CN's Acquisition of the EJ&E: A Political Economy Analysis

Christopher Berry
Ethan Bueno de Mesquita

The University of Chicago
Is there really a political economy of trains?

• Policy, including transportation policy, is the outcome of a contest between competing interests

• As a result, only part of the policy-making process is about cost-benefit analyses and the merits

• Political economy is about the other part
CN and the EJ&E

• CN has proposed to acquire the EJ&E
  – Reroute trains around Chicago

• Positive Externalities
  – Regional and national economic, environmental, and security benefits
  – Reduced rail traffic in Chicago neighborhoods (including ours) and some suburbs

• Negative Externalities
  – Increased rail traffic in some suburbs

• Resulting in a politically charged regulatory process with uncertain outcome
A thought experiment: 2 scenarios

• Suppose railroads own the right to run as many trains as they want

• Suppose people of Barrington have the right not to have trains run if they choose not to

• In the absence of government intervention, would the number of trains running through Barrington be different under two scenarios?
We are from the University of Chicago, shouldn’t the market solve this?

**Coase Theorem**: In the absence of transaction costs, if property rights are well defined, then if there are two competing interests, even in the presence of negative externalities

- Outcomes will be efficient
- The ultimate outcome is invariant to the initial assignment of property rights
The Logic of the Coase Theorem

• Efficiency
  – If property rights well defined, one party can compensate the other

• Invariance
  – Through efficient bargaining the more profitable activity should always occur

• Suppose net benefits
  – If CN own rights: Then run trains
  – If residents own rights: CN compensates them

• Suppose net loses
  – If CN owns rights: Residents pay CN not to run (or buy EJ&E)
  – If Residents own rights: No trains run
Why Might the Coase Theorem Fail

• Unclear property rights
• Large transaction costs
• More than two parties
• Credibility/Commitment problems

• An empirical example of failure:

• When Coase Theorem fails, market fails to solve problem
  – Public policy should try to approximate Coasian outcome
Principles of good policymaking

• The social good is hard to define

• One uncontroversial notion is Pareto Efficiency
  – Policy A Pareto Dominates Policy B if A makes at least one person better off and no one worse off

• Hard to find such policies, since all policies seem to have winners and losers

• If a policy is positive on net we can create Pareto Efficiency (Hicks-Kaldor)
  – Adopting good polices and compensating the losers
Is the CN Acquisition Hicks-Kaldor Efficient?

- **Winners (in order of directness)**
  - Owners of CN and the EJ&E
  - 1.25 million residents of city neighborhoods
  - 1.2 million suburban residents with reduced traffic
  - The region and nation

- **Losers**
  - 900,000 suburban residents with increased traffic

- **So why isn’t easy to get approval with compensation?**
Politics of Regulatory Approval

• In principle non-elected boards (such as STB) are insulated from politics

• In practice, not so
  – Career ambitions
  – Various forms of pressure

• Who can effectively exert pressure
  – Those who are mobilized
  – Those with clout
Comparing the Winners and Losers: Clout

- **CN**
  - Large corporation with lobbying presence
  - Not U.S. owned

- **City Residents that Benefit**
  - Median income: $46,000
  - Demographics: 70% minority

- **Suburban Residents that are Hurt**
  - Median income: $76,000
  - Demographics: 67% white
Comparing the Winners and Losers: Mobilization

• Suburban opponents more mobilized. Why?
  – **Opportunity Costs**: South Side city residents have bigger issues to petition their government on, suburbs may not
  – **Prospect Theory**: People tend to be more motivated by losses than by gains
  – **Size of Effects**: We haven’t quantified the per person gains and losses, but draft EIS makes them look roughly equal
Evidence of undue influence from opponents

- 7 “scoping meetings” to assess costs and benefits
  - 6 in suburbs
- 39 poster locations announcing those meetings
  - 38 in suburbs
- 22 minority outreach meetings
  - 21 in suburbs
- 8 meetings to take comments on draft EIS
  - 7 in suburbs
- State-level leadership has not supported the plan
What’s the likely outcome

• If you looked at this *ex ante* you’d think the combination of corporate and city interests would win

• CN was late to understanding the politics

• Suburbs are highly mobilized
  – Congressional delegation has proposed legislation

• The outcome is highly uncertain
  – No guarantee good policy will be good politics