Pentant Research Perspectives

Global Chemicals

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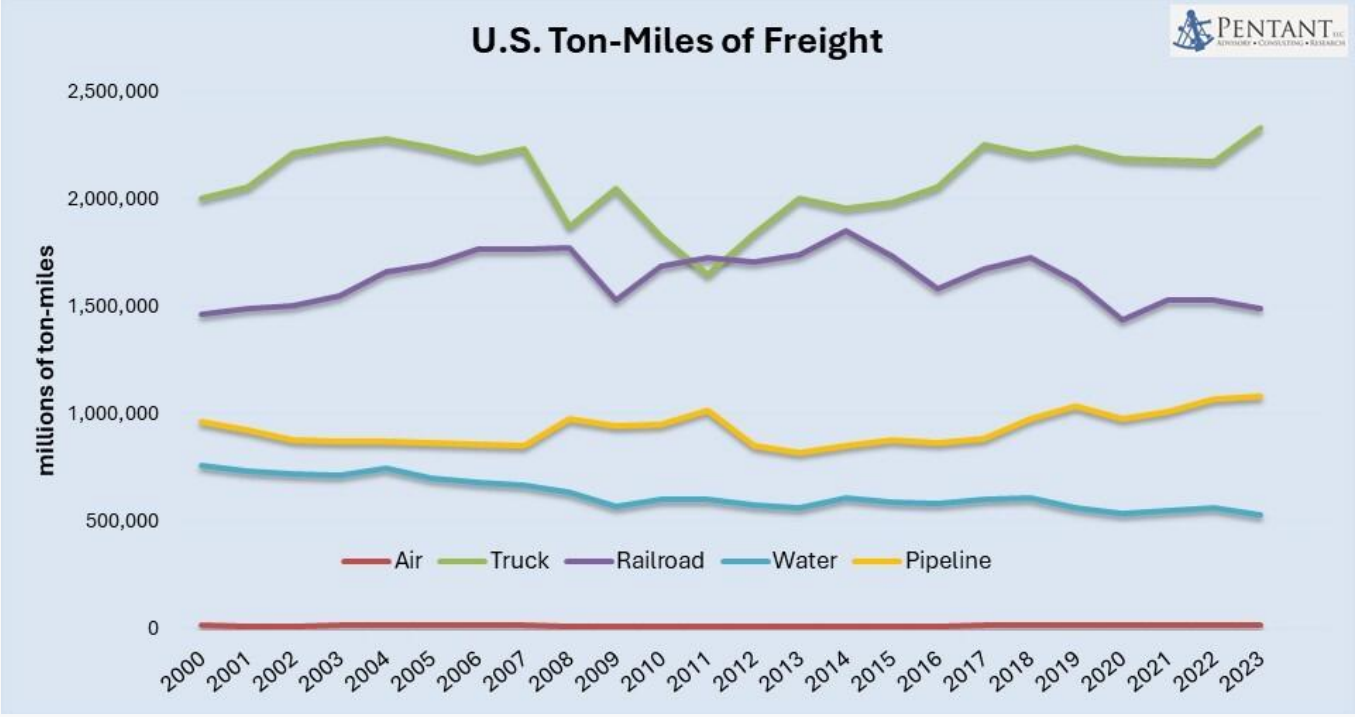
Rail Mergers – A Step Towards Making America Competitive Again

- **We believe that not only should Union Pacific and Norfolk Southern be allowed to combine, but so should others – if the focus is on improving efficiency/speed**
- **Speed is the scarce resource, not rail cars or track miles.**
- The US is uncompetitive in manufacturing industries for many reasons, and logistics are a challenge – freight in the US on the rails moves at half the rate of key China routes.
- Mergers in the US can remove bottlenecks and this should be the ask of regulators as they assess merger(s). Users might happily pay more per mile if turnaround time were reduced
- Higher average speeds mean less inventory on the rails and the need for fewer rail cars – all of which lower costs for US manufacturers along the supply chain.
- This alone will not fix competitiveness in the US, but it is one of many incremental steps that are needed to address why outside of natural gas prices the US struggles to compete.

Figure 1: Part of the rail vs road divergence since 2010 is because of relative speed



Source: Pentant Analysis

Regular readers of our work, both on chemicals and all things energy transition related will know that we are very focused on the competitive threat that China poses on many many levels. On a recent visit to a developing country, one looking to exploit some natural resource-based income, it was interesting to see the dominance of Chinese companies in every aspect of infrastructure building, some shipping, transport and equipment. Almost everywhere the work they were doing was of high quality, and it was happening quickly, even if their progress was driving the faster deterioration of old infrastructure. China is exploiting scale – making baby strollers for

example for a marketplace of hundreds of millions versus just the home market. But one of the other drivers of success in China has been its relatively recent (vs the US and Europe) and very strategic buildout of infrastructure – the key bridges and roads that need repair in the US tend to be brand new in China. Rail networks have been built efficiently and China is testing some of the fastest passenger trains in the world today. Every element of the Chinese manufacturing chain is more efficient than it is in the West, in part because it is much newer and in part because the way regulation and investment work in China tends to make things happen faster and more efficiently.

The scale of China's efficiency is being reflected in the levels of tariffs that the US and the EU have been considering trying to protect local producers in Europe and entice new manufacturing in the US. But as there are no proxies for developed economies restimulating a local manufacturing boom on tariffs alone, the US, and Europe will need to look for other ways to improve relative costs. Reducing regulatory red tape and speeding up project approval processes is one lever, but the other is making sure that all that can be done to make everything else work smoothly is done, and that includes infrastructure. The US government will either need to invest directly to make it easier for the US to compete or will need to put in place incentives for private sector companies to do the equivalent work. In the grand scheme of things, having a more efficient rail system in the US is no panacea, but it is one piece of a larger infrastructure need that will matter. If the rail industry wants to consolidate in the US, it is a great opportunity to discuss what the US needs in return for approving the consolidation – which in our view is investment in improving efficiency.

One of the more followed statistics for some chemical industry analysts is the number of chemical and polymer rail cars in use. Analysts often correlate more rail cars in service as a sign of improving demand, while at times it can be the opposite, a sign of slowing logistics or chemical and polymer producers using rail cars as additional storage. According to the American Chemistry Council rails transport 50% of US produced chemicals and polymers. This was over 2 million carloads in 2023 – more than 150 million tons. If the turnaround time on a rail car averages 20 days – 10 days full and 10 days empty – then on any given day there is more than 4 million tons of chemicals and plastics sitting in inventory in rail cars in transit, and the industry has at least 300,000 rail cars dedicated to chemical and polymer service to make this work including loading and unloading times and wait times for loading. If the logistics in the US could be improved by 25% through the merger of rail companies and the removal of many of the current bottlenecks it could take a million tons out of inventory – at an average cost of $750 per ton that is $750 million of lower industry working capital. 25% fewer rail cars at an average cost of $200,000 per car would eventually save as much as $15 billion in capital for the industry and their tank car providers. This would not be good news for the makers of tank cars, but the chemical industry would benefit, and it would drive costs lower.

A 25% improvement in US rail speed is a big ask – but it would only take average speeds from 20-25 miles an hour to 25-31 miles an hour. This would still leave the network operating at around half the speed of the dedicated new freight rails in China, but it should be an achievable goal. Playing around with inventory and the capital tied up in rail cars is not going to save the US chemical industry much on a per ton of product basis, and for the moment the US chemical and polymer

industry can rest on its natural gas cost advantage, which overwhelms any possible freight inefficiencies. But it would be extreme hubris to assume that this advantage will always be there. Industries in the US that are not heavily energy dependent do not have this cushion and those that are power rather than hydrocarbon dependent are already seeing possible alarming increases in power prices (all while power prices are falling in China). Consequently, rather than objecting to the proposed rail merger, US industry should be looking at it as an opportunity to negotiate for what they need, which is a more competitive system. With the distinction here that competitive means relative to competing nations not the guy down the street.

The other benefit of a more efficient rail system would be to pull freight off the roads – which is another overwhelmed infrastructure challenge in the US. Shipping by rail is very efficient from a cost perspective if you can live with the slow delivery and the need to hold higher inventories. Reduce the inventory and timing burden and rails become incrementally more attractive. The rail companies will likely make the valid point here that increasing rail freight versus roads could replace low wage truck driving jobs with higher wage union-based rail jobs, although it would not be one for one. Other arguments against the merger proposal do not hold water in our view:

Addressing the Principal Objections to Rail Consolidation

1. "The merger reduces competition in a highly concentrated industry"

Our view is that true competition failure already exists at interchanges. While it is true that the UP - NS merger would reduce the number of Class I carriers, the relevant question is where competition exists today. In practice, the most significant service delays and costs arise at interchange points between carriers, not from monopoly pricing on continuous routes. The absence of a single-operator transcontinental network is itself a structural inefficiency that acts as a tax on U.S. manufacturing.

- Many chemical shippers already face captive or semi-captive lanes.
- Interchange friction ≠ competitive benefit.
- Competition between rail and truck remains intact.

2. "A national duopoly would recreate 'railroad barons'"

Comparisons to the era of railroad barons overlook the modern regulatory environment. Unlike historical monopolies, a consolidated transcontinental railroad would operate under continuous Surface Transportation Board oversight, with pricing, service metrics, and access remedies available to shippers. The policy question is therefore not whether consolidation creates unchecked power, but whether regulatory tools are used to ensure that scale benefits are passed through in the form of speed and reliability. This is not 1890, and pretending it is doesn't help policy.

3. "Past mergers caused service disruptions and delays"

Historical rail mergers have, in some cases, resulted in short-term service disruptions. However, those disruptions were largely the result of integration without enforceable performance commitments. The appropriate lesson is not that consolidation should be blocked, but that it

should be conditioned on measurable improvements in velocity, dwell time, and interchange elimination. What we need are:

- STB-mandated speed benchmarks
- Phased integration milestones
- Financial penalties for failure

4. "The merger will raise prices for shippers"

A narrow focus on per-mile pricing ignores the dominant cost drivers for bulk shippers such as chemicals and polymers. Inventory carrying costs, rail car ownership, and working capital tied up in transit frequently exceed marginal freight rate differences. Even modest improvements in transit time can therefore reduce total delivered cost, even if nominal rail rates rise.

5. "Safety risks and negative impacts on workers"

Slower, congested networks are not inherently safer networks. Bottlenecks, crew shortages, and equipment dwell time increase operational stress and risk. A more fluid system with fewer handoffs has the potential to improve safety outcomes, particularly for hazardous materials, provided that workforce levels and training are maintained.

- We are not arguing for labor cuts
- We are arguing for system simplification

6. "Public interest and small business harm"

The public-interest test should consider not only intra-U.S. competition, but the ability of U.S. manufacturers to compete globally. For industries such as chemicals that underpin downstream manufacturing, logistics inefficiency acts as a hidden tax. Blocking consolidation without addressing these inefficiencies risks preserving domestic competition at the expense of international relevance.

The merger should therefore be viewed not as an endpoint, but as a negotiating opportunity to trade consolidation for measurable improvements in speed, reliability, and capital efficiency.