

Grain Transportation

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May I add my welcome to those that you received from the others participating in this conference.

You have heard a great deal about the various functions of the Board of Trade. You will hear some more today, but the thing that ties all these functions together is transportation.

My particular field is not so much concerned with the physical movement of the commodity, but rather the rates upon which this grain moves, the relationship of freight rates, one market versus another, one processing plant versus another, and particularly the rules and regulations under which these rates are set up, the laws, if you please.

We had quite a bit of excitement earlier this year with proposed changes in the Interstate Commerce Act. Many of the grain exchanges, as well as other people affected, were thrown into politics for the first time on transportation because of the tremendous excitement that these new changes in transportation laws generated and the effects of proposed laws upon the movement of grain and the other commodities, what they could or could not do, making or breaking markets, changing the marketplaces for a producer, etc.

I want to devote a little time this morning to the movement of grain under these various basic freight rate structures we operate under, and the changes that are taking place. It is quite a dynamic field at the present time.

We have within the grain-growing area—roughly east of the Rocky Mountains and up to about the center of Ohio—somewhere between fifteen and seventeen thousand places where grain can be loaded into a rail freight car. Our problem is to move this grain from those multitude of origins to the

terminal elevator facilities, sub-terminal elevator facilities, then to the processing plants, and ultimately to the consumer.

From a transportation standpoint grain is quite a peculiar commodity, in that you have many origin places and many destinations. It has some peculiarities and demands such as the ability for grain in a terminal warehouse to compete pricewise with grain that is yet to be sold from a farm. We have situations where different grains have different transportation demands upon them. Wheat, for example, is primarily milled into flour, flour going into the commercial bread bakeries. Different wheats must be taken from different sections of the country and milled and blended into flours to meet the production schedules in a commercial bread bakery.

Contrasted to that, you have corn which can be used either in a food product, a commercial product such as foundry flours or core binders. Or it can be fed directly to the animals, which is actually the prime use of corn.

Soybeans present still another problem in that they, too, must be processed before the ultimate products can be used.

How to take all these various different demands and set up a transportation schedule or system of rates is very complex, but actually it can be broken down into a relatively simple proposition.

I would like to deal with the rail features of these rate structures, mainly because the railroads are really the backbone of our transportation system.

Grain, of course, moves in large volume over inland waterways, St. Lawrence Seaway, and intercoastal canals; it moves in tremendous volumes in trucks, but the rails still are the backbone of our transportation industry.

The railroads have been under regulation since 1887, with the original act to regulate commerce, now called the Interstate Commerce Act. This Act governs every movement that the rail carriers can make, from the spending of their money in many respects to almost the phone calls that go out of an office.

The Interstate Commerce Act insofar as we are concerned sets up the rules and regulations under which the railroads operate and sets up the freight rate schedules. First of all, it says that rates must be reasonable and proper. They must be nondiscriminatory, nonpreferential, nonprejudicial. They don't define reasonable and proper, so we have what we term a zone of reasonableness.

The upper level of the zone of reasonableness is what the traffic will bear and the lower level generally sinks down to out-of-pockets costs.

The Interstate Commerce Commission has the power to prescribe what a particular railroad freight rate might be, but only after investigation. One of the peculiarities is the Commission cannot prescribe rates so low that they may be confiscatory. Yet, a railroad can establish freight rates lower than what the Commission can prescribe, the theory being that you can give your property away but nobody can take your property away without due compensation.

Railroads' rate charges and practices are filed in what we term tariffs. They are all of a uniform size. Rules and regulations prescribe exactly what they contain and how they are to be published. Normally, a freight rate which has been published must be on file with the Commission for thirty days before it becomes effective. There are certain exceptions to that, but that is what we know as the statutory notice period.

During that thirty days, the shipping public, other railroads and competing carriers, have an opportunity to examine those tariffs and to see if they are to their liking. Twelve days before the effective date anybody who wishes to object to those schedules can file a formal petition with the Commission asking for suspension and investigation of those rates. There are thousands of such petitions filed each year. The Commission has had such a tremendous barrage of criticism and complaint within the last few years that it is very touchy and very choosy about the freight rate schedules that it will suspend.

Rates filed in one of these tariffs have the effect of a statute—it is law. For example, the rate in a tariff may be published in error. Whether it is published in error or not, it is the only rate that the railroad may charge for a given service.

Now, let us look at our freight rate structure and I would like to get into a little terminology, if I may.

We have basically two systems of freight rates. One is constructed on mileage. In other words, after certain basic costs are figured into the freight rates, such as, say, ten cents to take care of your terminal cost, a graph of the mileage rate structure would show a straight, rising line. For each mile you pay relatively the same unit charge.

We have another system of rates which tends to ignore distance as a rate-making factor. They are rates which are published from large areas to large areas.

For example, in the State of Illinois there is one large grain rate area or group that extends from St. Louis clear over to the Illinois-Indiana state line and roughly along the lines of the L & N Railroad clear up to the Wisconsin border. From this one enormous grain rate group, rates are published to large destination groups, some even greater than the entire state of Maine. So there are big groups on the origin end and big groups on the destination end, and freight rates apply equally from all points within the groups.

There has been a lot of criticism of the group adjustments, notably, and very recently by the New York Central RR, saying that group adjustments are basically unfair because a person at the extreme distance selling to a person at the other extreme has the same rate as one located at the closest point selling to a person at the near edge of the destination group. Either the latter person is being overcharged or the first one is being undercharged for the services that the railroad performs.

I might digress here for a moment. There is one other point I want to cover before going into these freight rates. Let's take a look at the grain markets. The principal grain markets outside of the interior sub-terminal elevators in

Kansas, Oklahoma and Texas are located at points at which there is navigable water, starting with Buffalo, Toledo, Duluth-Superior, Milwaukee, Chicago, the Twin Cities, St. Louis, Peoria, Kansas City, and the other markets along the Missouri River.

In the early founding of our country, of course, water was the form of transportation. Water not only had the ease of physical movement of transportation, but it was also the low-cost way of moving grain.

I saw a reference the other day in one of our historical publications to the effect that in the early days the proceeds from the sale of a wagonload of wheat hauled sixty miles or so were taken up or eaten up by the wear and tear on the team and the wagon and the wages of the driver.

Where water was present as the form of transportation, it also was a barrier to the construction of the railroads in these early days. For example, you have a system of railroads starting from the east and running as far as Buffalo. You had other systems of railroads running from Buffalo and Pittsburgh west until they ran into some more of these natural barriers, such as your Illinois River or the Mississippi River. Then there are other such systems of railroads that start at Chicago and work west to the Missouri River and also systems of railroads that started at the Missouri River and worked westward from there.

These natural barriers caused railroads in these various areas to join together in sort of trade associations. As a result, to this day we have these various associations that have jurisdiction over the freight rates within a given area.

Now, some more terminology. If we have a rate from Point A to Point B, in our grain rate structure we call that a flat rate. We may have other rates that would apply from Point A to Point B, but they are conditioned upon a prior transportation service either into Point A or beyond Point B or both. We term that a proportional rate. It is in a sense a proportion of a rate.

For example, the granddaddy of all rates, a proportional rate from Chicago to New York City, is conditioned upon a prior movement into Chicago either by water or by rail. We have other types of proportional rates that are dependent upon a movement beyond Point B. For example, one would be an export rate, only for movement beyond the port of exportation.

We combine these two types of rates in our basic grain rate structures. We also introduce a third factor into the grain rate structure, and that is transit. Transit is the stopping at some point along a route for some special service, and ignoring from a rate standpoint the fact that it has been stopped.

In all forms of pricing you have certain basic costs. With respect to the railroads the real important costs are the terminal costs. Moving from Point A to Point B via Point C here, we may have the terminal costs which would produce a rate of 75¢ from A to C and 75¢ from C to B, and yet a rate from A to B may be \$1.25, or less than the combination of those two factors. Transit ignores the cost of this terminal operation for a stop at Point C and permits not a charge of two seventy-five cent rates, but a rate of \$1.25 for the entire service.

There has been a lot of criticism of that particular form of service very recently. Once again, the rates which include transit have to be artificially increased to cover transit services. In many cases the cost of giving that service is so great that the railroads can't meet the competition from other forms of transportation, so there is a trend to eliminate transit.

But in our basic grain rate structures, we operate under transit rates, combined with our two basic freight rates.

Now, let's see how this works for moving grain out of Kansas into New York City, as an example, and milling in transit.

First of all, into a marketplace such as Kansas City we have rates which we know as gathering rates. These are flat rates into a marketplace. A price is set at the Kansas City market and that price is related back to a country elevator by subtracting these known rail freight rates. In other words, the price of grain may be a dollar in Kansas City. If the rate is ten cents, the price of grain would be ninety cents at the origin point. Around all marketplaces are these systems of gathering rates into the market.

Then from markets such as Kansas City we have a proportional rate to Chicago. If grain moves into Kansas City and is consumed there, the price of ten cents may be charged; if it moves on beyond to Chicago they will charge another thirty-three cents a hundredweight. If the grain stops in Chicago, it will be charged the total of ten cents plus thirty-three cents; if it moves on from Chicago, another charge is added.

Our freight rate structure basically is broken down into a number of segments. These are so adjusted that you can move via a variety of routes to your final destination, all on equal charges.

For example, the proportional rate from Kansas City to Chicago is thirty-three cents.

At the same time we will have a proportional rate from Kansas City to St. Louis of twenty-five and a half cents. These rates reflect relative distances and also competition of water transportation.

Beyond Chicago and St. Louis to the same destination, the rates will be adjusted to compensate for the seven and one-half cent spread between the first two rate segments. So from Chicago to New York City there will be a fifty-five and a half cent rate, while the rate from St. Louis will be seven cents higher, sixty-three cents. Through Peoria we will have another equalized combination of rates.

But moving from Kansas City to New York City you have the same thru charges by a variety of routes, all these various factors being adjusted to produce equal charges from the fields of Kansas into the New York area.

This is what we term the so-called rate break system of making rates on grain, with complete equalization. A rate break system with equalization.

And then when you throw in transit, which permits a miller of wheat, for example, located someplace between Kansas City and Chicago, to mill on this thirty-three cent rate and to compete with a mill located at Kansas City or a mill located at Chicago for the sale of flour in Chicago. They all pay the same charges by virtue of this milling in transit system.

From Illinois origins we have a system of gathering rates into Chicago which works in combination with a proportional rate beyond Chicago. This permits flexibility in marketing grain; it is a system of rates which meets the demand on grain transportation, once again referring to the fact that grain being sold at the farm must compete with grain at a terminal.

It permits grain in a wet harvest to come into a terminal market for storage and conditioning, then be moved out. It also sets up orderly marketing of grain. It allows, as I said, mills to be located virtually at thousands of different places between a point in the country and the final destination of the product to be consumed.

The rate break system of rates with equalization. There are other proportional rates that move beyond St. Louis into the southeast, or proportional rates moving beyond Kansas City down for export.

Now, this particular system has many drawbacks, as well as advantages. One is that some of these segments may be artificially increased to make these patterns work out.

I had an interesting experience when I was with the Chicago and Eastern Illinois Railroad. The railroad serves basically the State of Illinois, with routes down into Evansville and St. Louis. Take a point such as Danville. Going into Evansville may have been around 150 miles, while from Danville into St. Louis it may have been close to 200 miles.

Now, under equalization of freight rates into the southeast, the rate from Danville to Evansville, was about seven cents higher than the rate from Danville to St. Louis, even in face of these distances. That would allow truckers to move grain from Danville to Evansville, where there are barge loading stations, under what you might term the protection of an umbrella. By rail, it may have cost thirty cents to move grain between these two points. The trucks could do it for fifteen cents and they were doing it. So we had a tremendous amount of trucking from this interior point in Illinois down to the Ohio River, where it would be put on a barge and either moved to export or down the Tennessee River system.

This is one of the drawbacks of this rate break system. You do have these rates which are artificially inflated to take care of equalization. Trucks can go in and literally capture all the traffic that there is to be hauled.

Just prior to my joining the C & E I Railroad, I established one of the barge loading stations on the river, so I knew this situation very well.

Now, that in its very simplicity is the basic structure of freight rates by which grain from the country moves into the consuming areas. It is a beautiful system on paper, but, in today's modern times with the extreme competition

in the movement of grain—with the man with the back of an envelope and a sharp pencil trying to figure ways to beat the system, with costs built into rates to accommodate special services, with the artificial inflating of a particular segment of rate to create equalization—railroads have been faced with some extremely heavy competition by trucking and waterborne transportation.

The railroads have been under regulation, as I said, since 1887. In 1935 the Interstate Commerce Act was amended to include motor carriers, but Congress left several loopholes in the law. One was the so-called agricultural exemption. Grain or any basic agricultural product which is hauled by a truck firm is completely devoid of any regulation, other than the safety of operation. This permits anyone to purchase a truck and go into the business of grain transportation without any rules or regulations at all. You don't have to file the fancy, expensive tariffs. You can charge one rate to one man and another rate to a different party for the same service.

In 1940 the Interstate Commerce Act was again amended by putting in a third part of the Act, and that was to cover the movement of products and commodities by water.

Once again, Congress had loopholes or exceptions to the Act in the so-called bulk commodity exemptions. A barge line can haul up to three bulk commodities in a single vessel or in a single tow and move those over the inland waterways of the United States completely devoid of any regulation outside of the safety regulations and the Coast Guard. This presents some real problems to the railroad carriers, in that the two major competing forms of transportation operate under a different set of rules than the railroads.

What to do about it? The railroads have had a difficult time operating under these handicaps. This has been accentuated in the post-World War II years, by virtue of the fact that their operating costs have gone up, and they have had to increase their freight rates accordingly. Every time the railroads have increased rates to satisfy the increased cost of doing business, it has created more of these so-called umbrella situations under which competing truck and barge lines have operated.

Very recently and a new form of competition has been the opening of the St. Lawrence Seaway. In 1959 the Seaway became a fact and it has literally affected the freight rates of the railroads throughout the entire nation. Here we have this all-water route from the very heart of the grain producing area to the European markets. You have a system of rail carriers that parallels this all-water route, and that normally would carry grain to the east coast.

The railroads were quick to react to the Seaway. For example, the freight rates from Central Illinois to the North Atlantic ports for export on soybeans were reduced from 72¢ to 38¢ a hundredweight. We have had similar reductions in the other grains.

Then to meet the effects of the St. Lawrence Seaway we have had rate reductions from Illinois down to the Gulf ports. We have even had freight rates proposed from Montana down to the Gulf ports to meet the competition of the St. Lawrence Seaway. We have had a lot of talk about the St. Lawrence

Seaway not paying its way. It has paid its way in freight rate reductions on the railroads by themselves.

That is literally true.

When a railroad will cut a freight rate from 72¢ down to 38¢, that is a tremendous reduction. When you consider that you are affecting all of this prime growing area in the movement of grains to the North Atlantic ports for export versus coming through Chicago or Toledo, there has been a tremendous savings to the producer and has been a tremendous factor in letting our grains go out for export.

The competition from the waterways has opened up the south. The Tennessee River System permits an all-water route into the Chattanooga-Decatur-Alabama area. It has opened up entirely new industries in the southeast.

One of the major changes to take place in rail rates has received much publicity in the press recently. I speak of the Big John cars of the Southern Railroad, where they have really slashed rates some sixty, seventy percent in some instances from St. Louis and points along the Ohio River into the southeast. The rails talk about their new and improved technology, the breakthrough in new equipment. Unfortunately, the technology that they have applied in reducing the grain rates does not apply in reducing the rates on products, so that you still have tremendously high rates on flour, for example, from Kansas City into the southeast and very, very extremely low rates on wheat from the Mississippi and Ohio crossings into the southeast.

The technology is there to be sure, but it is and has been brought about through competition of this all-water movement.

Now, how do freight rates affect the Board of Trade? We, for the first part, must have free movement so a tremendous supply of the grains can be brought to and from this market. Grain in store with rail billing behind it is the basis of the futures contracts. In other words, since there is a firm commitment to deliver, there must be some grain behind that futures contract, and in order to have grain behind the futures contracts you must have a system of rates which will bring grain into this market and also a system of rates that permit grain to move from this market.

Secondly, freight rates affect a futures market such as this in that you have known relationships, one point versus another. Those known relationships are very necessary in order for a hedger to be able to determine what his position is relative to the Chicago market at all times.

Those two factors caused us the greatest concern over the Congressional attempt to change the Interstate Commerce Act earlier this year. I have given you a few examples of the rules under which the railroads have operated as compared to the no-rules or very limited rules that the truck lines and the barge lines operate under. In our system of doing things, this is basically unfair. We want to treat everybody equally.

Chairman Harris of the Committee of the House Interstate and Foreign Commerce Committee, introduced legislation this year which, among other

things, would have removed all Interstate Commerce Commission authority over the rail carriers in the carriage of agricultural products. This would have permitted the railroads to charge different rates, just as a trucking operation charges different rates.

In spite of the tremendous competitive pressures of the rail and water operations, we could see just chaos in the marketing of grain by these changes. Literally, it could put a country elevator operator out of business overnight.

I will give you a few examples.

This is a map of the State of Illinois. On it we have all of the elevators in the State of Illinois. We have color-coded this because the rail and water pattern is what we like to term up in our department a can of worms. We have three basic systems of rail carriers operating within the state.

You have, first, a system of carriers that comes in from the west and terminates at Chicago, such as the Chicago and Northwestern Railroad, the Burlington, the Rock Island. We have another system of rail carriers that comes in from the south and terminates at Chicago, such as the Illinois Central and the C & E I, the G M & C. We have a third system of rail carriers that moves from Illinois directly east and that is represented by the Pennsylvania Railroad, the Nickel Plate, New York Central to some extent.

These are carriers which do not directly serve Chicago, except through extremely circuitous routes coming around through the State of Indiana.

Now, there are situations in the State of Illinois where you have an elevator located on the B & O, which is just a few miles from an elevator located on the Illinois Central, the B & O not serving Chicago directly while the Illinois Central does. There are farmers located midpoint between the two that have the option of carrying grain this direction to the B & O or this direction over to the Illinois Central Railroad.

Under the law as it was proposed the railroads would not have to file their tariffs, they would just have to file a memorandum of rates; not thirty days before the movement took place, but thirty days after the movement took place. We would throw in immediately the uncertainty of unknown transportation charges. In other words, in addition to speculating on the weather and drought conditions, you would be speculating in freight rates.

The B & O may have been able to put in some rates which would draw grain directly east, and the poor guy sitting over at the Illinois Central, not knowing about that rate going in for some thirty days, would be wondering where his business went.

We have two situations up here in Chicago, one that we are currently litigating before the Commission. It concerns freight rates on soybeans from points in south central Illinois to the Gulf ports for export—those rates are lower than they are to Chicago for export, notwithstanding the fact that the distance to New Orleans is three to four times as great as to Chicago.

We have a situation up here in Chicago proper where, for example, a carrier such as the Illinois Central Railroad does not serve the elevators located on what we term deep water. They have to turn the traffic over to a connecting switching carrier in Chicago in order to reach these elevators. For a carload of grain the average charge is somewhere around fifteen dollars; for a carload of soybeans it is up around fifty-five dollars.

How do you justify that? Under the present laws we have a tribunal to which we go to complain. Under the law as it was proposed earlier this year we would have had no recourse, we would have had no place to go to complain or to tell our story.

We are currently fighting a system of rates from Indiana origins. Indiana is one of the four top producing corn states in the nation. We are facing and fighting freight rates from Indiana origins which the railroads have published to become effective September 25th of this year to North Atlantic ports, rates which are at or near the railroads' out-of-pocket cost and which were put in to meet the competition of the St. Lawrence Seaway.

That is very laudible, but it presents situations at points within a hundred miles of Chicago, where the rates are higher to Chicago than they will be to the North Atlantic ports. Without the present law we would have no place to go to complain. You can multiply those situations a hundredfold.

So, an elevator or a small businessman could be very easily put out of business overnight.