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**PROGRESS OR PARALYSIS**  
**FOR 1920**

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Address of

**MR. SAMUEL REA**

President, The Pennsylvania Railroad System

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Delivered before the

**DETROIT REAL ESTATE BOARD**

**Detroit, Mich., January 15th, 1920**

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**ADDRESS OF  
MR. SAMUEL REA  
PRESIDENT, THE PENNSYLVANIA  
RAILROAD SYSTEM  
BEFORE THE  
DETROIT REAL ESTATE BOARD  
DETROIT, JANUARY 15, 1920**

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It gave me pleasure to accept your invitation to briefly discuss with you matters of mutual interest.

On the threshold of a new year, the first duty of every American citizen is to decide where he stands himself, and where he wants this Nation to stand. We cannot have progress and prosperity without an honest standard, in which individual or class selfishness must be held in check, so that public welfare shall predominate. In the words of Washington, "let us raise a standard to which the wise and honest may repair." The standard for owners, workers and management must be for liberty under law and order, for increased production, for an honest day's work and high wages, increased savings and satisfied lives.

Among the home problems that should be promptly solved is that of ample railroad facilities, and adequate and sound railroad credit.

Both of them have been stifled and starved for many years. The results are increased costs, congestion, and restriction of your business. It is time to promptly remedy this situation, not because the railroads' managements or owners desire that solution, but because the railroads exist solely for public service and depend solely upon the daily public service they perform. They give employment to large numbers and are the largest consumers of supplies which make them invaluable and regular contributors to our individual and national prosperity; they are owned by our citizens and their institutions, and they are one of the chief means of support of the Governments—Federal, State and Municipal—through the quarter of a billion or more of annual taxes they pay. The greater number of our institutions and private citizens who provided the moneys for their construction are not rich, and depend upon fair returns on their railroad investment as one of the means of living. If that return is too low, or is cut off, or the authorities are unfair in legislation or regulation, the new capital cannot be obtained for railroad betterment and new construction.

March 1st is the date fixed for the return of the railroads. The public accommodation will be our uppermost thought, but the public cannot expect that by then the roads will be working smoothly, nor that all of the special conditions essential for

War and Governmental purposes, will be adjusted to meet all of their expectations. That will come gradually from skilled supervision, and from the termination of artificial War conditions and the settlement of unrest that affects the Country at large. The release of the railroads from Federal Control is desirable, but their abandonment by the Government without proper business and legislative precautions would be a calamity, especially as their revenues have not been adjusted to present costs.

The immediate railroad essentials—and they are equally important to business and finance—are these:

1. Adequate rates to be at all times maintained to prevent the railroads from again getting into the weak position from which they are now trying to emerge. For this purpose the adoption of a rate-making rule, or, if that is not acceptable, the fixing of some minimum return is essential for the positive guidance of the Commission which regulate rates, and it should be on a fair average basis of return throughout a series of years.

2. Fund the War indebtedness to the Government, which chiefly consists of expenditures made by the Government for additions and betterments essential to carry the traffic of the War period and protect the life of the Nation; and also return the roads with sufficient working capital to

resume operations. The Government found it essential to have working capital, and the railroads were called upon to provide a large part of that working capital, at the beginning of Federal Control, both in money and materials and supplies.

3. Continue the standard compensation as prescribed by the Federal Control Act and Contract for at least six months, until the railroad situation has been steadied by adequate rates and stronger credit.

4. Provide sufficient capital to finish additions, betterments, and equipment already authorized by the United States Railroad Administration, as well as to finance additional new work and equipment that should be authorized in 1920, and enable the railroads to provide for securities maturing in that year.

The Government is not asked to make a gift to the railroads by such funding of past expenditures or for such new capital, but to advance the same and bridge over this difficult financial period, receiving from the railroads the best securities they can offer to evidence such debts, and require their payment in say ten years, with suitable interest. The public interest should be protected in this way, otherwise because of financial conditions new equipment and facilities cannot be provided in 1920.

It is our hope that the Conferees of the Senate and House of Representatives will take a sufficiently comprehensive view of the situation as to deal adequately with the entire railroad situation. We must prevent restriction of business from inadequate railroad facilities to accommodate the expanding business of this Country, we must see that labor will be justly dealt with, and the investors may have the basis upon which, by vigilant management and efficient operation, a proper return can be paid on the existing railroad investment and a fair margin earned to induce the new capital to invest in the roads. If the legislation is not of this character then we will have stagnated railroad systems, which will cripple industrial enterprise, curtail production, increase transportation costs and may ultimately compel Government ownership and operation.

Notwithstanding the difficulties with which the railroads have had to contend, they would not, in my judgment, be of moment today if the railroads had received in the past ten years rates at all commensurate for the service rendered, or reasonably compensatory with the investment. That service was not only the cheapest, but considered the best transportation anywhere. Fair wages were paid and their prosperity was shared with the employes, and the Governments received increased taxes. Nevertheless, the position of the

railroad investor was slowly but surely becoming weaker, not only through the reduction or passing of dividends, but through the loss in the purchasing power of his income. While our regulating authorities may have had all the good intentions in the World, the net operating income, taken as a whole, was smaller than demanded in the public interest and entirely inadequate as a credit basis. The Interstate Commerce Commission, in its notable decision in the 5% Eastern Rate Case of July, 1914, expressed this view when the return on property investment in the Official Classification Territory, which embraces these Eastern Railroads, for the preceding year was only 5.36%. Yet, taking the railroads as a whole, the property investment returns since 1910 did not reach that figure again until the increased War traffic of 1916, prior to the overdue adjustment of wages and other costs arising from the War.

The compensation to be paid during Federal Control was equal to a return on property investment of all the railroads of the Country of 5.22%. But the net operating return for 1919 on the property investment may probably be equal to about 3%, due to non-restoration of the equilibrium between income and expenses. None of these returns are adequate in the public interest, or as a basis for credit, and no matter what kind of legislation is enacted, if the National regulatory body is not going to change this condition, there

is no escape from inadequate railroad facilities, poor service and restricted investment. I am hopeful, however, that the viewpoint of the whole Country has been widened as to the dangers of this situation, and that the fear of having some few strong and prosperous roads will not prevent justice being done to all of them. We are told that if this situation is equitably dealt with by adequate rates the strong railroads will get too much, and the weak railroads not enough. Have we a dozen strong railroad systems now? I doubt it. Look at the period upon which the Government based the compensation to the railroads, the three years ending June 30th, 1917, one of the best in the history of these railroads, about eighteen systems could, upon the then existing rates, earn over 6% on their property investment, and consider what has occurred since in higher wages, material costs and taxes, with nothing like corresponding increases in rates.

The Railroads in 1900 had outstanding \$200,000,000. more stock than debt, now they have over Two and a Quarter Billions more debt than capital stock. Instead of relieving this critical credit condition by adequate returns, they receive homilies on expected future economies and increased business, without any assurance of what the future will be. In the past these suggestions have proven to be delusions, and the railroads

are too weak to exist in future on any such slender threads.

They are also constantly accused of watered capital, and a swollen property investment account. This delusion has not yet been buried. Have we forgotten the past with its many millions of good and poor railroad capital wiped out through reorganizations, or failure to earn dividends or interest, or the millions spent by solvent roads prior to 1907 out of surplus without any legal compulsion, for which not a dollar of securities were issued? Look at the Pennsylvania System with over five hundred million dollars of property and assets in excess of its capitalization. That is the result of 75 years of prudent financing. Can there be any doubt today that the real property investment for all the railroads exceeds their original cost or their capitalized cost, and that the property investment as stated is materially below its present actual value? I have none, but if I had, I can tell you that the question of watered securities or swollen values has been further corrected by four substantial factors:

1. On December 31st, 1917, the par value of the Outstanding Capital Stock and Funded Debt of all the railroads, said to contain billions of water, was \$21,249,357,241. Against that capitalization their gross investment, including road and equipment, miscellaneous phys-

ical property, investments in affiliated companies, and other general investments, aggregated, as shown in the Interstate Commerce Commission Report for 1917, \$24,281,550,363., so that their total investment was \$3,032,193,122. in excess of their total capital issues.

The companies also had a large amount in cash and materials and supplies as working capital in excess of their current liabilities, but for the present I have omitted this for good measure, so that I might be sure not to overstate the case, which is that the railroad property investment exceeds by at least Three Billion Dollars the outstanding railroad capital held by the public, and by the railroads.

The railroad companies themselves acquired and held \$4,847,571,224. of that outstanding capital, and the balance, \$16,401,786,017., was held by the public.

2. Let us look further at the question of capitalization from the income standpoint, and ask is the public fully supporting it. There we see that over 36% of the total outstanding capital stock of all the railroads, or \$3,250,000,000., does not pay dividends, and a very large part of that non-dividend paying stock is owned by the public, and an examination of the figures will show that the percentage of non-dividend paying stock instead of decreasing has been increasing in the

last ten years. Further there is a large amount of funded debt not paying the interest due thereon, but I omit it so as to state my case conservatively. We may, therefore, sum up the situation by saying that the railroad capital account is protected by over \$3,000,000,000., or almost 15% more of investment, and further the railroad income provided by the public on the other hand, has paid no dividends on \$3,250,000,000. of capital stock held in part by the railroad companies and in part by the public, nor interest on many millions of funded debt similarly held.

3. Let us now estimate whether the railroad property investment itself represents real value taken as a whole.

The whole railroad investment account, including road, equipment, and other investments, on December 31st, 1917, was \$24,281,000,000., and railroad capital about \$21,249,000,000., or over three billion dollars in favor of total investment as against outstanding capital. But let us exclude all investments except that in road and equipment, which is \$18,423,000,000., to see if it will stand the test of a rapid estimation. Since 1907 the property account has been kept under the classification of the Interstate Commerce Commission, and in fact for many years before that the State and Federal Commissions could have required the information essential in

connection with any feature of capital issues or investments.

4. It is clear that if property accounts did not represent cost it must have been prior to 1907. Let us spend a few minutes in reasoning out whether any such condition then existed. On June 30th, 1907, the railroads of the Country had a total track mileage of 327,975, the property investment account represented by road and equipment was approximately \$13,030,000,000., or an average per mile for track and equipment of about \$39,730. That amount also included terminals, stations, yards, land, 55,388 locomotives, 1,991,557 freight cars, and 43,973 passenger cars. That is the lowest construction cost in the World, and considering our higher rates of pay compared with other civilized countries, is of itself a quick answer to the questions of both an overstated property investment account and watered capital. But beyond that we know that \$39,730. a mile of track would not take us very far in the present day costs. A mile of track requires right of way, grading, track, switches, signals, bridges, etc., but when we also consider that the \$39,730. per mile includes as well the cost of all of the big terminals, station and yard structures, locomotives, freight cars, and passenger cars, then existing, we have a further assurance that now instead of the property investment being overstated as some have

told us by eight billions, the facts are that it is now understated by that amount.

That average of \$39,730. per track mile—which includes all the above factors and equipment—if spent for equipment alone would today purchase about one-half of a modern locomotive, or about a dozen freight cars.

We also know that there are large portions of roads and terminals constructed in and through large cities and on strategic locations in mountains and valleys, and having special originating traffic sources, that could not be reproduced for many times their original cost. The whole situation could be driven home with even greater force by applying reproduction costs to the transportation system and its equipment as a whole, and under any equitable valuation plan that is certain to be the result. The question of watered capital, or of alleged overstated property investment account, therefore as a whole, forms no part of the rate problem, and if it did nothing has been allowed to support it in railroad rates or returns.

In the meantime it is well to point out that the railroads of the Country show a remarkable advance in efficiency by the growth of the train load, the car load, and in public service generally, but their owners who furnished the money have never been allowed to participate sufficiently in the prosperity of the Country at large, of which they are one of the chief instruments.

The failure for a very long period to allow rates adequate to support the transportation system, is now being followed by a suggestion to patch up the present condition by suggesting the sacrifice of the conservatively managed roads for the benefit of the so-called weak lines. That we should not consider, unless the amount and value of the transportation service the weak lines render for the public justifies it, and their own financing has first been subjected to the keenest scrutiny. It is not from high rates that weak roads have grown strong, but from generations of conservative financing by which their stockholders sacrificed themselves in paying premiums for their stock, in foregoing larger dividends, and in allowing their managements to defer proper dividends, or to put back into their properties, without any public compulsion, earnings from both transportation and long-time investments, that might legally and morally have been paid to their owners. I do not see any miracle which will change that procedure in the future. There is, however, the necessity of changing the entirely inadequate rates and returns that have been allowed the railroads as a whole, including these weak lines, and in that readjustment the latter will have their honest share.

I cannot endorse the view that to deal adequately with the railroads in the matter of rates, will further increase the cost of living, or be an

excuse for profiteering. Compared with the value of the article transported and the total profit earned on such products, transportation costs have been very low, and any adjustment essential to bring the railroads to a proper self-sustaining condition, and take them from the backs of the taxpayers and the public Treasury will be equitable to the entire Country. The increase necessary to do so will be very small, compared to the rate increase that must be made on the railroads of any other Nation with which this Country competes in its trade and commerce. I am a firm believer in the fact that with better facilities, we can do an increased business and secure increased production and efficiency, and this is better for the Country as a whole than congested traffic, decreased output, and lower wages, and the total stoppage of new railroad mileage in our Country which is yet far from final development. Working and saving mean prosperity, but the railroads can never work efficiently nor at the lowest costs with a deficient plant, deficient revenues, nor insure the continued development of our vast mineral and manufacturing resources.

Surely this is not an unreasonable plan, particularly in this Country where rates are still lower and wages higher than any other civilized Country, and where the public—with the few exceptional and chronic dissenters—is generally

ready to pay reasonable and adequate rates in order to secure, under reasonable regulation, transportation facilities when and as needed to meet the traffic of the Country, which in the past has doubled about every twelve or fifteen years.

It was to meet this condition and give regulation a broadened power and increased responsibility that the Association of Railway Executives in its recommendations to Congress proposed a Secretary of Transportation, or a Transportation Board, to study and keep Congress and the Country constantly advised of the transportation conditions and necessities, and to certify its conclusions to the Interstate Commerce Commission. I will not dwell on the other suggestions of the Railway Executives for conservative Congressional action, looking to re-establishing the credit of the railroads by making Federal authority responsible for adequate returns from all rates, interstate and intrastate; suggesting a comprehensive rule for rate making; asking authority under proper approval to absorb or merge into the larger systems connecting lines and feeders, which collectively means about 1500 leased, owned and operated companies; also Federal approval of all securities before issue, and certification of the public need for all but nominal capital expenditures before they are made. You will understand on any large scheme of extended regulation how important it is to have well quali-

fied and experienced Transportation and Interstate Commerce Commissioners, amplified for local questions by State Commissioners, with long term of office and good pay, who will be able to give broad, just and prompt decisions in all these matters involving transportation needs and financial requirements. With all these powers the life and death of the railroads rests almost exclusively in their hands, they can make those decisions, or they can through unwise regulation or failure to regulate, paralyze them and crush out private initiative, and stop all broad measures to provide for their future.

Almost all of the large Cities on our lines are suffering from the lack of transportation facilities. The roads in the Eastern District have practically become the terminals of the railroad systems of the Country as well as the great centers of its population and business. All of this has added to the responsibility of railroad managers, and emphasizes the necessity for earning reasonable returns. It is so easy to promise and not be able to perform, to avoid disagreeable decisions instead of flatly saying "No" for fear of opening up a flood of public criticism. How is it possible to definitely commit the railroads to any extraordinary capital expenditures not already under way, when so many of them are not earning fixed charges, and nearly all of them have heavy debts due the Government? Unless the truth is told

plainly, how is the public to appreciate the true situation? Years ago we bought cars for \$1000. each and paid  $4\frac{1}{2}\%$  interest; now we have bought cars with the aid of the Government costing about \$3,000. each at  $6\%$ , so that the interest rate has risen about  $33\frac{1}{3}\%$  and price  $200\%$ , or both together means a  $300\%$  increase in the annual interest charges alone, to give service to the public. Nevertheless, the Pennsylvania System will do its full duty to the extent of its financial resources, and has agreed to accept over fifty million dollars worth of new equipment from the United States Railroad Administration, to be paid for in some way that will be satisfactory to both parties. It is, therefore, very essential that your City impress your representatives in the State and National legislatures with the necessity for returning these railroads to their owners in such physical and financial condition that they will be a benefit and not an obstacle to future National progress, and have proper funding provisions made by the Government as will enable the railroads to gradually repay their debts. A definite rate policy would do much to stabilize business. If the new legislation is unduly restrictive of private initiative and fair competition, and overlooks the important feature of sound railroad credit and expansion, the work of Congress is wasted. It is useless to offer political compromises or fair words and

more extensive regulation in a period of National reconstruction, when higher rates and better credit is imperative. Nothing but a straightforward business-like basis for dealing with the railroads will be protective of the public interest. We stand upon the threshold of losing the advantages on the one hand of private initiative and ownership of the railroads by our citizens, and on the other hand of abolishing the extensive system of National and State regulation built up in long years and at great expense. If following the release of the railroads from Federal Control, public regulation cannot allow railroad credit and expansion to progress, it will incur the verdict of gradually but surely ruining the railroads, and of wasting millions of money annually in the collection of information, and for making decisions and reports, which in practice proved useless in regulating constructively the transportation systems of the Country to serve it properly. This must mean that the Country will clean the slate and begin all over again, or go straight to Government ownership where the higher costs and political disadvantages can be concealed through appropriations, and the public will be unable to protect itself against a system from which individuality and responsibility will be eliminated or passed along from one Administration to another. All can be avoided by prompt action that will eliminate the railroad

problem from the political arena and let hard work, experienced direction and broad-minded regulation cure it for the Country's benefit. Delay and fettering legislation means our paralysis; broad-minded legislation, requiring equitable regulation means prosperity retained and extended in 1920.

As I regard the situation, I can see that the taxation bodies have protected themselves by large increases, that labor has insisted upon and received its share, and that higher prices for materials of all kinds have had to be met by the railroads, during Government control, but without a corresponding adjustment of rates to that higher basis of cost, nor their returns to a common-sense basis of attracting new capital into the business, which must be attracted from the investors and cannot be commandeered. It is imperatively necessary that these adjustments be made if we are to restore the credit of the railroads and again have progressive, efficient, growing systems of transportation, equal to the needs of our advancing commerce, industry and agriculture.