

ASLRRR Economic Impact Report Reveals Short Lines' Contribution To Economy

Editor's Note: RTA was actively involved in assisting ASLRRR to secure and vet the economic research on the impact of tie purchases occurring before and after enactment of the Section 45G tax credit. RTA's contribution to the report is noted within. For a full copy of the report, log onto ASLRRR.org>News.

The American Short Line and Regional Railroad Association (ASLRRR) in July released an economic impact report.

Prepared by the professional services firm PricewaterhouseCoopers LLP (PwC), the report demonstrates that the short line industry, composed of 603 Class II and III railroads, provides significant contributions to the U.S. economy:

- The total direct, indirect, and induced impact of the 603 small business short line railroads is 61,070 jobs, \$3.8 billion in labor income, and \$6.5 billion in value added to the U.S. economy in 2016.
- Industries reliant on short line transportation services provided 478,820 jobs, \$26.1 billion in labor income, and \$56.2 billion in value added to the U.S. economy in 2016.

In addition, the report looked at the investment impact of the Short Line Tax Credit (also known by its tax code reference, 45G), which

Short line customers add \$56.2 billion to the nation's economy and provide 478,000 jobs

expired Dec. 31, 2017, and has been a critical investment vehicle for short line railroads since its inception in 2004.

Since the Short Line Tax Credit has been in place, derailments have declined by 50 percent due to the infrastructure investment in ties and better rail. Extension of the credit is estimated to drive a 63 percent reduction in the cost of capital, which provides a strong incentive to continue to increase investment in short line infrastructure.

Finally, the report compares the benefit of the Short Line Tax Credit to the benefit of



The engineer of a Farmrail train positions freight cars (grain hoppers) for loading at a large grain elevator in Oklahoma. Farmrail System Inc. is an employee-owned holding company for two Class III common-carrier railroads comprising "Western Oklahoma's Regional Railroad."

the Tax Cuts and Jobs Act in this industry. The report shows that the Short Line Tax Credit provides a significantly more compelling increase in investment.

ASLRRR is calling for Congress to make the Short Line Tax Credit permanent. The report's Executive Summary follows:

Industry Overview

The U.S. short line and regional railroad industry (short line industry) consists of the nation's smallest freight railroads by revenue, defined according to the U.S. Surface Transportation Board as Class II or III railroads with freight revenue of less than \$475.75 million in 2016. There are an estimated 603 short line railroads as of 2016. The average short line railroad employs fewer than 30 people and operates less than

79 route miles. Combined, short lines operate 47,500 route miles, or 29 percent of the nation's rail network, extending the reach of the rail network to rural communities, farmers, manufacturers, and other industries.¹ Short lines, together with the seven Class I railroads (those with freight revenue of at least \$475.75 million), constitute the U.S. freight railroad industry.

Economic Contribution Of The Industry

PwC estimates the short line industry directly provided 17,100 jobs in the United States in 2016, paying labor income of \$1.1 billion and adding \$2.2 billion to the nation's GDP (see Table E-1). The short line industry's economic impact goes beyond its own employees and direct payroll and

Item	Direct impacts	Indirect and induced impacts		Combined Impacts
		Operational Impacts	Capital Investment Impacts	
Employment*	17,100	33,730	10,240	61,070
Labor Income (\$ millions)**	\$1,129	\$2,035	\$616	\$3,780
Value Added (\$ millions)	\$2,228	\$3,373	\$948	\$6,549

Source: PwC calculations using the IMPLAN modeling system (2016 database). Note: Details may not add to totals due to rounding. *Employment is defined as the number of payroll and self-employed jobs, including part-time jobs. **Labor income is defined as wages and salaries and benefits as well as proprietors' income.

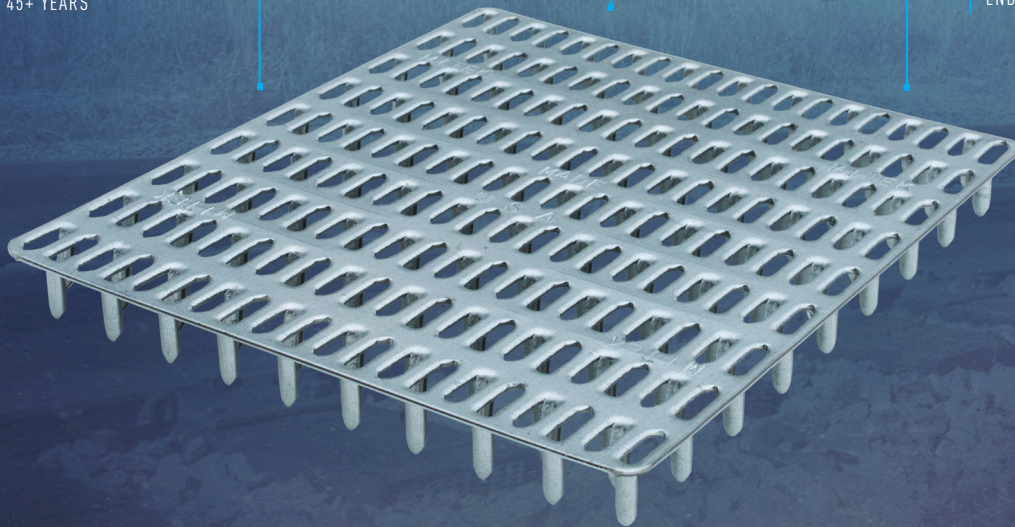
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value added. Including the indirect effects resulting from suppliers to the industry and induced effects resulting from expenditures of labor income, the industry supported 61,070 jobs in 2016. Operational spending by the industry supported 33,730 indirect and induced jobs in 2016, while capital spending by the industry of \$755 million supported 10,240 jobs. This indicates that each job in the short line industry supports an average of 2.6 additional indirect and induced jobs across the rest of the economy (combined jobs to direct jobs multiplier of 3.6). Combined labor income amounted to \$3.8 billion (labor income multiplier of 3.3), and value added amounted to \$6.5 billion (value added multiplier of 2.9).

The Section 45G Tax Credit

Since its enactment in 2004, the railroad track maintenance tax credit (Internal Revenue Code section 45G) has provided an important financial incentive to maintain and improve short line infrastructure. The result has been a marked increase in industry investment, as evidenced by industry purchases of railway ties, which have grown at an annual rate of 6.3 percent since enactment of the credit, compared to 0.1 percent before the credit (see Figure E-1). In addition, safety on short line railroads has improved since enactment of the credit. For example, train derailments on short line railroads have declined by 50 percent, from a rate of 4.72 per million train miles in 2004 to 2.37 in 2017 (see Figure E-2).

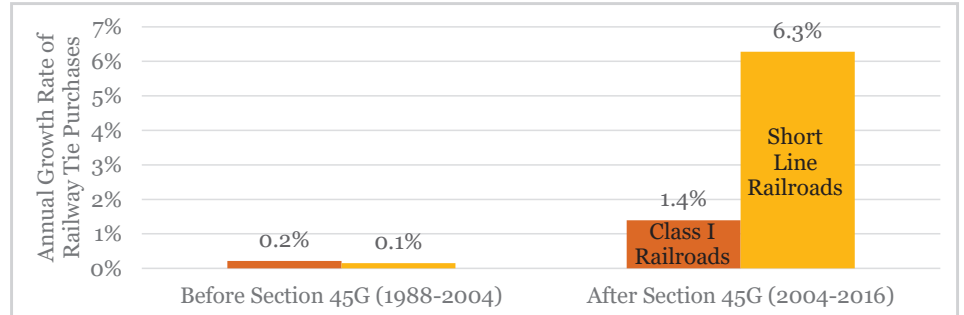
Standard cost of capital analysis indicates the section 45G credit provides strong incentives to invest in short line infrastructure.² For instance, for a corporate taxpayer making a break-even, or marginal, investment in short line track maintenance that is below the section 45G per mile cap, relative to current law in which the section 45G credit is expired, extending the section 45G credit reduces the user cost of capital by 63 percent. Empirical estimates of the responsiveness of investment to changes in the user cost of capital indicate that such a reduction in the user cost of capital is associated with a 47.3 percent increase in investment (see Table E-2).³

Commentary

“The report definitively shows what the industry has long known. Short lines are a

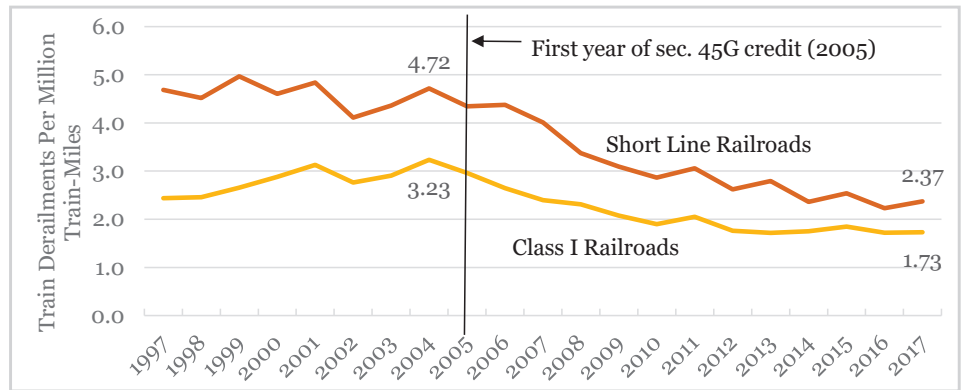
Table E-2. Impact of Section 45G Tax Credit and the Tax Cuts and Jobs Act (TCJA) on Cost of Capital and Investment for a Short Line Infrastructure Project		
Tax Change	Change in Cost of Capital	Change in Investment
Section 45G Tax Credit	-63.0%	47.3%
TCJA (reduced corporate tax rate and expensing)	-1.2%	0.9%

Figure E-1: Railway Tie Purchases Have Increased Since Enactment Of Section 45G



Source: Railway Tie Association

Figure E-2: Safety On Short Lines Has Improved Since Enactment Of Section 45G



Source: Federal Railroad Administration. Note: Class I data exclude Amtrak

critical piece of the U.S. transportation network and, in fact, the entire U.S. economy,” said Judy Petry, chair of ASLRRR and president and CEO of Farmrail Inc. “Moreover, the report clearly shows the tremendous and far reaching impact on our ability to provide value to our customers and the economy of the 45G short line tax credit. Our very future hangs in the balance as the credit expired in December 2017. The time is now to make the Short Line Tax Credit permanent.”

“The Short Line Tax Credit is shown to be smart public policy, improving safety and efficiency for our customers and our businesses. It is a proven solution, and we urge Congress to take action now to extend the Short Line Tax Credit. It will allow smaller railroads to continue to improve their safety performance, better serve their customers, and remain a catalyst for economic growth

in areas of the country that would otherwise not have connectivity to the national rail network,” said Jerry Vest, chairman of ASLRRR’s Legislative Policy Committee and senior vice president, Government & Industry Affairs for Genesee & Wyoming Railroad Services Inc.

NOTES:

¹ American Short Line and Regional Railroad Association (ASLRRR), “Short Line and Regional Railroad Facts and Figures,” 2017; Association of American Railroads (AAR) to ASLRRR, February 17, 2017, 2015 Short Line Railroad Industry Estimates.

² The user cost of capital is the real before-tax rate of return that a marginal (i.e., break-even) investment must earn to recover the cost of investment, pay taxes on business income, and pay an expected after-



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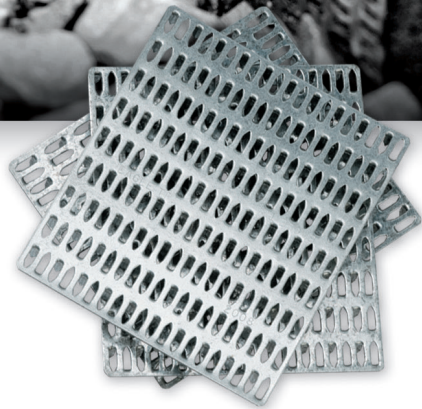
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tax rate of return to investors that covers their opportunity cost.

³ Kevin A. Haslett and R. Glenn Hubbard, "Tax Policy and Business Investment," in *Handbook of Public Economics, Vol. 3*, edited by Alan J. Auerbach and Martin Feldstein, pp. 1293-1343, 2002.

⁴ Expensing under TCJA has relatively little effect on short line investment incentives because short line investors previously were permitted to expense 75 percent of track maintenance expenditures under a safe harbor provided by IRS Revenue Procedure 2002-65.

²² Based on data provided by the RTA on the number of ties purchased by the short line industry and the average cost of treated ties, the short line industry spent approximately \$366 million on treated ties in 2013 and \$404 million in 2016. Installation costs incurred by the industry are in addition to these expenditures.

²³ Fred Norrell, "An Inquiry Into The Effect Of Tax Credits On Crosstie Purchases," RTA, March 28, 2018. ■

Railway Ties Factor Into The Short Line Equation

A major portion of short line infrastructure expense is the purchase and installation of railway ties.²²

According to data provided by the Railway Tie Association (RTA), since enactment of the section 45G credit in 2004, railway tie purchases by the short line industry have grown at an annual rate of 6.3 percent over the period 2004-2016, compared to an annual rate of growth of 0.1 percent over the period 1988-2004.

Purchases of ties by Class I railroads also increased but by a much smaller amount, from an annual rate of 0.2 percent before the credit to 1.4 percent after the credit.

After controlling through statistical analysis for various factors that normally predict railway tie purchases, RTA finds that approximately 1 million railway tie purchases annually by the short line industry are attributable to the section 45G tax credit—a 23 percent increase over the average of annual purchases for the period 1988-2016.²³ ■