Pricing Behavior in the U.S Railroad Industry: Lessons for South Africa. *

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ABSTRACT (558 words**)**

Goods and services worth billions of rands are traded each year, both within South Africa (SA) and within the Southern African Development Community (SADC). The rail industry is one of the most import player in the transportation of these goods. Transport costs comprise a significant portion of delivered prices of these goods and this has an important bearing on the welfare/economic empowerment, not only of SA but also of the whole Southern Africa region. The South African rail industry is undergoing a restructuring process. Spoornet, the largest player in the rail industry, whose rail infrastructure represents some 80% of Africa's rail infrastructure, is being restructured - an issue which has generated growing controversy lately.

The most important highlights of rail industry restructuring process was in 1990 when Transnet was created as a result of government policy to commercialize its transport business and to de-regulate the transport industry in SA. The Department of Public Enterprises is awaiting Spoornet restructuring report. Further restructuring of Spoornet is necessitated by its financial underperfomance, which has seen its market share reduced by road transportation (trucks). This market share reduction is a course for concern, as it is known that rail transportation possesses a comparative cost advantage over trucking, particularly over long distances. This should even be more serious in view of the continued escalating fuel prices.

In comparison, the United States (US) rail industry's restructuring / deregulation was completed in 1980. This was brought about by the realization that the distortionery regulatory constraints were adversely impacting on the financial performance of the industry. Thus deregulation was aimed, in part, at giving railroads more freedom in improving their financial performance and increasing the level of competition in the industry - which in turn should results in lower transport rates for consumers. The question then is: What can South African rail industry learn from US experiences?

In this paper I do not look at the whole deregulation process in the US rail industry, instead I look at how such a process affected the pricing behavior of railroad firms and see what SA can learn from that. Specifically, I analyze pricing behavior of railroads in the coal transportation market in the US, with special reference to the transportation of coal to electric utilities.

Railroads' cost data from the annual Analysis of the Class I Railroads, published by the Association American Railroads (AAR) are collected, and so are electric utilities' contract coal data from Coal Transportation Rate Database (CTRBD) published by the US Energy Information Administration (EIA).

Using AAR data, parameters of a railroad's translog cost model are estimated. From the estimated model, marginal cost of hauling coal is determined. Together with the CTRDB rate/price data, the magnitude of price-cost margins, as well as market power indices are computed and examined. These market power indices are found to be consistent with non-competitive behavior, suggesting failure of deregulation in bringing competition into the industry.

In order to understand the determinants of this non-competitive behavior, several factors (variables) are discussed. Further econometric analyses are performed on the impact of these factors on price-cost margins. This analysis provides bases for some policy recommendations. I find that there are very important lessons that South Africa can learn from US rail deregulation. These lessons are important not only to the rail industry in South Africa but also to other industries undergoing restructuring.