

Rucker Johnson
Fall 2006

**The Economics of Public Policy Analysis
PP210A**

Objective

The purpose of this course is to train MPP students to use microeconomic theory to analyze public policy problems and, more generally, everyday situations. We will be studying a wide range of theoretical topics, including (but not limited to) the basic functioning of markets, the analysis of decision making of individuals and households, inter-temporal decision making, and a theoretical analysis of firm behavior. Throughout the semester, we will place particular emphasis on the application of theory to real public policy problems. Some of the applications we will discuss are whether the Consumer Price Index overstates the inflation rate, the efficiency of Occupational Safety and Health regulations, the structure of the food stamps program, welfare reform, and the economics of healthcare. A major objective of this course is to provide the bridge between abstract theory and real-world problems. Hence, unlike micro theory courses taught in economics departments, this course will place heavy emphasis on applications.

Meeting Times

Class will meet Mondays and Wednesdays from 8:30 to 10:00 am. In addition, there are discussion sections on Fridays where material presented during the week will be reviewed.

Grades

Grades will be based on 3 exams (25 percent each), 6 problems sets (worth a cumulative 15 percent) and a writing assignment (10 percent). Problem sets will be handed out in class and are due a week later. Late problem sets are docked 20 percentage points per day. While you will not be docked for incorrect answers on problem sets, the problem sets will provide important practice for the exams. Hence, I urge everyone to do their best and hand them in on time.

The writing assignment (on a topic yet to be determined) will be handed out on November 3 and will involve writing a short (3 to 5 pages) memo providing a clearly-written, jargon-free analysis of a public policy problem. We will discuss the assignment in greater detail in later October.

Readings

There are two textbooks and a reader for this course. The first textbook is Friedman, Lee S. (2002), *The Microeconomics of Public Policy Analysis*, Princeton University Press. The second textbook is the eighth edition of *Microeconomic Theory: Basic Principles and Extensions*, by Walter Nicholson (Dryden Press). Both textbooks are available at the campus bookstore. The reader will be available at Vic's Copies, 2843 Hearst Avenue, Berkeley. The reader is a collection of scholarly articles that we will be reading throughout the semester. All three readings are required.

Office Hours

Johnson's office is on the third floor of the new building, room #347. His office hours for this course are Tuesdays, 3-5. Johnson can also be reached by phone at 643-0169 and Email at: ruckerj@berkeley.edu

Week 1: Overview, Supply and Demand, and Specifying Individual Preferences

August 28: Overview of Microeconomic Theory and Microeconomic Policy Analysis, Supply and Demand

[1] MPPA: Chapters 1, 2

[2] Nicholson: Chapter 1

August 30: Preferences and individual decision-making

[1] MPPA: Chapter 3, pp. 36-45

[2] Nicholson: Chapter 3, Chapter 4, pp. 92-97.

Week 2: The Theory of Individual Choice

September 4: NO CLASS

September 6: Optimization

[1] MPPA: Chapter 3, Appendix

[1] Nicholson Chapter 2, pp.22-46, Chapter 4, pp. 97-103.

HAND OUT FIRST PROBLEM SET

Week 3: Efficiency

September 11: Efficiency

[1] MPPA: pp 45-57

September 13: Is OSHA Inefficient?

[1] Ehrenberg, Ronald G. and Robert C. Smith (2000), *Modern Labor Economics: Theory and Public Policy*, 7th Edition, Addison Wesley: New York, pp 251-274.

SEPT 15: FIRST PROBLEM SET DUE IN SECTION

Week 4: Income Effects, Substitution Effects, and Demand

September 18: Income Effects, Substitution Effects, and Consumer Demand: Does the Consumer Price Index (CPI) Overestimate the Inflation Rate?

[1] Nicholson: Chapter 5

[2] Boskin, Michael J. et. al. (1998), "Consumer Prices, the Consumer Price Index, and the Cost of Living," *Journal of Economic Perspectives*, 12(1): 3-26.

[3] Abraham, Katherine et. al. (1998), "Working to Improve the Consumer Price Index," *Journal of Economic Perspectives*, 12(1): 27-37.

September 20: Cross Price Effects and Demand Elasticities

[1] Nicholson: Chapters 6, 7

HAND OUT SECOND PROBLEM SET

Week 5: Modeling the Food Stamp Program

September 25: Modeling the Food Stamp Programs

[1] Chapter 4, MPPA pp 81-107

[2] Whitmore, Diane (2002), "What are Food Stamps Worth?", Working Paper #568, Princeton University, Industrial Relations Section.

SECOND PROBLEM SET DUE

September 27: Review for Midterm
SEPTEMBER 29: FIRST MIDTERM EXAM DURING SECTION

Week 6: Labor Supply, Income Maintenance, and The Earned Income Tax Credit

October 2: The Theory of Time Allocation: The Labor-Leisure Choice
[1] Chapter 4, MPPA pp 107-113.

October 4: Taxes, Welfare Reform, and the Earned Income Tax Credit
[1] Chapter 4, MPPA, pp 107-113

[2] Ellwood, David T. (200?), "The Impact of the Earned Income Tax Credit and Social Policy Reforms on Work, Marriage, and Living Arrangements," *National tax Journal*, Volume LIII, No. 4, Part 2, pp 1063 – 1105.

[3] Blank, Rebecca M. (2000), "Fighting Poverty: Lessons from Recent U.S. History," *Journal of Economics Perspectives*, 14(2): 3-19.

Week 7: Equity Standards in Policy Analysis & The Effects of Intergovernmental Grants

October 9: Equity and Inter-Governmental Grants
[1] MPPA, Chapter 5, pp. 124-135

October 11: Design Features of Grant Programs
[1] MPPA, Chapter 5, pp. 135-146

[2] Hines, James R. and Richard H. Thaler (1995), "Anomalies: The Flypaper Effect," *Journal of Economics Perspectives*, 9(4): 217-226.

HAND OUT THIRD PROBLEM SET

Week 8: School Finance and Introduction to Benefit-Cost Analysis

October 16: Equity in School Finance
[1] MPPA, Chapter 5, pp. 146-160

October 18: The Compensation Principle of Relative Efficiency
[1] MPPA, Chapter 6, pp. 169-179

THIRD PROBLEM SET DUE

Week 9: Benefit-Cost Analysis

October 23: Measuring Benefits and Costs: Market Statistics and Consumer Surplus
[1] MPPA, Chapter 6, pp. 179-198

October 25: Compensating and Equivalent Variation
[1] MPPA, Chapter 6, pp. 198-210

[2] Ludwig, Jens and Philip J. Cook (1999), "The Benefits of Reducing Gun Violence: Evidence from Contingent-Valuation Survey Data," National Bureau of Economic Research Working Paper # 7166.

[3] Haneman, W. Michael (1994), "Valuing the Environment through Contingent Valuation," *Journal of Economic Perspectives*, 8(4): 19-43.

[4] Diamond, Peter A. and Jerry A. Hausman (1994), "Contingent Valuation: Is Some Number Better than No Number?" *Journal of Economic Perspectives*, 8(4): 45-64.

HAND OUT FOURTH PROBLEM SET

Week 10: Benefit-Cost Analysis Continued

October 30: Benefit-Cost Analysis in Practice

- [1] Stigletz, Joseph E. *Economics of the Public Sector 3rd Edition*, New York: W.W. Morton and Co, Chapter 11.

November 1: Review for Midterm

FOURTH PROBLEM SET DUE

NOVEMBER 3: SECOND MIDTERM EXAM DURING SECTION

Week 11: Choice Under Uncertainty

November 6: Choice in Uncertain Situations

- [1] MPPA, Chapter 7, pp. 223-257
- [2] Nicholson, Chapter 8

HAND OUT WRITING ASSIGNMENT

November 8: Risk Pooling, Risk Spreading and Alternative Models of Decision-Making Under Uncertainty

- [1] MPPA, Chapter 7, pp 235-254

Week 12: The Economics of Information and Intertemporal Decision-Making

November 13: The Economics of Information: Moral Hazard and Adverse Selection

- [1] Nicholson, Chapter 9
- [2] MPPA, Chapter 7, pp. 254-266

November 15: Intertemporal Decision-making and Discounting

- [1] MPPA Chapter 8

HAND OUT FIFTH PROBLEM SET

NOVEMBER 17: WRITING ASSIGNMENT DUE IN SECTION

Week 13: Capital Markets and Introduction to Production Theory

November 20: Capital Markets

- [1] MPP Chapter 8
- [2] Nicholson Chapter 23

November 22: Production Theory

- [1] MPPA, Chapter 9, pp. 317-335
- [2] Nicholson, Chapter 11

FIFTH PROBLEM SET DUE

Week 14: Production Theory

November 27: Costs

- [1] MPPA, Chapter 8, pp. 335-345
- [2] Nicholson, Chapter 12

November 29: Profit Maximization

- [1] Nicholson, Chapter 13

HAND OUT SIXTH PROBLEM SET

Week 15: Price Discrimination

December 4: Price Discrimination

[1] MPPA, Chapter 9, pp. 343-370

[2] Ayres, Ian and Peter Siegelman (1995), "Race and Gender Discrimination in Bargaining for a New Car," *American Economic Review*, 85(3): 304-321.

December 6: Review for the last midterm

SIXTH PROBLEM SET DUE

DECEMBER 8: FINAL EXAM GIVEN DURING SECTION