



## Railway Pricing Problem: The Effects of Monetary Decision-Making on a Duopolistic Freight Transportation Market

Amir Chamani Foomani Dana<sup>1</sup>, Mohammad Tamannaie<sup>1\*</sup>

<sup>1</sup>Department of Transportation Engineering, Isfahan University of Technology, Isfahan, Iran. 84156-83111

### ARTICLE INFO

#### Article history:

Received: 16.09.2020

Accepted: 21.11.2020

Published: 25.12.2020

#### Keywords:

Railway access charge

Pricing

Freight transportation

Competition

### ABSTRACT

Rail system is considered as the most efficient mode of freight transportation. While it may be expected that demand of rail mode would be higher than other means of transportation, sometimes it has been observed that road transportation is much more applicable. Therefore, economic aspects of transportation market such as process and access charges are prominent. It must be considered that rail transportation has its own drawbacks. Low flexibility and fixed origins and destinations, as well as the relatively high rate of access charges are regarded as the most problematic limitations of rail systems. In current study, an evaluation is carried out using game theoretic approaches in order to determine demands of two competing systems including rail and road. Moreover, Stackelberg approach is utilized in order to calculate optimal access charge of rail infrastructure which maximizes profit of government. The results and findings of current study may contribute policy makers for decision-making in a competitive freight transportation market.

## 1. Introduction

With the rapid economic growth of societies in recent years, freight transportation has become a substantial and critical concern all over the world. Governments and institutional authorities besides freight forwarders and carriers, tend to maximize their own shares and benefits from freight transportation market and concurrently satisfy the customer requirements. In such conditions, the sustainability plays a key role in determination of freight transportation modes. Adaption of appropriate policies in infrastructure development and pricing strategies can lead to the profitability of the entire system. Economic, environmental, and social facets of sustainability need to be appraised for a straightforward decision making toward sustainable freight transportation. Therefore, there always exists a competition between different modes in competitive transport market.

Rail system is considered as the green mode of freight transportation which affords sustainability, compared to road transportation, which is considered less sustainable. However, rail transportation has its own constraints. Low flexibility and fixed origins and destinations, as well as the relatively high rate of access charges are regarded as the most problematic limitations of rail systems [1-3]. Therefore, solving a problem which maximizes the profit of both rail and road systems seems to be mandatory. Game theoretic approaches can contribute to the development of transportation models by concurrent profit maximization of both systems.

Figure 1 is an illustration of road and rail transportation networks of Iran. Moreover, this figure represents that besides accessibility to rail transportation system, road is the main mode of freight transportation in many cities of Iran.

It demonstrates that the accessibility to the railway infrastructure does not guarantee the

\*Corresponding author, Assistant professor  
Email: Tamannaie@iut.ac.ir

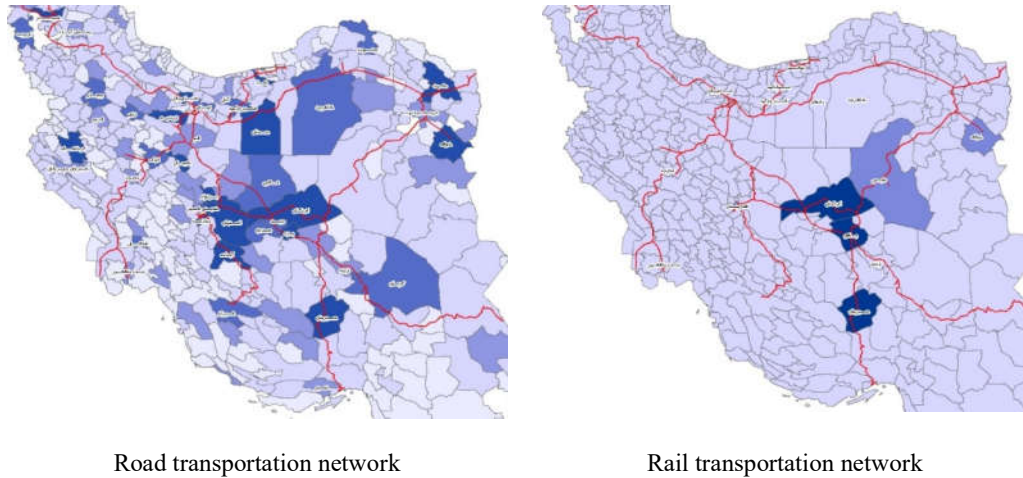


Figure 1. Iran transportation network

utilization of the rail system for freight transportation. Therefore, the other policy-making strategies must be considered to make the railway system appealing for the freight shippers and customers. It can be concluded that the impacts of other transportation factors such as road and rail final transportation prices, as well as rail access charge are prominent.

Many studies have assessed mode choice of freight transportation from various points of view [4-8]. In a study performed by Arencibia, Feo-Valero [4], a contribution is devoted to the freight transport demand analysis by application of discrete choice models. This study tries to divert traffic from road to alternative modes, such as rail or maritime for the carriage between Spain and the European Union. In a study performed by Wang, Yang [5], a fuzzy bi-objective optimization model is formulated for the network design problem considering economic aspects, in order to determine the most efficient modes of freight transportation under uncertain information. In a research performed by Feng, Liu [6], rail transportation pricing policy in addition with environmental considerations have been evaluated. Guo, Peeta [7] assessed cooperation between rail and road transportation systems in order to develop loading and unloading facilities and infrastructure planning. In a research proposed by Bask and Rajahonka [8] the main focus is on

the role of environmental sustainability and intermodal transport in transport mode decisions.

Determination of access charges in railway system is another emerging concept which has been evaluated in some previous studies [9-11]. While all these studies have considered transportation prices and marginal costs, there exists a gap in identification of optimal access charge that maximizes the government profit. Moreover, proposing a model that elucidates optimal transportation prices of competing systems with simultaneous maximization of their profits is crucial. Therefore, the present study develops a game-theoretic approach for modeling the competition between road and rail systems in a duopolistic freight transportation market, with consideration of external costs imposed by these systems.

The rest of the paper is structured as follows: Section 2 introduces a description of the problem. Section 3 is contributed to the problem modeling. In Section 4, the equilibrium solutions are presented. In Section 5, a numerical example is introduced; and the paper is concluded in the final section.

The main nomenclature of the current study is illustrated in Table 1.

Table 1. Nomenclature

$\theta_u$	Fuel consumption rate of a truck for carrying one unit of demand within one unit of distance
$\theta_a$	Fuel consumption rate of a train for carrying one unit of demand within one unit of distance
$\alpha$	The market baseline for demand of road system
$\beta_p$	Elasticity of demand with respect to transportation price
$\gamma_p$	Cross-elasticity of demand with respect to transportation price
$D_R$	Distance between origin and destination for road system
$D_L$	Distance between origin and destination for rail system
$f$	Base price of one unit of fuel
$\bar{c}_R$	Summation of costs excluding the fuel cost, imposed on road system for carrying one unit of demand from origin to destination
$\bar{c}_L$	Summation of costs excluding the fuel cost, imposed on rail system for carrying one unit of demand from origin to destination
$c_R$	Total cost, imposed on road system for carrying one unit of demand from origin to destination
$c_L$	Total cost, imposed on rail system for carrying one unit of demand from origin to destination
$p_R$	Transportation price for carrying one unit of demand from origin to destination for road system
$p_L$	Transportation price for carrying one unit of demand from origin to destination for rail system
$q_R$	Transportation demand for road system
$q_L$	Transportation demand for rail system
$\pi_R$	Profit function for road system
$\pi_L$	Profit function for rail system
$\pi_{gov}$	Profit function for government
$\mu_R$	External cost imposed to government for carrying one unit of demand within one unit of distance by road
$\mu_L$	External cost imposed to government for carrying one unit of demand within one unit of distance by rail
A	Rail access charge

## 2. Description of the Problem

In this study, a game-theoretic approach is followed in order to concurrently maximize the profits of two competing freight transportation systems. Each transportation system has its own demand function. This study has two variables including final transportation prices of two competing modes. A constant demand must be carried between a fixed origin and destination. Each transportation mode seeks to absorb available freight demand as much as possible. Therefore, proposing a model which can simultaneously maximize profit functions of both systems is the main objective of current study. In order to solve this problem, Nash game approach is followed.

As mentioned earlier, road and rail systems are the two competing modes selected for this study. Road transportation costs include a fixed cost and fuel consumption cost. Rail transportation costs include a corresponding fixed and fuel costs besides access charge. Two

different transportation routes including road and rail are denoted as  $D_R$  and  $D_L$  respectively.

To support this approach, the following assumptions are made.

- All involved parameters are non-negative.
- Demand of each mode is more sensitive to its own price than price of the competing mode.

## 3. The Model Formulation

In this section, first, the competition model of the two competing freight transportation systems is introduced. Subsequently, the government profit function and the corresponding optimal access charge which maximizes government profit are represented. Demand functions of road and rail modes are represented in Eq. (1) and Eq. (2).

$$q_R[p_R, p_L] = \alpha - \beta_p p_R + \gamma_p p_L \quad (1)$$

$$q_L[p_R, p_L] = Q - (\alpha - \beta_p p_R + \gamma_p p_L) \quad (2)$$

Cost functions for two competing systems are introduced in Eq. (3) and Eq. (4).

$$c_R = \bar{c}_R + D_R \theta_R f \quad (3)$$

$$c_L = \bar{c}_L + D_L \theta_L f + A_L D_L \quad (4)$$

$$\Pi_R[p_R, p_L] = (p_R - c_R) \cdot q_R[p_R, p_L] \quad (5)$$

$$\Pi_L[p_R, p_L] = (p_L - c_L) \cdot q_L[p_R, p_L] \quad (6)$$

By inserting Eqns. (1-4) into Eqns. (5&6), the profit functions can be rewritten as follows:

$$\Pi_R[p_R, p_L] = (\alpha - p_R \beta_p + p_L \gamma_p)(+p_R - \bar{c}_R - f D_R \theta_R) \quad (7)$$

$$\Pi_L[p_R, p_L] = (Q - \alpha + p_R \beta_p - p_L \gamma_p)(p_L - \bar{c}_L - D_L(A + f \theta_L)) \quad (8)$$

In addition to the aforementioned problem, a government profit function is developed in which rail access charge is considered as the main variable. In this case, two parameters are defined which denotes for environmental, economic and social costs of road and rail transportation for the government. Optimal rail access charge is determined by Stackelberg game approach. These two parameters are denoted as  $\mu_R$  and  $\mu_L$ . The government profit function is illustrated in Eq. (9).

$$\Pi_{gov}[p_R, p_L, A] = A \cdot D_L \cdot q_L[p_R, p_L] - \mu_R \cdot D_R \cdot q_R[p_R, p_L] - \mu_L \cdot D_L \cdot q_L[p_R, p_L] \quad (9)$$

Where, the first term reflects the government profit gained by the imposed access charge and the second and third terms reflect the environmental, economic, and social costs of each transportation mode incurred by the government.

#### 4. Equilibrium Solutions

In Nash game approach, the competing systems act at the same level. The model of Nash game approach for this competition is as follows:

$$\begin{cases} \max_{p_R} \pi_R(p_R, p_L) \\ \max_{p_L} \pi_L(p_R, p_L) \end{cases} \quad (10)$$

##### Theorem 1.

The equilibrium transportation prices, transportation demands, and profits of road and rail systems is represented in Eq. (11) to Eq. (16).

In Stackelberg game approach, access charge of the government acts as the leader and prices of two competing mode act as the followers of the model.

The Stackelberg's game structure is modeled as in Eq. (17).

##### Theorem 2.

The equilibrium government profit and optimal access charge are calculated as in Eqns. (18&19):

#### 5. Numerical Example

Following numerical example has been assumed in order to realize the effects of different parameters on the final results. The set of data that are assumed for this case are presented in Table 2. Figure 2 to Figure 4 illustrate equilibrium prices, demands, and

Table 2. Data for the example problem

$\beta_p = 2$	$\gamma_p = 1$	$f = 1 \left( \frac{\$}{lit} \right)$	$\theta_R = 0.0445 \left( \frac{lit}{Km \cdot m^3} \right)$
$\theta_L = 0.0072 \left( \frac{lit}{Km \cdot m^3} \right)$	$Q = 1000 \left( \frac{m^3}{hr} \right)$	$\alpha = 1300 \left( \frac{m^3}{hr} \right)$	$\bar{c}_M = 2.5 \left( \frac{\$}{m^3} \right)$
$\bar{c}_R = 3.4 \left( \frac{\$}{m^3} \right)$	$D_M = 1100 Km$	$\mu_R = 0.02 \left( \frac{\$}{Km \cdot m^3} \right)$	$\mu_L = 0.004 \left( \frac{\$}{Km \cdot m^3} \right)$
$D_R = 1100 Km$	$A = 0.5 \left( \frac{\$}{Km \cdot m^3} \right)$		

$$p_R = \frac{Q + \alpha + \gamma_p(\bar{c}_L + D_L(A + f\theta_L)) + 2\beta_p(\bar{c}_R + fD_R\theta_R)}{3\beta_p} \tag{11}$$

$$p_L = \frac{2Q - \alpha + 2\gamma_p(\bar{c}_L + D_L(A + f\theta_L)) + \beta_p(\bar{c}_R + fD_R\theta_R)}{3\gamma_p} \tag{12}$$

$$q_R[p_R, p_L] = \frac{1}{3}(Q + \alpha + \gamma_p(\bar{c}_L + D_L(A + f\theta_L)) - \beta_p(\bar{c}_R + fD_R\theta_R)) \tag{13}$$

$$q_L[p_R, p_L] = \frac{1}{3}(2Q - \alpha - \gamma_p(\bar{c}_L + D_L(A + f\theta_L)) + \beta_p(\bar{c}_R + fD_R\theta_R)) \tag{14}$$

$$\Pi_R[p_R, p_L] = \frac{(Q + \alpha + \gamma_p(\bar{c}_L + D_L(A + f\theta_L)) - \beta_p(\bar{c}_R + fD_R\theta_R))^2}{9\beta_p} \tag{15}$$

$$\Pi_L[p_R, p_L] = \frac{(-2Q + \alpha + \gamma_p(\bar{c}_L + D_L(A + f\theta_L)) - \beta_p(\bar{c}_R + fD_R\theta_R))^2}{9\gamma_p} \tag{16}$$

$$\left\{ \begin{array}{l} \text{Optimizing government model } (p_R^*, p_L^*, A) \\ \text{where } (p_R^*, p_L^*) \text{ are simultaneously obtained by solving:} \\ \left\{ \begin{array}{l} \max_{p_R} \pi_R(p_R^*, p_L^*) \\ \max_{p_L} \pi_L(p_R^*, p_L^*) \end{array} \right. \end{array} \right. \tag{17}$$

$$\pi_{gov} = \frac{1}{3}(-D_L(-2Q + \alpha + \gamma_p(\bar{c}_L + D_L(A + f\theta_L)) - \beta_p(\bar{c}_R + fD_R\theta_R))(A - \mu_L) - D_R(Q + \alpha + \gamma_p(\bar{c}_L + D_L(A + f\theta_L)) - \beta_p(\bar{c}_R + fD_R\theta_R))\mu_R) \tag{18}$$

$$A = \frac{2Q - \alpha + \beta_p(\bar{c}_R + fD_R\theta_R) - \gamma_p(\bar{c}_L + D_L(f\theta_L - \mu_L)) - D_R\gamma_p\mu_R}{2D_L\gamma_p} \tag{19}$$

profit functions with respect to fuel price variations. It can be concluded that as the fuel price increases, equilibrium demand and profit of road transportation system decline, contrary

to the rail transportation system. Figure 5 represents a three dimensional illustration of profit functions with respect to distance variations of both systems.

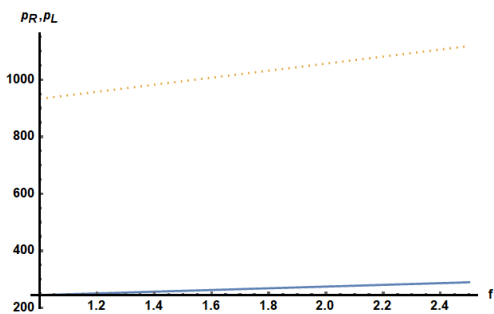


Figure 2. Equilibrium prices with variations of fuel price

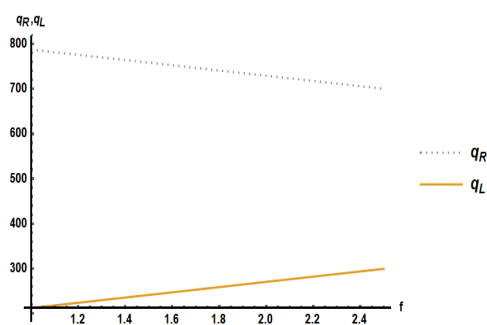


Figure 3. Equilibrium demands with variations of fuel price

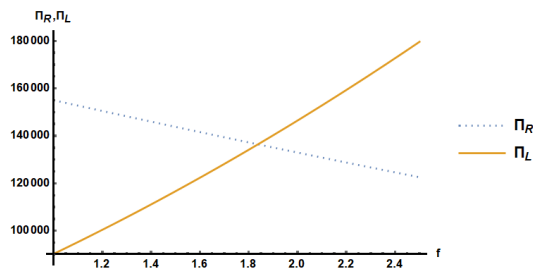


Figure 4. Equilibrium profits with variations of fuel price

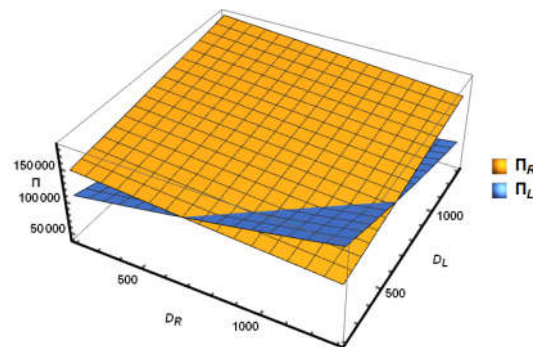


Figure 5. Relationship between profit functions and transportation distances

## 6. Conclusions

Rail system is considered as the green mode of freight transportation which affords sustainability, compared to road transportation, which is considered less sustainable. However, accessibility to the railway infrastructure does not guarantee the utilization of the rail system for freight transportation. Therefore, the other policy-making strategies must be considered to make the railway system appealing for the freight shippers and customers. It can be concluded that the impacts of other transportation factors such as road and rail final transportation prices, as well as rail access charge are prominent. The results of current research can contribute to the policy makers and managers who wish to optimize freight carriage system. In addition, governmental authorities can apply optimal access charge calculated in current study in order to maximize their profits.

## References

- [1] Goel, A., *A roadmap for sustainable freight transport*. Methods of Multicriteria Decision Theory and Applications, 2009: p. 47-56.
- [2] Wang, Y., et al., *An analysis of Interstate freight mode choice between truck and rail: A case study of Maryland, United States*. Procedia-Social and Behavioral Sciences, 2013. **96**: p. 1239-1249.
- [3] Calvo, F. and J. De Oña, *Are rail charges connected to costs?* Journal of Transport Geography, 2012. **22**: p. 28-33.
- [4] Arencibia, A.I., et al., *Modelling mode choice for freight transport using advanced choice experiments*. Transportation Research Part A: Policy and Practice, 2015. **75**: p. 252-267.
- [5] Wang, R., et al., *Modeling and optimization of a road-rail intermodal transport system under uncertain information*. Engineering Applications of Artificial Intelligence, 2018. **72**: p. 423-436.
- [6] Feng, F., et al., *Research on Price of Railway Freight Based on Low-Carbon Economy*. Mathematical Problems in Engineering, 2016. **2016**.
- [7] Guo, Y., S. Peeta, and F. Mannering, *Rail-truck multimodal freight collaboration: a statistical analysis of freight-shipper perspectives*. Transportation Planning and Technology, 2016. **39**(5): p. 484-506.
- [8] Bask, A. and M. Rajahonka, *The role of environmental sustainability in the freight transport mode choice: A systematic literature review with focus on the EU*. International Journal of Physical Distribution & Logistics Management, 2017. **47**(7): p. 560-602.
- [9] Nash, C., S. Coulthard, and B. Matthews, *Rail track charges in Great Britain—the issue of charging for capacity*. Transport Policy, 2004. **11**(4): p. 315-327.
- [10] Ljungberg, A., *Impacts of increased rail infrastructure charges in Sweden*. Research in Transportation Economics, 2013. **39**(1): p. 90-103.
- [11] Rotoli, F., et al., *An analysis of the railway access charges regime in the Italian context*. Transport Policy, 2018. **64**: p. 20-28.