

AAR Executive Discusses Future Prosperity Of Nation's Railroads

By Kristen McIntosh

According to the Association of American Railroads, railroads serve as the backbone of the nation's economy, providing more freight transportation service than any other mode—more than 40 percent based on ton-miles, according to the most recent figures.

To learn more about the significance of the industry and some of the key AAR initiatives for 2010, *Crossties* spoke with Ed Hamberger, AAR president/CEO.

Please discuss the significance of the rail industry in the nation's economy.

Key American industries—automotive, chemicals, mining, agriculture, and construction—all rely on efficient rail delivery of raw materials and/or finished products. Seventy percent of new automobiles make their first trip off the assembly line by train. Most of the coal that provides about half of the nation's electricity moves by rail. So do large quantities of grain and other food products. Even the contractors building our highway competitors rely on trains to deliver many of the materials they use. There's a rail connection to almost everything we use every day. U.S. manufacturers rely on rail to connect them to the ports that provide them access to markets worldwide.

With the economy struggling, how is the health of the nation's railroads?

Quite obviously, railroads have not been immune to the nation's economic problems. Freight traffic was off last year by more than 15 percent; intermodal slipped below 10 million units for the first time since 2003. Earnings took a major hit on all of the railroads. Yet because of the industry restructuring caused at least partially by the reforms brought about by the Staggers Act, railroads were able to respond quickly and

aggressively to the recession far more effectively than in past recessions. While recessions less severe than this led to bankruptcies in prior decades, nothing like that occurred this time.

What are AAR's expectations for traffic growth and infrastructure for 2010?

Our members do expect to see some improvement in traffic this year. However, I don't believe anyone expects volume to reach the levels we saw before the onset of the recession. That looks like it probably won't happen until 2011 or beyond. As to infrastructure spending, railroads maintained a high level in 2009, although about 10 percent lower than 2008. Still, 2009 was the third highest year of CAPEX (capital expenditures) on record. A number of capacity expansions continued to move forward, while some were put on hiatus until the economy improves. Long-term, I think railroads will continue to pour investment into infrastructure because we recognize that a strong infrastructure is essential to safe, efficient rail service.

Last year, we discussed your Cambridge Systems study that indicated about \$148 billion would have to be invested by 2035 in capacity expansion just to meet projected demand. Do the results of this study still ring true, especially with the economic challenges we've been faced with in 2009?

Long-term, I think the Cambridge study stands. Yes, 2009 was a recessionary year and it will take some time for traffic levels to return to prior levels. But the long-term outlook for rail remains very strong. The underpinnings of the Cambridge study haven't changed. The economy will resume growing as will the demand for freight rail service. Remember, freight rail volume almost doubled between 1980 and 2008, in spite

of the very serious recession of 1981-82 that saw a sharp decline in rail volume.

What additional issues will AAR focus on from a legislative perspective in 2010?

Obviously, the whole issue of preserving balanced regulation is of foremost importance. The Staggers Rail of 1980 led directly to the renaissance of the freight railroad industry. Any changes in that fundamental law must be considered very carefully so that we don't return to a situation in which railroads are unable to invest in service or capacity. As you know, in December, the Senate Commerce Committee reported legislation that would make changes in the Staggers Act. We have worked closely with Chairman Rockefeller and the committee to attempt to devise legislation that answers shipper concerns without affecting the railroad industry's ability to earn the money needed for future investment. We continue to have some concerns about the legislation, especially about a possible antitrust provision that has not yet been drafted. We will continue to be engaged with the committee as this legislation evolves.

We support expanded rail passenger service as long as it is done properly. As FRA Administrator Joe Szabo observed, the United States deserves a world-class passenger rail system, but not at the expense of what is already the world's best freight rail system. Rather, capacity needs to be expanded so that we can move both more freight and passengers by rail.

We also remain very interested in climate legislation and its potential impact



Hamberger

on the coal industry. Coal continues to provide about half of the nation's electricity. We believe it must remain an important part of the energy picture in the future. We have ample reserves of domestic coal, making it our most reliable energy source. We very strongly support clean coal initiatives and hope that the government will continue to fund programs to develop clean coal technology.

What used to be called the highway bill is also up for reauthorization. We support inclusion of an intermodal focus and support for projects of national significance such as the CREATE project in Chicago, which will benefit highway users, rail passengers and rail freight service. We continue to oppose efforts to increase truck sizes and weights which would result in larger indirect subsidies to trucks.

How would any push to re-regulate railroads impact railroad investment?

A total re-regulation would be devastating. Wall Street has said that capital would evaporate if anything like the system that existed prior to Staggers were re-imposed on railroads. Those who are working on proposed changes to the regulatory system say they want to avoid that. But we must be very careful that doesn't happen. As 19th century orator Wendell Phillips said, "Eternal vigilance is the price of liberty." We shall remain vigilant.

How will the newly enacted rail safety legislation affect the Class 1 railroads? What about Positive Train Control. Where will railroads find the money to invest in this mandate?

There is no doubt but that the safety legislation enacted in 2008 will increase costs for railroads, and not just because of the Positive Train Control (PTC) mandate. However, that is certainly the largest cost in the legislation. Estimates put the cost of implementation at

upwards of \$10 billion. This is in addition to the billions railroads must spend to maintain and upgrade their existing systems, not to mention the cost of capacity expansion. The Cambridge study put the gap between what railroads can invest in capacity expansion and what should be invested at more than \$50 billion. The PTC mandate could make it even more difficult to close that gap. We would hope that there might be some grants available to help cover those costs, particularly with respect to short lines and passenger rail. Also enactment of an infrastructure tax credit could help. But the fact remains that this places an additional challenge in front of railroads attempting to meet their capital requirements.

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We hear a lot about the Obama Administration wanting to develop alternative energy sources most notably to replace coal and other fossil fuel use. Do you expect an impact on railroad coal shipments, and if so when could this be felt and to what extent?

President Obama has also said he supports development of clean coal technology. This recognizes the fact that there are no viable alternatives to the continued use of coal as a critical element in our energy picture in the foreseeable future. We believe coal will remain a vital part of the railroad industry's traffic base for many years to come.

Last year, you told us that intermodal had been the fastest growing line of business even though it was buffeted by a slowdown in imports and a tough domestic shipping environment. Is intermodal still holding the top spot?

As a result of the recession and the sharp drop in consumer spending with its impact on imports, coal has reclaimed its historic spot as the railroad industry's number one source of revenue. Long-term, however, we continue to believe intermodal will be the industry's engine of growth and will at some point regain its spot as the industry's number one source of revenue. All of the conditions that led to the explosive growth of intermodal up until 2007—fuel efficiency, increased energy costs, highway congestion, mitigation of air pollution—remain. As the economy improves, we can expect intermodal to resume its growth as well.

Has AAR begun to model economic turnaround as it relates to products that are shipped by rail like automobiles and residential construction materials?

AAR does not do economic modeling of this sort. Our members do and so do the analysts who follow the industry. So they would be better able to

answer this. However, all indications are that the economy bottomed out last year and has begun to show some signs of growth. How long and how strong remains unanswered.

Is there any message you would like to send to members of the Railway Tie Association?

The big message is one of thanks—thanks for the work you do every day in ensuring that our rail network is safe and efficient through the quality products you provide. And, thanks also for the very strong support you provide the freight rail industry in Washington and in the states. Our industry depends on policies that will allow freight railroads to provide safe, efficient service. §