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The Rail/Ag Connection: An American Revival

By Joseph O'Reilly

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As U.S. growers and railroads embark on a new era of relevance, they are encountering new opportunities working together—and old grievances working apart.

Once upon a time, railroading and farming shared privileged company among the likes of Old Glory, baseball, and apple pie. Both were mainstays of life—artifacts of Americana—well before globalization and the “auto-nation” phenomenon radically changed the U.S. transportation and industrial landscape.

In the latter half of the 19th century, the U.S. railroad surfaced as a bridge linking rural farming communities with emerging urban centers. Accessible and expedient transportation created new domestic markets for local growers to sell in, especially as people migrated toward cities. Each supported the other and together they fed a growing population.

By the turn of the century, the railroad was figurative for U.S. industrialization. If the robber baron culture was impetuous and, at times, overly capitalistic, agriculture provided a balance weight. Farming remained the heart and soul of America, a reminder of its independence, self-subsistence, and work ethic.



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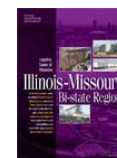
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Agriculture and railroading flourished as a pair. But they turned fallow together as well. For the better part of the 20th century, freight railroads were out-moded by trucks and small farms begat large agribusinesses that were increasingly marginalized by global competition.

Recently, however, both industries have experienced a revival of sorts. Domestic agriculture has been buoyed by a combination of forces: the growth of consuming countries around the world; greater concern over food safety; and a cultural foodie movement that is bringing fresh, locally grown food back into vogue. The railroad is also back in the ascendancy as transportation costs, capacity, and sustainability considerations increase the value of rail/intermodal solutions.

As U.S. growers and railroads embark on a new era of relevance, they are encountering new opportunities working together— and old grievances working apart.

“You can’t move a 1,000-acre farm 500 miles south. Nor can you move railroad tracks,” says Amy Homan, director of carload marketing for Iowa Northern, a shortline railroad based in Cedar Rapids, Iowa.

It’s a simple reality that speaks volumes. As growers and railroads explore new ways to expand their respective businesses and enhance products and services, they do so within basic constraints. Agriculture is held captive by climate and land, while Class I railroads and shortlines are confined to point-to-point transport networks. Given their shared restrictions, a mutual dependency has naturally coalesced over time.

“Shortlines engineer their services to match customer need —not the other way around.”

Amy Homan, director of carload marketing for Iowa Northern

RAILROAD-TIED BY SHARED CONSTRAINTS

For Monsanto, the St. Louis-based multinational agricultural biotechnology corporation, the railroad is an extension of its business.

“Rail has been an important part of our transportation plan for many years,” says Mark Baxa, global trade and compliance lead for Monsanto. “We use rail to accommodate intermodal ocean container movements to coastal ports as part of our U.S. export process for seed and crop protection products.”

More than 80 percent of Monsanto’s U.S. inland-containerized shipments to ocean ports are ferried by rail.

Dig a little deeper into U.S. grain commodities and the significance of rail transport becomes even more apparent. For example, the Soy Transportation Coalition’s 2010 annual study highlights the importance of the railroad system to soybean growers and soy product users. Among its findings:

- The largest Class I railroads transport 24 percent of the soybeans, 43 percent of the soybean meal, 67 percent of the soybean oil, and 99 percent of the biodiesel produced in the United States.
- Among the largest Class I railroads, revenue from transporting soybeans and soy products dropped two percent from the previous year— from \$1.5 billion in 2008 to \$1.47 billion in 2009. From 2006 to 2009, Class I railroad revenue increased from \$1.1 billion to \$1.47 billion.

“Our nation’s railroads are essential to the profitability of the soybean industry, and the soybean industry is essential to the profitability of railroads,” explains Dean Campbell, a farmer from Coulterville, Ill., and chairman of the Soy Transportation Coalition.

“Farmers acknowledge that railroads need to generate necessary revenues to maintain and enhance their infrastructure,” Campbell says. “Yet if rail transportation becomes too

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costly, farmer profitability and agricultural exports will be diminished.”

The rail/agriculture connection is not just about soybeans. Other grain exports continue to increase as developing countries grow. Farm products follow coal and chemicals as the third-largest commodity type moved by the railroads, accounting for 8.2 percent of tonnage and 9.2 percent of revenue, according to The Association of American Railroads.

If there is one salient fact illuminated by this data, it's that growers and railroads are benefiting from a boon in the agriculture industry. Expanding markets in Asia and other parts of the world are spiking export demand for U.S.-grown products. Interest in renewable energy sources— ethanol and other biofuels— has similarly granted agribusinesses a new economic lifeline and revenue stream.

But while railroads have interests in other industries— energy, construction, and intermodal, as examples— growers and agriculture users in rural areas are largely reliant on the rails to move product efficiently and economically. Absent railroad competition, pricing traction has become a contentious issue between shippers and carriers. And as both industries see new opportunities to grow, tension is building.

CONGRESS ON THE RAILS

In 2009, Senator Jay Rockefeller (D-W.Va.) introduced the Surface Transportation Board Reauthorization Act to the perked interest of all rail service providers and users. The terms of the legislation allow for the Surface Transportation Board (STB) to become an independent authority sanctioned to mediate disputes between railroads and shippers, as well as monitor operational performance on the tracks. It's a play to re-regulate the railroad industry, awakening echoes of President Grover Cleveland's Interstate Commerce Commission Act of 1877, a first attempt at reining in robber barons.

The proposed bill has drawn ire from railroads and praise from captive rail users. Carriers see government intervention as a step back in time that will negatively impact further investment in U.S. transportation infrastructure. Shippers, on the other hand, welcome oversight from the government to ensure their best interests are protected from arbitrary price increases.

With regards to railroad regulation, the Soy Transportation Coalition's contention is this: Between 2008 and 2009, rail revenues on a per-ton basis dropped five percent for soybeans. From 2007 to 2008 (the most recent data available), rail rates on a per-ton basis increased 16.7 percent for soybeans. More telling, 41 percent of rail movements of soybeans (9.89 million tons) are transported at rates the STB would classify as potentially excessive— resulting in a possible overcharge of \$110 million in 2008.

“The potential \$110-million overcharge by the railroads underscores the need for agricultural shippers to have a more accessible rate resolution process,” says Mike Steenhoek, executive director of the Soy Transportation Coalition.

The coalition, which comprises the United Soybean Board, the American Soybean Association, and nine state soybean boards, was established in 2007 to promote a cost-effective, reliable, and competitive transportation system that serves the agriculture industry.

“While many rail rates are justified, some are not,” Steenhoek says. “As a result, a significant amount of money is not being retained in farmers' wallets or in rural communities due to unreasonable rates.

“Creating an environment that encourages continued infrastructure investment by the rail industry, yet allows disaffected shippers to efficiently seek rate relief, is possible and should be the goal of everyone concerned with the future of U.S. agriculture,” he adds.

Steenhoek believes the new configuration of Congress following the 2010 elections will help the cause, and place pressure on railroads to be more transparent with regards to

pricing negotiations.

Railroads, for their part, have collectively voiced opposition to such oversight, while individually maintaining a lower profile on the issue. While it remains a fluid situation, most carriers are focusing on purposeful investments in services, equipment, and infrastructure as a means of deflecting any criticism.

If there is room for compromise between rail carriers and shippers, there are countless reasons why it should happen. U.S. railroads and agribusinesses share more things in common than not. As commodity producers and bulk volume transporters, their businesses fall in line like railroad ties on a long straightaway.

RAILROADING ON THE UP AND UP

One unique challenge both industries face today is the failing state of transportation infrastructure, especially in rural parts of the United States.

“Rural infrastructure receives scant attention. Unfortunately, we have a system of rural roads and bridges that is not equipped to handle the volume of production,” says Steenhoek. “Agriculture is a 21st-century industry relying on 1930s rural infrastructure.

“There is a stark contrast between the technology employed to produce and harvest agricultural products and much of the infrastructure responsible for delivering it to consumers,” he adds. “More is being asked of our rural infrastructure, while the revenue to support it has reached a plateau or is retreating.”

This failure also breeds unease for smaller growers that do not have the sophistication or resources to coordinate transportation and logistics solutions. It’s an imbalance that compels farmers to rely on bigger operations and cooperatives.

“The complexity of transportation poses a unique challenge for growers,” says Homan. “Most are realizing that the agribusiness typically can piece together the transportation puzzle more efficiently than they can as individual growers, giving them more time to concentrate on developing their core business.”

FINDING COMMON GROUND

As a consequence of these shortcomings, shippers have had to rely on transportation and logistics partners— railroads, shortlines, trucks, and inland river barges— to fill in the gaps. This is where collaboration among shippers and carriers has moved past the current pricing impasse, a hopeful sign that both sides will eventually find common ground.

“Historically, in rural areas, the railroad was the main connection point,” says Paul Hammes, vice president and general manager of agricultural products for Union Pacific.

“The agriculture industry started out as a collective of many smaller growers. Over time, these operations consolidated and became more concentrated in terms of farming specialization,” he says. “The railroads adapted to this change. For example, Union Pacific started running larger trains to processing facilities. We began using 110-car grain shuttles to go point to point and meet demand.”

One obstacle railroads face transporting grains in a heavily skewed export market is that it’s a one-way move; with an imbalance of freight moving inbound and outbound. This creates problems in terms of positioning railcars and containers.

Union Pacific recently launched a plant-to-port transportation and transload service offering agricultural product transfers from covered hopper unit trains directly to containers at its Yermo, Calif., facility. The service includes double-stacked intermodal trains serving the ports of Los Angeles and Long Beach. Union Pacific provides door-to-door supply chain logistics services— including real-time product tracking, direct ocean carrier contact, and transload management— to help shippers manage a single freight movement through the carrier with one point of contact.

“The service is a response to increasing agriculture export demand. Shippers need access to more containers. So we’re moving product to where equipment is,” says Hammes.

From a historical perspective, this attention to detail is not foreign to the railroad industry. In 1980, before the Staggers Act deregulated the industry, more than 40 Class I railroads were operating. Today there are seven. Contraction created greater economies of scale at the expense of denigrating service— a criticism the railroads have endured for 30 years.

While railroad consolidation has created a monopoly of primary U.S. and Canadian east and west coast carriers that overlap in the Midwest, a wealth of functioning shortlines still cater to the demands of farmers and agriculture users.

Iowa Northern Railroad, for example, maintains close ties to both growers and processors, providing an efficient and cost-effective method for moving goods to market. Agribusiness makes up a large portion of the railroad business in general, but it’s the backbone of Iowa Northern’s operation.

“Shortlines engineer their services to match customer need— not the other way around,” says Homan. “This becomes invaluable to growers and co-ops during harvest time, when the goal is to get crops out of the field and in the market as quickly as possible, allowing farmers to concentrate on their land.”

Compared to Class I railroads, shortlines are more adaptable and can cater to specific customer needs. Often they are the first and last mile in a captive rail shipper’s supply chain, so flexibility and attentiveness to detail is critical.

One example of Iowa Northern’s flexibility is its capacity to serve one grain elevator twice in a single day so that a shipper can keep loading cars and maintain clear space at the production point. Class I’s can provide that service as well, but it doesn’t always fit into their operational or financial models.

FIELDS OF OPPORTUNITY

Pricing and regulatory issues notwithstanding, U.S. railroads and agribusinesses are primed for a new period of growth as both industries see opportunities to expand and strengthen positions in their respective markets.

The agriculture sector is the beneficiary of promising new export markets where demand for U.S.-grown crops continues to build.

For example, in 2010, U.S. soybean exports as a percent of production was forecast at 48 percent. In 2006, it was 35 percent. China remains the top export market for soybean product, sourcing 826 million bushels in 2010, followed by Mexico (120 million bushels), and the European Union (100 million bushels). Growers see similar positive forecasts for other grain types such as corn and wheat.

On the rail side, prospects are equally positive. What carriers lack in convenience they more than make up for in energy efficiency and cost. And with capacity issues an increasing concern for shippers across all industries, the growing efficacy of intermodal has railroads on track for greater success.

In the crop chain, intermodal transport touches every mode apart from air. Shipments are moving in bulk volumes from remote locations. From truck-to-rail transloading ramps to barge transfers at river ports, shippers rely on railroads to make these transitions as seamless as possible.

“Most agriculture products are heavy bulk, so shipping via railcar is much more economical than container. More services are being directed toward carload than container,” explains Hammes. “As far as intermodal, we are working to cross-sell with the agriculture group to make that service product available to shippers.”

Of late, railroads have been investing capital in spades, expanding track and port

capacity to handle agriculture exports to Asia as well as intermodal import traffic. Apart from its transload facility in Yermo, Union Pacific is collaborating with BNSF on opening a new facility at the Port of Long Beach. BNSF also has plans for a transload facility in Amarillo that will cater to agriculture shipments.

These investments appear to be reaping some dividend among agriculture users. The Soy Transportation Coalition released its second-annual railroad report card in May 2011. Agricultural shippers were asked to rate carriers in three areas— on-time performance, customer service, and costs. Union Pacific received the highest rating, followed by BNSF, which topped the list in 2010. On average, respondents gave railroads a 10-percent higher score than in 2010.

One interesting footnote is that survey respondents report having an average of 1.4 options for rail service— including shortline and regional railroads— at individual shipping locations. Without competition for service, rail shippers by and large still remain captive in terms of alternatives.

For railroads, infrastructure expansion and service upgrades are means to help mollify shipper concerns over rate increases. As in other areas of the supply chain, if service providers can bundle more value into their product and provide an acceptable level of service, pricing becomes less of an issue.

Railroads are well aware of the cost vs. service dynamic, and increasingly recognize that helping agriculture customers is in their best interest. Everything they do to support export trade in terms of investing in infrastructure and facilities only expands their value to importers, especially from an intermodal perspective. Having balance in a transportation industry that is dependent on commodity cycles is important.

“This industry is very cyclical, with variations in production and sourcing locations on any given day. There is variability in terms of demand, as well as world climates,” says Hammes. “We must be flexible and ultimately stick close to the customer.”



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