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ADDRESS

By

W. J. HARAHAAN,
President of The Chesapeake and Ohio Railway Company

At the

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The railroads are, and have been for many years, the subject of criticism, much of which is propaganda. Most of such emanations originate from sources which have a selfish interest in the propagation of the misinformation, but a great deal of it comes from innocent people who merely repeat what they hear, because it sounds plausible and so far as they know is the truth. The railroads have tried to meet this flood in every way that would seem to be effective, but it is hard to make an impression which will not be dissipated by the ever-recurring deluge. A statement from one who has dealt with the various affairs of the railroads for over forty years and who has had qualifying experience in every detail of railroad operation and management should, perhaps, be entitled to some weight in the consideration of this matter.

Railroad men generally feel that the Transportation Act passed at the time the railroads were returned to private control, on March 1, 1920, represented the best thought in connection with railroad regulation and that it was designed to remedy the bad spots in the situation which had developed as regulation had progressed. Running through this Act it may be perceived that amongst its various requirements and as an in-

tegral and important part of its plan, the fact is set up that the railroads must be honestly and efficiently managed as a prerequisite to the benefits to be obtained from the provisions of the Act. This is as it should be. No business should succeed unless it is honestly and efficiently managed. To secure this much desired aim in management its affairs must be conducted along the lines of good business practice and must, consequently, be as free of guilt as is possible from those things which I have designated as criticism in the first sentence.

What are the criticisms to which I refer? What are the things that are said to our discredit? What are the facts?

Among those things that are said to our discredit, perhaps the following are the more important:

That the railroads are over-capitalized;

That the railroads have no method of rate making worthy of the name, but that their rates are a hodge-podge of inequities and past practices built up by "rule of thumb";

That they do not economically manage their properties, have no system of properly determining and watching their expenses, etc.;

That their relations with the public are not on the basis best calculated to win its support and sympathy;

That the Congress guaranteed them a certain specific interest on the investment, which concession is not granted any other business;

That the officers' salaries are enormous and out of proportion to other salaries paid in other lines of business;

That the private cars of officers are an abuse, because of the enormous expense involved in maintaining them; that they are a luxury which no man should be allowed to enjoy at the expense of any business;

That our relations with our employes are such that strife and hostility are engendered and not healthy co-

operation such as is necessary for the success of any business ;

That rates should be reduced and that such reduction would be of benefit to the railroads, and that, consequently, the railroads are short-sighted in not making such reduction at once.

There are perhaps other things that may form the basis of criticism, but these seem to be the most important ones and the ones upon which I should seek to throw the searchlight of truth so far as I am able to do it. To treat these in the order above set forth, I am beginning with :

OVER-CAPITALIZATION

Most business men are aware of the fact that there has been under way for the last eight years the valuation of the railroads by the government. When this has been finally completed there will be set at rest this much mooted question, which is nearly always the last argument of the gentleman who argues that the railroads are making excessive profits. In other words, when he is shown conclusively that the business is being honestly and efficiently managed, his retort is, "You are over-capitalized," and he is strengthened in his innuendoes by the fact that there have been a few evident and glaring instances of over-capitalization, which are familiar to most business men who read. In any business of any character there are people who are not honest in its conduct. I am quite willing to make the strongest character of assertion that the proportion of railroads which are fallen into dishonest methods is no greater than is the case in any other business, and I say just as emphatically that the proportion of railroads which are over-capitalized is very small indeed as compared to the total valuation of the railroad property of the country. The over-capitalization which occurred must have taken place prior to 1907, now fifteen years ago, because ever since

that date the Interstate Commerce Commission has had absolute control of the accounts of the railroads and has specified and scrutinized what has been charged to capital account. The property investment of the railroads on December 31, 1921, was \$20,144,581,415. There was at the same time in the hands of the public railway capital amounting to \$17,016,074,420. The capital outstanding was \$20,238,472,022, the difference between the last two figures being accounted for by securities owned and held by other railroad companies. You will, therefore, note that the public has paid just a little more than \$17,000,000,000 for property costing over \$20,000,000,000, provided, of course, that the book value of \$20,000,000,000 is nearly the correct value.

One of the most convincing evidences that the property account of the carriers is not far wrong is that in arriving at the rates set by the Interstate Commerce Commission in 1920 to produce six per cent on the value of the property, as prescribed in the Transportation Act, the Commission determined upon \$18,900,000,000 as the tentative valuation of the railroads for such purpose and did so upon the most searching and intelligent scrutiny of its records and the figures before it, as was demonstrated by the testimony of Commissioner Hall before the Senate Committee on Interstate Commerce January 5, 1922. While, of course, the Commission tried to make as honest a valuation as it could from the information at its disposal, yet it can be conceived that it would in arriving at this valuation not over-value the properties; in fact, in line with its usual careful and conservative policy it would probably rather under-value them slightly. The difference between their valuation — that is, \$18,900,000,000 — and the book value—\$20,138,000,000—is about six per cent. There are many disputed points in valuation which far more than cover such a comparatively slight difference.

The facts so far disclosed by the valuation which is being made by the government indicate quite clearly

that there will be a substantial vindication of the accuracy of the property accounts of the railroads when this valuation is completed.

Let me here call attention to the fact that rates are based upon the value of the property used by the public and not upon the value of stock and bonds.

The testimony usually given as to railroad valuation by those seeking to discredit it is generally not substantiated by any facts, but is merely based upon impressions gained from the few cases of manipulation which have occurred in railroad history, but it is always given as a final argument against specific rate increases. It should not be given credence unless supported by actual facts and figures. It is not fair to the railroads to merely accept such a statement without such facts or figures, and it will not merely do to call attention to the bad history of, say, one or two railroad corporations and attempt to say that because their history was unsavory this applies to the whole railroad situation. The receiverships of the past and the investments from surplus of the stockholders have undoubtedly wiped out all undue capital charges upon most of the over-capitalized properties. In any event, the burden of proof as to over-capitalization should be upon the one challenging the figures, rather than upon the railroads. Surely under the strict supervision of the Interstate Commerce Commission since 1907 there can be little room for the thought that railroad manipulation could be effective. To sum up all the evidence so far developed indicates quite clearly that substantially the values claimed by the railroads will be proven.

ALLEGED UNSCIENTIFIC METHOD OF RATE MAKING

The making of the rates of the railroads of the United States was a process of evolution. Before railroads were placed in operation the freight and passenger carrying was done by the crude facilities then in use. These facilities had established rates for the perform-

ance of their services. Railroad rate makers naturally used these as a basis from which their calculations were begun. As time went on and conditions became more complex it became necessary to multiply the number of rates needed to cover all movements of freight required. In each case it became necessary to determine what rate it would be necessary to make so as to move the greatest possible tonnage of the commodity which it was desired to move. A calculation was made always to insure that no rate was established which was less than what is designated as the out-of-pocket cost, which represents the amount paid out for the direct cost of handling the business, like train and enginemen's wages, fuel, repairs of cars, and the other immediate costs of operation. If after this out-of-pocket cost was fixed it was found that a reasonable contribution would be made to the remainder of the charges attending the owning and operating of the railroad by a rate which would move a proper amount of the commodity, then the rate was established. This gradually built up a system of rates which were fitted to the commercial needs of the country and which built up the great railroad network of the country.

While this may not at first thought seem to be a very scientific method, yet it was a perfectly natural and a good business one, and the best proof that it was commercially efficient is the great development of all business, both railroad and commercial, which was brought about by this method.

Of course, there sprang up during the practice of this method of rate making, abuses such as rebating, favoritism, etc., but these were only passing phases of the process of evolution. Notwithstanding the fact that they were so widely heralded, they affected only a small proportion of the total business. It has been estimated by a careful statistician that the rebates in their palmy days, when they were practiced the most, only affected two per cent of the total freight revenue of the

country. It is, however, a matter of great congratulation to this generation of railroad men that rebating and other objectionable practices have disappeared, as they are not consonant with good business practice or honest administration.

As time has gone on it has been found possible to establish more exact methods of rate making and a number of graduated scales, modeled upon scientific reasoning, have been applied, and they will increase as business grows and the potential capacities of the railroads are more nearly reached; that is, as the density of traffic increases we are better able to work out a scientific plan, because of the smaller absorption per unit of overhead and fixed costs. The fact that it is hard to work out an exact mathematical rule for rate making is further demonstrated by the necessity for adjustments like differentials, to overcome physical handicaps because of varying conditions, and quite frequently it is necessary to make a rate for the purpose of establishing a market for a product which it is desired by a manufacturer to develop. Then again comes the necessity for the establishment of a different rate per ton mile on such substances as coal, iron ore, stone, etc., as compared with products like fruit, general merchandise and other more valuable articles. A purely mathematical method of rate making would ascribe a certain amount in cents or mills per ton mile for any ton of freight moved which would be so high that coal and like commodities could not be moved, while the rate would be ridiculously low on the higher valued commodities.

In spreading the cost of transportation over all commodities you can, therefore, see that there must be room for the use of judgment in distributing it, so as to produce the greatest amount of movement and be fair to all users of the roads. The checks and balances on this method of rate making come from the rivalry of railroads, of markets, and of merchants, each striv-

ing to protect their own situation. There is also the protection of the various commissions, who are alert to protect the people. Rates now are much out of adjustment, because of the percentage raises made by the Railroad Administration during the time it operated the railroads and the other percentage raises which have been made from time to time. These will all be ironed out in time and placed upon a proper basis. All railroads are actively engaged in doing this now, but it must be done in an orderly way and with due reflection, because it is not uncommon to find that a rate adjustment proposed to rectify a local situation extends in its ramifications until it covers a large part of the country. A comparison of the rates of the railroads of the United States with those of any other country shows that our rates bear a most favorable comparison.

ECONOMICAL MANAGEMENT OF THE RAILROADS

The time has now arrived in railroad history when it is absolutely essential that these properties be managed as economically as possible. This is not only prescribed by the Transportation Act, but self-preservation demands it, because the limited margin between income and outgo is so constantly narrowing that unless it is conserved by the most careful and economical management it will entirely disappear, as it did during Government control, because of the adverse conditions affecting that period. I beg to assure you that most railroads are watching this matter in the most minute detail consistent with proper management. In considering our expenses we determine what is the lowest amount we should spend upon our maintenance of way so as to safely maintain the property. This amount must be spent as a minimum. We also determine what it is necessary to spend upon our equipment to maintain it in a proper condition. We then make an estimate as to what our earnings from the various sources

producing earnings will be, and it is surprising how close an estimate can be made by those accustomed to watching the earnings of the individual properties. When these are estimated the expenses are then set so as to produce the proper results, which means the expenditure of enough to insure absolute safety and as much more as is advisable from a true business standpoint to improve and build up the property, so as to make it an efficient machine for the adequate and economical handling of the business which it serves. When these expenses are determined allotment is made to the various officers whose duty it is to spend the money down to the foremen, and they are then carefully checked in detail. Those in charge of work are required to spend each day only that which they are allowed to spend and fit in with the predetermined expense as a whole. The results shown by the amount of work turned out by the various foremen, the various shops and other units of operation, are carefully checked against each other so that a standard performance is worked out and so that the performance of those obtaining the best results may be set up as a standard and those results attained rather than that of the mediocre. For instance, the number of ties put in by the various foremen are watched, for the setting up of a proper standard. The number of engines dispatched from the various roundhouses are watched, to see that no individual roundhouse exceeds a proper cost for the work it has to perform. The tonnage which should be handled by each freight train is first placed at the proper amount, considering grade conditions, size of engines and economy of operation, and then a daily check is kept upon each train, so that the standard thus set up can be obtained.

I only mention these detail matters to show that the planning and spending of railroad expenses are not haphazard, but are gone into with great care and with real planning.

Government control of operation had a great effect upon the morale and the performance of the men, but they are coming back and I am sure will get closer to the old standard as time goes on. Whatever may be said to the contrary, it was necessary for the Government to take over the roads, not because they were broken down, as so many think, but because war operation of railroads is essentially and necessarily different from peace operation. In war operation every effort had to be bent towards one end—the winning of the war. All efforts had to be so co-ordinated; individual desires had to disappear; traffic had to be sent by the railroads best equipped to handle that traffic. So far as the whole railroad system of the country was concerned, this meant that the business of some railroads had to be restricted, others had to be increased. Individual managements were not in position to bring this situation about in a way which would be conducive of the best results. In peace, how different the conditions. It is then for the benefit of the public that the greatest possible incentive be given to individual enterprise, so that ample latitude be given to the development of service as a means of controlling and developing business. The public undoubtedly gets the benefit of this individual activity as compared with the straight edge line laid down by Governmental rule. This was never more forcibly shown than in the declining months of the Railroad Administration, after the war was over, when the public became much disgruntled at the exactions and rules of the Railroad Administration.

Another very potent reason for the Government taking over the railroads was that before they were taken over on January 1, 1918, the various departments of the Government endeavored to and did issue orders in such number requiring priority in movement of one shipment as against another that the railroads were hopelessly involved in attempting to carry them

out, and this was a factor which hastened the taking of the railroads over, so that all the facilities might be co-ordinated. I do not criticise the detail management of the Railroad Administration, but their general management was bad in many respects, because it was too big a machine to attempt to handle successfully from one central point. Maintenance of track was not kept up and the freight cars were allowed to scatter all over the United States, so that while the total number of bad order freight cars was not materially greater at the end of Federal control than it was at the beginning, yet their condition was so much worse, because foreign roads, even under Government control, will not do the work on a car that the road that owns the car will, and the Government maintenance allowance was inadequate to fully repair all cars. The roads naturally under these conditions repaired their own cars first. Another great factor in the situation was that the rates were not advanced during Federal control to take care of the increased expenses as they occurred, no attempt being made to adjust the rates to the total expenses, which state of affairs necessarily brought about under-maintenance.

RELATIONS WITH THE PUBLIC

We are sometimes accused of being indifferent in our relations with the public to the extent of arbitrary methods. It is certainly far from our intention to carry out such a line of policy, because we feel most emphatically that it is most condemnable and likely to produce results that are damaging to the Company interested as a whole. I think much of this comes from the fact that many disputes are encountered in railroad operation as between different people and different communities. One community, for instance, may want passenger schedule set for a train and another community may want a different schedule for the same train; we must decide against one or the other. The one whom we must

decide against is likely to resent it and blame the railroad rather than the conditions. There are many of these disputes which occur in railroad problems and somebody must be decided against each time. To take care of such situations the Interstate Commerce Commission and the State Commissions are set up as arbiters. I believe in them most thoroughly. I believe each have their own peculiar and particular function. There is a definite place for the State Commissions in handling State matters, police powers, and rate matters when they do not affect interstate rates, although it is rare when they do not. They should not in my opinion handle rate matters where they do interfere with interstate rates, because a rate system is more or less like a house of cards, which will fall down if one card is moved, and, therefore, so interdependent that a rate made in Maine can and does often affect a rate situation in California. The Commissions are a great protection to the people and to the railroads, and I for one advocate working most harmoniously and closely with them for the advancement of the common good. I believe that as time goes on it will be found that the least possible interference with the detail management of the railroads will be worked out by the Commissions themselves which will produce the best results.

GUARANTEE OF NET INCOME

One of the most fallacious pieces of misinformation that has come out in recent years is the news spread about that the Transportation Act guaranteed the railroads six per cent on their investment, and this coupled up with the fable of excessive over-capitalization makes a condition which seems to give the agitator opportunity for the exploitation of that fallacy. The law contains no such guarantee. The cardinal principle of the law is that the railroads must be allowed to earn a reasonable interest on their value, and until March 1, 1922, a reasonable rate of

interest was set at $5\frac{1}{2}\%$, plus $\frac{1}{2}\%$ which the Interstate Commerce Commission in their discretion might allow for the purpose of providing improvements, etc. They were then instructed by the law to make such rates as would, under honest and efficient management, probably produce such a revenue as would perhaps bring this about. The Interstate Commerce Commission did their best to carry out this provision of the law, but on account of the fearful shrinkage in the volume of business in 1921 the rates they set for that period only produced 3.3%. It was, therefore, in no sense a guarantee and it only produced 3.3%, or a little more than half of the 6% set as a reasonable amount. The Government is not in any sense obligated to make up a cent of the difference between 3.3% and 6%, consequently has not paid and will not pay the railroads one cent of money for that purpose.

OFFICERS' SALARIES

There is an impression prevalent in some quarters that the railroads are paying extravagant salaries to their officers. The truth is, that there is scarcely another business in the country where brains command such a small percentage of the total income. Since 1916, the aggregate salary of *all* the general officers of Class One roads in the United States—not merely the Presidents—has been less than one per cent of their operating revenues. Between 1916 and 1921 the increase in the average officer's salary was about thirty per cent. For other employes, excluding division officers as well as general officers, the rate of annual pay was about seventy-five per cent higher in December, 1921, than in 1916. It must be reflected that the operations of the railroads require a great variety of talent. The Division Superintendent, for instance, must be a man who has had splendid all-around experience; the duties of his position require a man of action; emergencies are constantly occurring, requir-

ing a knowledge of many different kinds of business. Therefore, railway officials earn their pay. There is no time for sloth. And, too, considering the fact that the officers have to attend continual investigations and hearings of various kinds, all requiring great preparation, knowledge and experience, you will know that they have to work many hours a day.

It is a generally accepted fact that railroad officers' salaries are lower than are paid by industrial concerns to officers having corresponding responsibilities. Be that as it may, the railroads must continue to pay at least the present scales if they would attract and keep a class of men commensurate with the importance of their work. I have known in my own experience of the simple change from an incompetent to a competent officer making the difference of hundreds of times the salary paid to the incompetent man. Personnel is the great factor in business success.

OFFICERS' PRIVATE CARS

Of all the myths of railroad propaganda, one of the most prevalent is that of the officers' cars. These cars are not private cars in any sense of the word. They are merely traveling offices. When an officer goes over the road he must have some efficient means of seeing the property. He cannot stand up on the rear end of a sleeping car or coach over thousands of miles of railroad. He finds it necessary to stop off at out of the way places where there are no hotels in order to efficiently inspect the property intrusted to his care. They also must use these cars as their offices, in which to handle their mail; it is hard to conceive the amount of mail that a general officer of a large railroad has to handle, and it must be currently kept up or they become swamped in a short time. The use of the officers' cars, therefore, is for the production of greater efficiency, which means more to the railroads than if the officers were required to ride

around in sleepers or coaches and not given an opportunity to see the railroad in an efficient manner, and I can assure you that when a man has ridden around in private cars for twenty-five years he gets tired of them and welcomes an opportunity of getting away from them.

Considering it from the standpoint of furnishing of food, lodging, etc., as a general proposition a number of officers are taken along on these trips, and it is consequently cheaper to care for them in the car than for them to go to hotels, as they serve exactly the same food that a man is usually accustomed to—no more or less luxurious. The cars generally are not of expensive construction and not furnished with luxurious fittings.

RELATIONS WITH OUR EMPLOYEES

This is one of the most troublesome subjects with which we have to deal today. The situation is difficult because of the period of readjustment now in progress. Naturally men do not like to have their wages reduced. It seems necessary that we must insist upon their being so reduced, because it is our earnest belief that their wages in some occupations are out of line with those paid in other industries, and we cannot sustain a situation in which we pay more than someone else does for the same work under the same conditions.

When we attempt to do what seems to us our plain duty in this respect we encounter the opposition of our men, which we much regret, but we must do our duty as we see it. We can in this state of affairs only refer it to the United States Labor Board, the constituted government authority, to determine who is right in their contention. I am a firm believer in the principle that contented men produce the best results and I advocate going far to attain that end. I believe most thoroughly in doing to them what I would they would do to me were our positions reversed. On our railroad particularly we have a fine body of men, whom I admire more

as time goes on. The great trouble with the railroads is that there are so many men so widely scattered that it is impossible to have the personal contact that the best relations require. This is conducive to the spread of rumors by parties interested in so doing, which bring up at times sore spots because of statements attributed to the officers in certain instances which were never thought of by them. This is really a most potent source of discontent, and it is our constant endeavor to instill in the minds of our employes that when such rumors come they should believe that they are not true until they have a chance to verify them, as such an attitude will go far towards alleviating that situation.

QUESTION OF REDUCTION OF RATES

The situation today is, as I have shown above, that the rates set by the Interstate Commerce Commission in accordance with the provisions of the Transportation Act have produced a return on the investment of only 3.3% for the last year. I am convinced, as also set out above, that the railroads have been operated honestly and efficiently—in fact, I am positive that there was not as much money spent upon the maintenance of railroad properties in the year 1921 as should have been, and, consequently, if the full amount had been spent, the return would have been less than 3.3%. Surely the railroads should not be asked to work on a lower basis than 6%, and 3.3% must be inadequate. The only way that we can obtain the necessary 6% is either by reduction in our expenses or by an increase in business. It is the argument of those desiring that we make these reductions that they will stimulate such an increase in business as will mean the provision of the necessary earnings to provide the 6%.

Insofar as the stimulation of business is concerned, the railroads have gone into that matter thoroughly and carefully, because of the fact that irrespective of any public pressure they feel that

rates should be reduced if that will stimulate the business, and it is true business sense to make reductions if they will produce the results which it is thought that they will produce in the way of stimulation by those advocating the reductions. It requires a very large increased volume of business to make up for rate reduction. For instance, for each \$100 in freight earnings in 1921 the operating expenses were, say, 80%, and this is less than they were, they actually being 83%, but say 80%—this left a net return of \$20. If such freight earnings of \$100 were to be reduced 10%, this would leave \$90. With the same expense of 80%, unless the expenses could be reduced, the net return would then be \$10. If we assume that the operating expenses for additional business would be only 70%, instead of 80%, because of the overhead charges being taken care of, it would require the earning of \$33.33 additional to produce additional net of \$10 so as to make up the original \$20. This means a 37% increase on the \$90. It seems improbable that we would get such an increase through stimulation of business; in fact, I think it is impossible for some time. We have reduced a number of rates and we have generally found that they did not produce the stimulation which it was thought that they should. The only thing that we can do is to watch the situation carefully, make readjustments as they should be made, and reduce the rates to the extent that we are able to make reduction in expenses. Any other course of action means that we will simply have a lot of railroads which will either be bankrupt or so near it that they cannot provide the facilities necessary to handle the country's business, and to my mind this is going to be the critical situation insofar as the future is concerned, and there is no question but what the business man will find that inability to handle the business as it develops in the future will be of far greater pecuniary damage to him than the reduction in rates of ten per cent or

fifteen per cent will benefit him. In other words, in one instance he will not be able to do the business at all. The fact of the matter is today that the railroads are lying dormant so far as improvements and increases in facilities are concerned. While this does not hurt today, yet it will when business revives.

We have a long, hard road in front of us. We make an appeal for the help of the public. We are desirous of doing what is necessary to conquer the situation. I believe that the solution of the railroad situation is private ownership. I believe that the Transportation Act passed in 1920, above referred to, should be given a thorough trial before it is changed. As Mr. Herbert Hoover has said with reference to government ownership:

“No one with a week’s observation of government railways abroad, or with government operation of industry in the United States, will contend that our railways could ever be operated as intelligently or as efficiently by the Government as through the initiative of private individuals. Moreover, the welfare of its multitude of workers will be far worse under government operation.”