

# The Case for Government Operation and Ownership

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UNTIL comparatively recently the theory of those favoring the private management of public institutions was that a few were wiser and more capable than the many and that every such institution, whether operated for profit or not, should be kept out of the control of the general public. Accordingly the schools, libraries, hospitals and all charitable institutions were at first controlled by the church acting through its ecclesiastics and later to a considerable extent through corporations usually self-perpetuating. Little by little such institutions have come with increasing number under public control, and this fact itself sufficiently proves that the people as a whole are satisfied with the result; and very few can deny that the result has been an enormous gain both in the quality of the service rendered by these institutions and in the efficiency of their administration.

The same is true of transportation facilities. In the early days of this country the poverty of the people and their inability to pay taxes forced them in many cases to grant to private individuals and to quasi-public corporations the right to construct and operate the more costly of these facilities and to collect fees from those using them for their reimbursement. It was in this way that the toll-roads and toll-bridges came into existence. This, however, was recognized to be a temporary expedient only; and gradually the people have taken over and given free service of these facilities, the private control of which in every case had come to be recognized as detrimental to the public interest. In acquiring them the public authorities generally borrowed money for the purpose and then paid off the indebtedness incurred by levying taxes on the property of those benefited. The levy of such taxes was in all material respects identical with the assessment of stockholders in private corporations, the benefits accruing from the free use of the utility being the equivalent of a dividend.

These general propositions apply as well to ferries, street rail-

ways and all other public utilities which require operation as well as maintenance and for which it is necessary to charge fares or rates. In these cases the fundamental difference between private and public operation is that under public management the primary purpose is to provide efficient service at the minimum cost, while under private management the primary purpose is to pay the largest possible dividends to the relatively small number who are in possession of the utility and for that purpose to charge the public all that the traffic will bear.

The temptation to private owners to exploit the public is irresistible and the results invariably are detrimental to the public, not only in a material way but by corrupting the public morals, as it almost always leads to the perversion of public officials and to the undue enriching of a few by reprehensible methods. This is especially true where the utility is a monopoly.

The largest single monopolistic public utility now under private control is that part of the national transportation service consisting of the railroads. In applying to it the principles I have laid down it is necessary to consider the railroads as a unit, for that is the relation they sustain to the public. That the railroads are public highways and that "the function performed is that of the state" is not open to question. This was settled long ago by the Supreme Court of the United States,<sup>1</sup> and the right of the government to acquire and operate them is as well settled as the right of a state to acquire a toll-road, or of a city to acquire and operate a street railway or a ferry. The only question to consider is whether the interests of the public can be better served if the service is rendered directly by the public through its own employes or indirectly through the agency of a public service corporation privately administered.

In considering this question it is necessary to bear in mind that for nearly three-quarters of a century the railroads have been privately operated under regulations of the state and federal government, and that they have never been operated by the government, except for less than two years and then under abnormal conditions which the private managers had been unable to meet, and that the carrying out of the details of this operation remained with those who were operating the roads when they

<sup>1</sup> *Olcott vs. Supervisors*, 83 U. S., 678.

were taken over by the government—the general manager of all the lines in the eastern territory being the president of the New York Central company. Because of this a comparison of the two methods can be made only by pointing out some of the evil conditions which have always been a feature of private management in spite of all attempts to regulate them in the public interest; and assuming in this case that, as in all others, public operation as the only alternative would be more satisfactory to the public. In this necessarily brief paper I shall limit my presentation of the case to the principal evils invariably resulting from the conflict of private with public interests.

The one harmful feature of private management which began earliest and has continued longest and caused the greatest loss to the public is that commonly called *stock-watering*. Closely associated with this as a feature of all railroad financiering under private management has been the basing of issues of bonds and stocks on the dividend paying capacity—actual and anticipated—of each road, and not on the amount of capital invested. If a road is prosperous these capital obligations are never reduced but are steadily increased. The stock and bond issues of the Pennsylvania company, for instance, issued and authorized, increased from \$217,000,000 in 1900, to \$1,000,000,000 at the beginning of 1919.

The methods adopted to bring about both these forms of over-capitalization have been as varied as ingenious. The result has been to make it impossible to tell what the amount invested by its stockholders in any railroad has been, and to enable them to claim the right to establish rates sufficient to pay, in addition to the cost of maintenance and operation, interest on their bonds and apparently moderate dividends on their stock. The amount of these issues runs into the billions. In the period from 1900 to 1916, inclusive, the stock issues alone have increased from \$5,845,570,000, to \$8,743,106,000, of which 45.66 per cent was paying dividends in 1900 and 60.38 in 1916; and the average dividend rate on the dividend paying stock had increased from 5.23 per cent in 1900, to 6.45 in 1916.

These evils would at once disappear if the government should acquire and operate its railroads, for the stocks acquired by it would be paid for by the issue of low-rate interest bonds, and the

outstanding bonds of the railroads at their maturity would be paid in the same way. The saving to the people by this alone would amount to an enormous sum annually. And following the unbroken precedents of all public financing, taxation would be resorted to in order to reduce the amount of the bond issues until, as in the case of ordinary highways, canals, and all other property owned by the people, the indebtedness would be eventually paid, after which the railroads could be operated on the basis of the actual cost of maintenance and operation. This, I may note in passing, is the policy adopted for the Erie Canal in which the legislature authorizing its construction specifically provides for state taxation for the payment of the bonds issued for its construction.

One inevitable effect of overcapitalization of the railroads has been the depreciation of the credit of the companies to such an extent that they now turn to the government to provide funds for their maintenance—the purchase of rails and rolling stock. It has also reacted disadvantageously on the public as it has imposed capital obligations in many cases far exceeding the cost of construction of new lines. This has forced the overcapitalized companies to prevent the building of additional railroads; to oppose every appropriation by the public for the improvement of ordinary highways and canals; and even to buy up and destroy canals and steamboats to prevent competition. And for such purchases they issue more bonds and stock!

How this policy has been carried out to destroy coastwise water transportation is graphically described by Professor Van Metre in a paper published in *The Traffic World* of November 30, 1918. The following may be fairly taken as an illustration of its application in every case where the private managers meet or fear competition:

If coastwise transportation is cheap and practical, why is it that with the great increase in the general productivity and commerce of the country the coastwise shipping business has not made satisfactory progress? The answer is merely that the business has been kept under control and wilfully suppressed by the railroad interests of the country. Virtually all of the coastwise lines on the Atlantic coast have for many years been directly controlled by or closely affiliated with powerful railroad interests, and these interests have also obtained control of a large portion of the water front of the leading seaports. . . . Time after time companies organized to carry on a coastwise shipping business

have been destroyed by unfair methods of competition by railroads. . . . The printed testimony of the committee's (House Committee on the merchant marine and fisheries, 1912-13) report is replete with actual instances of how, by these methods and by others equally reprehensible, the established transportation interests of the Atlantic and Pacific coasts had to the detriment of the commercial interests of the entire country throttled attempts at competition and caused investors in independent coastwise shipping companies to lose millions of dollars. . . . Nothing accomplished by the railroad companies in their efforts to perpetuate their monopolistic power has resulted in greater loss to the country than the suppression of the coastwise shipping business.

The enormous development of our country and its commerce demands the extension of its railroad facilities. These the railroad companies should but do not provide. In 1905 the Interstate Commerce Commission reported that a prominent railroad president had declared that the traffic offered for transportation in the United States had increased 110 per cent over that of 1895 and that the instrumentalities for handling it had increased only 20 per cent. In September 1916 Mr. Howard Elliott said: "Equipment showed a marked decline in 1915 and in that year less mileage was built than in any year since 1864. There have been only three years since 1868 when there was a smaller mileage of railway construction than in 1915." In 1918 nearly twice as much mileage was abandoned as the new mileage built, and the greater part of the new mileage was branch lines and extensions to coal mines. As the private managers cannot or will not provide the facilities needed, the country must either go without or the government must provide them. And in any event if provided they must be operated in connection with the existing lines, because the private interests control practically all terminal facilities, and the railroads to render efficient and economical service must operate as a unit. By their control of the terminal facilities and of the water fronts of the leading seaports the railroad managers have secured a strangle-hold on the nation's commerce which can be broken only by the government.

The selfish disregard of the interests of the public either as a whole or of lesser units in every case where their interests conflict with those of the private managers is a fact so well known that no illustrations are needed. The hostility necessarily created by this condition is everywhere apparent and the only remedy suggested by those who have felt it is that this department of the

public service shall no longer be administered by those who have controlled it in the past. At the Farmers' National Reconstruction Conference held in Washington early this year the policy of government ownership and administration of the railroads was unanimously endorsed, and a resolution was adopted demanding legislation eliminating watered stock and stock fraudulently issued, and urging government ownership and operation at once. And this is also the demand of the Farmers' National Council, which represents a membership of about 750,000.

This hostility is equally pronounced among the employes of the railroads. The four great brotherhoods have formally declared in favor of taking the operation of the roads out of the hands of their private managers; and an overwhelming majority of the vast army of nearly two million railroad employes favor the same policy so that they may serve directly under the government where they can receive the protection of its civil service rules and the other benefits accorded those serving in its other departments.

The opposition to government operation and ownership which is most aggressive and efficiently organized is that of the great investment banking interests of New York commonly called the Wall Street financiers. Their interest in the subject is apparent. From the very first the money lending classes have found in the railroads a principal source of their profits. As recently as five years ago Mr. Clark of the Interstate Commerce Commission said: "I know of a large railway corporation that has paid \$32,000,000 in commissions to bankers for the sale of its securities." Another source of large profits to these bankers has been from the purchase of these railroads securities and their resale at an advance to foreigners. The amount of these foreign holdings at the time of the breaking out of the war was enormous. To maintain these sources of profits a constant supply of such securities was absolutely essential. If the financial operations of the railroads were performed by the government by the sale of its bonds directly to the people, the Wall Street financiers would lose these sources of income, and to the same extent the people would profit by it.

But the interest of Wall Street financiers is not limited to commissions and profits on the sale of railroad securities. These financiers are not only the bankers of the railroads, they are also

their managers. Mr. Prouty of the Interstate Commerce Commission, speaking of the evidence before the Commission in 1903 in its investigation as to the reasonableness of certain rate advance made by the companies from which appeals had been taken to it, said: "In the present investigation into increases in the grain rates from the Missouri River to Chicago, it became apparent that the traffic managers of the railroads had nothing to do with it. On the contrary Wall Street financiers needed the money and ordered the rate to be made."

This was and still is inevitable because the policies of the railroads must be formulated by the directors who are elected to promote the interests of the stockholders. The railroad presidents are merely their servants charged with the duty of carrying out these policies. And for many years the railroad stocks have to a preponderating extent been either owned outright or controlled by Wall Street financiers.

The dominating influence of a few of these men appears from the reports filed with the Interstate Commerce Commission. In 1917, "1.3 per cent of the number of stockholders in the railroads in this country held about one half of the number of shares of stock." "Of the Wabash stock, 46,642 shares were held in Amsterdam, Holland, and 36,321 shares were held by fourteen New York and one Boston company or partnership." "Of the stock of the Chicago, Milwaukee and St. Paul, 216,528 shares were held by eleven New York concerns," etc. An illustration of the composition of the boards of directors of these companies may be found in the fact that in a recent election of the six directors elected for a three year term by the stockholders of a great railroad running west out of Chicago, one was Mr. Depew of the New York Central, one was a principal officer of the National City bank of New York, one was H. C. Frick and a fourth was a brother of the last named. The others were names less well known and have escaped me.

With these facts before us it is interesting to note that at the Reconstruction Convention of the Investment Bankers' Association of America which met last December, the convention while unanimously putting itself "squarely on record as opposed to public ownership of railroads or their permanent operation by the government, and emphatically in favor of the return of the



railroads to their owners," qualified the demand for such return by adding, "under such regulations as will insure sound credit and adequate service."

But as this recommendation comes from the men who have for years dictated the policies of the railroads, it is well to bear in mind that there has never been a time since the first railroad charter was granted when legislators have not attempted to impose such regulations, with the further purpose of protecting the interests of the public; and that there has been no time since the first charter was granted when every effort and device conceivable has not been resorted to by "the owners" of the railroads to prevent the enactment and enforcement of such regulations. The demand of the investment bankers therefore suggests no new policy, or attitude different from that which the public has maintained and attempted to enforce from the beginning; and there is no reason whatever for assuming that if the railroads were to be returned "to their owners" there would not be the same opposition by the private managers to the enforcement of restraining legislation.

The attitude of the private managers toward attempts at regulation by the public has been too plainly declared to be open to question. About ten years ago Mr. Harriman gave out an interview which was published in the *New York Times*. In it he said: "In all the laws propounded by the states there is the question of Constitutionality. But one thing is obvious, and that is that the railroads have got to fight these measures as they come along." Even more instructive is the statement which was made by Mr. Shouts about the same time in a public address which was printed in pamphlet form and widely circulated and which under the circumstances may be fairly accepted as the attitude of the Wall Street managers. That which called for this address was that prior to 1910 the railroad companies had the right to establish freight rates and put them in force, and the only redress offered shippers was through appeals to the Interstate Commerce Commission. In such appeals the issue was as to whether a particular rate on a particular commodity between specified terminals was reasonable; and upon the shipper was placed the burden of proving the negative of the proposition. As no rate was ever based upon the actual cost of the transportation



of a particular commodity between designated terminals, but upon the adequacy of the railroad's income from all sources the evidence was in the hands of the railroads and difficult of access to the shippers. The remedy allowed the shipper was so costly and inadequate as to be in fact a denial of justice. In 1908 the companies were about to put in force a large horizontal increase of rates. The shippers appealed to Congress to grant the Interstate Commerce Commission the power to suspend proposed increases pending an inquiry by it as to their reasonableness. This request met the bitter opposition of the railroad managers. It was while this bill was pending that Mr. Shouts, then president of the Clover Leaf, said:

We still have hope that we are going to be let alone and allowed to run our own business. . . . This is a period of governmental control and interference. In this period of business depression the railroads should be preparing for the return of industrial activity. But not a mile of new track is being laid, nor is any equipment being purchased that is not absolutely essential to the present needs of the roads. Improvements involving hundreds of millions have been abandoned because of the vengeful spirit that has temporarily possessed the minds of men whose duty it is to carefully consider proposed legislation.

Notwithstanding the attitude of the railroad managers Congress granted the relief asked by the shipping interests. And the facts that ever since the enactment of this law the railroad interests have fought to secure its repeal, and failing in this have allowed equipment to deteriorate and have discontinued the construction of new lines, sufficiently disclose the attitude of the Wall Street financiers toward governmental regulation and their ability to enforce the policy toward the public indicated by Mr. Shouts. Under these circumstances the demand of the Investment Bankers Association of America for "the return of the railroads to their owners," under regulation to be imposed by the government is not entitled to serious consideration.

Bearing in mind the relation actually sustained toward our railroad transportation system by New York financial interests, the question before us becomes the simple one of whether public interests will be better served if this department of the public service is operated and its policies dictated by a group of Wall Street financiers for the profit of a few or by the government, *not for profit* but, as is done by the Post Office Department, for

the benefit of all the people. And in my opinion we are limited in our choice to the one or the other.

But it must always be borne in mind that even government operation—whether by the system now applied to all its other departments or by the so-called “democratization” of the transportation department asked by the railway employes—to be free from the temptation to exploit the people as a whole for the benefit of a particular group or class must exclude all opportunity to do this. If the cost to the people may include a profit to be divided among the members of any groups or class there will inevitably be the temptation to make the cost include such profit, which in the case of the transportation of the necessities of life adds to the cost of living, which tax falls most heavily on those of every community least able to bear it.

But government operation, however applied, would be unnecessarily costly and unsatisfactory without the ownership of all the instrumentalities, and there would still remain the demoralizing element of selfish interests seeking always to increase their profits. To make this department most efficient and economical and of the greatest benefit to the public, the government should be the sole owner of all the railroads, of their equipment, and of all other property now owned or controlled by the railroad companies.