The Daily Dish

Regulatory Challenges

DOUGLAS HOLTZ-EAKIN | JULY 13, 2020

Eakinomics: Regulatory Challenges

The Trump Administration's approach to regulation has provided some significant policy advances. Notably, its use of "regulatory budgets" – literally limits on the amount of additional burden an agency can impose on the private sector – has permitted sharp controls, and even reductions, in the overall regulatory burden. (Recently, however, even this progress seems to have slowed.) The ability to offset regulatory costs by eliminating old and outmoded rules has yielded a more coherent regulatory apparatus. There is no reason to turn back on these advances.

Yet there is nothing about this apparatus that applies to the independent agencies and there are no guarantees that their new rules will make economic sense. Indeed, AAF's Dan Bosch recently documented two regulatory missteps. The Surface Transportation Board's (STB's) attempt to increase the number of shippers that can challenge freight railroad rates would tilt the playing field against railroads and hurt their ability to make the investments to improve technology. Similarly, the Federal Energy Regulatory Commission (FERC) sought to deal with state-subsidized electricity production, with the result that government intervention increases and will naturally end up reverting to a cost-of-service model that disincentivizes innovation.

Consider the STB. With railroad partial deregulation in the 1970s and 1980s, the STB was given the authority to litigate rate complaints and award relief where appropriate, but in the decades since few shippers challenged rates. A recent report from a Rate Reform Task Force pinned this fact on the time and expense of bringing challenges. In response, the STB proposed a rule for Final Offer Rate Review – essentially baseball-style arbitration in which the STB first does due diligence on an expedited timetable and then chooses between the rates offered by the railroad and the shipper.

While this might be cheaper and quicker for the shippers, it is biased against the railroads in three ways. First, shippers have little to lose. The worst-case scenario is that the STB sides with the railroad, and they could gain substantially. This suggests that multiple shippers may be contesting any single rate and draining resources from the railroad as it defends its rates.

Second, by law, there is greater scrutiny on the reasonableness of the railroad's "offer" than the shipper's. According to Bosch: "During deliberations, the STB needs to determine whether the railroad's proposed rate is reasonable. If it is not, even by a small margin, then the STB is to side with shipper's proposed rate nearly regardless of how small it may be." There is a real downside risk to revenue.

The third tilt of the playing field comes from defending rates on the expedited timetable. A shipper can take as long as it likes to prepare a challenge, while the railroad has to do its market dominance analysis and rate reasonableness defense on the expedited timetable. This makes it more likely that shippers win.

In each case, it is likely that railroads would lose revenue, with the consequence of inhibiting their ability to invest in upgrades and innovations. The moral is simple – in making new rules it is just as important to interfere as little as necessary in market functioning as it is to keep the overall burden low.