Congress Solves the Railway Problem

By T. J. RUSSELL

The railroad transportation companies constitute one of the largest industries in the United States, and from a standpoint of service rendered, one of the most important.

The steam carriers operate a network of about 238,000 miles of point-to-point mileage within the country and do a gross annual business in the neighborhood of $4 billions. This mileage, together with rolling stock, buildings and other capital equipment is valued in the property accounts of the companies comprising the industry at $26 billions.

The greater part of the growth in the industry took place during the latter half of the last century. The population of the country was increasing rapidly. As periodic depressions resulting from excesses in land speculation pressed the population westward, railroad lines followed and sometimes preceded the settlers.

The rapid increase in rail facilities during that period was by no means entirely dependent upon private capital. The various governmental authorities, federal, state and local, assisted in financing the building of the roads. Land-grants and direct subsidies were freely given. To aid in the building of the Union Pacific, for example, the Federal Government gave in addition to the right of way, a land-grant of ten alternate sections per mile and subscribed to the purchase of bonds. Altogether the land grants to the railroads totaled more than 130 millions of acres, an area comparable to the state of Texas.

For nearly a century this industry possessed practically an absolute monopoly of overland transportation of goods and persons in the United States. The potentialities for exploitation were tremendous—and they were not left unused. Railroading became a very profitable form of enterprise. Its securities were regarded as the very soundest of investments.

More recently, the railroads have encountered difficulties. In fact, during the past decade earnings have decreased so drastically that serious doubts have been raised concerning the industry's future. Since the early 1920's the carriers have been faced with a relative decline in freight hauled and consequently in revenues. The rapidly expanding production of the 1920's obscured the decline and prevented it from becoming absolute; the railroads continued to show small absolute gains in revenue during that period. As a matter of fact revenues of the steam carriers reached an all-time high of $6,382,000 in 1926. Nevertheless, comparison of freight revenues and volume of production for that period with similar ratios for periods previous to 1920 reveal that a stage of relative decline had begun.

About 1930 with the advent of the depression the decline became absolute. It soon became obvious that a serious downward trend in rail revenues was in progress. Furthermore, while industry in general managed to stage a recovery after the 1932-33 lows, tonnages moved by the railroads displayed an alarming tendency to lag. By 1937, a year when the Federal Reserve Index of Production averaged 110, as compared with 114 in 1928, railway tonnage handled was 21% below 1928. In 1940 the Federal Reserve Index averaged 11% above that of 1929. Rail revenues were 32% below those derived in 1929.

Three factors contributed most largely to the decline of the railroads.

1. The development of the auto and trucking industry.

2. Relocation of plants with regard to nearness to raw materials and markets.

3. The increased use of pipelines, inland waterways and other competitive modes of transportation.

Perhaps not without significance also is the fact that a long series of increases in freight rates by the railroads culminated in 1921 in an all-time high of 1.275 cents average per ton mile. This represented an advance of about 70% above the average rates prevailing near the beginning of the century.

Undoubtedly this series of advances was a factor of some importance in the considerable amount of relocation of industry that took part during the 1920's. Also, higher rates encouraged the growth and use of pipelines and inland waterways. However, it is to buses and trucks that the greatest diversion of traffic has occurred. High freight and passenger rates added tremendous impetus to the growth of this new industry.

Registrations of motor trucks rose more than 450% between 1920 and 1940. At the present time there are more than 4 million motor trucks in operation in the United States. Today the trucking industry has grown to where it rivals, and in some respects exceeds the railroad industry.

For example, it is estimated that about four million men are employed in the trucking industry as compared to slightly less than a million by the railroads. Revenues of the trucking industry have grown to the point where they compare with those of the railroads. Reasonable estimates indicate that trucking revenues approximated $3 billions for 1940 as compared with a little over $4 billions for the railroads.

The huge overbalanced capital structures of the railroad companies, consisting to a large extent of fixed-interest liens, made them particularly vulnerable to any long-continued period of depressed earnings. Defaults and receiverships became

numerous soon after 1930. By 1939 thirty-four railroad companies operating about 88,000 miles of line were in bankruptcy or receivership. In addition, the finances of a group of companies comprising a like amount of mileage, the so-called "borderline" railroads were in such shaky condition that receivership has probably been deferred only by the fillip given to their earnings by the "defense" program.

The inroads being made into their revenues by their competitors made some action by the railroads imperative. Two courses of action were open—1. Competition with the other modes of transportation. 2. An appeal to the State. The latter was the one chosen. After the usual fact-finding boards, committee reports, investigations, hearings, etc. lasting over a period of several years, Congress enacted two pieces of legislation designed to aid the railroads, namely, the Motor Carrier Act of 1935, and the Transportation Act of 1940.

Among other things the bills provide that:

1. Both interstate truck and bus traffic and inland water carriers are to be placed under the jurisdiction of the Interstate Commerce Commission.
2. Truck and bus companies are required to adhere to rate schedules.
3. New interstate trucking concerns cannot be established without obtaining a certificate of necessity from the Interstate Commerce Commission.
4. Stringent safety and labor restrictions are imposed upon trucking concerns.
5. Low land-grant rates on government traffic carried by the railroads are eliminated (a gift of about $10 millions annually to the railroads).

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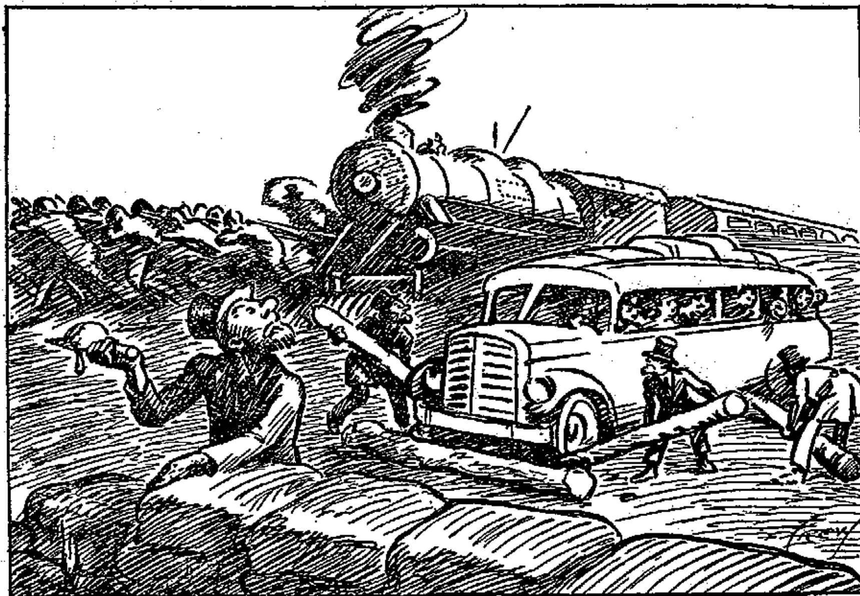
This legislation has not been in effect long enough for the results to become fully apparent. However, the Acts have already had the effect of raising truck rates to a level considerably closer to rail rates in many cases. It can be seen that further growth of the trucking industry will be seriously impeded. The benefits which have accrued to the public as a result of the lowering of transportation costs by the apparently more efficient trucking industry are nullified by an attempt to preserve the security values of an enterprise, a large proportion of which represents nothing more than the capitalized value of the excess earnings of a monopoly industry.

According to statistics published by the Committee on Public Relations of the Eastern Railroads, the gross capital expenditures made by the Class 1 railways during the fifteen years 1926-1940 totalled $6,820,596,000. The life of railway equipment is usually estimated at twenty to twenty-five years. If a maximum average life of twenty-five years is taken, it follows, on the basis of the above-mentioned expenditures, that the total investment of the railway industry in depreciable capital equipment is about $12 billions. But the total property investment of the railroads is valued on their books at $26 billions. Evidently, the remaining $14 billions represent the amount at which the rents derived from control of the right of ways have been capitalized by the various companies comprising the industry. By the same token, railway securities outstanding against the railway properties are, to a large extent, not investments in wealth-producing assets, but merely legal claims to the amounts over and above the cost of service exacted by the railroads. The State-granted privilege of exclusive ownership of the right of way has made this extortion possible.



A railroad is a narrow, unbroken strip of land, which may extend for several blocks or for hundreds of miles, to which the railroad company has been given exclusive use by legislative enactment—the right of way. In addition the company may own terminals, the rails, rolling stock, locomotives, buildings and other capital equipment necessary for operation of the road.

It is to be noted that railway property falls into two categories, which might be termed depreciable and non-depreciable; duplicable and non-duplicable. The land which constitutes the right of way is non-depreciable and more important non-duplicable. Ownership of these important strips of land forms the basis of the monopoly. It enables the railroads to levy on shippers, in addition to the cost of the service performed, a surcharge which in reality represents rent for the use of the right of way.

Railroad freight and passenger rates are not, and never have been based on any cost of service formula, but rather upon what the traffic will bear. According to

Chairman Eastman of the Interstate Commerce Commission rates are usually set by what is known as the "Three C's," which are "Comparison, Competition and Compromise." The various companies comprising the railroad industry range from those with tremendously profitable operations to those marginal units which barely manage to exist; from those with densely traveled lines to those with traffic so sparse that no economic justification for their existence is discernible. A blanket rate on a commodity which will make its transportation profitable for all may be many times the cost of the service to the more efficient roads. Under freely competitive conditions rates would tend to approach the cost of service performed. The goods would be carried by the mode of transportation that could perform the service most efficiently—tnat is, the cheapest.

The above legislation is apparently designed to bring the trucking industry and other competing modes of transportation under this blanket rate arrangement. Where previously competition between the truck carriers kept rates near the cost of service, restriction of this competition will enable them to charge the higher arbitrary rates set by the Interstate Commerce Commission, designed to enable the railroads to participate in the traffic. Also the obstructions placed in the path of further expansion of the trucking industry will in itself tend to restrict competition and to result in higher rates.

It would seem that in enacting the above legislation Congress had in mind primarily the interests of railroad security holders. Following this line of reasoning, the Congress in the early 1800's might well have declared that the railroads must keep their charges on a sufficiently high level to enable the less efficient stage coaches to share the available traffic; that no railroads should be built without obtaining a "certificate of necessity" lest the stage coach companies be forced out of business. It is difficult to escape the conclusion that the public interest received secondary consideration in the enactment of these two bills.

Better perhaps from the public viewpoint might have been the appropriation of the land on which the roads and terminals of the railways are built. The railway transportation business could then be thrown open to free competition just as the trucking business was before being brought under jurisdiction of the Interstate Commerce Commission. The State could retain the duties of traffic regulation and maintenance of the roads as the public highways are at present. If a charge for the expense of maintenance is considered necessary, this could easily be collected on a "wheelage" basis as is now done by many privately owned roads for the use of their right of way by the equipment of other companies.

Since the ownership of rolling stock, locomotives and other equipment is not a monopoly, charges would tend to approach a level consistent with the cost of service performed. The impossible task of the Interstate Commerce Commission to "regulate" the railroads and the other carriers and to arbitrarily set "fair" rates on several thousands of commodities would be achieved in the marketplace. The relative efficiency of the several competing modes of transportation would be decided on a basis of performance. The public would benefit from the lowest of rates for the carriage of goods and personnel and the readiest adoption of improvements, and all industries would share the advantages.