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Chapter 1 : Keynes v Hayek: Two economic giants go head to head - BBC News

An economic theory called monetarism holds that the supply of money is the key to the nation's health, and having too much cash and credit in circulation stimulates inflation.

Beginning in the nineteenth century in the United States, a vast system of railroads was developed that moved goods and people across great distances, facilitated the settlement of large portions of the country, created towns and cities, and unified a nation. Early railways were a far cry from the great system of railroads that were built in the nineteenth century and that continue to be used today. The earliest railways in the United States were short, wooden railways built by quarries and mines along which horses pulled loads to nearby water ways. In 1825, quarry and mine operators in Quincy, Massachusetts, and Mauch Chunk, Pennsylvania, constructed the first full-size railways. The first locomotive for use on railways was imported from England in 1825. The English had been experimenting with steam-powered locomotives since the late eighteenth century and had developed a prototype by 1825. One, Stourbridge Lion, was tested on 8 August 1825, but proved to be too heavy for the tracks that had been constructed and was subsequently retired. Undeterred, railroad companies continued to seek a viable steam-powered locomotive. Locomotive engines were needed. Peter Cooper rose to the challenge and on 28 August 1830 drove his diminutive Tom Thumb locomotive at speeds approaching fifteen miles per hour while towing a car filled with thirty people. With the viability of steam-powered locomotives proven, the race was on to build other, larger locomotives. Miller was commissioned by the South Carolina to construct what would be the first locomotive built in America for use on railroad. He named the locomotive The Best Friend of Charleston. Tested in October of 1830, the engine performed admirably. Unfortunately, The Best Friend exploded the following year, but not before the South Carolina Railroad inaugurated service on 25 December 1830. The Best Friend pulled train cars, the first locomotive to do so in the United States, along six miles of track out of Charleston. The age of the railroad in America had begun. By 1850, railroad track in the United States had reached almost three thousand miles; by 1860, more than nine thousand miles; by 1870, over thirty thousand miles. During these decades, technology associated with the steam locomotive continued to improve, and innovations were made in the design of the tracks themselves. Early tracks were constructed of wood, which was not strong enough to support ever-heavier locomotives. Iron rails were developed that could carry the weight of large, steam-powered locomotives. These rails were originally laid on crossties made of blocks of stone, which were not only expensive, but also could not support the weight of locomotives. They were replaced by wooden crossties similar to those used today. Several other innovations helped foster the growth of railroads between 1830 and 1870. These included T-shaped rails that distributed the weight of trains evenly and hook-headed spikes that grabbed the rail, thus attaching it securely to the crossties. Swiveling trucks under railroad cars created greater stability, allowing trains to travel over rough roadbed and high terrain. The development of truss and cantilever bridges provided a way to get railroads over water ways and other obstructions. By the 1850s, track could be laid virtually any where. In the 1830s the ambitious efforts to reach the seaports of the Atlantic and to reach the West were successful. Philadelphia established an all-rail connection with Pittsburgh, and Baltimore reached the Ohio River at Wheeling, Virginia now West Virginia, early in the 1830s. Other lines were built across the more open and level country of the Middle West. Two railroads, the Michigan Central and the Michigan Southern, reached Chicago from the east in 1848. Both were later incorporated into the New York Central system. Lines were also built west from Chicago. Only a year later a route between Chicago and East Saint Louis afforded another rail connection between the eastern seaboard and the Mississippi River, while in two more connections were added. A direct route from the Atlantic to Chicago was constructed from Baltimore via Cincinnati. Railroads were also being built from the far bank of the Mississippi River westward. In 1856, the locomotive The Iron Horse crossed the Mississippi on the first railroad bridge. Standardization The thousands of miles of track laid and the locomotives and other railroad equipment built in the early years of the railroad in the United States were all done by private companies. These

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companies built their railroads to suit their needs and to specifications they determined. Tracks were built in a variety of gauges the distance between the rails ranging from two and one-half feet to six feet. By the s, close to two dozen gauges of track were in use in the United States. Locomotives were built to fit the gauge of the track. In addition, the couplings used to attach one train car to another varied. The incompatibility of railroads was not a problem if the purpose of the railroads remained to move people and goods over short distances. However, when the potential of the railroad to travel greater distances, even to traverse the country, was realized, the need for industry standards became evident. Track gauge was the first of such standards to be achieved. The standard gauge in the South was five feet. In the rest of the country, the predominant gauge was four feet eight and one-half inches—the standard English gauge that had been used because locomotives had been imported from England. In , the South changed its gauge to conform to that of the rest of the country. Trains today run on this gauge of track except for a limited number of narrow-gauge railroads. Next came standardization of locomotives and railroad cars to fit the track; standardization of couplings followed. Early couplers were simple link and pin devices that were unsafe and unreliable. In , forty-two improved couplers were tested in Buffalo, New York. In , a coupler designed by Eli H. Interchanging cars between railroads also required the standardization of brakes. Early train brakes were hand brakes operated by brakemen in each car. Efforts to standardize brakes were unsuccessful until In that year, George Westinghouse developed his first air brake. In , he designed an air brake that would immediately engage if cars became separated. These air brakes, with improvements, have remained an integral part of freight trains. One final, crucial feature of rail transport needed to be standardized: Efforts were made in the s to standardize rail schedules and timetables. In light of the increasing interconnection of railroad lines, the timing of trains became critical. Each railroad originally had its own "standard time. In an era when people were still keeping local time, the idea of a standard time seemed implausible if not impossible, but local time was increasingly becoming railroad time. Each town had a "regulator" clock by which local people set their watches and clocks. This clock often hung in the railroad station. On 18 November , the American Railway Association adopted a "standard time" with four time zones one hour apart. The standard time system remained under the auspices of the railroad until , when the U. The Growth of the Railroad, Railroad Towns, and the Population of the American Interior Railroads began in the East, but quickly moved west, spider-webbing across the country. Wherever railroads went, people followed and towns grew. Previously uninhabited or sparsely inhabited areas of the country became towns almost overnight when the railroad came through. One striking example is the case of Terminus, Georgia. In , it was renamed Atlanta and went on to become one of the most important cities in the South. Railroads required land on which to lay tracks, build rail yards, and construct depots. Beginning in the s, speculators bought land in the hopes that a railroad would come through an area and they could then resell the land at a much higher price. Also in the s, the United States government realized the value of the railroads and the land associated with them. One of the first railroads built as a single unit was the Illinois Central. The line could be built as one unit partly because the government granted land to the rail company in a patchwork pattern of alternating one-mile-square sections, with the government retaining ownership of the intervening lands. The combination of public and private ownership created by the grant and others like it led to the use and settlement of vacant lands, the extension of railroads into underdeveloped areas, and increased production and wealth. In return for the land grants, the railroads transported government freight, mail, and personnel, including military troops, until The government further encouraged settlement in the wake of the railroads through the Homestead Act of Few farmers could afford to take advantage of the latter provision, but many land speculators could. Thousands of acres of homestead land were purchased by speculators at what were paltry sums, forcing new settlers, in turn, to purchase land at inflated prices from speculators. Railroads were crucial in moving goods to markets. Cities in the East, like New York and Boston, and in the Midwest, like Chicago, that had begun life as ports, became the centers for railroad transport of agricultural and industrial products. Railroads freed trade of the constrictions of the natural sources of transport, such as rivers, because railroads could be constructed almost anywhere. Like canals before them, railroads became in essence

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man-made rivers. Railroads moved freight and people between urban centers in the East into the interior of the country and ultimately toward the West. Towns in the center of the country became boom-towns, acting as railroad transshipment points for goods. Perhaps the best examples of this are the Kansas towns like Abilene and the infamous Dodge City. From the mids to the mids, Texas cowboys drove herds of longhorn cattle to these towns where they were loaded onto trains for shipment to stockyards and slaughterhouses in cities like Chicago. The cattle drives ended when the railroads moved even farther west and south to areas where the cattle were grazed and when farmers across whose lands the cattle were driven erected barbed-wire fences to keep out the trampling herds. Railroad towns that were no longer needed as access points for railroads often were abandoned as quickly as they arose or greatly reduced in population. Railroads brought boom and bust to towns and cities across the nation. The Transcontinental Railroad A large part of the effort to bring the railroad to the freight instead of the freight to the railroad culminated in the building of the first transcontinental railroad. On 1 July , President Abraham Lincoln signed a bill authorizing the construction of a railroad between the Missouri River and California. The idea for a transcontinental railroad had been around since at least

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Chapter 2 : Railroads | calendrierdelascience.com

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Sylvain Leduc and Glenn D. Rudebusch Over the past two years, both monetary and fiscal policy projections have been based on the view that declines in the long-run potential growth rate of the economy will in turn push down interest rates. In contrast, examination of private-sector professional forecasts and historical data provides little evidence of such a linkage. This suggests a greater risk that future interest rates may be higher than expected. The aging of the labor force, weak productivity growth, and possible long-run supply-side damage from the Great Recession have all suggested recently that the potential growth rate of the U. According to standard economic theory, such slower growth would push down the level of the natural rate of interest. This natural rate, also called the neutral or equilibrium real interest rate, is the risk-free short-term interest rate adjusted for inflation that would prevail in normal times with full employment Williams Moreover, a decline in the natural rate of interest would tend to lower every other real and nominal interest rate in the economy. Therefore, understanding the linkage between economic growth and the natural rate is crucial for forecasting all types of interest rates. Indeed, this linkage has been at the center of recent fiscal and monetary policy forecasts. In addition, earlier this year, some Federal Open Market Committee FOMC participants appeared to reduce their estimates of the natural rate of interest because of an expectation of slower growth ahead for potential output. This Economic Letter examines the linkage between growth and interest rates as embodied in recent projections by FOMC participants, the CBO, and private-sector forecasters. Although forecasts of potential growth or the natural rate are rarely reported, we can construct reasonable proxies from long-run forecasts of GDP growth, the short-term interest rate, and inflation. In essence, the long-run nature of these forecasts strips out cyclical variation and reveals the fundamental secular trends that underlie the concepts of potential growth and the natural rate of interest. Although in the CBO and FOMC policy projections long-run forecasts of growth and the real interest rate have fallen together, private-sector forecasters do not anticipate a similar dual drop. In particular, the recent downward revisions in private-sector expectations for long-run growth have been associated with no change in their long-run projections of the real short-term interest rate. If the private-sector forecasters are correct, this would raise a concern that the CBO and FOMC may have overestimated the effects of slower potential growth toward reducing interest rates, which may introduce some upside risk to CBO and FOMC interest rate projections. FOMC and CBO projections of growth and interest rates In standard economic theory, the natural interest rate is that is, the short-term real interest rate at which the economy would stay at full employment is related positively to the growth rate of potential output. Higher potential growth can affect the real interest rate via two key channels. First, it increases the returns on investment and thus leads to higher investment demand. Second, because higher growth boosts future earnings, it leads forward-looking households to consume more and save less. The combination of higher investment and lower savings raises the real interest rate. As a result, higher potential growth would be associated with a higher natural rate Laubach and Williams Of course, this simple theory is not definitive, and in the real world, other factors may obscure or overwhelm this relationship, including those highlighted in the recent debate about secular stagnation Summers Most importantly perhaps, in an open economy with international financial flows, the real interest rate is determined by the interaction of growth, saving, and investment at a global level rather than by developments in any single country. Because we do not directly observe the natural rate of interest or potential trend growth, we construct proxies from long-run forecasts of real GDP growth and short-term real interest rates. Long-run real GDP growth forecasts are available since Long-run forecasts of the equilibrium real interest rate can be constructed since using long-run forecasts of the nominal federal funds rate and of inflation in the price index for personal

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consumption expenditures. We use the average of five- to ten-year-ahead forecasts. We calculate the real interest rate forecast using projections of the three-month Treasury bill rate and of inflation in the consumer price index CPI. Based on historical differences among the data series, we subtract 0. Since the beginning of , FOMC participants have lowered their projections of the short-term rate from 2. Echoing the views of FOMC participants, the latest report on the long-term budget outlook from the CBO emphasized that a key factor behind the declining real rate was the decline in potential growth. The two series have a fairly close correlation of 0. Evidence from private-sector forecasts and historical data Are the views of FOMC participants and the CBO about the linkage between long-run growth and interest rates shared by private-sector forecasters? Since , the Blue Chip Economic Indicators has reported long-run forecasts from business economists for growth and interest rates. We use the average five- to ten-year-ahead consensus forecasts for real GDP growth and for the short-term real interest rate. We base the latter on projections of the federal funds rate and CPI inflation adjusted by 0. However, despite this weaker growth outlook, the Blue Chip long-run estimates of the short-term real interest rate have actually edged up during this period. Furthermore, this recent episode is not unusual. Over the past three decades, it appears that private forecasters have incorporated essentially no link between potential growth and the natural rate of interest: The two data series have a zero correlation. This evidence is surprising given the predictions of standard economic theory, but it is in line with some other research findings. For instance, Goldman Sachs recently examined the effect of real per-capita GDP growth on short-term real interest rates in 20 countries since the early s. The report found no statistically significant relationship between these two variables. Similarly, Carroll and Summers and Bosworth found at best a weak positive relationship between growth and short-term real interest rates using data for a number of countries. A strong positive link between higher growth and higher real interest rates depends in part on a decline in the saving rate, arising from household assumptions about longer-term income. However, much research has instead found that higher growth is associated with a higher saving rate for example, International Monetary Fund In this case, although higher growth would raise investment demand and put upward pressure on real interest rates, this effect would be mitigated by a rise in the saving rate. The Blue Chip results could be interpreted in three ways. Alternatively, it is possible that the Blue Chip forecasters have a more subtle understanding of the many factors other than growth that influence investment and saving in a way that masks a positive connection between potential growth and the equilibrium real interest rate. Finally, the Blue Chip forecasters may correctly recognize that there is no significant relationship between potential growth and the equilibrium real funds rate. If either the second or third of these interpretations were true, it would imply that many FOMC participants and the CBO may have overemphasized the effect that weaker potential growth has on damping future interest rates. Conclusions and policy implications In this Letter, we document a range of views about the link between potential growth and the natural interest rate. In particular, while the CBO and many FOMC participants expect weaker long-run growth to translate into lower interest rates, private-sector forecasts do not seem to share this view. Thus, future downward pressure on interest rates may be more muted than indicated by current monetary and fiscal policy projections, which would translate into an upside risk to these longer-term interest rate forecasts. Rudebusch is director of economic research and executive vice president in the Economic Research Department of the Federal Reserve Bank of San Francisco. Douglas Bernheim, and John B. Chicago University Press, pp. Goldman Sachs Global Macro Research. Economics Analyst 14 25, June Laubach, Thomas, and John C. This publication is edited by Anita Todd. Permission to reprint must be obtained in writing.

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Chapter 3 : Carter ruined the economy; Reagan saved it

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Carter ruined the economy; Reagan saved it. The Federal Reserve Board was responsible for the events of the late 70s and 80s. Summary Carter cannot be blamed for the double-digit inflation that peaked on his watch, because inflation started growing in and snowballed for the next 15 years. To battle inflation, Carter appointed Paul Volcker as Chairman of the Federal Reserve Board, who defeated it by putting the nation through an intentional recession. Once the threat of inflation abated in late , Volcker cut interest rates and flooded the economy with money, fueling an expansion that lasted seven years. Neither Carter nor Reagan had much to do with the economic events that occurred during their terms. Argument In , the "misery index" -- unemployment plus inflation -- crested 20 percent for the first time since World War II. Reagan then caught the business cycle on an upswing, for what conservatives call "the Seven Fat Years" or "the longest economic expansion in peacetime history. Carter battled the peak of an inflationary trend that began in In the following chart, take special notice of the long, slow climb in the inflation column: Year Inflation Unemployment 1 1. This fiscal policy as predicted by Keynesian theory increased inflation and reduced unemployment. Unfortunately, inflation is a self-fulfilling prophecy. If business owners expect it, and raise their prices by the anticipated amount to compensate for it, then they have created the very inflation they fear. This process forms a vicious circle -- inflationary expectations and price increases feed off each other, with the potential of creating hyper-inflation. Growing inflation in the 70s received two huge boosts: Soaring oil prices compelled most American businesses to raise their prices as well, with inflationary results. The second boost to inflation came in the form of food harvest failures around the world, which created soaring prices on the world food market. All this was accompanied by a growing crisis in monetary policy at the Federal Reserve. Traditionally, the Fed has fought inflation by contracting the money supply, and fought unemployment by expanding it. In the 60s, the Fed conducted an expansionary policy, accepting higher inflation in return for lower unemployment. It soon became clear, however, that this strategy was flawed. Expanding the money supply created jobs because it put more money in the hands of employers and consumers, who spent it. But eventually businesses learned to expect these monetary increases, and they simply raised their prices by the anticipated amount instead of hiring more workers. The result was that the Fed gradually lost its ability to keep down unemployment; the more money it pumped into the economy, the more businesses raised their prices. As a result, both inflation and unemployment started growing together, forming a twin monster that economist Paul Samuelson dubbed "stagflation. However, Carter did in fact take a tremendously important step in ending stagflation. Volcker was committed to eradicating stagflation by giving the nation some bitter medicine: In , Volcker tightened the money supply, which stopped job growth in the economy. In response to hard times, businesses began cutting their prices, and workers their wage demands, to stay in business. Volcker argued that eventually this would wring inflationary expectations out of the system. The recovery of was unintentional, and with inflation still high, Volcker tightened the money supply even more severely in This resulted in the worst recession since the Great Depression. Unemployment in the final quarter of soared to over 10 percent, and Volcker was accused of the "cold-blooded murder of millions of jobs. But Wall Street demanded that Volcker stay the course, and that may have been the only thing that saved him. In the late summer of , inflation looked defeated, so Volcker sharply expanded the money supply. Within months, the economy roared to life, and took off on an expansion that would last seven years. Because the recession had been so deep, and the number of available workers so large with not only laid-off workers waiting to return to work, but also a record number of women seeking to join the workforce , the recovery was guaranteed to be long and healthy. Interestingly, Volcker was transformed from villain to hero after the victory over inflation. His reputation and integrity were so

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unquestioned that when his term as Chairman came up for renewal, Reagan renominated him with overwhelming popular approval. The policies recommended by the two theories converged at this point. Milton Friedman, the creator of monetarist theory, and other conservatives were pleased that the Fed had finally converted to monetarism. However, they were outraged in late when Volcker threw off the cloak of monetarism and openly returned to Keynesian policies for expanding the economy. Most economists now accept that the Fed was not monetarist at all during this period, and that the label was merely political cover for drastic but necessary action. Of course, conservatives have a far different interpretation of these events. Reagan also slashed regulations, unshackling the entrepreneurial spirit of American business. There are several problems with this historical spin. First, total federal taxation under Carter rose by an insignificant 1. Although many conservative laymen would gladly accept such a notion, it is not one entertained by serious economists. West Germany in the s, for example, had a total taxation rate of 39 percent of its GDP compared to 29 percent of combined government taxes for the U. Although the top rate for income taxes was 70 percent under Carter where it had always been, since Kennedy , Carter gave the rich the most sacred tax cut they hold dear: Thus, Carter gave the rich their first tax cut in 15 years. According to conservative theory, this should have nudged the economy in the right direction, not sent it into the worst economic crisis since the Great Depression. But Carter actually began deregulating during his term; in , he deregulated airlines; by , he was deregulating trucking, railroads interest rates and oil. Carter also set up the deregulatory machinery that Reagan would later use to slash regulations almost in half by the end of his second term. The economies of Western Europe are far more regulated than the U. The timeline better fits the liberal explanation than the conservative one. Volcker expanded the money supply in late , and a few months later the economy took off. Tax cuts were supposed to have spurred economic recovery by liberating the tax dollars of entrepreneurs and allowing them to invest them in greater productivity and jobs. However, such greater investment never occurred. It appears that the rich simply pocketed the savings, because investment fell during the 80s: Private investment 4 - Return to Overview Endnotes: Bantam Books, , p.

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Chapter 4 : Production versus Consumption | Mises Institute

B) the manipulation of interest rates by the government to affect economic growth rates. C) based on the principle that government should not meddle with the economy. D) the manipulation of the supply of money and credit in private hands.

The actual opportunities forgone as a consequence of doing one thing as opposed to another. Opportunity cost represents true economic costs, and thus, must be used in all cases. The cost the society incurs when its resources are used to produce a given commodity, taking into account the external costs and benefits. The cost a producer incurs in getting the resources used in production. Shared costs[edit] The production of transport services in most modes involves joint and common costs. A joint cost occurs when the production of one good inevitably results in the production of another good in some fixed proportion. For example, consider a rail line running only from point A to point B. The movement of a train from A to B will result in a return movement from B to A. Since the trip from A to B inevitably results in the costs of the return trip, joint costs arise. Some of the costs are not traceable to the production of a specific trip, so it is not possible to fully allocate all costs nor to identify separate marginal costs for each of the joint products. For example, it is not possible to identify a marginal cost for an i to j trip and a separate marginal cost for a j to i trip. Only the marginal cost of the round trip, what is produced, is identifiable. Common costs arise when the facilities used to produce one transport service are also used to produce other transport services e. The production of a unit of freight transportation does not, however, automatically lead to the production of passenger services. Thus, unlike joint costs, the use of transport facilities to produce one good does not inevitably lead to the production of some other transport service since output proportions can be varied. The question arises whether or not the presence of joint and common costs will prevent the market mechanism from generating efficient prices. Substantial literature in transport economics Mohring, ; Button, ; Kahn, has clearly shown that conditions of joint, common or non-allocable costs will not preclude economically efficient pricing. Traceable cost untraceable cost: A cost which cannot be directly assigned to a particular output service on a cause-and-effect basis. Traceable untraceable costs may be fixed or variable or indivisible variable. Traceability is associated with production of more than one output, while untraceable costs possess either or both common costs and joint costs. The ability to identify costs with an aggregate measure of output supplied e. A cost which is incurred simultaneously during the production for two or more products, where it is not possible to separate the contributions between beneficiaries. These may be fixed or variable e. A cost which is incurred simultaneously for a whole organization, where it cannot be allocated directly to any particular product. External and Internal Costs[edit] External costs are discussed more in Negative externalities Economics has a long tradition of distinguishing those costs which are fully internalized by economic agents internal or private costs and those which are not external or social costs. The difference comes from the way that economics views the series of interrelated markets. Agents individuals, households, firms and governments in these markets interact by buying and selling goods and services, as inputs to and outputs from production. A firm pays an individual for labor services performed and that individual pays the grocery store for the food purchased and the grocery store pays the utility for the electricity and heat it uses in the store. Through these market transactions, the cost of providing the good or service in each case is reflected in the price which one agent pays to another. As long as these prices reflect all costs, markets will provide the required, desirable, and economically efficient amount of the good or service in question. The interaction of economic agents, the costs and benefits they convey or impose on one another are fully reflected in the prices which are charged. However, when the actions of one economic agent alter the environment of another economic agent, there is an externality. An action by which one consumer's purchase changes the prices paid by another is dubbed a pecuniary externality and is not analyzed here further; rather it is the non-pecuniary externalities with which we are concerned. More formally, "an externality refers to a commodity bundle that is supplied by an economic agent to another

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economic agent in the absence of any related economic transaction between the agents" Spulber, The essential distinction which is made is harm committed between strangers which is an external cost and harm committed between parties in an economic transaction which is an internal cost. A factory which emits smoke forcing nearby residents to clean their clothes, cars and windows more often, and using real resources to do so, is generating an externality or, if we return to our example above, the grocery store is generating an externality if it generates a lot of garbage in the surrounding area, forcing nearby residents to spend time and money cleaning their yards and street. There are alternative solutions proposed for the mitigation of these externalities. Closer to our research focus, an automobile user inflicts a pollution externality on others when the car emits smoke and noxious gases from its tailpipe, or a jet aircraft generates a noise externality as it flies its landing approach over communities near the airport. However, without property rights to the commodities of clean air or quiet, it is difficult to imagine the formation of markets. The individual demand for commodities is not clearly defined unless commodities are owned and have transferable property rights. It is generally argued that property rights will arise when it is economic for those affected by externalities to internalize the externalities. These two issues are important elements to this research since the implicit assumption is that pricing any of the externalities is desirable. Secondly, we assume that the property rights for clean air, safety and quiet rest with the community not auto, rail and air users. Finally, we are assuming that pricing, meaning the exchange of property rights, is possible. These issues are considered in greater detail in Chapter 3 where the broad range of estimates for the costs of the externalities are considered. Other terms[edit] Sunk costs: These are costs that were incurred in the past. Sunk costs are irrelevant for decisions, because they cannot be changed. Do not vary continuously with different levels of output or must expenditures, but be made in discrete "lumps". Indivisible costs are usually variable for larger but not for smaller changes in output Escapable costs or Avoidable costs: A cost which can be avoided by curtailing production. There are both escapable fixed costs and escapable variable costs. The escapability of costs depends on the time horizon and indivisibility of the costs, and on the opportunity costs of assets in question. Time Horizon[edit] Once having established the cost function it must be developed in a way which makes it amenable to decision-making. First, it is important to consider the length of the planning horizon and how many degrees of freedom we have. For example, a trucking firm facing a new rail subsidy policy will operate on different variables in the short run or a period in which it cannot adjust all of its decision variables than it would over the long run, the period over which it can adjust everything. Long run costs, using the standard economic definition, are all variable; there are no fixed costs. However, in the short run, the ability to vary costs in response to changing output levels and mixes differs among the various modes of transportation. Since some inputs are fixed, short run average cost is likely to continue to fall as more output is produced until full capacity utilization is reached. Another potential source of cost economies in transportation are economies of traffic density; unit cost per passenger-kilometer decreases as traffic flows increase over a fixed network. Density economies are a result of using a network more efficiently. The potential for density economies will depend upon the configuration of the network. Carriers in some modes, such as air, have reorganized their network, in part, to realize these economies. The long run average cost curve, however, is formed by the envelope of the short run average cost curves. For some industries, the long run average cost often decreases over a broad range of output as firm size both output and capacity expands. This is called economies of scale. The presence of economies at the relevant range of firm size means that the larger the size of the firm, the lower the per-unit cost of output. These economies of scale may potentially take a variety of forms in transportation services and may be thought to vary significantly according to the mode of transportation involved. Time horizon in economic theory Short run: That is, the short run cost functions represent the behavior of costs when at least one factor input is fixed. If one were to develop cost functions for each level of the fixed factor the envelope or lower bound of these costs would form the long run cost function. Thus, the long run cost is constructed from information on the short run cost curves. The firm in its decision-making wishes to first minimize costs for a given output given its plant size and then minimize costs over plant sizes. In the diagram below the relationship between average

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and marginal costs for four different firm sizes is illustrated. Note that this set of cost curves was generated from a non-homogeneous production function. You will note that the long run average cost function LAC is U-shaped thereby exhibiting all dimensions of scale economies.

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Chapter 5 : Transportation Economics/Regulation - Wikibooks, open books for an open world

v. 1. Railway equipment.-v Railway organization.-v Financing constructing, and maintaining.-v Train service.-v Passenger, baggage, express, and mail.

These objectives fall under a few broad categories that characterize many of the efforts at government regulation. The following are some of the more commonly observed regulatory objectives. Maximize social welfare[edit] Among the most common set of objectives for government regulatory policy is the maximization of social welfare through the remediation of various types of market failure. For example, agents can gain market power through the creation of monopolies, cartels, or other forms of organization that limit the benefits from competitive markets and trade. Natural monopolies are one such type of market failure that has been prevalent throughout the historical development of transportation networks, often due to the high fixed costs of developing infrastructure. Externalities are another common type of market failure that can justify regulatory intervention. Regulatory efforts toward externalities often focus on negative externalities. For example, in the context of transportation many modes experience congestion where prices as a means of rationing capacity are absent. Likewise, the consumption of energy often leads to emission of pollutants which, when unpriced, can lead to undesirable outcomes. Positive types of externalities are also possible and can in some situations justify government intervention. For example, in systems where Network effects are present, government may be able to increase social welfare by speeding up the growth of the network so that it serves a large number of users. Other types of market failure justifications for intervention involve the provision of certain public goods a classic example being national defense and the remediation of some types of information asymmetry. Macro-economic objectives[edit] A second set of objectives that are pursued primarily by national governments revolve around macroeconomic performance. Macroeconomic objectives include efforts to control inflation , for example through the adoption of monetary policy. They also include efforts to counteract the effects of economic cycles, for example by adopting policies to maintain employment during periods of recession. Socio-economic objectives[edit] Government may also intervene in order to promote a range of socio-economic objectives. Many of these objectives may be motivated by concerns over fairness, such as efforts to achieve a desired income distribution, or a desire to provide a basic standard of service to all citizens, such as programs that offer mobility to people with mental or physical disabilities. Other interventions may be designed to promote safety where it is thought that market participants are unable to account for certain types of risk. An example of this in the United States is the Consumer Product Safety Commission CPSC , an agency that has the authority to regulate the sale and manufacture of thousands of consumer products. Still other socio-economic objectives may include things like industrial policy , where governments intervene to promote certain sectors of the economy, or even to promote individual industries or firms. Other objectives[edit] Apart from the three categories of objectives for intervention listed above, governments may intervene for other reasons broadly related to national interests. Some interventions are undertaken to promote national unity, such as the construction of the Transcontinental Railroad in the US during the Civil War. The provision of national defense which, as noted above is an important type of public good, is almost universally seen as grounds for government intervention. Finally, some interventions are undertaken in order to promote national prestige. Efforts in many world cities and their respective countries to attract the summer or winter Olympic Games , which may often involve the development of expensive new infrastructure projects, might fall into this category. Instruments of Government Intervention[edit] Governments have many different instruments of intervention at their disposal in order to pursue the types of objectives outlined in the previous section. These may range in scope from simple instruments such as exhortation and information provision to actual ownership and operation of enterprises in certain industries. Regulation is among these instruments and will be introduced in the context of some of the more common instruments of intervention. Here, government attempts to affect user choice through propaganda. The

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provision of information by itself may sometimes be enough to influence desired outcomes. Public speeches and exhortation may sometimes be used as a way to influence support for a particular policy. He often uses public speaking engagements to tout the benefits of Amtrak and to encourage support, both through actual patronage of the system and through support for additional public spending. The use of exhortation to influence policy outcomes is one example of a set of policy instruments collectively referred to as moral suasion. Moral suasion strategies may rely on a variety of mechanisms in order to enhance policy success, but they tend to have common elements of the use of persuasion such as appealing to moral authority or community spirit, as opposed to outright coercion, in order to achieve desired outcomes [1]. Posters were issued by the government and distributed throughout the country to promote programs such as the planting of victory gardens and investment in war bonds. The propaganda poster to the right, promoted the conservation of energy through voluntary carpooling referred to in the poster as "car-sharing" during WWII, appealing to citizens with the phrase "When you ride alone, you ride with Hitler! In addition to exhortation, several other types of instruments of moral suasion are frequently used. These include the promotion of research, organization of academic or professional conferences on a given topic, the establishment of advisory and consulting bodies, and the reorganization of existing agencies. Where regulatory bodies are involved, the threat of regulation if not actual use can sometimes be used in order to achieve compliance. While moral suasion in general does not serve as a good substitute for more direct economic incentives, it can complement other types of policy instruments in order to increase the chances of policy success. Romans [2] identifies two necessary conditions for the success of a moral suasion policy: Government expenditures[edit] One of the more common methods of government intervention is to provide direct expenditures in order to ensure the production of goods considered socially beneficial. Government expenditures may be justified on the grounds that they promote the provision of public goods or quasi-private goods that have some public good aspects, such as education. Grants and subsidies may be used to encourage the production of a good by public or private sector. Often these instruments are combined with the direct public provision of facilities. For example, the US federal government makes grants to state and local governments for the provision of highway and public transit networks, payed for largely with revenues from the Highway Trust Fund. In most cases, the recipients of these funds are public entities that build and maintain these networks. A common rationale for the public provision of these networks is that they display characteristics of natural monopolies. Regulation - economic and other regulation:[edit] Governments may also reserve the right to regulate certain activities for economic, social or other purposes. In the transportation sector, for example, many industries have market structures that inherently limit entry and can lead to concentration or monopoly e. Rather than provide these services directly, many governments have chosen instead to maintain private provision, subject to some form of regulation. Some examples of these will be provided in the next section. There are many instruments that governments may use in order to implement and enforce regulation. Most government regulatory bodies promulgate rules or guidelines in order to set standards of firm behavior in a regulated industry. Fines and penalties may be used as tools of compliance in order to punish violations of established rules. In the context of international trade, where sovereign nations may have no formal legal powers over their trading partners, taxes and tariffs may be used in order to influence trade activities. These instruments may also be used by voluntary associations that govern trade activities, such as the European Union and the World Trade Organization. The use of public ownership may allow governments to set more efficient prices in cases where production is subject to strong scale economies, or where regulation of an activity through conventional means is particularly difficult. Government provision of a good may rely on direct ownership and operation, or may involve some form of private involvement, perhaps through a lease arrangement with the public owner. This type of arrangement will be discussed further in the chapter on ownership. Rationales for Economic Regulation[edit] Economic regulation is an attempt by government to deliberately alter the allocation of resources and distribution of incomes away from that which would have occurred in the absence of such regulation. Transportation had been a heavily regulated industry in the US until recently. There are two major

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opposing theories on why economic regulations exist, consumer protection and industry protection, which are discussed below.

Consumer Protection[edit] The traditional and ideal view is that regulation is a device for protecting the public against the adverse effects of monopoly. This view, as described by Posner [3] , is commonly referred to as the public interest theory of regulation. Nominally, the main objective is to maximize social welfare by correcting market failure, which may occur in several forms. For example, governments may choose to regulate monopolies in order to force them to produce the level of output that maximizes social welfare. Monopolies may arise for a couple of reasons. In some cases, an industry might be inherently "monopolistic" due to the existence of economies of scale, limited markets, or requirements for high levels of initial investment, which may deter entrants. Another consumer protection rationale for the provision of regulation is the need to correct for externalities.

Industry Protection[edit] The contrasting and more recent view, that of regulatory capture , is that regulation is procured by politically effective groups assumed to be composed of the members of the regulated industry itself , for their own protection. The reasoning behind this view is that industry attempts to acquire regulation mainly because regulation will help them generate economic rents. Furthermore, producers in an industry are more likely to have an incentive to influence regulatory activities, given their greater financial interest relative to individual consumers. Thus, producers are far more effective in pressuring government than are general interest consumer groups. Stigler [4] argues that producers essentially "capture" regulatory agencies, stating that "as a rule, regulation is acquired by the industry and is designed and operated for the industry and not for the "public interest" p. Therefore, regulatory commissions end up "protecting" industry from consumers, conferring benefits on producers that they would not be able to obtain in more competitive markets. Similar arguments have been used by political scientists to describe the relationship between Congress, federal agencies, and interest groups, often under the term iron triangle. In this case, the relationship is tripartite, disaggregating the role of government into objectives pursued by elected officials and those pursued by agencies responsible for administration and oversight of federal programs. This framework has been used to analyze the behavior of certain federal agencies, such as the Tennessee Valley Authority , as well as to describe the dynamics of industry-government relationships in the Military-industrial complex. An interesting variation on the regulatory capture framework, commonly referred to as Bootleggers and Baptists , has been applied to describe situations in which incumbent firms demand greater regulation, often with lobbying support from groups with conventionally opposing positions [6]. The namesake application of the theory describes the phenomenon, frequently observed in southern states, of alcohol sales being banned on Sundays. The ban is supported primarily by Baptists and other groups that seek to limit the consumption of alcohol, ostensibly for moral reasons. The ban also enjoys tacit support from illegal suppliers of alcohol the "bootleggers" , who benefit from the prohibition in the form of greater market power in the provision of alcoholic beverages on Sundays. Outside of this traditional application, the framework has been applied to other areas of regulatory policy, such as certain aspects of environmental regulation. In this case, environmentalists demanding greater regulation to ensure better air quality serve as the Baptists, while the equipment suppliers who manufacture the scrubbers serve as the bootleggers and lobby for specific provisions requiring the use of scrubbers. A common feature of firm behavior in this framework is the use of regulation to obtain market power, often through entry restrictions. In the clean air example, plants that must comply with the regulation often have incentive to support it after it has been implemented. Compliance in this case involves one-off expenditures on the procurement of the pollution control equipment. The equipment might be expensive, but becomes a sunk cost after implementation. The requirements for this expensive, new equipment become a barrier to entry for prospective firms looking to enter the market. The incumbent firms also tend to operate at higher levels of output, thus enabling them to spread the costs of the pollution control equipment across a greater number of consumers, lowering average costs.

Infant Industry[edit] Economic regulation has also historically been employed in some cases where a government sought to promote the growth of an infant industry. The infant industry argument for regulation is typically invoked in cases where a nation sees the existence of potentially large external benefits from the growth of an industry, or

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the potential for other important non-economic benefits. While air mail was initially provided by the US government between and , the Kelly Act contained provisions that required the US Post Office Department to contract with commercial air carriers for the delivery of air mail on intercity routes. These contracts were an important source of revenue for the nascent airline industry. The mail contracts may be considered a form of implicit subsidy to the early airline industry. In addition to subsidization, other instruments that may be used by government to promote infant industries include regulations on entry entry barriers or regulations mandating the supply of a specific quantity of a good. Cut-throat Competition[edit] Governments have sometimes intervened in markets in order to prevent what is know as destructive or cut-throat competition. Cut-throat competition is one example of anti-competitive business practices, that is, practices that reduce or prevent competition in a market, and is characterized by competitive situations where prices do not cover production costs over extended periods.

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Chapter 6 : Keynesianism vs Monetarism | Economics Help

Railway rate theory was the precursor to modern multiproduct pricing theory, and railroads were the data source and focus for the development of cost function estimation. The economic analysis of regulatory performance and subsequent deregulation in North America were models of modern applied economics.

Preth century[edit] The history of privatization dates from Ancient Greece , when governments contracted out almost everything to the private sector. However, the Roman Empire also created state-owned enterprises – for example, much of the grain was eventually produced on estates owned by the Emperor. During the Renaissance , most of Europe was still by and large following the feudal economic model. By contrast, the Ming dynasty in China began once more to practice privatization, especially with regards to their manufacturing industries. This was a reversal of the earlier Song dynasty policies, which had themselves overturned earlier policies in favor of more rigorous state control. Significant privatizations of this nature occurred from to , preceding the industrial revolution in that country. The firms belonged to a wide range of sectors: In addition to this, delivery of some public services produced by public administrations prior to the s, especially social services and services related to work, was transferred to the private sector, mainly to several organizations within the Nazi Party. After , council house tenants in the UK were given the right to buy their homes at a heavily discounted rate. One million purchased their residences by British Rail had been formed by prior nationalization of private rail companies. The privatization was controversial, and the its impact is still debated today , as doubling of passenger numbers and investment was balanced by an increase in rail subsidy. Companies providing public services such as water management , transportation, and telecommunication were rapidly sold off to the private sector. Agency for International Development, the German Treuhand , and other governmental and nongovernmental organizations. Ongoing privatization of Japan Post relates to that of the national postal service and one of the largest banks in the world. After years of debate, the privatization of Japan Post spearheaded by Junichiro Koizumi finally started in The privatization process is expected[by whom? It was also said to be the largest holder of personal savings in the world. Criticisms against Japan Post were that it served as a channel of corruption and was inefficient. After the Upper House rejected privatization, Koizumi scheduled nationwide elections for September 11, He declared the election to be a referendum on postal privatization. Koizumi subsequently won the election, gaining the necessary supermajority and a mandate for reform, and in October , the bill was passed to privatize Japan Post in Large privatization of the Soviet economy occurred over the next few years as the country dissolved. Other Eastern Bloc countries followed suit after the Revolutions of introduced non-communist governments. The privatization received very mixed views from the public and the parliament. Even former Conservative prime minister Harold Macmillan was critical of the policy, likening it to "selling the family silver". By the time of her resignation in , there were more than 10 million shareholders in Britain. Egypt undertook widespread privatization under Hosni Mubarak. He was later overthrown in the revolution , the public called for re-nationalization as the privatized firms were accused of practicing crony capitalism with the old regime. Private sector involvement in Medicare and Medicaid is not limited to MCOs; private doctors, hospitals, nursing homes provide medical care; reimbursement claims are processed by private intermediaries; and peer review organizations, utilization review committees and accreditation organizations like JCAHO are staffed by private medical personnel. Welfare services that are often privatized include workforce development, job training and job placement are often privatized. EMOs are usually for-profit and manage charter schools and sometimes traditional public schools as well. Private prison In the US in , private prison facilities housed Contracts for these private prisons regulate prison conditions and operation, but the nature of running a prison requires a substantial exercise of discretion. Private prisons are more exposed to liability than state run prisons. Many of the military interrogators at Abu Ghraib prison were provided by a private contractor and lacked formal military training; this was subsequently identified as a contributing factor to detainee abuse at

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the prison by the Fay report. US Constitution[edit] The United States Constitution only constrains state action and, with few exceptions, "erects no shield against merely private conduct, however discriminatory or wrongful". Adequately guarding against abuse of public power requires application of constitutional principles to every exercise of state authority, regardless of the formal public or private status of the actor involved: Tort law might be another avenue of protection, and some may argue that this protection could be even more effective as public agencies and employees usually enjoy some degree of immunity from civil liability. Please help improve this article by adding citations to reliable sources. Unsourced material may be challenged and removed.

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Chapter 7 : Privatization - Wikipedia

Classical economic theory advocates for a limited government. It should have a balanced budget and incur little debt. Government spending is dangerous because it crowds out private investment.

Austrian Economics- Economics is the lifeblood of every nation. How money flows through from employers, to employees, to governments, and back again is the basic idea of economics. Two prominent economic theories that are often hotly debated are Keynesian and Austrian economics. The two schools of thought share drastically different views on economic functions and the role of the private and public sectors. Many economic theorists trace the roots of Austrian economics back to the fifteenth century and the followers of St. As his followers sought an explanation for the full range of human action and social organization, they took notice of the existence of economic laws and the inevitable forces of cause and effect. Austrian Economics Ludwig von Mises Austrian Economist The first true wave of Austrian economics as it is known today came from Vienna in the Austrian Empire during the mid-th century. Several notable economists from the Austria-Hungary region of Europe were responsible for the development of what has become known as Austrian economics. Social cooperation, however, can be based only on the foundation of private ownership of the means of production. The assertion that there is irrational action is always rooted in an evaluation of a scale of values different from our own. Whoever says that irrationality plays a role in human action is merely saying that his fellow men behave in a way that he does not consider correct. They must reluctantly admit that they are subject to the laws of nature. But they reject the very notion of economic law. There are no statistical characteristics to human behavior. It is purposeful rather than random, and changeable rather than constant. The premise of Austrian economics is to allow the private sector to control the economy without outside factors influencing the marketplace. Austrians believe that recessions and depressions are normal and necessary functions of any economy that serve to purge the marketplace of unnecessary or weak enterprises that waste precious capital investment. These drops help pave the way for new businesses, new capital investment, and new jobs. Keynesian Economics John Maynard Keynes Keynesian economics was developed in the early 20th century based upon the previous works of authors and theorists in the 19th and 20th century. Keynesian economics believes that private sector decision-making occasionally results in inefficient practices that have a negative impact on a greater macroeconomic scale. The result is a need for the public sector to step in and correct the direction of the economy with monetary and fiscal policies. In short, Keynesian economics views any recession or depression as unnecessary and believes in the need for the public sector to step in and prevent the loss of current businesses and jobs. Keynesian economics called for the public sector, the administration of Franklin D. Roosevelt in this case, to step in and adopt fiscal and monetary policies to try and stabilize the economy. Austrian economics on the other hand would have had the government remain on the sidelines and wait for the market to correct itself and the economy to emerge from the downturn stronger, without the government running up a deficit to prop up the economy. And that by the time the War came around, the excesses had finally been worked out of the economy and it was ready to recover and that all the War did was create shortages of materials and destroy productive capacity and thus the world was poorer as a result. Keynesian economics enjoyed great popularity from the publishing of Keynes book in through the mids when the U. At that point Austrian economics began to take hold as the U. The Reagan administration was the first that followed a more Austrian approach and is credited with reducing inflation and cutting the Misery Index in half. The Misery index is a combination of Unemployment and Inflation. The current global situation has restarted the debate over the merits of Keynesian and Austrian economics as governments across the globe battle to jump start stagnant economies. With Keynesians saying that the Trillion Dollar stimulus saved the Western World from economic ruin and Austrians saying that it did nothing but transfer private debt to the public sector. Bankruptcy although unpleasant eliminates debt from the books allowing for a fresh start. The crisis was made much worse by: Government policies allowing the transfer of risk from private issuers to

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Public agencies through the resale of loans to Fannie Mae and Freddie Mac. The problem was exacerbated by derivatives that converted these junk loans into high quality debt instruments by theoretical diversification although that diversification was among like quality borrowers subject to the same underlying factors. See *The Big Short: Inside the Doomsday Machine* See Also:

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Chapter 8 : Marshall Monroe Kirkman - Wikipedia

viability of any economic theory that relies on government spending and management. I believe there are some politicians who want to increase our nations dependency on government programs because this increases the power of the government.

There are two fundamental views of economic life. One dominated the economic philosophy of the nineteenth century, under the influence of the British classical economists, such as Adam Smith and David Ricardo. The other dominated the economic philosophy of the seventeenth century, under the influence of Mercantilism, and has returned to dominate the economic philosophy of the twentieth century, largely under the influence of Lord Keynes. What distinguishes these two views is this: In the nineteenth century, economists identified the fundamental problem of economic life as how to expand production. Economic theory, therefore, could take for granted the desire to consume, and focus on the ways and means by which production might be increased. In the twentieth century, economists have returned to the directly opposite view. Economic theory in the twentieth century takes production for granted and focuses on the ways and means by which consumption may be increased. It proceeds as though the problem of economic life were not the production of wealth, but the production of consumption. These two diametrically opposed and mutually exclusive basic premises concerning the fundamental problem of economic life play the same role in economic theory as do conflicting metaphysics in philosophy. Point for point, they result either in opposite conclusions or in the advancement of opposite reasons for the same conclusion. So thoroughly and fundamentally do they determine economic theory that they give rise to two completely different systems of economic thought.

Two Views of Employment

If one is on the nineteenth century, productionist premise, one realizes first of all that there is no such thing as a problem of "creating jobs. At all times, the productionist holds, there is as much work to be done" as many potential jobs to be filled" as there are unsatisfied human desires which could be satisfied with a greater production of wealth; and as these desires are limitless, the amount of work to be done" the number of potential jobs to be filled" is also limitless. The employment of more and better machinery, therefore, argues the productionist, does not cause unemployment. It merely allows men, to the extent that they do not prefer leisure, to produce more and thus to provide for their needs more fully and in a better way. Nor does the working of longer hours or the employment of women, children, foreigners, or people of minority races or religions deprive anyone of employment. It simply makes possible an expansion of production. If one is on the twentieth century, consumptionist premise, one takes another view of machinery and the employment of more people. One regards every expansion of production as a threat to some portion of what is already being produced. One imagines that production is limited by the desire to consume. One fears that this desire may be deficient and, therefore, that an expansion of production in any one segment must force a contraction of production in some other segment. Hence, one fears that the work performed by machines leaves less work to be performed by people, that the work performed by women leaves less work to be performed by men, that the work performed by children leaves less to be performed by adults, that the work performed by Jews leaves less to be performed by Christians, that the work performed by blacks leaves less to be performed by whites, and that the extra work of some means a deficiency of work available for others. Neither the productionist nor the consumptionist desires long hours or child labor. Here, to this extent, both reach the same conclusion. But their reasons are completely different. The consumptionist does not desire them because he thinks there is a problem of what to do with the resulting products, unless other products are to cease being produced and other workers are to become unemployed. The productionist does not desire long hours or child labor because he attaches no value to fatigue or premature exertion. The problem, in the eyes of the productionist, is not what to do with the additional products produced by longer hours or by child labor" only the intense need for the additional products calls forth this additional labor" but how to raise the productivity of labor to a level at which people can afford to have time for leisure and to dispense with the

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labor of their children. Because he imagines production to be limited by the desire to consume rather than consumption being limited by the ability to produce, the consumptionist values not wealth but the absence of wealth. For example, after World War II, he imagined that the relative absence of houses, automobiles, television sets, and refrigerators in Europe was an asset of the European economy because it represented a large supply of unused consumer desire, thereby supposedly ensuring a strong consumer demand. By the same token, he imagined that the relative abundance of these goods in the United States was a liability of the American economy because it represented a depleted supply of consumer desire, thereby supposedly ensuring only a weak consumer demand. Prosperity depends on the absence of wealth, and poverty follows from its abundance, the consumptionist concludes, because that priceless commodity, consumer desire, more limited in supply than diamonds, is produced by the absence and consumed by the presence of wealth. It is on this principle that the consumptionist relishes war and destruction as sources of prosperity and attributes the poverty of depressions to "overproduction. Though he believes it difficult of accomplishment, he has hopes that the supply of his commodity, consumer desire, may nevertheless be increased by positive measures. One such measure is a high birth rate. By bringing more people into the world, one brings more consumer desire into the world. The existence of a larger number of people, the consumptionist tells businessmen, will make it possible for business to find someone upon whom to unload its otherwise superfluous goods. Business will prosper because its supply of goods will find a counterpart in an adequate supply of desire for goods. In the absence of a high birth rate, or along with a high birth rate, the consumptionist believes advertising may suggest to the otherwise fully sated consumers some new desire. And, on a somewhat different plane, technological progress, the consumptionist argues, may provide new uses for an expanding supply of capital goods, which otherwise would find no "investment outlets. Or perhaps, the consumptionist hopes, a country may be fortunate enough to be in danger of attack by foreign enemies and therefore stand under the necessity of maintaining a large defense establishment. Production Limits Consumption The productionist, of course, takes a different view of matters. He argues that the birth and upbringing of children always constitutes an expense to the parents. In raising children, the parents must spend money on them which they otherwise would have spent on themselves. Of course, the parents may, and hopefully will, consider the money better and more enjoyably spent on their children; but still, it is an expense. And if they have a large enough number of children; they will be reduced to poverty. This is a fact, the productionist argues, that anyone may observe in any large family which does not possess a correspondingly large income. The presence of children does not make the parents spend more than they otherwise would have, but only spend differently than they otherwise would have. They buy baby food, toys, and bicycles instead of more restaurant meals, a better car, or costlier vacations. There is no stimulus given to production. Production is merely differently directed, to the different distribution of demand. The only increase in production that could take place, the productionist maintains, would be as a result of the parents having to take an extra job or work longer hours to support their children and still be able to maintain their own previous standard of living. And when the children grow up, the additional market which they are supposed to constitute for houses and automobiles and the like will only materialize to the extent that they themselves are able to produce the equivalent of these things and thereby earn the money with which to purchase them. It will only be by virtue of their production, and not by virtue of their desire to consume, that they will be able to constitute an additional market. Advertising and the Consumer Advertising, the productionist holds, does not create consumer desire where no desire for additional goods would otherwise have existed. It is not the case that, in the absence of advertising, people would be at a loss as to how to spend their money. Advertising is not required, and would not be sufficient, to rouse vegetables into men. What advertising does is to lead people to consume differently and in a better way than they otherwise would have. Advertising is a tool of competition, and, as such, for every competing product whose sale is increased by it, there is another competing produce whose sale is decreased by it. His estimate of advertising, like that of war and destruction, is ambivalent, and necessarily so. On the one hand, he approves of it, on the grounds that by creating consumer desires, it creates the work required to satisfy those desires.

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However, this very belief, that advertising creates desires where absolutely no desires would otherwise exist, also makes him condemn advertising. For if it were true that, in the absence of advertising, men would be perfectly content with very little, the desires created by advertising must appear to be only superficial and basically unnecessary and unnatural. And this is precisely how the consumptionist regards such desires. In his eyes, all desires men have for goods, beyond what is necessary to make possible bare physical survival and a vegetative existence, represent an unnatural taste for "luxuries. Their only justification is the creation of work. Paradoxical as it may first appear, it is the productionist who attaches importance to consumer desires. It is from the importance which attaches to the satisfaction of the desire for "luxuries," the productionist maintains, that the importance of the work required to produce them is derived, and not vice versa. Technology and Capital Goods The value of technological progress, the productionist holds, does not lie in the creation of "investment outlets" or "investment opportunities" for an expanding supply of capital goods. If the concept of capital goods is properly understood, as denoting all goods which the buyer employs for the purpose of producing goods which are to be sold, then, the productionist maintains, there is no such thing as a lack of "investment opportunity" for capital goods. For example, ten million automobiles of a given quality require the employment of twice the quantity of capital goods — twice the quantity of steel, glass, tires, paint, engines, and machinery — in their production as do five million automobiles. If the quality of the automobiles is to be improved, then a larger quantity of capital goods is required for the production of the same number of automobiles. For example, a given number of cars of Chevrolet quality require a larger quantity of capital goods in their production than the same number of cars of Volkswagen quality; the same number of cars of Cadillac quality require still a larger supply of capital goods; and the same number of cars of Rolls Royce quality require yet an even more enlarged supply. The identical principle applies to houses of different size and quality. A given quantity of eight-room houses of a given quality requires the employment of a larger supply of capital goods than the same number of seven-room houses of the same quality. A given number of brick houses requires a larger supply of capital goods than the same number of wooden houses of the same size; the bricks or any more expensive material constitute a larger supply of capital goods because a larger quantity of labor is required to produce it. The principle applies to food and clothing, to furniture and appliances, to every good. As Technology Advances It is not the case that in the absence of technological progress, the supply of capital goods would continue to expand, but find no "investment outlet. On the contrary, what we have to fear from a lack of technological progress, the productionist argues, is that we shall not have an increase in the supply of capital goods, that we shall not be able to exploit any considerable portion of the virtually limitless "investment outlets" which already exist, within the framework of known technology. The value of technological progress, the productionist maintains, consists in the fact that it enables us to obtain a larger supply of capital goods, and not that it solves the problem of what to do with a larger supply. The technological advances which made possible the canal building and railroad building of the nineteenth century and the development of the steel industry were valuable, not because they absorbed capital goods, as the consumptionist maintains, but because they made possible the accumulation of capital goods. The consumptionist does not realize that capital goods can only be expanded in supply by means of an expansion in their production, and that precisely this is what technological progress makes possible. Had the technological advances which made possible the first railroads in the s not taken place, the supply of capital goods required for the expanded and improved railroad building of the s would not have been obtainable; or, if obtainable, only at the price of the expansion of some other industry. Had no technological advances been made in railroading in the s, the supply of capital goods in the s would have been less, both for railroads and for all other industries. And so it would have been decade by decade, had the technological advances made in railroading or in any other industry not taken place. For capital accumulation to continue for any period of time, technological progress is indispensable. Only it can make possible continued increases in production, and only continued increases in production can make possible continued capital accumulation. The consumptionist is not aware that the very thing which he considers to be the solution to his imagined problem

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is the source of what he imagines to be the problem. Only the use of money lends it the least semblance of plausibility. A slave should have been grateful if his master desired a larger house, an improved road, more food, more parties, and so on; for the provision of the means of satisfying these desires would have given him correspondingly more work to do. The belief that the consumption of the government benefits and helps to support the economic system is on precisely the same footing, the productionist argues, as the belief that the consumption of the master benefits and supports the slave. It is a belief the absurdity of which is matched only by the injustice it makes possible. It is the means by which parasitical pressure groups, employing the government as an agent of plunder, seek to delude their victims into imagining that they are benefited and supported by those who take their products and give them nothing in return. It is by means of what one produces and offers in exchange that one benefits producers, not by means of what one consumes. To the extent that one consumes the products or services of others without offering products or services in exchange, one consumes at their expense. The use of money makes this point somewhat less obvious but no less true. Where money is employed, producers do not exchange goods and services directly, but indirectly. The buyer exchanges money for the goods of a seller.

Chapter 9 : The science of railways - CORE

Economic theory, therefore, could take for granted the desire to consume, and focus on the ways and means by which production might be increased. In the twentieth century, economists have returned to the directly opposite view.