THE RAILROADS AND THE PEOPLE

By E. P. RIPLEY

President of The Atchison,
Topeka and Santa Fe
Railway Company

Appearing in "THE ATLANTIC MONTHLY" of January, 1911

SHALL RAILWAY RATES BE RAISED?

By WALKER D. HINES

Chairman of the Executive Committee of The Atchison, Topeka and Santa Fe Railway Company

Appearing in "THE OUTLOOK" of December 10, 1910

THE RAILROADS AND THE PEOPLE

By E. P. RIPLEY

There is just one point about the present relations between the railroads and the people of the United States as to which all agree. This is that they are very unsatisfactory. Opinions differ as to why this is so. Many say that the roads themselves, by numerous sins of omission and commission, raised and have prolonged the storm of hostile public sentiment which has been sweeping over them for some years. The shortcomings and abuses in railway management, it is argued, have made necessary, for the protection of the public, strict and detailed public regulation; and railway owners and managers, it is asserted, have not met in the right spirit efforts to secure such regulation. Senator A. B. Cummins of Iowa expressed a widely-taken view when he said on August 17 in a letter to me, "The trouble with the railway owners and railway managers is that, instead of loyally and finally accepting the supervising and regulating power of the government, and helping to make its exercise fair and effective, they resist every proposal to enlarge public authority, and resent every attempt to interfere with their management. The outcome is constant irritation and increasing turmoil."

Railway managers do not deny that many mistakes have been made and many abuses have grown up in the development and administration of American railways. But they do deny the truth and fairness of many of the counts in the sweeping indictments of the roads that have been made and printed throughout the country, and feel strongly that most of the public hostility to the carriers is unjust. They do not doubt that the public means to be fair. But they feel that it has allowed itself to be misled, to its own injury, by these wholesale charges of wrong-doing. They believe that some of the legislation that has been passed recently is wholesome. But they think that many laws that have been enacted, and many projects for further regulation which are receiving popular support, are unwise, because they aim to do things that are undesirable, or to secure ends the attainment of which would be impracticable even if it were desirable.

Railway transportation is one of our largest industries. It employs over a million and a half of men to whom have been paid over a billion dollars in wages in a single year. The concerns that make and deal in railway equipment and supplies, whose prosperity depends on that of the railways, employ perhaps as many more. Upon the amount their employers can pay these men depends the amount they can spend with the local merchant. Upon how much goods the local merchant can sell depends the quantity he can buy from the jobber. Upon how much the jobber can sell depends upon how much he can buy from the manufacturer. And upon how much the manufacturer can sell depends how much wages he can pay and how much raw materials he can purchase. Therefore, the prosperity of the entire country depends to a very large degree on the prosperity of the transportation industry. I do not take the narrow view that this is true only of the transportation industry. But how much all classes will be affected by the condition of any industry depends on how large and important it is, and how extensive are its ramifications; and the prosperity of all depends so much on the condition of the transportation industry because it is the largest, the most important, and the most extensive in its ramifications, except agriculture.

The country has been feeling the effects for the last three years of an unhealthy condition of the railway business. If the railways had spent as much in proportion during this time for operation and additions and betterments as they did in 1907, their expenditures for these accounts would have been during this period about four hundred million dollars larger than they were. If there had been during the last three years as much new railway construction in proportion as there was in 1907, the mileage built would have been seventy-two hundred miles greater than it was, which would have involved an additional expenditure of approximately three hundred million dollars. Who can doubt that the fact that the railways during these years greatly curtailed their expenditures has been one of the main influences protracting the depression? In order to keep abreast of the growth of commerce they should have increased instead of reducing their expenditures.

That the relations of the railways and the people have not been put on a better basis has not been because there is any antagonism between their interests, but largely because the officers of the railways, on the one hand, and the leaders of public opinion, on the other, often have not approached the subject in the right spirit. It would be a thankless and fruitless task to inquire who has been the more to blame; both sides have been at fault. The discussion of railway regulation has too often resolved itself into arguing over what rights are guaranteed to the railways, and what power over them is given to the people by the Federal Constitution. Now, it is very desirable that the relative constitutional rights of the public and the carriers should be clearly defined, thoroughly understood, and faithfully respected. But the people and the railways have a relation which is even more important than their constitutional relation. This is the relation indicated by the subject on which the editor of the *Atlantic Monthly* has asked me to write—their "ethical relation." An ethical relation involves reciprocal duties, and the constitutional rights of the railway and the constitutional power of the public do not mark the boundaries of their duties to each other. There are many things railways ought to do for the convenience and benefit of the public that they could not constitutionally be forced to do. And on the other hand, the criterion of the duty of the public as to adopting any proposed policy regarding the railways is not merely whether it would be constitutional, but whether it would be just to the railways and for the good of the people. The proper relation between the railways and the people is that which, not merely temporarily, but in the long run, will best promote the "greatest happiness of the greatest number."

The formulation of correct general principles is important. Their practical application to specific cases is more important, and also more difficult. The principle that the proper ethical relation between the railroads and the people is that which will, in the long run, best promote the "greatest happiness of the greatest number" is easy to formulate; it will be universally accepted; but wide differences of opinion will arise as to its application. Yet it must be applied to practical affairs to be of any value.

The part of the railroad's business which has received the most discussion and regulation is its rates. Both the law and sound ethics require rates to be "fair and reasonable;" that is, equitable as between different commodities, shippers, and localities, and not exorbitant.

Two widely different theories have been advanced as those which ought to govern the making of rates. These theories may be denominated as—

(1) The value of the service.

(2) The cost of the service.

The railroads themselves (and I think nearly all intelligent students of the question) advocate the former. There is little difference in the cost of transporting a car of automobiles and a car of sand, yet it is manifest that a rate which would be much less than fair for the automobiles would prohibit the movement of the sand; therefore, the rate on the sand, if moved at all, must be actually less than the *average* cost of moving all freight, while the rate on the automobiles must be very largely in excess of the average cost. A mere statement of this proposition should suffice to prove it. There is one point regarding this matter that many forget: this is that in all affairs there are two kinds of discrimination. There is the kind which, as the dictionary expresses it, "sets apart as being different," which "distinguishes accurately," and there is the widely different kind which "treats unequally." In all ordinary affairs of life we condemn as "undiscriminating" those who have so little judgment of fairness as not to "distinguish accurately" or "set apart things that are different"—who either treat equally things that are unequal, or treat unequally things that are equal. Now, when the railway traffic manager "sets apart things that are different," and treats them differently, he simply does what it is the duty of everyone to do.

This shows what is meant by basing rates on the "value of the service"—on "what the traffic will bear." This method of making rates has been widely and vigorously denounced; but, when properly carried out, it is merely the "setting apart of things which are different" in a way that is highly beneficial. The free movement of all commodities promotes the "greatest good of the greatest number;" and as the adjustment of the rates on the various commodities roughly in proportion to the value of the services rendered in hauling them is an imperative condition to the free circulation of the cheaper and bulkier commodities, in so adjusting its rates the railway simply does its public duty. At all events, this policy has built up the business of the country to its present proportions.

Many, while conceding that the rates on different commodities must be adjusted according to the value of the service, contend that the rates for different hauls of the same commodity should be based on cost, or on distance, which is a rough measure of cost. Railroad men do not believe that rates ought always to increase *in proportion* to distance. They believe that here again we should "set apart things that are different." All statesmen and economists agree that free industrial and commercial competition promotes the public welfare. Now, the policy of American railways in generally making their rates lower in proportion for long than for short distances—in basing them on the value rather than the cost of service—has enabled producers throughout a large territory to compete in every market, and consumers to get commodities from every point of production in that territory; and has, therefore, I believe, been of great benefit to the public.

Many persons who concede that distance must, to a considerable extent, be disregarded, argue that at least there can be no excuse for so far ignoring it as to charge a higher rate for a shorter than for a longer haul over the same line. But this, again, is often merely "setting apart things that are different." When a railway makes a lower rate for a longer than for a shorter haul, it is usually because it meets controlling competition either by water or by rail at the more distant point, which it does not meet at the nearer point. It could no more afford to make rates proportionately as low to the intermediate as to the more distant point than it could afford to make as low rates on all commodities as it makes on sand. If it quit meeting the competition at the more distant point, the shipper at the nearer point would not be benefited, because he would still have to pay the same rates as before, while the shipper at the more distant point would still be able to get his goods by the competing rail or water line at the same rate as before. The railway which had withdrawn from competing would be injured, because it would no longer get any of the competitive traffic; and shippers and consumers at the more distant points would be injured, because they would no longer enjoy the benefit of its competition with the other lines serving them.

This shows that the "greatest good of the greatest number" is often best promoted by almost entire disregard of distance in rate-making.

No doubt many will say that theoretically the value-of-the-service principle is right, but that many mistakes have been made and many abuses have developed in its application. This is quite true; there have been many discriminations which have consisted in "treating unequally," and for them the railways deserve condemnation. But unfair discriminations in rates afford the best illustration of the fact that, in order that the railway may do its full duty to the public, the public must do its duty to the railway. Secret rebating has been practically extirpated. For the fact that it and other forms of unfair railroad discrimination continued so long, and that some still exist, the public is much to blame. Since the original Interstate Commerce Act was passed, there has not been a time when our laws regulating railways have not been so inconsistent and conflicting that railway men could not obey one part of them without violating another part. The best parts of the Interstate Commerce Act are those prohibiting unfair discrimination. The big shippers and large centers of industry and commerce control a great deal of traffic. By withholding their business from roads which will not give them unfair concessions, and giving it to those which will, they have got many unfair advantages. In compliance with the provisions of the Interstate Commerce Act, and in the performance of their duty to the public, the railways ought to abolish these unfair discriminations. But to do so, all competing railways must act in concert regarding rates; and under the Sherman Anti-Trust Law such a perfectly reasonable and salutary combination by the railways has been held to be an illegal conspiracy! In other words, existing laws forbid the railways to discriminate unfairly, and then make it criminal conspiracy for them to take the only action that will effectually prevent unfair discrimination.

It may be said that, as the Interstate Commission now has authority to reduce any rate, and to prevent any advance in rates that it finds unreasonable, it is unnecessary for the railways to be allowed to act together to stop or to prevent unfair discrimination; that the Commission can do this. But unfair discrimination consists in the fixing of unfair relations between two or more rates, and may be due either to the fact that one rate is too high or that some related rate is too low. Therefore, anybody, in order in all cases fairly to correct discriminations, must be able either to reduce a rate that is too high or raise a rate that is too low. But the law confers on the Commission only authority to reduce rates and prevent advances.

The public very properly requires the railways to give it and all its patrons a "square deal." Have not the railways an equal right to demand a square deal from the public? And can they be said to be getting it as long as the laws are such that they cannot obey part of them without incurring the danger of punishment for violating another part of them? The Interstate Commerce Law and the Sherman Anti-Trust Law should be so modified as to permit railways to enter into reasonable agreements regarding rates. This is allowed in every other leading country in the world. The Interstate Commerce Act should be further amended so as to authorize the Commission, when it finds a certain adjustment of rates unfairly discriminatory, to correct it by ordering either advances in the lower or reductions in the higher rates, according to which may be most fair.

For the last two or three years the pubilc has been giving less attention than formerly to unfair discrimination, and more to the question of the absolute amount of the rates that ought to be allowed to be charged. As has already been said, it is the duty of the railway not only to make its rates fair as between different commodities, shippers, and communities, but also to make them reasonable—that is, not excessive. I believe the railways of the United States have fully discharged that duty. Traffic cannot grow rapidly on excessive rates; and industry and commerce cannot thrive on them. But traffic and industry and commerce have increased in an unprecedented and unparalleled degree on the rates made by American railways.

If further evidence be desired that the rates of the railways of the United States have been reasonable, it can be found in a comparison of them with those of the railways of other countries. Such comparisons are deceptive unless account be taken of the differences between transportation and industrial conditions here and abroad; but, making generous allowance for all these differences, it is conceded by every competent economist who has ever investigated the subject that the rates of our railways are the lowest in the world.

A railway, however, has not discharged its full public duty even when it has made its rates both fair and low. It is also its duty to treat its employes well, and to give good service to the public. That the railways of the United States, while keeping their rates low, have done well by their employes, is amply demonstrated by the statistics regarding the wages paid them. While railway rates have remained almost stationary, railway wages have been increased during the past ten years about twenty-three per cent; and railway employes are today—as, in fact, they have been for years—the highest-paid workingmen in this or any other country. It is the duty of railways, not only to treat their employes well, but, whenever at all possible, to reach settlements of disputed points with them in an amicable way. This duty was not fully appreciated in past years, and the consequence was strikes and lockouts which caused enormous trouble and loss to the public. It is a duty which been fully appreciated and performed in later years, and, in consequence, there has been no very serious interruption to commerce, due to railway strikes, for a long time.

As to the railway service in general in the United States, it has many shortcomings; but the managements of the roads are constantly striving to make it better; and the great improvements that have been made in it in recent years ought to be sufficient evidence that they will in course of time make it as good as anyone can reasonably ask, if they are allowed to charge rates that are reasonably proportionate to the value of the services they render for them.

There are many persons, however, who think that the reasonableness of rates should be measured by some other standard than the value of the services rendered for them. They contend that all a railway is entitled to is a "fair return" on the fair value of its property; that a fair return is the current rate of interest; and that if it is earning, or in future shall earn, more than this, then its rates should be reduced. Is that an equitable proposition? It is true that the railway's service is public and it is therefore subject to regulation; but its ownership is private. When private capitalists built our railways they did so with the understanding that if they gave good service at fair and reasonable rates their duty to the public would be discharged; and that, in return, the public would no more limit the *profits* they derived from their business than it would limit the profits derived by investors from any other business. The railways have in the main carried out their part of the bargain. Now, obviously, the proposition to regulate rates as to limit the earnings of railways to a "fair return" is a proposition, not merely to require their *rates* to be reasonable, but to limit their *profits* in a way that profits in no other business ever have been limited in any other commercial undertakings in any country on earth.

It is sometimes said that the fact that railways exercise the power of eminent domain gives the public a special right narrowly to limit their profits. But the power of eminent domain can be exercised only for the public benefit; railways are allowed to exercise it only because otherwise they could not be built at all, and because their construction and operation is of benefit to the public. On what theory of equity can the exercise by the railroad of a power which is conferred on it, and which it exercises for the public good, be turned into an argument for so regulating it as to make it less profitable than concerns which do not serve a public use, but merely serve a private purpose?

One of the greatest difficulties in the way of so regulating rates as to limit each railway to a "fair return" is that railways differ as widely as individual men. Some roads are favorably, others unfavorably located. Some managements have great, and others only moderate foresight and ability, and others almost none. To limit the profits of the favorably located and well-managed railways to the current rate of interest would deprive them of the rewards of, and the incentive to, good management. As rates on all competing roads must be the same, it would prevent weaker roads from earning any return, and bankrupt them. How is it possible that anyone can believe that such a policy would be just either to the strong or to the weak roads?

If one formed his opinion solely by following the discussions of railway rates, he would conclude that all the public wants is low rates, and that it is willing that the railroads should reduce the quality of their service indefinitely if this be accompanied by proportionate reduction in rates. But this is far from the case. Railway men are beset constantly by demands for reductions and opposition to advances in rates. But they are beset just as constantly by demands for improvements in service. The public cannot both eat its cake and have it. It cannot at the same time get, and ought not to ask, both lower rates and more expensive and better service. Which of the public's demands, then, ought the railways, with the coöperation of the regulating authorities, chiefly to seek to meet?

It seems to me that they ought mainly, at least for some years to come, to try to meet the public's demand for better service. For railway rates in this country are the lowest in the world. In some respects, railway service here is the best and most efficient; but everyone knows that there are many improvements in service which ought to be made in the interest of the public safety, convenience and economic welfare.

The statistics of accidents on American railways are only too familiar. I need not repeat here the harrowing details to show the need of making our transportation safer. About eighty percent of railway accidents are caused by mistakes, or reckless violations of the rules of the companies by employes; but a great many are due to defects and shortcomings of the physical plants of the railways. The total number of miles of railway in the United States on June 30, 1909, was 236,869. Block-signals are very useful in preventing accidents, even on roads where traffic is comparatively light, and are absolutely requisite to safe operation where it is heavy. Yet a report of the Block-Signal and Train-Control Board of the Interstate Commerce Commission shows that on January 1, 1910, the mileage operated by block-signals was but 65,758 miles, or only twenty-seven percent of the total, and that of this only 14,237 miles were operated by automatic blocks. In the interest of public safety there should be a very great increase in the mileage of block-signals.

In order to make their service safe, many roads will have to do an amount of work for the strengthening of their tracks which will amount practically to reconstruction of large parts of them, or, in the cases of not a few roads, of all of them. In the course of time all grade-crossings between railways, and between railways and highways, ought to be eliminated. Many other costly improvements ought to be made to render transportation safe; and the roads are not only willing, but anxious to make them as fast as their financial resources will permit, and also to submit to and comply with all reasonable legislation intended to promote safety. It is significant that while the railways have contested in the courts a great deal of legislation regarding rates, they have never tested the validity of the original federal safety-appliances acts, although their constitutionality has always been doubtful, but have faithfully complied with them; and that at great expense, they are now pursuing the same policy in reference to the new safety-appliance act passed by Congress in 1910. Railway managers are just as anxious to make their service safe, both for their employes and for passengers, as the public is to have them do so. The main difference between them and those who criticise them is that the railway managers appreciate more keenly the expense that must be incurred, and the difficulties that must be overcome, in making transportation safe.

Every railway manager in the country has in his files scores of petitions for the construction of new passenger stations. These vary in importance and amounts of money involved from the request of villages that their little wooden depots be replaced by larger and more pretentious brick ones, to the demands of cities, such as Kansas City, Washington, Chicago and New York, for new passenger terminals and stations costing from $20,000,000 to $100,000,000 each. In many cases the roads are asked to build not only handsome and expensive stations, but to surround them with beautiful parks. The railways at Kansas City, as one of the conditions of the passage by the city of an ordinance authorizing them to build a new union station, are giving the public a park adjacent to it costing $500,000. The appearance of the railway station and grounds considerably influences the opinions visitors form of a town or city, and it is perfectly natural that the people should desire them to be commodious and beautiful. The public constantly grows more exacting in its demands for comfort, and even luxury, on passenger trains, and for their strict adherence to their schedules, so that the traveler can tell with unvarying accuracy at what time he will reach his destination.

Shippers constantly ask more and faster freight service. There has been during the last several years a great deal of complaint because the roads have been unable in the busiest parts of the year to handle promptly all of the freight traffic that has been offered them. In order that they may become able to do this they must build numerous extensions and branches, and many miles of second, third and fourth track. The railways of the United States today are practically a single-track system; of the 236,869 miles of line, only 21,000 miles are double-tracked. The roads must also greatly enlarge their terminal facilities and provide hundreds of thousands of new cars and locomotives.

The roads ought to make all these great improvements. But it is perfectly evident that if they are to be made, they must be paid for; and that if they are to be paid for, the public has a part to perform—that of letting the roads earn whatever is necessary to make it practicable to pay for them. Now, while some improvements increase the earning capacity of a railway, others do not. For example, from the $500,000 the roads are spending on a park at Kansas City they will never derive a dollar of return.

They are spending two or three million dollars on the union depot at Kansas City. A station which would serve adequately all purely transportation purposes could be built for $200,000. On the difference between these amounts the roads will receive no return. Similar comment might be made on all large passenger stations. They are built for the benefit of the public, not for the profit of the railroads. Elevation of tracks and separation of grades increase to some extent the efficiency of railway operation, but the amount by which they reduce operating expenses is far less than the interest on their cost. The amounts by which the enlargements of terminal facilities in big cities, which must be made if the growing traffic is to be properly handled, will increase net earnings, will in many cases be less than the interest on their cost.

Improvements which increase earning capacity ought to be capitalized because they afford the means for paying interest and dividends. But suppose the total investment of $2,000,000 in a passenger station be capitalized. In twenty-five years the interest on the investment at four percent will have equaled the original cost. At the rate this country grows, the station may then be so obsolescent that it must be replaced by another station, costing perhaps $6,000,000. If this station also be capitalized, the road will thereafter have to pay interest on the $8,000,000 it has spent on the two stations, alhough it will have but one station.

Now, if a railway is allowed to earn nothing over a "fair return," it will have no earnings to invest in improvements; in that event it will have to make from capital improvements that do not increase earning capacity; and that would result in a rapid and heavy increase of capitalization. Would that be fair to posterity? That the English roads have piled up a capitalization of $314,000 a mile is very largely because they have paid for all improvements and betterments out of capital whether they increased earning capacity or not. Unable to raise their rates high enough to earn a return on this enormous capitalization without imposing an intolerable burden upon commerce, they are now threatened with general insolvency. This is the situation American railways would be facing in a comparatively few years if the policy of narrowly limiting their net earnings, and thus forcing them to make all improvements from capital, were adopted.

If the public can and shall regulate railway profits, it should adopt the policy of letting the railways, or at least the better-managed ones, earn as much to be spent on improvements as they pay out in dividends on a reasonable stock capitalization. If, for example, a road is paying seven percent on its stock, it ought to be allowed to earn an equal additional amount with which to make improvements. This policy, which is the one followed by well-managed industrial corporations, would both allow the better-managed roads to enjoy the benefits of their good management, and protect the weaker roads from reductions in rates which would bankrupt them. It would also strengthen railway credit. That the railway exercises the right of eminent domain is held to give the public a special power to regulate it; but when it goes into the money market to raise capital, the power of eminent domain gives it no better credit than that possessed by an industrial corporation. If it is barely able to earn its dividends, the investor will know that if bad times come it will become unable to meet its obligations to its bond and stock holders, and he will not invest in its securities except at a discount proportionate to the risk taken. Therefore it is necessary for the railway in good times to earn more than its interest and reasonable dividends, not only that it may have surplus earnings to invest in improvements that will not increase its earning capacity, but also that it may be able to get on reasonable terms the capital necessary to make extensions and improvements which will increase its earning capacity.

It may be replied that if the railways are allowed to earn large profits in order to have earnings to invest in improvements, they will subsequently capitalize all such investments, and then seek to make the public pay a return on them, and that, to prevent this, the public should regulate their issuance of securities. The past history of our railways, which is the only thing we can judge by, is against this theory. Some railways have capitalized earnings invested in the properties, but many have not. The amount of invested earnings that has not been capitalized greatly exceeds the amount that has been. And it is due largely to this that American railways are now the most conservatively capitalized railways in the world. This statement will be received with incredulity by most people. The public has lent an all too willing ear to the oft-repeated mis-statement that our railways are overcapitalized. It is true that some of them are, but who can believe that they are as a whole after reading the following figures regarding the capitalization per mile of the railways of our own and other countries: United States, $59,-259; Argentina, $59,930; New South Wales, $63,999; Canada, $66,752; Switzerland, $109,000; Germany, $109,788; France, $139,290; United Kingdom, $275,040; England alone, $314,000?

If the public, in order to enable the roads to make needed improvements in their facilities, shall permit them to earn more than enough to pay substantial dividends, the roads, no doubt, will be under a moral obligation properly to invest the surplus earnings in the properties and to abstain from capitalizing them. It has been proposed to subject the issuance of railway securities to regulation by the Interstate Commerce Commission; and undoubtedly, if the roads did not deal fairly with the public in regard to this matter, this would strongly reinforce the argument for such regulation.

There are many other points regarding the relations of the railways and the people on which I should like to touch if space permitted. The one point, however, that I am most anxious to drive home is the one that comes out most prominently in the intelligent discussion of every phase of the railway question—namely, that the duties of the railways and the people, whether in regard to rates, or service, or capitalization, or any other feature of railway policy, are equal and reciprocal. This must always be true while the service of the railways is public and their ownership is private. The public, on the one hand, and the private owners of the railways, on the other hand, have exactly equal rights to demand that each shall give the other a "square deal." When either asks much, it must, for equitable as well as economic and legal reasons, be prepared and willing to give much in return.

Up to a comparatively few years ago, the public probably did its duty by the railways better than the railways did their duty by the public. Broadly speaking, the management of our railways was good; but some deplorable abuses characterized railway management. The public was amply justified in growing incensed at these conditions, and taking vigorous measures to remedy them. But the course the public actually has adopted has not been fair to the railways, or to itself. It has not been content merely to pass and enforce laws for the suppression of the real evils in railway management. It allowed itself to be hurried into a fit of passion against the roads; and this has been succeeded by a prejudiced mental attitude toward them. The result has been that it has given willing ear to innumerable glaring misrepresentations of them, and has passed numerous laws which are extremely unjust and injurious.

Take, for example, its attitude toward secret rebating. This was the most pervading and pernicious abuse that ever developed in the railway business in this country, and the public was justified in adopting measures for its suppression. But the public has been unfair in that it has habitually refused to give due weight to the fact that no rebate was ever given which was not received by some one; and that the recipients were just as guilty as the givers; or to the further fact that the railways tried repeatedly to stop rebating, and did more than any one else to get passed the Elkins Act of 1903, which did more to suppress that evil practice than any other piece of legislation.

Again, the railways have been bitterly denounced by the press, public men and the people for having at times used corrupt means to prevent the passage of laws which their managers thought would hurt them. The use of such means was ethically indefensible; but the people were largely to blame for it. The people elected corrupt men to the legislatures, who introduced measures whose passage would have been injurious to the roads, and the purpose of whose introduction was to blackmail them. No doubt the roads should have submitted to the passage of these unfair measures instead of submitting to being blackmailed. But can the people who elected these men to office fairly lay all the blame on the railways for the corrupt bargains which their chosen representatives struck with the representatives of the railways? The railways all over the country are now trying very hard to avoid entirely the use of improper measures to influence legislation. They have a right to ask that the public shall meet them halfway in this matter. But the blackmailing lawmaker still regularly turns up in many of our city councils and state legislatures.

Once more, some newspapers and public men have purveyed for public consumption, and the public has accepted, the most tropical misrepresentations of railway capitalization. For example, certain public men have repeatedly asserted that the railways of this country are overcapitalized to the extent of $8,000,000,000. Now, there is not one scintilla of evidence to support that statement. Every fair valuation of railways which has been made by commission or court has shown that most of the railways valued were capitalized for less than it would cost to reproduce their physical properties. Only a short time ago I saw the statement in the Washington correspondence of one of our leading newspapers that our railways are capitalized for an average of $235,000 a mile. The writer of that statement, and the readers of it, could have found by investigation that there is not a single railway in this country capitalized for as much as the amount stated, and that the average capitalization of our railways, as reported by the Interstate Commerce Commission, was, on June 30, 1909, as already stated, but $59,259 per mile. But the public has not investigated misstatements such as this, which are quite worthy of Baron Munchausen. It has accepted them as the true gospel, and it is mainly owing to this that there is today in progress a widespread agitation for a physical valuation of railways which is being conducted on the utterly erroneous theory that the railways are charging excessive rates to pay a return on excessive capitalization, and that for the protection of the public their value must be ascertained and used in future as a basis for the regulation of rates.

Meanwhile, the attitude of the railway managements has been changing. The duty of the railways to the public is now more clearly recognized by their managers, more frankly conceded, and more fully and faithfully performed, than it ever was before. In consequence of these changes, I believe that it can truthfully be said that, whereas up to a few years ago the public did its duty to the railways better than the railways did theirs to the public, the reverse is now the fact; and that the railways have a right to complain that they are now doing their duty to the public much better than the public is doing its duty to them.

To remedy the present unsatisfactory condition it is needful, on the one hand, that railway managers as a class shall clearly see and frankly concede that they are quasi-public servants, owing a different and a higher duty to the public than almost any other business men, and act accordingly. They must also recognize that their duty does not consist merely in making reasonable rates, giving good service, and honestly managing the properties entrusted to their care for the benefit both of the owners and the public, for the public has a right to interest itself in all the various questions about railway policy that arise; many of these questions are very complicated; and it is a duty of railway men, which usually has been rather poorly done, to discuss these questions with the public fully and candidly, that the public may know the imperative practical conditions which require the railway business to be managed on much the same commercial principles as other businesses, and why it is to the interest of the public that it shall be so conducted.

On the other hand, it is the duty of the public to disabuse its mind of much of the misinformation and prejudice about railways with which it has been filled by the anti-railway agitation of the last five or six years. As it is the duty of railway managers to remember and to act always in accordance with the fact that the railway is a public service corporation, so it is the correlative duty of the public always to remember and act in accordance with the fact that the railway's ownership is private; that the private persons who own it have the same right to demand protection in the enjoyment of their property rights as the owners of any other private property; and that unjust attacks on their rights of property are just as immoral as attacks on the property rights of the manufacturer, the merchant, or the farmer, and will, in the long run, react just as disastrously on the welfare of the country. The people can make the ownership as well as the service of our railways public if they wish to; and as long as they do not do so they cannot fairly treat them as if they were public property.

It is perfectly feasible to establish proper ethical relations between the railway and the people; but I know of no way in which this can be done except by following substantially that noble rule, whose influence is all too seldom felt in modern politics and business, of each doing by the other as he would be done by.

Shall Railway Rates be Raised?

By WALKER D. HINES

In controversies respecting railway rates attention is generally centered upon the active contestants, who are usually the merchants and shippers and the railway companies. But the public interest in the conservation and development of the country's transportation service reaches far beyond these classes of society. The interests of railway labor, of the investors in railway securities, of the producers of railway supplies and materials, of those concerned in the opening up of the undeveloped regions of the country, and, above all else, the interests of all the people in the extension of railway transportation and in the increased convenience, efficiency and safety of that transportation, are vitally involved.

These general interests of the public require that railway companies should be given an opportunity not merely to earn interest and dividends with respect to their existing property, but also to earn an adequate surplus to serve as a basis for providing the money needed for the continual improvement and expansion of railway properties so as to keep up with the progress of civilization, the development of new territory, and the growth of population and business. This article supplies a concrete illustration of this proposition, through the presentation of a brief history of the actual financing of an important railway system.

The Atchison, Topeka & Santa Fe Railway system is one of the great railway properties of the country. It has a mileage of about ten thousand miles, and the vast area of country which it serves is shown in graphic form by the accompanying map. Some of its important terminals are Chicago, Kansas City, Galveston, Denver, El Paso, Los Angeles and San Francisco. Its main lines and branches cross or penetrate nine States and Territories—Illinois, Missouri, Kansas, Oklahoma, Texas, Colorado, New Mexico, Arizona and California, and also reach one or more places in Iowa, Nebraska and Nevada.

The original Santa Fe Railroad was organized and began business about 1875. It and its competitors were, however, extended too rapidly in an undeveloped country which could not supply business enough to go around, and the result was that in 1895, at a period of business depression which prevailed throughout the country, and which caused a very large number of railway receiverships, the company, after many ups and downs, became hopelessly bankrupt. The property was reorganized, and the present Atchison, Topeka & Santa Fe Railway Company began business in January, 1896. Roughly speaking, it paid for the property about $377,000,000 in stock and bonds. Since that purchase it has spent in the development and improvement of the property not less than $150,000,000 raised by the sale of additional bonds, and fully $50,000,000 more which it has taken out of surplus earnings, a sum greater than the total amount of dividends paid upon the common stock during the entire life of the company, such dividends aggregating about $48,000,000. That the stock and bond holders have not received an unreasonable share of the earnings is indicated by the fact that the bond interest and stock dividends actually paid on the total outstanding securities have averaged for the last fourteen and a half years 3¾ percent per annum.

The reader will at once ask why the company has had to spend $200,000,000 upon its property in fourteen and a half years, in addition to all the heavy running expenses of operating the property and keeping it in repair, and whether similar expenditures are to be expected in the future. Here is the answer:

The expenditures have been on account of additional and improved equipment and other additions and betterments, such as second track, improved track and roadway, improved terminal facilities, and in part on account of additional mileage. The expenditures on account of additional mileage have averaged for the fourteen and a half years about $4,500,000 per year, but for the year ending June 30, 1910, were nearly $9,000,000. The necessity for the construction of many additional lines is already apparent, and more and more of such work will become essential as the country develops. The Santa Fe system serves a largely undeveloped country whose complete development will demand that thousands of miles of additional railways shall be constructed by the company.

But by far the greater part of the capital expended has been for additional and improved equipment and for other additions and betterments to lines already in the system. The progressive way in which these expenditures tend to increase is strikingly shown by the following statement by years of the combined expenditures for equipment and other additions and betterments to lines already in the system:

Year ending June 30.	
1896 (6 months)	$ 396,615
1897	1,301,308
1898	2,848,710
1899	4,292,165
1900	4,452,713
1901	3,581,521
1902	11,030,816
1903	7,835,408
1904	8,109,373
1905	4,312,065
1906	16,402,112
1907	18,168,100
1908	21,457,543
1909	6,241,127
1910	19,632,586
	$130,062,262

But for the unfavorable business conditions in the year ending June 30, 1909, these expenditures for that year would have kept up with the rate of increase shown for the preceding three years. Likewise the expenditures for the year ending June 30, 1910, would have been substantially larger but for the recurrence of unfavorable business conditions.

For the entire fourteen and a half years the actual expenditures for betterments (including equipment) have averaged a little less than nine million dollars per year, while for the last five years they have averaged over sixteen million dollars per year, and but for the unfavorable conditions in 1909 and 1910 would probably have averaged, for the five years, about twenty million dollars per year.

It is the opinion of the officers of the company that in the next few years these expenditures for betterments should continue to average from twenty million to twenty-five million dollars per year, and perhaps more, in order to meet the never-ceasing requirements for additional and improved equipment, and for innumerable improvements of the existing lines. In addition, there should be provided funds for construction of new mileage to the extent of five to ten million dollars per year.

It is not practicable to forecast the more remote future, excep to say that there is every reason to believe that all such expenditures will increase continually and progressively. As population and business increase and civilization advances, there is an ever-increasing necessity for the continual remaking of the existing railways and their equipment, and for the construction of additional mileage. If the Santa Fe and other railways had been so managed as to be merely just as good today as they were fifteen years ago, with the same small locomotives and cars, light rail, poor roadbed, heavy grades, absence of conveniences and safety appliances, it is clear that the country's transportation facilities would be hopelessly obsolete and out of keeping with the civilization of today. Such expenditures as those which the Santa Fe has had to make for equipment and other additions and betterments have been necessary in order to avoid such obsolescence and to keep step with the spirit of progress, and similar expenditures in increasing amounts will be needed more and more in the future.

In view of this showing of what has been done and of what will have to be done by the Santa Fe, it must be apparent that the raising of enormous amounts of money for improvements and extensions is a prime function of the company, and one of the very highest importance to the public. I have already shown that the Santa Fe, in order to protect its property from depreciation or obsolescence, and to extend and improve it to meet the demands of the public, ought to raise and spend about $30,000,000 a year in addition to its current operating expenses. Before discussing the ways and means of raising these millions let me present a few figures which, even without comment, may give some impression of the problems of finance involved in managing a great railway system. Last year the Santa Fe spent for additions and betterments to its existing lines over nineteen million dollars. Of this, over five millions went for freight cars, two millions for passenger cars, one million for locomotives, nearly three millions for additional main tracks (so as to provide double tracks), over a million for reducing grades, and nearly two millions for new buildings and shops.

There are only four ways by which the money for these expenditures can be raised. They are, first, by taking it out of the profits of the business; second, by selling new stock; third, by borrowing on bonds secured by mortgage on the property; or, fourth, by borrowing on promissory notes or bonds not secured by mortgage. It is obvious that none of these methods can be followed in a business which is not profitable or cannot show with reasonable surety that it will be profitable in the near future. Surplus earnings cannot be drawn upon unless there are surplus earnings; nobody will buy stock unless it can be expected to pay reasonable dividends; property which is already fully covered by mortgage cannot be mortgaged anew; and a borrower whose credit is not good (that is, who is not doing a profitable business) cannot borrow money on unsecured bonds or promissory notes. Every man who reads this will understand how these principles apply to his own private business. At the present time, generally speaking, the property of the Santa Fe is covered by first and second mortgages for nearly two hundred and fifty million dollars, and therefore is not available as security for additional mortgage bonds. That source of raising the twenty-five or thirty millions of necessary new capital annually is therefore virtually exhausted. The money, then must be raised by selling stock or by selling unsecured bonds or notes, or by drawing upon surplus earnings accumulated after interest on the bonds and reasonable dividends have been paid.

Fortunately the success and conservatism of the company created sufficient confidence in the investment value of its common stock to make it practicable for the company in the five years ending June 30, 1910, to raise about one hundred and fifteen million dollars by the sale of bonds convertible into stock. These bonds are not secured by mortgage or otherwise, and the company has been able to sell them on favorable terms solely because the bonds conferred the privilege upon the bondholder to convert them at his option into an equal amount of common stock, and the investing public regarded the common stock as a sufficiently attractive investment to make this privilege valuable. Of the convertible bonds so sold to June 30, 1910, nearly ninety million dollars were long-term four-percent bonds, and a little over twenty-five million dollars were ten-year five-percent bonds, and on an average they were all disposed of practically at par.

Thus it appears that up to the present time the company would have failed very largely in the performance of the function of raising the needed funds to improve and extend its system but for its ability to raise the larger part of those funds upon the strength of the attractiveness of its common stock. It is clear that its common stock would not have been attractive if the company had not been able to pay a fair dividend upon it (never, however, in excess of six percent).

But it must be remembered that, while the company has spent on the property not less than $150,000,000 of borrowed money, it has also spent upon the property over $50,000,000 of surplus earnings. It is clear that the ability of the company to borrow the $150,000,000 was vastly promoted by, and indeed dependent upon, the fact that it expended fully one-third as much out of earnings. If the company's income had been so reduced that it could not, after paying interest and dividends, expend this fifty millions out of earnings, the company would have had to borrow two hundred million dollars, instead of one hundred and fifty million dollars, in order to make these necessary improvements and extensions. If this had been practicable at all, it would have increased the permanent fixed charges upon the property by not less than two and one-half millions per year; probably the increase in fixed charges would have been much greater, because the increased borrowing would have made the securities less attractive and would have necessitated the payment of higher interest rates. However, there is a wide gulf between borrowing one hundred and fifty million dollars when the property has been strengthened by the expenditure upon it of fifty million dollars of surplus earnings, and the borrowing of two hundred million dollars without any surplus put back into the property. The former has been practicable; the latter would not have been practicable.

The theory that improvements and extensions should be made only by borrowing new capital, and that the return on the entire amount of such expenditures will be assured by the increased receipts from such improvements and extensions, fails to work in practice. This theory makes no allowance for the payment of a return on the new capital pending its becoming productive (sometimes a period of several years), and makes no allowance for such considerations as that many improvements which are necessary and distinctly in the public interest (such as improved station buildings) will never yield any pecuniary return at all; that many others (such as increased safety appliances, cost of elevation of tracks, etc.) will never yield any return commensurate with their cost; and that many improvements and extensions, though expected to be profitable, will turn out to be unprofitable; and this theory makes no allowance for the supremely important fact that investors are not friendly to enterprises which issue new securities for all expenditures not chargeable to current operating costs—that is to say, which do not accumulate savings and invest them in the property.

The increasing demands of the public are responsible for a great many expenditures which do not appreciably increase the profits of the railways. For example, there is constant pressure for improved facilities of all sorts for passenger travel. The public demands better cars, better lighted cars, and more spacious stations. The railway companies at Kansas City have recently found it necessary, in order to handle the increased business through Kansas City, to rearrange and extend their terminals, both freight and passenger, at that place, and have been compelled on account of local public sentiment to provide for the erection of a magnificent passenger station, much of the expense in connection therewith being simply to gratify local pride, and tending in no way to increase the profitableness of the terminals. This is merely one illustration of a general demand throughout the country for a higher grade of passenger facilities, which will not increase the profitableness of the passenger business.

Likewise, there is a steadily increasing demand for improvements which will promote the safety of the general public and of employes. The city of Wichita, Kan., is insisting that the Santa Fe elevate its tracks, which at present are upon the surface of a city street. While this is a very proper demand, it is evident that the elevated tracks will be no more profitable than the surface tracks, and, on the contrary, the increased expense of maintaining the elevated structure will probably more than offset any pecuniary advantages which may result from the change. Many costly improvements to rolling stock are necessitated by the public demand for increased safety appliances. There is no hope, however, of realizing specific pecuniary benefit from these expenditures, even though they may reduce the number of personal injuries, because the constantly growing ideas of juries as to the amount of damages which ought to be awarded for such personal injuries as will still occur will more than offset the decrease in the number of such injuries.

In general, progressive railway managers concede the entire propriety of these additional expenditures for the protection of human life, the promotion of comfort, and the gratification of the æsthetic tastes; but all these things cost money, and the investment will not produce additional profits. Hence the desirability of meeting these demands by expenditures out of earnings, rather than by obtaining the money through issue of new stock or bonds, the dividends or interest on which would not be earned by the improvements.

The notion is frequently suggested that when earnings are expended upon betterments and improvements the result is that money is unjustly taken from the shipping public and converted to the benefit of the stockholders of the railway companies. This article is not designed to discuss the numerous freight-rate fallacies which underlie such a contention. It is sufficient for present purposes to point out that the stock of the Santa Fe Company has never been increased on account of surplus earnings expended upon the property, and that there is no plan for increasing the stock on any such account.

It has been exceedingly fortunate for the country served by the Santa Fe that it has been able to earn enough to pay fair dividends on its stock and to put back large amounts of earnings into the property, thereby being enabled to borrow on the basis of its stock the enormous additional amounts needed for still further improvements and extensions of its public service. The comfort and safety of the traveling public have been enhanced; the business and the convenience of the shipping public have been greatly promoted; new territory has obtained much-needed railway mileage; the demand for railway labor has been greatly increased, and the consumption of railway material and supplies has been vastly enlarged. All this has constituted an important factor in the civilization and in the prosperity of the country. This factor would have been most seriously impaired by any serious diminution in the Santa Fe earnings.

It has already been pointed out that the expenditures for improvement and extension of the property will continue to increase very rapidly. It is evident that the portion derived from surplus earnings for such expenditures ought to increase correspondingly, but it is apparent that increased cost of operation, coupled with the increased burden of paying a return upon a new capital borrowed and put into the property, tends to decrease very seriously the amount which the company can spend upon the property out of earnings.

The theorist may urge that increased business will make up for increased expenses, but the fact is that, after meeting increased operating expenses due to higher wages and prices and to increased expense of public regulation, after meeting increased taxes, and after meeting the interest and dividend requirements, the surplus earnings available for expenditure upon the property threaten to diminish very rapidly.

The amounts of surplus earnings so available have been about as follows for the past five years:

For the year ending June 30.	
1906	$4,500,000
1907	9,600,000
1908	340,000
1909	9,000,000
1910	4,000,000

The year ending June 30, 1910, represented the largest business the company ever did, and yet its surplus earnings for expenditure on the property were less than one-half what they ought to be. It is anticipated that there will be very large increases in operating expenses for the year 1910, on account of increased wages of employes, and there will probably be a still further increase in taxes, so the outlook is that the company will have even less to put back into the property for the current year.

For the purpose of maintaining the company's credit so as to enable it to borrow the large additional amounts which it must borrow, the condition now existing cannot be met by reducing dividends on the common stock so as to afford sufficient surplus earnings to spend upon the property. Any such course would have the effect of rendering the common stock so unattractive as an investment as to impair the company's credit and prevent its borrowing the new capital that it needs. Nor can the condition be met by reducing capital expenditures out of surplus earnings, for such a step merely postpones needed improvements, thereby increasing the amounts which in the future must be expended out of earnings or out of borrowed money.

In brief, in order to fulfill the function of improvement and extension, the company *must* pay a sufficient dividend on the common stock to make that stock attractive as an investment, and *must in addition* have a sufficient surplus for expenditures upon the property. These two essential conditions to the company's credit cannot be adequately met except by a *substantial increase* in the company's net revenue.

It must be emphasized that the grave need of additional revenue is not for the purpose of paying the stochkolders a greater return than six percent. The additional earnings are needed to preserve and continue the company's ability to raise the necessary funds to improve and extend its property in the public interest. Such ability depends on the power to pay a dividend, say, of six percent on the common stock already outstanding and on the additional stock that must from time to time be issued in exchange for convertible bonds or issued directly for new money, and also on the power to expend upon the property out of earnings a due proportion, say one-fourth or one-third, of the total expenditures of new capital which conditions require the company to raise.

The Santa Fe has been an exceptionally prosperous railway company, and yet the increasing burdens of railway operation make it imperative that the company should have such increased revenues if it is to fulfill the reasonable expectations of the public for the improvement and extension of the transportation service. If such imperative need exists as to the Santa Fe it exists even more clearly with respect to numerous other less fortunate railway companies whose transportation service calls for the expenditure of enormous amounts of additional capital in order to keep pace with the increasing demands for improvements and extensions. Comparatively few companies have been able to expend in improvements and extensions amounts of capital proportionately as great as the Santa Fe, but that is all the stronger reason why such other companies should be protected against undue encroachment upon their surplus earnings by the rising tide of expenses.

The problem is one which will be successfully solved if it is dealt with in accordance with business conditions. If the business of the country continues to increase, the railway companies will be able to raise the additional capital without any undue burden in any direction, provided they are permitted in the adjustment of their rates to regard within reasonable limits those conditions which control the prices of everything else, and, provided further, the railway companies are not overwhelmed with too greatly increased operating expenses to meet the public demands for additional conveniences and comforts. In other words, it may be said that the question is one for the public to decide. It must either be satisfied with fewer and poorer railway facilities than it now demands or it must permit the railways to earn more net revenue to enable them to raise the money to satisfy those demands.