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## Lessons for Canada from the Railway Experience of the United States

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AT a special luncheon of the Club, held on the 10th Nov., Professor Ripley said:

*Mr. President and Gentlemen of the Club,*—I wish I might speak to you on the great subject which is so much in all our minds at this time. It is very impressive to come here and see the young men drilling out at the University grounds, and then in Convocation Hall to see the women knitting and knitting, and then not to be able to say anything about the way we feel concerning it. (Applause, and voices, "Go ahead!") If it were not for being neutral, and if it were not for the possible endangering of that position of aloofness from the conflict in which the United States now stands, I should like to tell you how fully the American people (hear, hear, and applause) sympathize with the nations that are fighting for the civilization of the twentieth century against mediævalism. (Hear, hear, and applause.) I can't tell you that, because I must be neutral. (Laughter.)

I should like to go further, and to assure you that in spite of a campaign which is being conducted with an energy which shows that the learned world of Germany is not sure of its position (hear, hear), though that campaign is directed to what is called the learned world in America with an energy and persistence that would surprise you,—there is hardly a day that I do not receive a report or something of one sort or another from my friends in Germany—of course I am telling you what I really ought not to tell you (laughter)—which is an insult to our intelligence. (Hear, hear, and applause.) And if I only could, how glad I should be to go on and develop that subject, in order that whatever moral sympathy and moral support there is in the United States you should feel was yours. (Hear, hear, and applause.)

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Again, I regret that I cannot express my own views. (Laughter.)

But, to turn from that, to the subject which has been appointed for this occasion,—we have a very interesting situation in the United States by reason of the extraordinary shift of scene and circumstance within the last seven or eight years. About 1906 it looked as if nothing could stop the forward movement of railroad prosperity and earning power which promised to go on indefinitely. The prices of all sorts of railroad securities were soaring to unprecedented figures. All kinds of securities could be marketed freely. The railroads seemed to be clear of financial difficulties. And now, within so short a space of time, beginning in 1910, we find them practically pleading with the Federal Government for the right to increase their rates by what seems like a very small amount, only 5 per cent. The attention of the American people is focussed upon this issue, because now for the third time the matter is coming to the front in official proceedings. It seems almost like a case—as some one put it when writing on the subject—of a "re-irritation of the same subject." (Laughter.) The last of the three cases in the course of this plea for more generous treatment is now pending. So sharp is the contrast within the last seven or eight years, it seems well worth while to understand the different conditions which present themselves, in particular the conditions which coincidentally confront your Canadian roads. First, there has been a steady increase in the "cost of living," and a rapid increase, probably more marked with us than with you, in the wages paid to employees. You have had the advantage of what many of us regard as a great piece of constructive legislation, the Canadian Industrial Disputes Act. (Applause.) I have been endeavoring with others to secure the adoption of similar legislation in our own State of Massachusetts. The Federal Government has had such an Act,—a sort of half-way, half-baked measure, which, however, threw the whole responsibility in cases of this sort upon one man, the third member of a threefold board. All the railroads were compelled to assent to increases based upon demands for two loaves where only one was really expected or deserved. The result is that the wage outgo of the railroads has rapidly increased. And now, in addition, it has come, to where it is difficult borrowing money at any rate. That has imposed heavy additional burdens.

On top of all this has come a development which perhaps you may feel here in Canada, but which I am sure you are bound to notice more as the years go by. As your population

grows and your territory fills up, there is a demand from the public and a necessity for a very large number of quite unproductive expenditures,—the abolition of grade crossings, the construction of terminals, safety appliances, which no doubt you now have, all sorts of legislation for train crews, and the like, every one of which adds to the cost of running a road. And then when with us they ask for higher rates, the Government replies that they should manage the roads with greater efficiency. A campaign for efficiency may well be prosecuted to a certain extent; but everyone who has had experience will agree that it is extremely difficult to apply a modern, up-to-date efficiency plan to a plant spread out over some thousands of miles. The situation is well revealed in the story a railroad man is fond of telling, of the way in which a certain road tried to lessen its wastes in management. They preached to the men all along the line not to waste any material and to recover everything that was lost. The road master picked up a couple of spikes lying in the bushes and coming to the track gang, he held them up saying to the foreman, "Somebody has been careless. Here are two spikes you have lost!" "Bejabbers," replied the foreman, "I'm glad you've found them; I had two men out for three days hunting them up." (Laughter.)

There is another feature of our railroad finance which has been pressed home to us very closely, and which perhaps you have not yet felt. But I am quite certain before many years you will note the same tendency. A railroad is a business subject to a law called that of increasing returns, which is to the effect that the more business you do, the greater your profit seems to be. Fifteen years ago, it was believed that all our American railroads, having a bright future before them, might look forward to greater and greater profitableness. But they soon found out, beginning about ten years ago, that there is a sort of cycle in the outgo of railroads. They are like any business where you have a given plant, which you can operate more and more fully to a certain capacity, and secure, up to that capacity, greater profit; because you spread the overhead charges over a greater number of units. But if you pay out every cent you earn, you suddenly discover the necessity of doubling your plant. But sometimes when you double your plant, instead of spreading the outgo more thinly, you have more than doubled your overhead charges to spread over the same outgo. You have reached that limit from a state in which the profits were increasing, to a condition of expensive operation. That is what is the matter with what used to be one of the great railroads of New England,—the Boston &

Maine. It went on paying more dividends than it should for years, not setting aside proper reserves. It was then discovered that heavier bridges could not be added piecemeal nor could it put on heavier rolling stock because of want of bridges, without rebuilding the whole line. You could not in other words develop a railroad beyond a certain point without doing the whole thing over from bottom to top. This called for a reserve of surplus in the treasury or else a reserve of credit which could be drawn upon. There comes a slump in profits. And it is that depression in which a number of railroad properties in the United States are found at the present time.

Our American roads are also suffering from an undue accumulation of mortgage indebtedness. Ten years ago, stocks and bonds were about equal, about 50% of the one to 50% of the other. But with the passage of time the weaker roads borrowed and borrowed; until, over the United States as a whole, the last time I looked it up, mortgage indebtedness was \$11,000 per mile more than the stock capital, and that too as applied to 250,000 miles of line covering the whole of the United States. Individual roads could be found in which 75, yes even 85 per cent. of the capitalization is in bonded indebtedness instead of stocks. Unfortunately this is exactly like the experience of all borrowers. When one begins to borrow, one must keep it up, first on long time bonds, but pretty soon on the pawnbroker basis of loans on short term notes. Presently the accumulation of notes come upon the road suddenly, and there is a crisis. That is the situation in which a number of American roads find themselves at this time; and that is the reason for the panic in which the managers of some of them seem to be.

And then to explain finally the reason of the precariousness of the situation among American roads; we seem to be recovering somewhat from an orgy of speculation and manipulation of securities which did an incalculable amount of harm, in my judgment, between the years 1899 and 1906. It is a great pity that constructive geniuses like Harriman should at times have permitted things which ought never to have been done. It is a pity that a great financial genius like J. P. Morgan should also have done what he did in New England. Who is there among men of genius, one may ask, but has had occasional lapses from virtue? But the result upon the roads altogether, all over the country, is that the American people have been occupied for the last three or four years in undoing a lot of work done originally for no other reason than the immediate advantage of the bankers concerned.

The description in a boy's composition on James II. aptly sets forth the situation at this time. He wrote, "The English people stood a great deal from James II.; but when he gave birth to a son, they said, 'This thing must stop!'" (Laughter.)

Thus the Federal Government has separated the two parts of the New England system,—as I think unwisely,—but the Federal Government does not, and the Federal Government seems to be ahead at the present time. The Gould system was the first great combination stretching from the Atlantic to the Pacific. This went to pieces by way of bankruptcy. The Rock Island has since followed suit. The trunk lines were tied up as well; but are now to quite a considerable degree set off again. The result is that our transportation is conducted by smaller units, which perhaps may achieve better results than have been obtained in the past few years.

The present situation of the country, then, is this: The high cost of living, more wages, extremely onerous governmental interference in forty-five or fifty different States, each peppering away independently with legislation. The railroads are thus suffering from many things for which they are not to blame except what some banker-managers are distinctly culpable. Unfortunately the collapse of roads like those in New England is so far-reaching in effect, that I can only compare the tragedy to such an event as the possible bankruptcy of the Canadian Pacific Railway in your own territory.

What are we doing constructively? Is there anything which may have significance for you? You are aware, of course, that we have only recently, that is to say in 1906-10, given authority to our Federal Interstate Commerce Commission similar to that which your Railway Commission of Canada has enjoyed for a long time. We have, however, now conferred that authority, and the question is, what shall be done with it. These Commissioners, sitting at Washington, have the right to say yes or no to every application for rates coming before them; and at this time the whole of United States is watching for the exhibition of that far-sighted wisdom which should be exercised in deciding matters of such moment. Their present attitude is a little bit like that of "Mamma," when she said to the nurse, "I wish you would find little Johnnie; I don't know what he is doing, but tell him to stop it at once." (Laughter.) That is to say, it is a negative policy, of denying, of turning down, instead of a policy which shall have a constructive upbuilding influence. Of course, the Federal Governmental Commissioners do not bear the same direct responsibility which is placed upon the

managers of these properties; but, nevertheless, the time seems to have come for a more constructive policy. As bearing upon the question whether the carriers should have more revenue or not, we have just started upon a piece of work which you have not attempted yet in Canada; but which some day may be worth your while, or someone at all events may think it so. The experiment will cost fifteen or twenty million dollars, and will take four or five years to complete. Quite a while ago, different local authorities began to make what are called physical valuations of the properties of their carriers. There was complaint that they were very much over-capitalized, that they had very many more securities outstanding than were represented by their assets; and that they were really earning not a modest 8%, but 16%, or even 25% in dividends. This widespread popular opinion fifteen or twenty years ago was probably justified. But at all events, as one road after another went to the Supreme Court of the United States on questions concerning reasonable rates, it became apparent that this august body itself was not able to decide. It could find no sure footing, no criterion by which to judge whether the carriers were getting a fair return or not.

There is manifestly a relation between the amount of the investment and the sum which a railroad should be allowed to earn. That is evidently the opinion of the Supreme Court of the United States, and the other Federal Courts which have followed its lead. The result is that the people have set about making an inventory of this wealth representing, let us say, one-fifth of the possessions of the United States. That is a pretty big job. They are calipering the rails and counting the ties. They will find out what it costs to reproduce every road. All the blue prints of cuts and fills, the specifications for every bridge, every building, all are being estimated as to value. They are rebuilding on paper every road in the United States. It is a stupendous task. They are trying to find out not only what it costs to reproduce them, but how much investment is actually represented historically. That is to say, they go over a road like the Canadian Pacific, and find out what is represented by donations from the public. The intention is to afford a basis thereby upon which the tribunal called upon to judge in the last instance shall be able to determine whether the receipts are yielding a fair return or not. This may affect the side of the question so far as the rates to shippers is concerned, but obviously it has no bearing on the other side, the willingness of capital to come forward and offer for development that which the

roads will steadily need. Unless there is a sufficiently generous attitude of the Government, it is obviously certain that these roads cannot proceed farther extending their lines as must be necessary in a rapidly growing country. Yet, bearing that in mind, I still venture to assert that this very valuation is necessary to meet the situation. If we had had an inventory of the New England railroad, trolley lines and steamship lines, it might not have been possible for investors to have lost the millions of dollars which have gone to waste. Had an inventory of the component parts of the Rock Island system been available some of the scandal at least attaching to that road might have been prevented. The amount of the investment should certainly mean something, and stand in some relation to the assets. If the situation does not promise results to the investor as it should, the courts will be the more likely to favor them in all possible ways.

There is another detail which is now upon the *tapis*, and which, I venture to suggest, may sometime become of interest to you in Canada. It has not yet passed beyond the individual States. Much as we may criticize or object to the division of authority between the Federal power and fifty different States, there is some advantage in that division, because it is the little States which experiment here and there, so that if it seems worth while the Federal Government can carry on the good work in due time. A number of our States have already passed beyond the stage of merely regulating rates, and have taken under their control and supervision the issuance of securities. This, however, is so burdensome and bothersome when controlled piecemeal, to judge from the great systems which cover many States, that it is better for them if the control be exercised by one central authority, rather than by these numerous single ones. As a matter of fact no fewer than eighteen different States in the last five or six years have given over the control of their rates and securities in this way to what are called Public Service Commissions, and had it not been for other and more pressing matters associated with what we call the "New Freedom," no doubt Federal legislation also might have followed along this line.

Every loss to investors, every scandal like the New Haven or Rock Island, has emphasized the need of a law of this kind by the Federal Government. It seems to be a particular detail of the general program, of governmental control, upon which we have entered so definitely.

This whole program in relation to the state control of the issue of securities is accompanied by a very great change of

attitude towards things which used to be regarded entirely as the property of private stock holders. Twenty years ago no one ventured to suggest that the surplus earnings of a corporation which they did not choose to divide among their owners belonged in any way to the public. Yet one is compelled to estimate surplus earnings much, as the American Telephone Company in its annual report for 1912, adopts this policy definitely, regarding its surplus as "guarantee fund," to be administered for the general interest of the public and the investors alike. It does not look just now as though there need be much discussion about surplus railroad earnings. But of course the controversy may arise either as to whether such surplus is the joint property of the public and the stock holders, or whether deficits shall also share in like manner. That brings us face to face with the question of possible state guarantee of securities issued by railroads.

We have thus reached a point in the United States where Government ownership looms in the background, not to come yet for a good while, I hope,—for I should regard it as a great catastrophe for the United States. But unless regulation is wisely administered,—unless administered in so liberal a way that a fair return and an encouraging return shall be given to capital, the improvements and development so necessary to progress will not be made. And there will be no other alternative except for the Government to step in either in the capacity of an owner or in some other way so that capital would be guaranteed the right to a fair return.

The situation in the United States may not unlikely drift into this condition of threatening public ownership. A few years ago I had the good fortune to meet many British railway men in England. It surprised me not a little to learn that under the inviting guarantee of the British Government to purchase at high prices, many owners of securities were inclined to contemplate public ownership with equanimity. If we go on in the United States without a definitely constructive policy of public regulation which will amply encourage private capital investors may well look forward to the prospect of unloading their burdens on the shoulders of Uncle Sam. In conclusion, it is suggested, that our experiment of regulations under purely private ownership emphasizes the need of great foresight in the matters of financing railroads; so that there shall be a more liberal provision made both by private management and by the State, for all those unproductive expenditures which are bound to become insistent in the course of time; and that the proper attitude for the Government

is to take fully into consideration not alone the immediate need that the shipper get as low rates as are consistent with good service, but also that the Government should keep an eye all the time to assure ample encouragement to capital to come forward for investment. This is just as much in the interest of the shipper as it is of the public at large.

I thank you for your attention. (Applause.)

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