

UNIVERSITY OF WISCONSIN-MADISON
La Follette School of Public Affairs

PUBLIC AFFAIRS 880--Fall 2009
MICROECONOMIC POLICY ANALYSIS

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TA: **Rebecca Lessem, rlessem@wisc.edu**

Course Description: This course emphasizes the nature of decision-making by consumers, firms, and governments, and the effect of these decisions on the allocation of resources--land, labor and capital. A central issue is to establish the meaning of "efficiency" in resource allocation, and to understand what is necessary if the resources in the economy are to be allocated efficiently. We will investigate the conditions under which a market economy is able to secure an efficient allocation of society's resources, and explore how the public sector has an important role to play in a market economy like that of the U.S.. The role of the public sector is of central concern if private markets fail. We will study the ways in which private market failure exists, and the possible response of government to this failure.

A second basic issue is to understand how the income generated by the economy's use of resources is allocated among people--workers and capital owners; high skilled workers and unskilled workers, rich and poor. The questions here are ones of "equity," or inequality. The public sector also has a role in altering the nation's income distribution.

A third objective is to assess the effectiveness of collective action--public policy--taken to improve economic efficiency and enhance equity. Having developed the analytical tools of microeconomics necessary to discuss efficiency and equity issues, we will apply them to a series of important contemporary public policy issues. Many of these issues involve public policy proposals, and our objective will be to understand how these proposals might affect the efficiency of the allocation of the nation's resources and equity or fairness in the distribution of income.

The course can roughly be thought of as having three segments. In the first segment, we will deal with the basic principles of consumer decision-making and the concepts of efficiency and equity, after which there will be a midterm examination. In the second section, we will work on the economics of production, costs, and different forms of market organization and their implications, and again a midterm examination will be given. The third section will deal explicitly with the economics of some larger policy issues, such as investments in people and the economics of the environment. The final exam, which follows this segment, will be a comprehensive examination.

Course Web Site: The class website can be found on Learn@UW (<https://learnuw.wisc.edu/>). The website includes links to the readings and EconWeb assignments. Weekly problem sets, answer keys, supplementary readings and other important information will be posted on the website over the course of the semester. The TA and the instructors will be communicating with you through email class lists, and these emails will often direct you to the website.

Class Lecture Sessions: The class will meet two times per week, on Monday and Wednesday. On Monday and Wednesday, the class will meet jointly from 1:20P to 2:45P (but, hold the time from 2:45P to 3:15P in case it is needed); either Professor Kamata, Professor DeLeire, or Professor Haveman will be conducting these sessions. All of the Monday and Wednesday sessions will involve formal presentations, but with questions and comments encouraged. This material will supplement the readings but will not be a substitute for them.

| | | | |
|-----------|----------------|---------------|-------------------------|
| Monday | Joint | 1:20-2:45 | 1520 Microbial Sciences |
| Monday | (just in case) | 2:45 to 3:15 | 1520 Microbial Sciences |
| Wednesday | Joint | 1:20 to 2:45 | 1520 Microbial Sciences |
| Wednesday | (just in case) | 2:45 to 3:15P | 1520 Microbial Sciences |

Discussion Sections: There are three discussion sections, and each student is assigned to a discussion section. The TA, Rebecca Lessem, will be responsible for the discussion sections.

| | | | |
|---------|--------------|---|-------------------------|
| DIS 302 | 12:00-12:50A | R | 1510 Microbial Sciences |
| DIS 303 | 11:00-11:50A | F | 2106 Mech Engr |
| DIS 304 | 12:05-12:55P | F | 240 Van Hise |

In the weekly discussion session, Rebecca Lessem will go over the problem sets for the prior week. On some weeks, she will make a presentation on a topic that could not be covered in sufficient depth in the two class sessions during the previous week. There will also be time for questions regarding the material covered for the previous sessions.

The separate discussion sessions will be similar in format and content. Should conflicts arise during a particular week, students may substitute another discussion section for the one in which they are registered.

Examinations and Grading: There will be two midterm examinations and a final examination. The midterm examinations will be given during regularly scheduled class periods. The final examination will either be given at the scheduled time during the final exam period or we may make an arrangement such that students could take the exam anytime during a pair of days after the end of classes. Each of the midterm exams will count for 25 percent of the course grade; the final exam will be comprehensive, and will count for 40 percent of the course grade. Hence, the exams will count for a total of 90 percent of the final course grade. Your homework performance and participation in class and discussion section will account for the remainder of the grade.

Homework/Problem Sets: There will be a problem set posted on the class web site by the ‘close of business’ each Wednesday. Students will complete the problem sets and hand them in at the lecture on the following Monday. This will allow four days for completing the assignment. The problem set handed in on Monday will be discussed in the discussion sections that week. While students are encouraged to discuss homework assignments with each other, the work turned in must be the student's own work. Late homework will not be accepted. The homework assignments will be ‘graded’ using simple check, check–, and check+ grades.

Strong Recommendation: In the past, students have found it very helpful to form ‘study groups’ to work through these problems, and you are strongly urged to do so this semester. All of the instructors will be pleased to help you form these groups.

Class Participation: Regular attendance at the two weekly lectures is essential to gain full benefit from the course. Attendance at discussion sections is required. Questions and discussion in the lecture and discussion sections are an integral part of the course. Attendance and active participation in the lecture and discussion sections will be reflected in the 10 percent of the course grade not accounted for by the examinations.

Important -- Flu (H1N1) Update: The University, the La Follette School, and your instructors are especially concerned about your health and the health of your classmates this flu season. Students should email the instructors in the event they are not feeling well or contact the flu – students can be excused from attending lectures. In the event a student misses class, we will make every effort to ensure students are able to have access to class materials. In the event of a widespread outbreak or University closure, be sure to check your email for further information.

Required Materials:

The following textbook has been ordered for the course and is available for purchase at the University Bookstore.

Jeffrey M. Perloff, **Microeconomics**, Addison Wesley, 5th Edition, 2008

In addition, you should subscribe to **EconWeb**, which is an on-line textbook/problems/answers/applications website. The cost of signing up for the Intro Micro (economics) portion of web course is minimal. The registration site address is <http://www.econweb.com/sub/iMicro.html> . Note: If you pull up the Syllabus page from the web, clicking on the EconWeb assignments will take you directly to them. Along with purchase of the Perloff text, you obtained access to an on-line learning program entitled “My Econ Lab.” That program contains sample exams and other materials that you may find useful; its use is at your discretion.

Finally, additional readings are available through the website and UW Library e-reserves. These readings are essential for class discussion in section meetings, assignments, and for following some of the lectures.

The reading assignments for each class meeting are shown on the attached schedule.

Related Readings: Because we will be discussing many current issues and policies, students are expected to keep abreast of major developments in the economy as well as the emergence of new economic issues and policy proposals. The best way to follow these developments is by reading regularly THE NEW YORK TIMES, or THE WALL STREET JOURNAL, or such business publications as BUSINESS WEEK and THE ECONOMIST.

Instructor Office Hours:

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|-------------------|-----------|--------------|---------------------------------|
| Rebecca Lessem | Friday | 1:45-3:45P | Office: 7308 Social Science |
| Professor Kamata | Monday | 3:30-4:30pm | Office: 309, La Follette School |
| | Tuesday | 2:30-3:30pm | Office: 6426 Social Science |
| Professor DeLeire | Wednesday | 10:00-11:00A | Office: 203, La Follette School |

In addition, a meeting can be arranged outside of these hours by directly contacting the instructors.

Concerns About the Course: If you have a concern about the course please bring it to the attention of the TA or instructors. If you have a concern about the grade you receive on a homework assignment or an examination, first talk to Rebecca Lessem. If you believe you still have a legitimate concern that has not been addressed, please provide either Professor Kamata or Professor DeLeire with a written explanation of your concern. We will review the materials and one of us will be in touch with you.

| SCHEDULE AND READINGS | | | | | | |
|---|---------|-----|------------|----------|---|------------------------------|
| Week | Date | Day | Instructor | Module # | Topic | Readings |
| 1 | Sep. 2 | Wed | DeLeire | 1 | Introduction to Microeconomics; Concept of tradeoffs; Supply, demand, and market equilibrium. | Perloff—Ch. 1 & 2; RP 1-2 |
| 2 | Sep. 7 | Mon | | | Labor Day: class off | |
| 2 | Sep. 9 | Wed | DeLeire | 2 | Government market interventions (Quotas, Price Floors and ceilings); The shapes of the S and D curves; Elasticity; why it matters | Perloff—Ch. 3, 46-59; RP 3-5 |
| <p>Week 2 <u>EconWeb Assignment</u> Work through EconWeb (Micro): Intro, Supply and Demand, Elasticity</p> <p>Week 2 <u>EconWeb Current Events Assignments:</u> Law School Applications Increase as Opportunity Costs Fall U.S. Energy Usage Major Methamphetamine Bust</p> | | | | | | |
| 3 | Sep. 14 | Mon | DeLeire | 3 | The market effects of sales/unit taxes and subsidies | Perloff—Ch. 3, 59-68 |
| 3 | Sep. 16 | Wed | Kamata | 4 | Underpinnings of Demand; Preferences, Budget Constraints; and Consumer Choice | Perloff—Ch. 4 |
| <p>Week 3 <u>EconWeb Assignment</u> Work through Consumer Choice (parts 1, 2, 3, 5, 6) (i.e., skip part 4—surplus, for now)</p> <p>Week 3 <u>EconWeb Current Events Assignments:</u> Cigarette Tax Hikes Surf Inspired Fashions For Women (Part 1, Part 2) French Chefs Protest Tax on Restaurant Meals The Rich Get Richer. and Buy Mansions</p> | | | | | | |
| 4 | Sep. 21 | Mon | Kamata | 5 | From Consumer Choice to Demand Curves: Income and Substitution Effects | Perloff—Ch. 5, 111-127 |
| 4 | Sep. 23 | Wed | DeLeire | 6 | Some applications of consumer theory: The effect of taxes and transfers on labor supply | Perloff, Ch. 5, 134-143 |

Week 4 EconWeb Assignment:

Work through EconWeb Consumer Choice, income and substitution effects and Labor Supply [incl: indifference curve analysis]

EconWeb Current Events Assignment:

[PCs Increasingly Find Their Way to the Trash Heap](#)

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|---|---------|-----|---------|---|---|---------------------------------------|
| 5 | Sep. 28 | Mon | DeLeire | 7 | Some applications of consumer theory: In-kind transfers, school vouchers, excise subsidies, paying for trash. | Perloff— Ch. 4, 99-102; RP 6 |
| 5 | Sep. 30 | Wed | Kamata | 8 | More applications of consumer theory: In-kind transfers, school vouchers, excise subsidies, paying for trash. | Perloff— Ch. 4, 99-102; RP 6 |

Week 5 EconWeb Assignment

Work through EconWeb: Industry Policy (all parts)

EconWeb Current Events Assignment:

[CHEAP FLIGHTS TO EUROPE](#)

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|---|--------|-----|---------|----|---|--|
| 6 | Oct. 5 | Mon | Haveman | 9 | Concepts of Economic Surplus | Perloff— Ch. 9, 269-284; RP 7 |
| 6 | Oct. 7 | Wed | Haveman | 10 | The welfare effects of sales/unit taxes, price floor and ceilings; Rent control and minimum wages | Perloff— Ch. 9, 284-298; RP 8 |

Week 6 EconWeb Assignment

Work through EconWeb: Consumer Choice, surplus.

Week 6 EconWeb Current Events Assignments:

[MINIMUM WAGE INCREASE](#)

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|---|---------|-----|---------|----|--|--------------------------------|
| 7 | Oct. 12 | Mon | Haveman | 11 | Capital market, discounting, and present value | Perloff, Ch. 16, 541-559 |
| 7 | Oct. 14 | Wed | | | First Midterm Exam | |
| 8 | Oct. 19 | Mon | Haveman | 12 | Economics of Higher Education | RP 9, 10 |
| 8 | Oct. 21 | Wed | Haveman | 13 | Economics of Higher Ed--Payback website | |

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|---|---------|-----|---------|----|--|-----------------------------|
| 9 | Oct. 26 | Mon | DeLeire | 14 | From inputs to outputs to costs to supply-- The short-run supply curve of the firm | Perloff , Ch 8; RP 11 |
| 9 | Oct. 28 | Wed | DeLeire | 15 | Perfect competition in the short- and long- run; The process of 'general equilibration' | Perloff, Ch. 8; RP 12 |

Week 19 EconWeb Assignment:

Work through EconWeb: Production Costs, all parts; Perfect Competition, all parts; Long Run Supply, all parts.

[Note: The cost concepts/curves on which you should focus are marginal cost (MC) and average total cost (ATC). The examples in EconWeb also involve average variable cost (AVC) and average fixed cost (AFC) concepts/curves. These are also important concepts/curves, but we will not emphasize them in the course; do not get bogged down in them. In going through EconWeb, Production Costs, sections 8-10 may be a bit confusing, but keep your eye on MC and ATC. In going through EconWeb, Perfect Competition, section 5 may be a bit confusing; also section 8 has some variable and fixed costs floating around that might also be confusing.]

Week 9 EconWeb Current Events Assignment:

RISING ICE CREAM PRICES

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|----|--------|-----|--------|----|--|---|
| 10 | Nov. 2 | Mon | Kamata | 16 | Some applications of the competitive model: regulation-deregulation; airline deregulation; taxi medallions | Perloff, Ch. 9, 280-284; RP 13 |
| 10 | Nov. 4 | Wed | Kamata | 17 | Monopoly and oligopoly: The effects of market power | Perloff, Ch. 11, 349-366; Ch. 13, 419-442 |

Week 10 EconWeb Assignment:

Work through EconWeb: Monopoly

Week 10 EconWeb Current Events Assignments:

HEAT BASED SODA PRICES
TEXTBOOK PRICE DISCRIMINATION
DIAMONDS AREN'T FOR HOARDING
MICROSOFT BUNDLING BROWSER
MICROSOFT ANTITRUST CASE

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|----|------------|-----|--------|----|---|--------------------------------|
| 11 | Nov. 9 | Mon | Kamata | 18 | Gains from Trade; Comparative Advantage: An Introduction | Perloff— Ch. 10; 317-331 |
| 11 | Nov. 11 | Wed | Kamata | 19 | Welfare effects of tariffs, quotas, and import controls | Perloff— Ch. 9, 298-303 |

Week 11 EconWeb Assignment:

Work through EconWeb: Trade; all parts (you may find some of it difficult.)

Week 11 EconWeb Current Events Assignments:

TARIFF ON LUXURY GOODS
VIDEO CONFERENCE OR FLY?

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|--|------------|-----|----------------------------|----|--|-------------------------------------|--|
| 12 | Nov. 16 | Mon | Kamata | 20 | Free Trade: Some Policy Issues | RP 14-19 | |
| 12 | Nov. 18 | Wed | Second Midterm Exam | | | | |
| 13 | Nov. 23 | Mon | Kamata | 21 | Externalities; Public Goods; Policy Responses | Perloff, Ch. 18, 605-619, RP 20, 21 | |
| 13 | Nov. 25 | Wed | Kamata | 22 | Policies toward Environmental Pollution: Emissions Charges and Tradeable Permits | Perloff, Ch. 18, 605-632, RP 22-25 | |
| Week 13 EconWeb Assignment: | | | | | | | |
| Work through EconWeb: Externalities; all parts | | | | | | | |
| 14 | Nov. 30 | Mon | DeLeire | 23 | Wage determination; The role of compensating variations | Perloff, Ch. 9, 280-284, RP 26 | |
| 14 | Dec. 2 | Wed | DeLeire | 24 | Risk, Uncertainty and Insurance | Perloff, Ch. 17, 572-591 | |
| 15 | Dec. 7 | Mon | DeLeire | 25 | Adverse Selection, Moral Hazard, Lemons | Perloff, Ch. 19, 639-650; RP 27 | |
| 15 | Dec. 9 | Wed | DeLeire | 26 | Taxes, Transfers, and Labor Supply Disincentives | RP 28, 29 | |

CONTENTS of E-RESERVES

Class readings are available through the links provided on the class web site (<https://learnuw.wisc.edu/>)

Reading Number

Reference

1. Jonathan Welsh, "Want a Used 'Econobox'? Better Get in Line: Prices of Fuel-Efficient Models Approach Those of New Cars; Is Trading Down Worth It?" The Wall Street Journal, July 16, 2008, page D1, available at <http://online.wsj.com/article/SB121617183225056575.html>
2. Ernesto Zedillo, "Shooting Ourselves in the Food" Forbes August 11, 2008, available at <http://www.forbes.com/opinions/forbes/2008/0811/025.html>.
3. Michael Wines, "Caps on Prices Only Deepen Zimbabweans' Misery," New York Times August 2, 2007.
4. Hugh Rockoff, "Price Controls", Available at <http://www.econlib.org/LIBRARY/Enc/PriceControls.html>
5. Greg Mankiw, "A Veto Threat" Available at <http://gregmankiw.blogspot.com/2007/06/veto-threat.html>.
6. Chapter 5, sections 5.1 (Excise Subsidies, Health Care and Consumer Welfare), 5.2 (Public Schools and the Voucher Proposal), and 5.3 (Paying for Garbage), from Edgar Browning and Mark Zupan, Microeconomics: Theory and Application, Wiley, 2002, pp. 118-128
7. Chapter 10, sections 10.5 (Consumer and Producer Surplus, and the Net Gains from Trade) and 10.6 (Government Intervention in Markets: Quantity Controls; Sugar Policy, from Edgar Browning and Mark Zupan, Microeconomics: Theory and Application, Wiley, 2002, pp. 283-291
8. "Can Higher Wages Be Legislated?" from Gwartney and Stroup, Microeconomics, Dryden Press, 7th ed., 1995, pp 378-381
9. Michael R. Edgmand, Ronald L. Moomaw, and Kent W. Olson, "College Education: Is It Worth the Cost?" Economics and Contemporary Issues, Dryden, 1994
10. Robert Haveman and Barbara Wolfe, "Does Education Matter: More Last Words" Milken Institute Review, 2nd Quarter, 2003, pp. 84-90
11. Robert Haveman and Kenyon Knopf, The Market System: An Introduction to Microeconomics, fourth edition, pp. 94-132
12. Robert Haveman and Kenyon Knopf, The Market System: An Introduction to Microeconomics, fourth edition, pp. 171-180.
13. Chapter 10, sections 10.3 (Airline Regulation and Deregulation) and 10.4 (City Taxicab Markets), from Edgar Browning and Mark Zupan, Microeconomics: Theory and Application, Wiley, 2002, pp. 274-282
14. Paul Krugman, "In Praise of Cheap Labor" Slate. Available at www.slate.com/id/1918.
15. Paul Krugman, "A Raspberry for Free Trade" Slate. Available at www.slate.com/id/1926.
16. Council of Economic Advisers, Economic Report of the President, 2006, GPO, pp. 149-171
17. Federal Reserve Bank of Dallas, "Racing to the Top: How Global Competition Disciplines Public Policy." 2005 Annual Report, pp. 4-18

18. Case Study: Bare Feet, Hot Metal, and Globalization,\" in Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy*, 8th edition, Addison-Wesley, 2009, p. 279.
19. "The Doha Round...and Round...and Round," *The Economist*, July 31, 2008
20. Charles Whelan, "Markets Make Sense, Except When they Don't" Available at <http://finance.yahoo.com/expert/article/economist/24259>.
21. William Vickrey, "Principles of Efficient Congestion Pricing" Available at <http://www.vtpi.org/vickrey.htm>.
22. Issue 17, "Should Pollution be Put to the Market Test?" from T. Swartz and F. Bonello, *Taking Sides: Clashing Views on Controversial Economic Issues*. Dushkin/McGraw-Hill, 2000, pp. 336-357
23. *New York Times*, 2/6/93, "A New, Unregulated Market: Selling the Right to Pollute."
24. Jeff Goodell, "Capital Pollution Solution." *New York Times Magazine*, July 30, 2006.
25. United Nations Framework Convention on Climate Change (UNFCCC)"Emission Trading," available at <http://unfccc.int/2860.php>
26. Chapter 17, section 17.4 (Why Wages Differ), from Edgar Browning and Mark Zupan, *Microeconomics: Theory and Application*, Wiley, 2002, pp. 468-472
27. Chapter 14, sections 14.4 (Asymmetric Information) and 14.5 (Adverse Selection and Moral Hazard), from Edgar Browning and Mark Zupan, *Microeconomics: Theory and Application*, Wiley, 2002, pp. 397-403
28. Congressional Budget Office, 2007. "Changes in the Economic Resources of Low-Income Households with Children" Available at <http://www.cbo.gov/ftpdocs/81xx/doc8113/05-16-Low-Income.pdf>.
29. Robert Haveman, "When Work Alone is Not Enough." In *One Percent for the Kids: New Policies, Brighter Futures for America's Children*. Edited by Isabel Sawhill. Washington, DC: The Brookings Institution, 2003