this proceeding were described in its written submission dated April 17, 2008 In the interests of brevity, they are not repeated herein

In this passage, AECC was using the term "economies of scale" as it is used in standard economics texts For example, the standard textbook Economics says economies of scale "arise when an increase in all inputs leads to a more-than-proportional increase in the level of output."[2] This textbook further describes how a "natural monopoly occurs when the technology exhibits economies of scale over a range of output that is as large as the entire demand " In this situation, " average and marginal costs, fall forever As output grows, the firm can charge lower and lower prices and still make a profit, since its average cost is falling " This text specifically cites "long distance links in railroads" as an important example of such a natural monopoly [3]

The term "economies of scale" was used in this sense by the Board, during the UP/SP merger oversight proceedings, to describe the savings that would prospectively be available to a single carrier serving a plant in comparison to the possibility that two carriers would serve the plant [4]

The term "economies of scale" has also been used more narrowly, forming a subset of the "economies of scale, scope and density" historically associated with the freight railroads In this context, "scale" refers generally to the extent of a firm's market coverage (e.g , network miles operated), while "scope" refers to the mix of different commodities moved and "density" refers to the quantity of a given mix of commodities moved over a given line or set of lines

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2 See Samuelson, Paul A and William D Nordhaus, Economics (Eighteenth Edition), McGraw-Hill (New York, 2005) at page 111

3 Economics at pages 170-172

4 See STB Finance Docket No 32760 (Sub-No 21), Union Pacific Corporation, Union Pacific Railroad Company And Missouri Pacific Railroad Company -- Control And Merger -- Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St Louis Southwestern Railway Company, SPCSL Corp , And The Denver And Rio Grande Western Railway Company [Oversight], Decision No 10 (October 24, 1997) at pages 9-10

AECC's written submission used the term "economics of scale" to refer to the behavior of costs as volume increases for a given set of carriers and mix of traffic types. This is consistent with the textbook definition of the term, and corresponds to the concept of "economics of density" in the more narrowly-defined lexicon.

The point of AECC's comment in its written submission was that the presence of such economies means that the railroads cannot point to increasing volumes as an excuse for service degradations and increasing rates. Several studies based on post-Staggers Act data demonstrate that economies of density continue to exist even after railroads have eliminated excess capacity.[5] The Board should not allow railroads to excuse their failure to meet their common carrier obligations through self-serving denials of their innate capability to not only serve, but prosper, from volume increases at constant or declining rate levels. Carrier or industry actions that have the effect of restricting or "metering" service have no foundation in the industry's cost structure, and represent increases in the exercise of carrier market power that are wholly inconsistent with the public interest.

Respectfully submitted,

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[5] See, for example, Friedlaender, A F, "Coal Rates and Revenue Adequacy in a Quasi-Regulated Rail Industry", The RAND Journal of Economics, Autumn 1992 (Volume 23-3), pages 376-394; Bitzan, J., Railroad Cost Conditions – Implications for Policy, prepared for FRA/DOT, Grant No. DTFR53-99-H-00025 (May 10, 2000); and, Bereskin, C G, "Railroad Cost Curves Over Thirty Years: What Can They Tell Us?", Transportation Research Forum – Annual Forum Proceedings (2008 - Best Paper)