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WHY WESTERN RAILWAYS CANNOT REDUCE RATES

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The railroad problem of the country is tending to become very largely or even mainly a problem arising from the situation of the railways in western territory and the sentiment of the people they serve, especially the farmers. It is from this territory that the most insistent demands for early reductions of freight rates are coming. From this territory have been elected most of the senators and congressmen who are attacking the valuation placed upon the railways by the Interstate Commerce Commission and demanding that thru legislation or some other means the valuation shall be reduced principally as a means of bringing down freight rates.

It is also in western territory that the railways are making the poorest earnings, and that in consequence a reduction of rates would be most disastrous. There are a very few railways in this territory—four or five at most—that are making good net earnings. The exact opposite is true, however, of a large majority of the western lines.

It is this combination of an adverse public sentiment with the poor earnings being made by the railways of the west that is causing the railroad problem to become so largely a problem of western territory.

The railways of the country as a whole earned in 1921 an average net return of 3.28 and in 1922 an average of 4.01 per cent upon the tentative valuation placed upon them by the Interstate Commerce Commission. In the first five months of the year 1923 the railways of the country, as a whole, earned at the annual rate of 5.69 per cent on their valuation. This last-mentioned fact has been widely published and commented upon, and has created the impression that all the railways of the country are doing well. But in the first five months of 1923 the railways of western territory earned net return at the annual rate of only 4.2 per cent upon their valuation. It is most desirable, in view of the agitation in western territory for a reduction of freight rates, that the significance of this fact should be made clear.

There is a singular illusion prevalent regarding the relationship between the valuation placed on the railways, the net return they are allowed to earn and the rates they are allowed to charge. This illusion is to the effect that the rates the railways are allowed to charge depend principally upon their valuation and the net return they are allowed to earn. Those who share this illusion apparently believe that any reduction which might be made in the valuation of the railways would result in a corresponding reduction in the rates charged by them. In other words, they seem to believe that if the valuation were reduced 25 per cent, this would result in a reduction of approximately 25 per cent in rates.

How utterly erroneous is this belief is strikingly illustrated by the situation of the western roads at the present time. Their total earnings in the first five months of this year were $898,000,000. They paid $726,000,000 of these earnings out to meet operating expenses and $65,000,000 to cover their taxes and equipment and joint facility rents. These things took 88 per cent of the total earnings of the western railways in these months. In other words, they took 88 cents out of every dollar these roads earned.

This means that if a 12 per cent reduction of rates had been made on January 1, 1923, and had been in effect during these five months, the western lines as a whole would have earned barely enough to pay their operating expenses and taxes and equipment and joint facility rentals, and would not have earned a single dollar with which to pay either interest or dividends upon their securities. There has been a great deal of talk in the west to the effect that rates should be reduced as much as 25 per cent. If the rates of the western lines had been 25 per cent less than they actually were in the first five months of this year, this would not only have prevented them from earning a penny with which to pay interest and dividends, but would have left them with $117,500,000 less earnings than were required to pay their operating expenses and taxes and equipment and joint facility rents. With rates 25 per cent, or even 10 per cent, lower than those now actually being charged, practically every railway in western territory would soon be bankrupted.

The fact cannot be too strongly emphasized that the present rates, and this is especially true in western territory, are made necessary, not by the valuation placed upon the railways by the Interstate Commerce Commission and its ruling that they are entitled to earn $5\frac{3}{4}$ per cent on this valuation, but by the prevalent high operating expenses and taxes. Let us compare the financial results of the operation of the western railways in the first five months of 1916, seven years ago, with those of the first five months of operation in 1923. The western lines in the first five months of this year made total earnings 66 per cent greater than in the same months of 1916.

But their operating expenses were 99 per cent greater. In consequence the "net operating income" earned by them was almost $38,000,000 less, or about 26 per cent, than in the same months of 1916, altho during this period of seven years there was a large increase in the investment in the railways. The railways are being more efficiently operated than ever before. The increase in their operating expenses and the decline in the net return earned by them are entirely due to the great increases that have occurred in the cost of labor, fuel, materials and supplies, and the advances that have been made in the taxes they are required to pay.

Since the valuation that the Interstate Commerce Commission has placed upon the railways is being widely attacked by radical labor leaders and public men as the principal reason why present rates are maintained, and its reduction is being advocated upon the theory that this would bring about a large reduction of rates, let us see just what has been the relationship between the valuation of the western railways and the rates charged by them in the year 1923. If the western railways in the first five months of the year 1923 had earned the rate of net return which the Interstate Commerce Commission has held would be "fair"—namely, 5¾ per cent annually upon their valuation—their net return in these months would have been $146,247,000. The net return actually earned by the western railways was $106,750,000, or at the rate of 4.2 per cent upon their valuation. This was about $39,500,000 less than the Interstate Commerce Commission has held would be fair.

Senator Brookhart of Iowa, who is one of the chief spokesmen of the radical element, claims that the valuation placed upon the railways is too high and should be reduced approximately 37 per cent. If the valuation of the western roads had been 37 per cent less than it actually was, and they had in the first five months of the year earned at the rate of 5¾ per cent upon the lower valuation, the net return earned by them would have been only $92,136,000. In other words, the net return the western lines actually did earn was only $14,614,000 more than they would have been allowed to earn even on Senator Brookhart's basis of valuation. As already shown, the total earnings of the western roads in these five months from all their rates were $898,000,000.

How much of a reduction in rates would have been required to take away this \$14,614,000? A reduction of only 1.6 per cent in rates would have reduced the net return of the western railways to $5\frac{3}{4}$ per cent upon the valuation which even Senator Brookhart is willing to concede them. Mr. Brookhart and others who agree with him tell their constituents that if the valuation of the railways were reduced as they contend it should be freight rates could be reduced 25 per cent. I have even seen the statement made in print that if the "water" in the valuation were pumped out rates could be reduced by one-half. Here, however, are the incontrovertible facts; and they show that even the reduction of the valuation advocated by Senator Brookhart would authorize a reduction of rates in western territory of less than 2 per cent.

Facts seem stranger to many people than fiction. The people, especially the farmers, of the west have been told so long by agitators that the principal reason why their rates are higher than before the war is that the railways are being allowed to earn excessive returns upon "watered" capitalization or "watered" valuation that it will be a shock to many of them to be told that even if the valuation of the western railways was reduced as advocated by Senator Brookhart, this would authorize at present a reduction in their rates of less than 2 per cent.

The widespread misunderstanding of the true reasons why railway rates in western territory cannot be reduced is due to the persistent refusal of those who disseminate anti-railroad propaganda among the western farmers to tell them the truth about this matter, which is that thus far neither the valuation nor the capitalization of these railways has, since the transportation act went into effect, had the slightest effect upon the rates.

The amount of the rates which has had to be charged has been due entirely to the wages, the prices for fuel and materials and supplies and the taxes that the railroads have had to pay and still must pay. As long as the operating expenses and taxes of the western lines remain as high as they are, and in consequence the net return earned by them remains as small as it is, any general reduction of rates in this territory would bankrupt many of the railways and so financially cripple all of them as to make it impossible for them to render the transportation service required by the farmers and other producers and shippers of this territory.