The Future Of the Railroads

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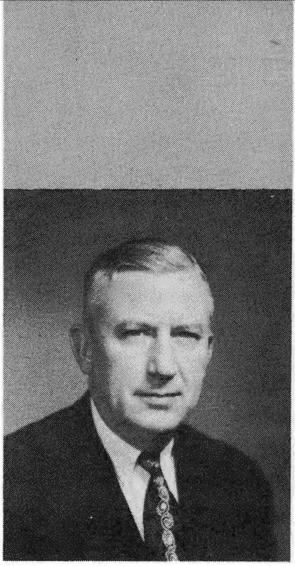

JAMES M. SYMES

The Future Of the Railroads

ADDRESS BY JAMES M. SYMES
PRESIDENT, THE PENNSYLVANIA RAILROAD
AT LUNCHEON MEETING OF
THE EXECUTIVES' CLUB OF CHICAGO
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I would like to report to you, in a broad and informal way, what we on the Pennsylvania believe is the future of our own railroad and of the American rail industry generally. You understand, of course, that industry-wise I can speak only for our own management, and that I shall tell you some things with which the presidents of some other railroads would not agree. My estimate of the future is what one railroad's management thinks—and I might add that we think it on the basis of all the business insight we can command.

Let's begin by reminding ourselves of the revolution in transportation that has taken place in our lifetime. Using myself as an example, I went to work on the railroad as a young fellow in 1916. Today's airliner, pipeline, big inter-city truck, big inter-city bus, mass-owned automobile and far-flung network of wide highways and superhighways for the most part did not exist. Except in areas served by water, most travel and freight moving for any distance went by rail: the internal combustion engine was in its infancy. The railroads, set up to handle volume, did handle most of the volume there was—and the industry prospered.

Today, as you know, all that is changed. Rails handle but half of the freight and two-fifths of the fare-paying travel. Since much of the freight is in low-rated commodities, and the passenger side operates at a deficit, the railroad industry is no longer prosperous. Last year, for instance, was one of our best since the war—yet the industry's average return on investment was just short of four percent. Naturally, this situation makes railroad stockholders uneasy, bars the door to new equity money, makes borrowing for improvement difficult and costly, and raises grave doubts in some minds as to the industry's future.

"Raises grave doubts" is putting it somewhat mildly. There are some businessmen—and even some railroad men—who look on the rails as a dead duck—or at best a dying duck. Let me give you a few of the facts which prove we aren't dead or even dying: we are just undernourished. Some of this undernourishment, as I shall show you, is our own fault. The rest is because our wings have been kept cropped so close, for so long, that we have been unable to forage properly for enough of the right food.

THE PUBLIC'S INTEREST

We'll go into all that in a moment. First, though, I want to make the Pennsylvania's attitude to its own and the industry's future unmistakably clear. Here it is:

We believe railroads will be a growth industry. We believe they have all the ingredients necessary for growth, of which not the least important are the Nation's need that they grow and their own determination to grow. We believe that the industry is rapidly coming to grips with the obstacles to growth which are its own fault and which can be overcome from within. As to the obstacles imposed from without, we believe that the public, the buyer of transportation, and government are all three at last beginning to see that it is in their interest—and not simply that of the railroads—that these obstacles be removed and the railroads permitted to grow. The sum total of all this, we believe, is that the railroads are going to assume their full place in the Nation's growing economy—which includes sharing properly in the growth and prosperity they help to create.

Now that is quite a set of beliefs, and I want to spend the rest of my time documenting them for you.

Let's begin with the Nation's **need** that the railroad industry grow. As you know, population and industrial output are increasing from year to year, and this requires increased transportation. Rails today handle, as I have said, one-half the freight and two-fifths of the fare-paying travel. If the railroad industry went out of business tonight, the airways, highways and waterways couldn't possibly take over the load we would lay down. Nor can they possibly meet all the increase in transportation requirements as population and industrial output increase. There just isn't the money to build—and the room to put—all the additional roads, airports and waterways that would be required, let alone all the additional trucks, buses, airplanes and barges that would be necessary. So if the economy is to go on expanding, the railroads must handle a sizable part of the increase in transportation requirements.

GROWTH IS A NATIONAL NECESSITY

There is also the role of the railroads in national defense. In World War II, they were called on to handle 90 percent of all military freight and 97 percent of all organized military travel—along with a greatly increased share of non-military travel and freight. No doubt in any future war, if one comes, the rails will get more help—percentage-wise—from the other forms of transport. I certainly hope so. But the railroads' special ability for heavy and mass transportation will still assign them the bulk of the job—and if they are to do it they must be growing and strong.

In short, the rails **have** to grow if the economy is to be kept expanding and the Nation kept militarily safe. Railroads aren't a luxury or comfort that can be dispensed with. They are a stark necessity—like the fuel and food industries—and like such industries they must grow with the increasing amount of work to be done. I imagine you will agree that—when national necessity dictates that an industry grow—it is one of the basic ingredients of any permanent—as against temporary—growth industry. Our problem here is not to be necessary, but to get the Nation—for its own benefit—to recognize that we **are** necessary—and so to stop hampering our necessary growth.

Perhaps we had better be clear as to what is meant by railroads "growing." It means growing in amount and profitability of load handled—not in miles of track. I mention this because in many industries "growth" presupposes more factory floorspace—and track is our counterpart of factory floorspace. The fact is that many railroads, including certainly the Pennsylvania, already have more track than they need for present volume—and the excess miles are a heavy drain in the form of maintenance costs and taxes. Some of this is in branch lines that have passed all possibility of ever returning a profit and we are taking up some of that. The rest is multiple track that was laid down years ago, before technological advances in signaling, communication and centralized traffic control made it possible to run more trains over the same or even fewer tracks. Here the problem is raising the money to make the technological changes as fast as we should—which is far faster than we are now making them.

Of course you understand that we eagerly **add** trackage where it is needed to serve new or expanded industry along our lines—that is one of our own ways of growing. In other words, our aim is not arbitrary shrinkage of "floorspace" for its own sake. Our aim is simply to "tailor" our railroad to actual requirements, saving money and doing a better job in the process.

This "tailoring," naturally, requires more than constant improvement and adaptation of our fixed plant. It also requires constant increase in amount, type and efficiency of rolling stock. In the first ten years after the war, the railroad industry spent ten billion dollars on new or refurbished plant and equipment. The Pennsylvania itself spent a billion of the total.

TWENTY BILLION DOLLARS NEEDED

Hard as that pull was, we believe that our industry generally should for the next ten years or so spend at about twice that postwar rate. We admit that is an ideal—but it is also a minimum ideal. In this technological age, we cannot expect to grow properly with the economy without buying our share of technology. On a railroad, that always comes high. Today it comes far higher than our earnings make possible.

So now our discussion comes face to face with the crux of our growth problem—the industry's present unsatisfactory earnings position. With your indulgence I would like to inventory for your inspection the major causes for this as our particular management sees them—together with what we think can be done about each. You will note that these causes for low earnings divide pretty much into three categories. Some originate outside the industry and can be corrected only from outside the industry. Some are our own fault and can be corrected only by us. And some are of mixed origin and can be corrected only by a combination of internal and external remedies.

Suppose we begin with the causes from outside the industry, since they compose the man-made bad business weather in which railroads today live and work. Please bear in mind I am **reporting** this weather to you—not complaining about it as shortsighted and unfair, which it is. Also I ask you to note that the harm done by this man-made bad weather does not stop with the railroads and the communities and customers they serve. The harm spreads from there to **all** users of transportation, and to the Nation's future prosperity and safety. In other words, my purpose here is not to solicit your sympathy, but to give you the business facts and their repercussion on everyone—not just on us.

FOUR "COLD FRONTS"

Our artificial bad weather consists, as we feel it, of four very frigid "cold fronts" that blow on our earnings column and help keep it depressed.

One is government favoritism to our competitors. Except for the pipelines, we are the one form of transport that owns and maintains its "factory floorspace" or right of way. Our air, waterway and highway rivals have theirs provided by government or quasi-government authorities, and where they do pay any charges or taxes for the use of these rights of way, their costs are only a fraction of the percentage of our revenues which go to building and maintaining our tracks and terminals. You can imagine the disadvantage that is to us in the fiercely competitive business of transportation.

Another "cold front" that depresses rail earnings is heavy State and local taxation on our facilities—while airports, airways, highways and waterways are public facilities and the transportation companies using them in most cases pay nothing for taxes on those facilities. In 1956, for instance, the Pennsylvania paid $32,000,000 in State and local taxes—over three-fourths as much as net earnings. Much of this was on rail line that parallels untaxed highways or waterways, rail bridges and tunnels a stone's throw from untaxed highway bridges and tunnels, rail passenger stations and yards serving the same cities as untaxed airports, and rail commuter lines competing directly with networks of untaxed roads or subsidized buses or subways.

The third "cold front" that shrinks our earnings is the Federal and State regulation under which we must operate, but from which most of our competitors are exempt. Many of these rules go back to the last century, when practically all traffic moved by rail and they were the traffic lights that regulated the flow. Today, transportation no longer moves in just one channel—nor does it "flow." It is a turbulent race among skilled and aggressive competitors by land, air and water—with only the rails forced to touch all bases and halt for all lights.

In short, the pattern of regulation does not fit today's situation—and this depresses rail earnings in three direct ways. Sometimes it costs us profitable business by restraining us from competitive pricing. Sometimes it denies us profit-making or even break-even charges, or delays granting them. And sometimes it forces us to operate heavily-losing branches or trains which the public no longer needs, but which some commission insists we must keep running.

The fourth man-made "cold front" that depresses our earnings is a problem that concerns all American business nowadays—inflation. But as a regulated industry, the railroads are special victims of inflation. They have over a million employes and they buy over a hundred and seventy-five thousand separate items of supplies and materials—a double guarantee that they catch the full force of every wave of inflation. But they cannot on their own decision adjust their charges to increased costs: they must lay the situation before Federal and State commissions. These Commissions often take months to reach a decision.

Meanwhile the railroads must pay the higher costs without any increases in rates and fares to meet or help meet them. This loss cannot be made up, since whatever increase is finally granted cannot be retroactive. The process, repeated with every wave of inflation since the close of World War II, has cost the industry uncounted hundreds of millions of dollars. This needless loss has been a key factor in preventing the rails from keeping up with the prosperity they help engender. They live in prosperous times, but do not share them.

Now you have to admit that is a pretty cold deal all around.

And—if that were the whole story—the future of the railroads might be inevitable government ownership. But there are other facts in the picture which cause me to believe that we will grow regardless of the present obstacles—now I'd like to review a few of them.

THE OTHER SIDE OF THE COIN

For one thing, the industry has "staying power." Except for the brief boom of the 'Twenties, it has been in trouble ever since I can remember—and it hasn't backed off yet. As a young fellow in the 1916-1920 period, I well remember the mess of government operation in World War I—and the mess we were left in. Then came the Depression of the early 'Twenties—and then, after a breathing spell of good times, the tragedy of the 'Thirties, with so many trains laid up and so many men laid off, and 110 railroads bankrupted. Then I saw the trains and men swarm back and do an incredible war job—with the earnings that should have been going into maintenance and equipment renewal going to income taxes and excess profits taxes. I saw us enter our first postwar year with a war-battered plant and a war-weary team. That was my railroad's Centennial year—and the first in our century of history when we ended the year with a loss. Then came the ten-year business of borrowing and rebuilding—while fighting with one hand for rational treatment by government, and fighting to stay abreast of increased competition from greatly improved planes, trucks, barges and automobiles with the other. So you see we know what rough going is, and haven't been scared off yet.

None of which is to suggest that resilience and a fighting attitude are enough. We need a fighting chance, too—and we can't be denied it forever.

AWARENESS OF THE FACTS

Actually, signs are appearing that it won't be denied us forever. One such sign is the Cabinet Committee Report to the President a couple of years ago. This report spread on the public record, for all to see, many of the things I have been telling you—and more besides. Basically, the report cites the inequities in transportation regulation today, and how that is not only hurting the industry itself, but the economy it serves. As a remedy it suggests greater equality of regulation among the different forms of transport, thus allowing the interplay of competition to bring the public the most economical and effective service. This equality of treatment would have the effect of freeing the railroads to fit into the Nation's transportation system and contribute to its strength and performance. In short, the change would **allow** the creative power of free enterprise competition to operate for the buyer of transportation—just as it is **required** to do in the rest of our economy.

So far the Report's recommendation of equal regulatory treatment has not been translated into formal government policy. But the need for it is now on the record—and I believe that as the public begins more and more to see how it, as a purchaser, will benefit by free enterprise competition for its patronage, equality will begin to come.

STATE AND LOCAL TAXES

Another cheering sign of eventual equality is in the matter of discriminatory taxation of railroad plant. I admit this is an isolated case—but in State and local taxation you are dealing in isolated cases. In the State of New Jersey it has been the custom to tax railroads according to a 19th century formula which worked out in most cases to a point where taxes were more than the railroad earned in that State—a piece of cannibalism if I ever heard of one.

Last year the State government set up a Commission to Study Laws Affecting Industrial Development in New Jersey. Among its recent recommendations was this one: **"The Commission recommends that the railroads be treated the same as and equally with other businesses in all taxes."** To me the important thing here is what probably inspired the recommendation. My guess is that their concern was not with railroads themselves, but with the State's need for strong railroads if industry is to develop. At least I hope it was their concern. For it is that kind of enlightened self-interest in what we can do for

them—rather than any sympathy they may feel for **us**—that is going to get people to see that the railroads are given a chance to do their full job.

SUBURBAN SERVICES

That brings up another hopeful sign—this one in regard to rail suburban passenger services, which are heavy money-losers for railroads that have them. I will cite the Long Island Rail Road as an example. It's a commuter line that the Pennsylvania owns and has had a long history of deficits caused by three unnatural burdens: exorbitant real estate taxes, expensive crossing eliminations to improve highway safety, and the Public Service Commission's resistance to needed fare increases. Three years ago the State accepted a program whereby for nine years about half of those taxes go to help pay for new equipment for commuters. The taxes remaining are still too high and should be eliminated altogether, since there is no source of money to pay them except in the price of commuter tickets, and the commuter is already paying his share of the cost of government in direct taxes on his purchases, his home and his income. But half a loaf is better than none. The program includes a guarantee that the railroad can have fare increases when they are demonstrated to be necessary. This sensible pattern of community cooperation is rehabilitating the railroad—thus saving a public service instead of continuing its destruction. I predict that in time other communities that do not want to lose rail services will see the wisdom of the cooperative approach—as against the attitude of "You will run your trains for us regardless, until you go bankrupt." In fact, several cities are already edging toward the approach of cooperation and support of such deficit operations as commuter services—including financial support—while the railroad is still solvent—although generally undernourished.

SELF-SEARCHING

Let's take a minute now to look at some obstacles to growth that are the railroads' own fault—and which we are beginning to correct from within. Needless to say, I include my own railroad in this "examination of conscience."

Perhaps our biggest fault, I believe, has been in our way of presenting the railroad case for equality to the public. For years we have talked as if it were only **our** case—whereas it is also the **public's** case. And we have talked as if we were **complaining** rather than explaining. Now at long last we are "accentuating the positive"—emphasizing how free enterprise competition for their patronage will benefit the users of transportation, which includes just about everybody. We are learning to put the tax equality we need on a more constructive basis, too. As you know, the pressure is on government for bigger and better airports, airways, highways and waterways. However it is disguised, this is going to cost the taxpayer money—and the installations themselves are not going to pay taxes. In the past the theme of our tax case to the public has been: "If the installations our competitors use do not have to pay taxes, then in all fairness ours should not have to, either."

Now, as a matter of self-interest to the taxpayer himself, we are beginning also to emphasize that equal treatment of railroads could save him at least some of this new expenditure. A good illustration of this is one I have already touched on—rail suburban services. Many cities are finding that the more money they spend for highways into the city, the more private cars try to come in—generating pressure for still more highways. Now, as you know, more and more cities are considering re-developing a resource they have been allowing and even forcing to dwindle —rail passenger lines between the city and its satellite communities. And cities are realizing this will cost them some money—both in tax relief and in direct help in one form or another—though only a fraction of what additional highways would cost them. I understand that Toronto, for instance, has estimated that each dollar expended on rail transportation is equivalent to five dollars spent on highway costs.

As I said, we are now pointing such constructive things out, along with our call for tax equality. Nor is the passenger phase of it confined to suburban services. As you probably know, the whole rail passenger business operates at a loss. There's not a railroad in the country that makes money on it. The Pennsylvania's deficit for 1956 was $55,000,000, and four other roads lost over $40,000,000 apiece—it will be more than that this year. At least some of this is due to State and local taxation of railroad passenger stations, tracks and yards. It is beginning to dawn on the cities—and both in the public interest and our own we are helping it dawn—that if they want rail passenger connections with the rest of the Nation, we cannot continue to subsidize it for them. So along with tax relief, there will have to be some of the kind of support they give their airports—such as providing and maintaining rail passenger terminals. You people are now talking about taking a first step in that direction for Chicago.

Incidentally, what I have just said indicates that the railroads are at last eliminating another internal obstacle to their growth. I mean their traditional attitude that however much their rivals for business are helped, railroads must not accept a nickel's worth of comparable help. Some railroad people still cling to this laudable but unrealistic ideal. Most of us in the Eastern railroads now know we can no longer afford that point of view. We can no longer subsidize services that are being kept in the red by publicly subsidized competitors. We ask nothing more nor less than equal treatment with competing forms of transportation.

Nor can this kind of adjustment be limited to passenger service. Industry and the defense people are constantly pressuring us to add more freight cars than we can afford. The best way I know to get these cars—and the only way I know to get enough of them—is through some sort of government cooperation. Right now we in the East are discussing with leading industrialists a plan for a pool of government-owned cars that would be rented to the railroads. The rent, plus eventual scrap value, would more than repay the government's outlay. There would not be a penny of subsidy.

You gentlemen may be surprised that I have spent the bulk of my time here discussing the external and internal **obstacles** to our growth—and what we are doing about them. One reason for that is **how much** we grow depends a great deal on how well we surmount these hurdles. The other reason is that the factors and pressures favoring our growth are so self-evident that they hardly require explanation. One of these I have already mentioned—the Nation's **need** that we grow if the economy is to expand and the Nation kept safe.

Another is that the railroads, by their very nature, are in position to furnish mass transportation at the lowest true cost of any form of general transport—and that is becoming better recognized by the American public.

Another is the great room we still have for technological improvements. This includes developments we are not yet able to buy enough of—and others that the research people have on the way. Far as we have come in things like mechanized maintenance, centralized traffic control, "push-button yards," lightweight passenger equipment, TrucTrain, and so on—we have just scratched the surface. We may be over a hundred years old, but technologically speaking we are in our infancy.

Another is the room in the industry for constructive and beneficial consolidations that have strengthened so many other industries and improved their service to the public. In many parts of the country you have three, four or five railroads or segments of railroads starving to death on the traffic that one or two lines could handle profitably while giving much better service. There is a rich field for consolidations that would strengthen the industry and benefit the public —and I am happy to note that some are now being progressed.

Another resource for growth is the volume of business we already have. It isn't as though we were a new store, to which people might come or might not. Customers we already have: all we need is to serve them better and thus get more of their business. Fortunately this last can be done without "robbing" our competitors, since as the economy grows the pool of customers grows.

So there are the railroads as we see them—a growing industry in a market that is growing with the economy. Now and then some of my own railroad's friends in the industry tell us we are too optimistic. We do not think so. We have all of the problems most of them have, and a few more besides. Even so, we managed last year to net forty-one million dollars —which, while insignificant for a two and a half billion dollar investment—is our best since the war. We also made heartening progress in our program of debt reduction. We got it down by another twenty-five million, making a total reduction of a hundred and fifty-four million, or fourteen percent, below our 1952 peak.

So we are making some progress—though how much progress we and the industry finally make will depend very much on the understanding of business and industrial leaders like yourselves. It is only because we so deeply feel that this progress and growth are in the national interest, as well as our own, that I have used this opportunity to talk to you about it.

We are not on the way out—I think we are on the way in—providing railroad managers are big enough to intelligently solve the problems they face—and I, for one, believe they will.


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