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Railroad Ills and Remedies

BROAD CONSOLIDATION THE WAY OUT—DISASTROUS EXPERIENCES OF GOVERNMENT OWNERSHIP IN CANADA

By
GENERAL W. W. ATTERBURY
President
THE PENNSYLVANIA RAILROAD

ADDRESS
at the
TWENTY-FIFTH ANNIVERSARY
of the
HARVARD GRADUATE SCHOOL OF BUSINESS ADMINISTRATION

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Broad Consolidation the Way Out

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I shall endeavor to present to you the situation of the railroads of our country as of today, the causes underlying that position, and what I regard to be the remedies.

Within a few years, three-quarters of a million railroad employes have lost their places by shrinkage in traffic; and the forces are down over a million from the peak in 1920. At the same time there has been a decline of many billions of dollars in the value of railroad securities; nearly all dividends have been reduced and many omitted entirely; numerous bond defaults have occurred and others have been averted only through government loans.

The effects, operating through the wide ramifications of ownership by our great insurance companies, savings banks, colleges, hospitals, foundations, charitable institutions, etc., and individual investors, have been to impair the income or the financial security, or both, of practically every citizen of this nation. The curtailment of railroad employes' buying power has hurt every industry, including agriculture.

In order to devise an effective remedy, we must first get at the basic causes.

As a preliminary, let us examine the capital structure of the railroads as a whole. Using the figures of the Interstate Commerce Commission, the total property investment of the railroads, as of December 31, 1931, was over \$26,000,000,000. Against this there were outstanding, in the hands of the public, \$18,000,000,000 of securities. Of these, \$6,600,000,000 were stocks and \$11,400,000,000 funded debt. The funded debt was 44 per cent. of the property investment.

In other words, the railroad properties are mortgaged for less than half of their fair intrinsic worth on the basis of the investments which created them. Certainly there is in these figures themselves no particular mark of a faulty capital structure for the railroad industry as a whole.

Four Principal Causes of Railroad Difficulties

It is evident, therefore, that we shall have to look further for explanation of the fact that in 1932 the railroads, as a whole, failed by \$153,000,000 to earn their fixed charges, and are doing worse so far this year.

As I see it, the principal causes of the present condition of the railroads may be grouped under four heads:

1. The depression itself;
2. Governmental regulation of railroad wages and rates;
3. Waste due to the competition of unregulated and partly subsidized transportation agencies by highway and by water; and
4. Excessive competition of the railroads with one another.

Now let me give you the views and recommendations of certain responsible bodies or groups which have a direct bearing upon the railroad situation.

Republican Party's Stand in National Platform

The Republican National Platform, adopted at its national convention in Chicago, June 14-16, 1932, is very explicit in stating that—

“The promotion of agriculture, commerce and industry requires co-ordination of transportation by rail, highway, air and water. All should be subjected to appropriate and constructive regulation.

“The public will, of course, select the form of transportation best fitted to its particular service, but the terms of competition fixed by public authority should operate without discrimination, so that all common carriers by rail, highway, air and water shall operate under conditions of equality.

“The railroads constitute the backbone of our transportation system and perform an essential service for the country. The railroad industry is our largest employer of labor and the greatest consumer of goods. The restoration of their credit and the maintenance of their ability to render adequate service are of paramount importance to the public, to their many thousands of employes and to savings banks, insurance companies, and other similar institutions, to which the savings of the people have been intrusted.”

President Roosevelt's Recommendations

Rather curiously, the Democratic National Platform, adopted at its national convention in Chicago, June 27, 1932, makes no reference whatever to railroads, nor to transportation except with respect to the “expansion of the federal program of necessary and useful construction affected with a public interest, such as flood control and waterways.”

The candidate of the Democratic Party, however, and now our President—Mr. Roosevelt—makes up in explicit recommendations what his Party's platform omitted.

He expresses the feeling that the government should announce its intention to stand back of the railroads for a specified period through continued Reconstruction Finance Corporation loans.

He advocates regulation by the Interstate Commerce Commission of competing motor carriers.

He believes that the railroads should be permitted and encouraged to supplement rail with motor service, in the public interest, and to modernize and adapt plant to new needs of the changing world.

He recommends that the Interstate Commerce Commission be relieved of requiring competition where traffic is insufficient to support rival lines, retaining, however, responsibility for protecting the public against abuse of monopoly.

He recommends the elimination of non-paying mileage where transportation needs of the community can be otherwise adequately met.

He asks that lawful consolidations should be pressed to conclusion, with proper safeguards for those who have invested their money or lives in railroad service.

He suggests government encouragement and co-operation rather than restriction and repression to produce lasting improvement in transportation.

National Transportation Committee's Views

Now on February 13, 1933, there was published the report of the National Transportation Committee, of which the late Mr. Coolidge was chairman.

In discussing Reconstruction Finance Corporation loans, the Committee said, “‘Adequate security’ does not necessarily mean ‘marketable collateral.’” Where a proposed R. F. C. loan “is sufficiently protected by priority of lien and reasonable prospects of earnings available to its priority of payment, we do not regard marketable collateral as a determining factor.”

The Committee recommended:

That in the regulation of competing agencies of transportation, such regulation should be extended to water rates and practices in coastal, intercoastal, and lake shipping to relieve commerce of present chaotic conditions. “Automotive transportation,” they said, “should be put under such regulation as is necessary for public protection.”

Unprofitable rail service should be replaced by cheaper alternative methods. Railroads should be permitted to own and operate competing services, including water lines.

Development of regulation and new methods of transport have ended need for further governmental fostering of competition with or among railroads. Regulation is sufficient. Railroads should co-operate to reduce competitive expense, abandon unnecessary services, consolidate metropolitan terminals, and eliminate circuitous haulage. Unnecessary facilities should be scrapped. Parallel lines and systems are declared “wasteful and unnecessary” and their elimination is urged under the plan of non-competitive consolidation.

Consolidation is advocated on regional lines, "looking eventually to a single national system with regional divisions, and the elimination of all excessive and obsolete lines and equipment." This implies total extinction of competition. Consolidation work "should be hastened and, where necessary, enforced."

Regulation should be extended to the whole national transportation system, but be applied only to the extent necessary for public protection.

Retroactive repeal of the recapture clause in the Transportation Act was recommended.

Inland waterways "should bear all costs of amortization, interest, maintenance, and operation," or be abandoned. Ratification of the St. Lawrence Waterway Treaty should depend upon meeting this test. Government barge lines should be discontinued. Motor transportation "should bear its fair burden of tax but only on a basis of compensation for public expenditure on its behalf, plus its share of the general tax load." Beacons, weather service, etc., should be continued to encourage air traffic during the development stage, but ultimately it should pay its own way.

Position of United States Chamber of Commerce

The Chamber of Commerce of the United States, as the result of its Referendum No. 62, as made public on January 5, 1933, developed the following:

Water and highway transportation should be open to railroads on equal basis with water and highway carriers.

Regulation should be reduced to the point of assuring fair rates and safety of operations, with avoidance of interfering with managerial functions.

The recapture clause in the Transportation Act should be retroactively repealed.

Section 15-a, which embodies in the Transportation Act the principle of a "fair return" should be replaced with a provision that rates be fixed with reference to their effects on traffic, the furnishing of efficient service at lowest consistent costs, and the yielding of reasonable average returns, permitting reduction of indebtedness and accumulation of adequate reserves.

Recommendations of Interstate Commerce Commission

The Interstate Commerce Commission, in its forty-sixth annual report, dated December 1, 1932, and its report on Co-Ordination of Motor Transportation, dated April 6, 1932, advocated regulation of interstate common carrier buses and common carrier and contract motor trucks, and urged Congress to consider the desirability of further regulation of interstate port-to-port rates of water carriers.

The Commission recommended:

That the railroads should be specifically authorized to engage in regulated transportation of both persons and property by motor vehicles in interstate commerce;

That Congress investigate the subject of subsidized competition against the railroads and the taxation of their competitors with respect to rail, water, motor and air carriers "with a view to placing competition on a just and equitable basis."

Railroad and Utility Commissioners' Views

The National Association of Railroad and Utility Commissioners, in a report by its Committee on Motor Vehicle Transportation, adopted November 15, 1932, endorsed the principle of adequate federal and state regulation of highway transportation service. It also approved a proposed uniform state carrier law, which declares all common and contract carrier trucks and buses to be affected with a public interest. The terms of the law include regulation of common carrier trucks and buses as to rates, fares, facilities, accounts, services, safety, schedules, prevention of unnecessary duplications, filing of reports, and certificates of convenience and necessity; contract trucks and buses to be regulated as to permits, safety, accounts, and operating methods, to be forbidden to give their patrons undue preference over those of common carriers, or to establish rates and fares less than those of common carriers for substantially the same service.

Platform of National Association of Manufacturers

The National Association of Manufacturers, in its Platform of American Industry for 1932, published May 16, 1932, recommended that each competing agency of transportation should be subjected to appropriate regulation upon non-discriminatory terms, so that all common carriers by rail, highway, air and water may compete under conditions of equality.

Railroads and Highway Users Agree on Principles

The Joint Committee of Railroads and Highway Users (of which Professor Cunningham was its most able Executive Secretary) agreed in its Report and Recommendations made public January 30, 1933, that in principle all commercial users of highways should be subject to federal or state regulation, and that railroads should be free to engage in highway and motor vehicle service on equal terms with all others.

This, I think, brings you up to date on the published recommendations of responsible organizations or persons in authority.

Now, getting back to our four factors of adversity: I shall not discuss the first cause—the depression—except to say that it has affected every form of gainful endeavor. The railroads will benefit with all other industry and agriculture when economic conditions reach that sustained plane of improvement toward which our energies must be co-operatively directed.

The second cause—the inconsistency of governmental policies in dealing with railroad wages and rates—I believe has never been accorded the importance which it deserves and, in consequence, the public is unaware of the extent of its bearing upon the present difficulties of the railroads.

Railroad Wages, Rates and Commodity Prices Unbalanced

During the World War, the government removed railroad wages and working conditions from the operation of natural economic law and

deliberately adopted the policy of regulating them politically. The result was an enormous inflation of payrolls and operating costs. It is elementary, in an industry having over half its costs in labor, that if earnings are to be safeguarded the rates must follow wages.

In the federal control war-time period, following each of the three major wage increases, the government acknowledged this principle by making rate increases, but it failed to the extent that wage and rate increases did not bear a proper relationship to each other.

In 1913, according to the records of the Interstate Commerce Commission, the average yearly pay in the railroad service was \$757; the average revenue per ton-mile was 0.729 cent; and the commodity price index of the United States Bureau of Labor Statistics stood at 100.

In 1920, the average yearly pay of railroad employes had been increased to \$1,820; and the average ton-mile revenue to 1.069 cents; while the average commodity index for the year rose to 221.

The increase in average pay had been 140.4 per cent.; the effective increase in rates only 46.6 per cent.; and the increase in commodity prices 121 per cent. Wages had gone up more than three times as fast as the ton-mile revenues, and nearly 20 per cent. faster than commodity prices.

Since 1920, all three have declined, but in widely differing degrees. From 1920 to 1932, average commodity prices fell 58 per cent.; but railroad wage rates declined less than 8 per cent.; and average ton-mile revenues 2.2 per cent.

Comparing the average conditions of 1932 with the pre-war basis of 1913, we find that the rates of pay of railroad employes were still more than doubled; that ton-mile revenues were higher by 43.3 per cent.; but that commodity prices were 7 per cent. lower.

At the present time, making full allowance for the voluntary reduction which became effective during 1932, the average wage scales of railroad employes are only 10 per cent. lower than in 1929, and only from 11 per cent. to 12 per cent. below the peak in 1920.

Lower Operating Costs Must Precede Lower Rates

The plain lesson of these figures is that the wage-fixing policies of the government, established during the war and continued after it, have resulted in imposing upon the railroads wage scales which are far out of line with commodity prices, while at the same time there has been established a schedule of freight rates inadequate to the wage levels, but still too high to stimulate rail traffic.

Shippers are dissatisfied with the rates, but the present financial condition of the railroads makes it impossible to reduce rates until economies in operation, following wage reductions; economies through co-ordination of service; and economies through drastic consolidation, can be made effective. Any reduction in earnings through rate reductions, under existing circumstances, would merely still further detract from the ability of all carriers to meet fixed charges. However, eventually rates must come down.

Relatively high rates bring results which follow the law of diminishing return. Either the traffic will find less costly means of transportation, or industry will relocate to reduce transportation costs. The rail carriers face disastrous effects in either event.

To further complicate the matter, provisions of the Railway Labor Act of 1926 have tended to freeze the then existing high wage level on account of the procedure pertaining to readjustments, which is so involved and prolonged that railroad management has not as yet generally resorted to it, preferring to work for voluntary reductions. Under the circumstances now existing, however, resort will probably be had to this procedure.

Governmental Power Without Responsibility

When federal regulation was first undertaken by this country in 1887, the original provisions of the Interstate Commerce Act were designed only for the protection of the public. No duty was placed upon the Interstate Commerce Commission to protect the rates or foster the welfare of the railroads. Presumably that was felt to be the duty of management, and so long as management was not unreasonably restricted the duty was capable of discharge.

The demand for increased regulative power, however, was insatiable. The Hepburn Act of 1906 gave the Interstate Commerce Commission what it had long sought—authority to establish rates according to its own ideas in place of those which it disapproved. Four years later, the Mann-Elkins Act made the Commission's power over rates almost supreme by authorizing it to suspend the operation of any proposed rate change pending investigation, and by placing upon the railroads the burden of proof to justify any advance.

Legal Basis for Governmental Obligation as to Rates

Assumption by government of such vast control over the conduct of privately owned enterprise logically called for corresponding responsibility for results. Indeed, it may well be urged that such obligation has a legal basis. It has long been recognized, as a part of the law of the land, that the authority of the government with respect to the rates of utilities—and these included the railroads—becomes arbitrary and, therefore, invalid, when the utilities are denied a fair return on the value of the property which they devote to the public service.

The multiplicity of regulating authorities in the case of railroads that extend through many states, and the hundreds of thousands of different rates which they have on the numerous commodities they handle, make it difficult, as a practical matter, for the railroads to secure the recognition of their constitutional rights to the same extent as is possible for the ordinary utility which deals in but one commodity such as gas, electricity or water. But this practical difficulty serves, as I see it, to emphasize the obligation of the government to recognize the right, since I can not bring myself to believe that the government would wish to take advantage of the opportunity to do injustice simply because available legal remedies are complicated and unlikely to produce satisfactory results.

Duty Recognized, but Defectively—"Recapture Clause"

However, no provisions to protect the right of the railroads to a fair return were contained in any of the laws respecting the regulation of interstate commerce up to and including the Mann-Elkins Act. Finally, however, in the Transportation Act of 1920, the principle was definitely recognized and the Commission was specifically directed to adjust rates from

time to time so that the carriers as a whole, or by territorial groups, should, under honest, efficient and economical management, earn annually an aggregate fair return upon the value of their property used in railway service.

This was accompanied by the famous "recapture clause" of which mention has heretofore been made, and under which a railroad earning over 6 per cent. on its property value, in any given year, would have to turn one-half the excess over to the government and place the remaining half in a reserve fund to be used as directed by the Act.

In this legislation two errors were made. One was in prescribing an annual basis for the computation of the "fair return." The other was the inclusion of the recapture clause.

The annual basis means only one thing, and that is that rates shall be adjusted downward in prosperous times, when business can afford relatively higher rates, and upward in bad times, when business wants lower rates. A longer period should have been prescribed for the computation of the fair return—say ten years—so as to cover business cycles.

Efficiency Penalized—Extravagance Encouraged

As to the recapture clause, it penalizes efficiency of management in prosperous times and puts a premium upon extravagance when earnings are good. That is, we must plough maintenance costs into our properties when times are good, and wages and material prices are high; whereas if maintenance were distributed over lean years it would aid materially in leveling peaks and valleys, stabilizing industry and labor, and would accomplish these ends with economy to the railroads.

The annual basis for the "fair return" provision, and the recapture clause, operating together, serve to prevent the railroads from doing what any well-managed enterprise should be free to do, namely, accumulate a surplus in prosperous years to tide over periods of depression. But even the return provided for in the law has not been accorded the railroads.

Effects of Governmental Intervention Summarized

To summarize, governmental intervention in rates and wages has given us:

1. A scale of rates which shippers constantly complain is higher than one under which the traffic of the country could prosper; but
2. Still not high enough to support the railroads under the governmentally determined wage scales.

At the same time, the annual basis of the "fair return" provision and the recapture clause violate sound business principles.

I shall now refer briefly to the third of the causes which I have enumerated for the present condition of the railroads—the wastes of highway and water competition.

Costly Abuses of Motor and Waterway Competition

Our highways, our 25,000,000 motor vehicles, and their accessory facilities make up a transportation system which has cost more than the railroads, but cannot replace them. It can and does, however, deprive them

of large revenues by selective absorption of some of the more desirable forms of traffic. It has a real field of usefulness. Fair criticism can only be directed at departures from that field.

The inland waterways, upon which perhaps \$2,000,000,000 have been expended, and which cost many millions annually for maintenance, chiefly represent the use of public funds to perpetuate and extend an inferior and outmoded form of transportation which, on equal terms, could not possibly hold its own against the railroads. Waterways divert much traffic from the railroads, and the government has taken the unwise step of going into the transportation business upon them itself, through the Inland Waterways Corporation.

In this connection it may be interesting to point out that on the Ohio River, in the 980 miles between Pittsburgh, Pa., and Cairo, Ill., there are 49 locks and dams and that the cost of canalizing this stretch of river was over \$129,000 per mile. In the year 1931, lock and dam operation, maintenance, interest, and depreciation cost the taxpayers nearly \$11,000,000, and all the freight carried by the river could have been taken care of by a single freight train daily in each direction on rails already paralleling the river.

Unsoundness of St. Lawrence Seaway Project

Above all, we should reject the costly and wasteful St. Lawrence Seaway project, before it is too late. Neither country needs it, since each is already greatly oversupplied with transportation facilities. If the two governments are determined to subsidize the transportation of western grain for export, by all means let them do so in the least costly way, which would be on the existing railroads. Even then the effect would probably be to reduce the world price of wheat, with little if any permanent benefit either to the Canadian or the American farmer. It seems to me incredible that the American people would, with their eyes open, sanction the spending of several hundred millions of dollars upon a project the principal effects of which would be to injure their own railroads and divert traffic from their own seaports.

No more inland waterways should be built until need for them is clearly shown and willingness and ability of their prospective users to pay for them demonstrated.

The Panama Canal has created a new intercoastal transportation system which has largely destroyed the transcontinental business of the railroads. I cannot, however, question its utility. Nevertheless, that is a story by itself. It is typical of governmental control on one hand and lack of control on the other.

Diversion of "Cream" of the Traffic—Unstable Rates

Since the adoption of the Constitution in 1787, Congress has had complete power, under the commerce clause, to regulate both highway and water transportation. It has never exercised the power at all in the case of the highways, and only in a very limited and inadequate degree in the case of water shipments. Most of the states attempt some degree of control over highway service within their own boundaries, but the measures are conflicting and, in the absence of federal control, ineffective. The completely regulated railroads are, therefore, compelled to meet the competition of carriers by highway and water which are largely, and in many cases totally, unregulated.

It is due to this fact, chiefly, that the railroads suffer from the diversion by trucks of the "cream" of the freight traffic. In the case of both highway and water transportation, lack of proper regulation has brought about a competitive condition of rates so serious and wasteful that service is frequently offered at less than actual cost. This injures every instrumentality of transportation, not only the railroads, but the competing agencies themselves. It is also against the interests of the public and of the shippers, and is a serious disorganizing element in practically every form of industry and agriculture. It should not be forgotten that the need for stability of rates was one of the great reasons for undertaking regulation of the railroads. Need for it is just as urgent now in the case of highway and water service.

Subsidies, Taxes—Rail, Highway and Waterway

Both highway and inland waterway transportation are subsidized. The extent of the subsidy on the highways is now known. Its existence may be deduced from the facts that motor vehicles as a whole do not, through gasoline taxes and license fees, fully support the highways which they use, and that the burden of the taxes is borne by the light cars, for which only low-cost highways are required, and not by the relatively small number of heavy trucks, for which high-cost highways are essential.

Properly contrasted: The railroads own and maintain their own rights-of-way, and pay taxes on them; the trucking industry's entire taxation would not carry its proportion of the costs of the highways and, therefore, as a comparative transportation unit, it is altogether tax free.

The subsidy to the users of the waterways arises from the fact that they contribute nothing to the charges on the public capital invested in the waterways, nor to their annual upkeep.

Excessive Inter-Railroad Rivalry—Its Chief Causes

The fourth cause for the present condition of the railroads which I have enumerated—namely, excessive competition among themselves—is a matter which recently has been much before the public eye. I will, therefore, not attempt to examine it in detail. The railroad managements cannot claim entire immunity to criticism, but the principal causes for the excessive duplication of services and facilities rest upon the traditional policy of the government to encourage competition and the long-established practice of patrons to demand as much of it as possible, blind to the inevitable increase in costs.

Five Measures of Relief Are Advocated

I suggest the following relief measures:

1. Acceptance of the principle that there is a relationship between rates and wages, and that the control of both must be so tied together that the governmental body which has the responsibility of regulating the one must not only have first-hand knowledge of the other, but also its control.
2. Assistance by the government, in the form of long-term low-rate financing, to carry the railroads along until safely stabilized by new methods of organization and the revival of business.

3. The regulation applied to the railroads should be more liberalized and brought back to its original basis, and then all competing forms of transportation should be regulated on an equal basis with the railroads. The regulative authority should be the Interstate Commerce Commission. Regulation of the various transport instrumentalities cannot be properly, equitably, or to the greatest advantage of the public, carried out with responsibility divided.
4. The appointment of a railroad co-ordinator as a temporary expedient, pending permanent regrouping of the rail lines.
5. Ultimate consolidation of all railroads into a very limited number of systems, in the interest of efficiency and economy; conserving competition between the great terminals only and abolishing it at intermediate points; and with due regard to employes thereby displaced.

As alternatives to the suggested consolidation there would appear to me to be only two possibilities.

Uncontrolled Deflation Not a Tenable Course

One would be to follow the custom of the past—let deflation take its course and hope, on precedent, for ultimate revival. This would mean prolonged receiverships, drastic reorganizations and scaling down of capital structures, with recovery—if and when it occur—beginning from a new and much lower base. It would mean, for a period, further serious reduction in the incomes of fiduciary institutions, etc., and individual investors, with the possibility of eventually regaining at least a part. It would mean more railroad unemployment than at present, and no means to take care of it. The depressing effects would spread to other industries and increase unemployment in them also. Certainly upon the premise that unemployment is our basic problem, the customary procedure fails to meet the test. If we adopt it again it would mean that after all our experience in past depressions we have still learned nothing effective about controlling our economic destiny.

America's War-Time Lesson in Government Control

The other alternative, at the very opposite end of the scale, would be government ownership.

Now, let me bring you up to date on government ownership. The experience of practical government control and operation in this country during and subsequent to the war should have taught us our lesson; but so much water has passed over the dam since that time that unquestionably many of us, except those, perhaps, in active railroad operation, have forgotten it. Briefly, the picture that it left in my mind was the lack of discipline and initiative as compared with their higher development under private operation; the danger of the creation of a powerful political machine; the building of unnecessary improvements, determined by sectional pressure, now so compelling in governmental expenditures; and the inevitable pressure of labor, on the one hand, for higher wages and uneconomic working conditions, and of patrons, on the other, for lower rates and extravagant services. It seems inescapable that with political forces tending to drive wages up and rates down, and with no effective counter influence, it would be only a question of time when railroad service would cease to be self-supporting.

Government Ownership's Test in Canada

While such was our own experience, let us see what has happened to the north of us in that great, friendly neighbor, the Dominion of Canada, where government ownership and operation of one of the rail systems has been effective for a sufficient period of time to demonstrate what it means. Here is an excellent opportunity to compare the operating policies and financial results of a great railroad system under government ownership and operation with another extensive railroad system under private ownership and direction, with both systems serving all important sections of the same country.

Merely to refresh your memory, I might say that Canada has about 25 per cent. greater area than the United States. Its population today is only 224 per mile of railroad, whereas in the United States we have a population averaging 493 to the mile of railroad.

The facts I shall now give you are taken from a Report of the Royal Commission to inquire into Railways and Transportation in Canada, submitted September 13, 1932, so that we can fairly assume them to be not only correct but unprejudiced.

The Canadian Pacific Railway was built in 1880-85. It had a comparatively small amount of government aid at the start. It has always been privately owned and very successful.

Nine Decades of Government in Railroad Business

The Canadian government has been in the railroad business for 90 years. The first 60 years covered the period of slow railroad expansion, much of which was in a sparsely settled territory—the government always lending a helping hand to the struggling rail lines during pioneering days. In 1917, the Canadian Northern was about to collapse and the government acquired control of 9,559 miles of railroad which, added to the 4,393 miles owned previously, gave the government a system of 13,952 miles. In 1920 and 1921 there were added 7,621 miles of Grand Trunk and Grand Trunk Pacific, which made the government system comprise about 22,000 miles.

Much could be said of the condition of these railroads when the government assumed control, but as the report of the Royal Commission deals primarily with the results of government operation of the 22,000-mile system for the period from 1923 to and including 1931, the previous history is not necessary except to state that in 1917 another Royal Commission studied the railroad situation and rendered two reports. The majority report recommended immediate control by the government of several thousand miles of railroad then in bad financial condition. The minority report, rendered by Mr. A. H. Smith, of the New York Central, disagreed with the majority and expressed doubt as to the adequacy of the machinery proposed by his colleagues to obviate what he considered the inherent defects of any scheme of public ownership and operation of railways.

Since January 1, 1923, all government owned railroads have been combined into a system called the Canadian National Railway System, with the late Sir Henry W. Thornton, until recently, as the operating head.

The Canadian government has voted unstinted financial support to this system. The Royal Commission reported that:

“Not only have the requisitions of the Board of Directors been freely met, but the management have from time to time recommended, the government, has approved, and Parliament has authorized and directed the construction of branch lines and the purchase of more or less bankrupt lines.”

Private Ownership Succeeds Despite Handicaps

As a result, the Canadian Pacific Railway Company, the largest taxpayer in Canada, has been subjected to the competition of a publicly owned and operated railroad supported by the financial resources of the country. Early in the existence of the Canadian Pacific, it paid back its obligations to the government, and this great railroad system has had an important part in the binding together of the western and eastern sections of the Dominion of Canada. Its success has commanded the admiration of railroad operators and the public generally, and has been “a material factor causing Canada to be favorably known upon three continents.” The operations of the Canadian Pacific were profitable to the investors and the Road became “a national asset of acknowledged value and importance to the Dominion.”

When the Canadian Pacific found itself subjected to intense competition on the part of the Canadian National, in order to protect its interests its managers were obliged to meet their competitor in the construction of new lines in prairie sections and, generally, in the character of service and equipment used by the governmentally supported railroad system.

“Irrational competition developed and intensified unhealthy operating conditions” in the Canadian National System. These conditions have imposed upon the Canadian public—the real owners of the Canadian National System—losses of great magnitude, “and have caused anxiety to holders of securities of the Canadian Pacific Company.”

The Canadian Pacific wanted to buy a controlling interest in what is now the Canadian National, but the Canadian government would not permit.

The Canadian National was never a well-planned, rounded-out system. It has much competitive mileage within its own system.

Disciplinary Check Upon Outlays Lacking

While the Canadian National has deservedly won approval by its success in welding together the various working forces of separate companies into a consolidated system, nevertheless the Report observes that running through its administrative practices “has been the red thread of extravagance.”

“The disciplinary check upon undue expenditure, inherent in private corporations because of their limited financial resources, has not been in evidence,” says the Royal Commission, and adds that, “Requisitions of the management have been endorsed by governments, and successive parliaments have voted money freely, if not lavishly.”

The Royal Commission found, in the Canadian National organization, a degree of “freedom in expenditure and encouragement in plans for expansion and extension of services which were inconsistent with prudent administrative practice.” The administration in charge of government railroads, with constant access to government money drawers, did not appreciate that the Dominion of Canada, with the greatest railway mileage in the

world in proportion to population, could not afford many of the expenditures for branch lines, for de luxe services, hotels, and ships in competitive service, which were entirely out of proportion to the requirements of the country.

Since the Canadian government has been in the railroad business it has invested and advanced \$1,200,000,000, on which it has received practically no return. In addition, the government has guaranteed bonds and securities of government owned railroads totalling \$1,280,000,000. In other words, the cash outlay and the guarantee of the government now amount to almost \$2,500,000,000.

The interest charges upon the securities of the government owned railroads, outstanding in the hands of the public, amount to \$56,000,000 annually. The system is unable to earn these interest charges and the government must provide the cash and, in addition, meet all maturing obligations.

Outstanding Superiority of Private Ownership Shown

The Canadian Pacific and the Canadian National System serve, in general, the same sections of Canada. Many additional miles have been constructed by both railroad systems during the past nine years. These additions were made under similar conditions and often in the same territory. For the purpose of comparing operating policies, efficiency and results, no better example can be found than these two enormous railroad systems operating side by side throughout the Dominion of Canada.

While the mileage of the two systems increased during the nine-year period, the new mileage was about the same for each system, and for comparative purposes we can properly use the mileage figures as of December 31, 1931, when the Canadian National reported 23,880 miles as against 16,886 miles for the Canadian Pacific.

The total operating revenue for the nine-year period ended December 31, 1931, for the Canadian National was \$2,337,793,894. For the Canadian Pacific it was \$1,885,803,690. The average annual revenue per mile on the Canadian National was \$10,877.50, but on the Canadian Pacific it was \$12,408.72.

The average operating ratio, excluding taxes, for the Canadian National during the nine-year period was 88.43 per cent. and for the Canadian Pacific it was 78.16 per cent. On the Canadian National this ratio increased from 91.8 per cent. in 1923 to 99.8 per cent. for the year 1931, comparing with corresponding ratios on the Canadian Pacific of 81.0 per cent. and 80.3 per cent. During 1926, 1927 and 1928, both systems showed a substantial reduction in these ratios, the Canadian National reporting a low mark of 82.0 per cent. in 1928 as against 75.4 per cent. in the same year for the Canadian Pacific. For all railroads in the United States, the average operating ratio in 1923 was 77.83 per cent.; in 1928, it was 72.45 per cent.; and, in 1931, 76.97 per cent.

Net Deficits Borne by Public Exceed \$400,000,000

For the nine-year period, there was a deficit of \$456,063,195 in the Canadian National System, after allowing for the payment of taxes amounting to \$45,426,397, as against a surplus of \$312,879,000 in the Canadian Pacific System, after the payment of \$47,980,820 in taxes.

The losses to the Canadian people, therefore, from operations of the Canadian National Railway, through interest deficits on bonds held by the

public and unpaid interest on government loans, in the nine years from 1923 to 1931, considerably exceeded \$400,000,000. Contrasted with this, the privately owned Canadian Pacific, in the same period, was a source of public income to the extent of nearly \$48,000,000 paid in taxes, despite the handicap of having to operate in competition with a publicly subsidized and parallel transportation system.

The Canadian Pacific, during the same period, in addition to paying its taxes and bond interest, also paid out \$278,000,000 in dividends on preferred and common stocks and added \$36,375,000 to surplus. These figures include income from steamships, lands, mines, and other investments.

Costliness of Inevitable Political Atmosphere

While apparently there was little or no direct political interference by Ministers and Members of Parliament in the detailed operation, there was always that larger political background which led to unwise and unnecessary capital expenditures. There was always an atmosphere in which the ordinary principles of commercial operation of a railroad were lost to sight. Sir Henry Thornton stated:

"After all in any form of popular government it must be accepted as axiomatic that the business of government is politics and, irrespective of whether one likes it or not, politics is something with which a government must reckon in all its activities."

The President of the Canadian Pacific Railway, Mr. E. W. Beatty, who also testified before the Commission, expressed these views:

"We talk a great deal about political interference being damaging to railway operations, and we know that that is true, generally speaking. But when we say it we seem to think the only political influence is that exercised by a government, or a member of government, or a member of parliament. To my mind the worst kind comes from the political attitude of men in publicly-owned institutions. Possibly they are not conscious of it, but they become politically-minded; their policies and actions have a political tinge, and that, from my standpoint, is more serious as representing the attitude of the corporation than the isolated act of a member of parliament who tries to get a man employed."

Privately-owned railroad companies, Mr. Beatty indicated, are today able to say "no" to political influence. "But," he added, "the politics that develop inside an organization because it is publicly-owned, and not privately-owned, is a serious thing."

The Royal Commission's Report makes it obvious that the Board of Directors and the management of the Canadian National were amendable to political influence and pressure when considering branch line extensions, acquisitions of new railroads, hotel expenditures and duplicate steamship services.

"The cash outlay of the Dominion government and the guarantee of securities for the railways now comprising the Canadian National System had," says the Report, "up to December 1, 1931, amounted to \$2,536,665,089. Of this amount, \$639,414,489 represented cash loans to the Canadian National, including operating deficits." The Report continues:

"The Treasury has charged, but has not received from the Canadian National Railways, simple interest upon its cash loans. There is no reason to believe that the capital sum will ever be repaid, or that it will have at any time a realizable value.

"The Dominion Treasury is also liable for payment of the guaranteed interest upon \$970,562,290 of bonds, as well as the principal sum at maturity. In addition, by provision for deficits and refunding, it accepts liability for the interest upon and principal sum of \$315,894,917 of bonds in the hands of the public, which, though not specifically guaranteed, are, in effect, a liability of the Government, as the bonds are secured by mortgage upon lines which are a necessary part of the National System.

"In the absence of net revenue sufficient to cover the interest charges (amounting in 1931 to approximately \$56,000,000) upon the securities in the hands of the public, the country must continue to advance the cash necessary to pay the unearned interest. The country must also provide the cash necessary to meet all maturing obligations and all capital expenditures for additions, betterments and new equipment."

Out of fairness to the government-owned railroads, there should be some emphasis placed on the fact that when Sir Henry Thornton took charge practically all the railroads put into the government system were insolvent and the over-capitalization was a serious handicap.

Strangling the National Credit of Canada

One of our outstanding engineering firms, in commenting on The Royal Commission's Report, states:

"The Canadian situation is so serious that the Canadian National Railways may be characterized as a strangling millstone about the neck of the country's credit, as it is the cause of about one-half of the direct national debt and of nearly three-fourths of both the direct and indirect debt, and with an ever increasing strangle-hold in prospect."

The Royal Commission stated that unless some action is taken promptly to stop the losses of the Canadian National System, the very stability of the nation's finances and the financial credit of the Canadian Pacific Railway will be threatened, with serious consequences to the people of Canada and those who have invested their savings in that railroad.

I believe I have now given you sufficient to convince you that if there is any other possible way out it should be attempted rather than resort to government ownership or operation of the railroads of this country.

Broad Consolidation the Hope of a Way Out

Nation-wide consolidation, I believe, offers the hope of such a way. The number of systems should be few; the grouping chiefly, but not entirely, regional. Competition between main terminals and its abolition at intermediate points is suggested upon the theory that the character of the through service determines that of all service, including that supplied at intermediate points. Therefore, if the lines of the country are so regrouped as to offer two—but in no case need there be more than two—optional competitive

routes between the principal traffic centers, we shall retain whatever good is inherent in competition and at the lowest possible cost. At the same time, public fear of monopoly would be allayed.

Such a plan of consolidation is the one which I advocate as best adapted to meet the situation which now exists. If intelligently followed, I believe it will result in putting the railroads in a secure financial position, in producing the best service at the lowest practicable cost, and in stabilizing employment.

Consideration Due Investors of Both Capital and Services

Consolidation would mean abandonment of considerable mileage and other facilities. The public would have a right to expect a corresponding scaling down in capital structure; but capital facing obsolescence through these causes, I believe, is entitled to consideration.

I have indicated my belief that the capital structure of the railroads, as a whole, is essentially sound—the total outstanding securities being materially less than property value, and mortgage debt less than half that value. If there be individual cases of improper financing, where they exist the usual penalty will have to be paid. But where investments are to be wiped out, or greatly scaled down, which, by the accepted standards of prudent judgment, were sound when made, and which were in accordance with the then existing policies of encouraging competition, I do not think the owners of those investments should bear the burden of a reversal of public policy.

The system of railroads which exists in this country today was created to conform with the policy of maximum competition, enjoined by the government and demanded by the public. If that policy is now to be radically revised, in line with what I certainly believe to be sound progress in economic thought, the government and the public owe a moral duty of reasonable consideration to those who, in good faith and judgment, have invested their services and savings in our existing system of rail transportation.

Is Money to be Treated as a Symbol, Not a Commodity?

Now as to our present situation:

To the consumable possessions which constitute the chief material wealth of our country, science has added in this modern day our great mechanical facilities for production and transportation; and these are now—potentially at least—our most valuable resources. In this view of the nature of wealth, the United States and the world are richer today than ever before in history.

Our troubles are due to the fact that our system of domestic and foreign exchange, and of credit and money, have not enabled us to use these productive facilities to anything like their full advantage.

As indicative of some present-day thought upon this subject, let me quote from some remarks made by Dr. Nicholas Murray Butler before the 179th Commencement at Columbia University just last Tuesday. "As a result of what has been and is now going on in the world," Doctor Butler said, "money may be dethroned and expelled from the high place which it has been occupying for some four hundred years." He speaks of money as having, in itself, no reality and but little value. "It is an invention of man," he says, "to meet the practical situation which is created when men are

able to produce more than they consume or when they produce something different from that which they wish to consume," and adds this significant statement:

"Until a condition is brought about in which money is looked upon and treated as the symbol which it is, and not as a commodity with a value and a purpose of its own, men can never shake themselves free from the shackles of what they have so long described as the 'money power.'"

Courage and Achievements of President Applauded

If I correctly understand the aim of President Roosevelt and his advisers, it is their determination to view wealth and production realistically, and not merely to repair, but in part rebuild our economic system in order that we may use these facilities and resources to better advantage than in the past.

I admire the President's courage. I admire his candor in telling us that in many respects he is experimenting and feeling his way. I wish him every success. I believe that he has already achieved real and definite results, and to a degree which I, for one, frankly admit I would not some months ago have thought possible.