ECONOMICS, LABOR & BUSINESS

Doubting Self-Interest

"Making Up Our Minds" by Richard J. Herrnstein and James E. Mazur, in *The Sciences* (Nov.-Dec. 1987), New York Academy of Sciences, 2 East 63rd St., New York, N.Y. 10021.

"The natural effort of every individual to better his own condition . . . is so powerful a principle," wrote Adam Smith in 1776, "that it is alone . . . capable of carrying on the society to wealth and prosperity." Economists still hew to this theory of "utility maximization," which is applied not only to financial decisions but even to animal behavior. According to the theory, a butcher may cut his prices at Christmas because he thinks he will do more business or because he feels generous. Either way, he seeks "the greatest possible value from the sum" of his actions.

Harvard psychologists Herrnstein and Mazur demur. They maintain that people often "behave in ways directly at odds with self-interest." Consider the college student who chooses an 8:00 A.M. class at which attendance is required. When the alarm clock rings, he often turns it off and misses the class, taking the ultimately less profitable action. Economist Robert H. Strotz in 1956 called this phenomenon temporal "myopia," since favoring immediate gratification can decrease long-term rewards.

The authors argue that utility maximization theory describes how individuals *ought* to act, not how they *tend* to act. To deal with actual human behavior, they propose "melioration," a theory that takes into account both "our occasional rationality" and "our frequent irrationality." People, the authors say, tend to pursue not maximum but *average* utility, which is simpler to calculate and requires less perceived risk. Within an overall situation, some individual decisions are rational, others are not.

Once economists recognize their "mistaken assumptions about economic motivation," the authors believe, they can apply melioration theory to public-policy questions. In hostage incidents, for example, leaders could make laws in advance against negotiating with terrorists, recognizing that they will be tempted to seek an immediate solution—despite their conviction that dealing with terrorists now may encourage hostage-taking in the future. "Because it anticipates and accounts for our departures from rationality," the authors contend, their theory of melioration "provides the foundation for a real understanding of human decision making—and, in so doing, may help make us more rational."

The End of the Line?

"The Great Train Robbery" by Phillip Longman, in *The Washington Monthly* (Dec. 1987), 1711 Connecticut Ave. N.W., Washington, D.C. 20009.

America's railroads may soon become bankrupt—not because of competition from airlines or other forms of transportation, but due to the rising cost of government-mandated pension plans.

Longman, author of *Born to Pay: The New Politics of Aging in Amer-*

ica, maintains that the "crippling payments" both employers and employees must give to retirement plans "are surely hastening the decline" of the railway. The story of railroad pensions, he argues, is one that "shows how a worthy cause can be perverted by the politics of selfishness."

Congress passed the Railroad Retirement Act in 1934, over the protests of the Roosevelt administration. The act nationalized existing pension plans into a Railroad Retirement Fund (RRF) that taxes both workers and employers in a manner similar to (but separate from) Social Security. Lobbying by retiree groups has kept pensions generous. Railroad pensions range up to 125 percent of a worker's final salary.

Railroads pay for these generous pensions through high taxes. Since 1937, payroll taxes paid by employers and employees have risen from a combined six percent rate to 33.3 percent today. (The combined employer-employee Social Security tax rate is currently 14.3 percent.) Twenty-three percent of Amtrak's payroll costs go to retirement, far above the 3.1 percent average of other corporations. To pay for the rising tax burden, railroads have cut costs by slashing payrolls; employment in the railroad industry has fallen by 44 percent since 1979.

Because retirees outnumber currently employed workers by three to one, even high taxes cannot pay the entire cost of railroad pensions. Since 1957, Social Security has partially subsidized the RRF. The cost to the taxpayer in Fiscal Year 1987: $2.8 billion.

The Office of Management and Budget has proposed the privatization of railroad pensions. But such a move, Longman warns, would be "prohibitively expensive" for railroads because the system is already obligated to pay $44 billion in pensions even if the industry "never hires another worker." Unless Congress decisively cuts benefits, Longman warns, the bankruptcy of America's railroads is "just a recession away."

Trimming Business Fat

"The Pedagogy of Competition" by Murray L. Weidenbaum, Richard Burr, and Richard Cook, in *Society* (Nov.-Dec. 1987), Rutgers Univ., New Brunswick, N.J. 08903.

To many economists, America's current struggle to compete in world markets indicates only harder times ahead.

However, Weidenbaum, Burr, and Cook—at the Center for the Study of American Business at Washington University in St. Louis—believe that greater competition has spurred U.S. firms to reduce costs, improve product quality, and increase investment in research and development.

The long-term, cumulative effects of these actions, the authors believe, should lead to "sustained prosperity" in the 1990s.

Cost-cutting strategies have ranged from reducing labor expenses (which account for two-thirds of production costs in the United States) by slowing wage increases and by improving union relations, to adopting the Japanese "just-in-time" inventory system, in which parts are supplied as needed, instead of being made in advance and stored. By using the just-in-time approach, a Missouri Chrysler plant cut its parts inventory to $20 million from $29 million, thus saving $1 million each year in interest costs