

UNIVERSITY OF WISCONSIN-MADISON
La Follette School of Public Affairs

PUBLIC AFFAIRS 880--Fall 2006
MICROECONOMIC POLICY ANALYSIS

Professor Robert Haveman; Professor Andrew Reschovsky
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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 ours. 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: There is a web site established for the course. The address is: <http://www.lafollette.wisc.edu/courses/pa880>. A number of important items will be posted on the web site, including the weekly problem sets, answer keys, etc. The TA and the instructors will be communicating with you through email class lists, and these emails will often direct you to the web site.

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 Haveman or Professor Reschovsky 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	6102 Social Science
Monday	(just in case)	2:45 to 3:15	6102 Social Science
Wednesday	Joint	1:20 to 2:45	6102 Social Science
Wednesday	(just in case)	2:45 to 3:15P	6102 Social Science

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

DIS 302	3:30-4:20P	W	54 Bascom
DIS 303	12:00-12:50P	R	58 Bascom
DIS 304	9:30-10:20A	F	106 Social Work

In the weekly discussion session, Michael will go over the problem sets for the prior week. On some weeks, he 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 can 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 sections 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.

Required Materials:

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

Jeffrey M. Perloff, **Microeconomics**, Pearson Addison Wesley, 4th Edition, 2007

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/assignment 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.

In addition, a **Public Affairs Reading Packet** has been assembled and can be purchased from the Copy Center, 6120 Social Science. The readings packet will also be placed on reserve. Every student needs access to the reading packets; they 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, THE WALL STREET JOURNAL, and such business publications as BUSINESS WEEK and THE ECONOMIST. Another excellent periodical is CHALLENGE, which contains timely in-depth articles on economics written by leading economists for the general public. Still another is the JOURNAL OF ECONOMIC PERSPECTIVES, which presents excellent and slightly more sophisticated articles, written by leading economists, on current economic issues and problems.

Instructor Office Hours:

Michael Malcolm	Monday	12:00-1:00P	Office: 6473 Social Science
	Friday	11:00-12:00P	
Professor Haveman	Wednesday	10:00-11:00A	Office: 3 rd floor, La Follette School
Professor Reschovsky	Monday	3:00-4:15P	Office: 3 rd floor, 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 grade you receive on a homework assignment or an examination, first talk to Michael Malcolm. If you believe you still have a legitimate concern, email either Professor Haveman or Professor Reschovsky concerning the problem, and one of us will be in touch with you.

SCHEDULE AND READINGS

Note: If you pull up the Syllabus/assignment page from the web, clicking on the EconWeb Current Events Assignments will take you directly to them.

DATES	TOPICS	READINGS
<i>Week 1</i>		
Sept. 6—Wednesday (Professor Haveman will conduct the class.)	Introduction to Microeconomics; Concept of tradeoffs; Supply, demand, and market equilibrium. Government market interventions (Quotas, Price Floors, and Ceilings)	Perloff—Ch. 1 and 2 RP—1
<i>Week 2</i>		
Sept. 11—Monday (Professor Reschovsky)	The shapes of the S and D curves; Elasticity; why it matters	Perloff—Ch. 3, 46-60
Sept. 13—Wednesday (Professor Reschovsky)	The market effects of sales/unit taxes and subsidies	Perloff—Ch. 3, 60-70
<u>Week 2 EconWeb Current Events Assignments:</u>		
Law School Applications Increase as Opportunity Costs Fall		
U.S. Energy Usage		
Major Methamphetamine Bust		
<i>Week 3</i>		
Sept. 18—Monday (Professor Reschovsky)	Concepts of Economic Surplus	Perloff—Ch. 9, 264-279
Sept. 20—Wednesday (Professor Haveman)	The welfare effects of sales/unit taxes, price floors, and ceilings; Rent control and minimum wages.	Perloff—Ch. 9, 284-293 RP 2, 3 and 4
<u>Week 3 EconWeb Current Events Assignments:</u>		
Surf Inspired Fashions For Women (both parts)		
Cheap Flights to Europe		
French Chefs Protest Tax on Restaurant Meals		
Cigarette Tax Hikes		
(Note: Also, work through EconWeb: Industry Policy; all parts.)		
<i>Week 4</i>		
Sept. 25—Monday (Professor Haveman)	Welfare effects of tariffs, quotas, and import controls	Perloff—Ch. 9, 294-300
Sept. 27—Wednesday (Professor Haveman)	Gains from Trade; Comparative Advantage: An Introduction	Perloff—Ch. 10; 313-327
<u>Week 4 EconWeb Current Events Assignments:</u>		
U.S. Tariff on European Luxury Goods		
(Note: Also, work through EconWeb: Trade; all parts; you may find some of it difficult.)		

<i>Week 5</i>		
Oct. 2—Monday (Yom Kippur) (Professor Reschovsky)	Demand: Preferences, Budget Constraints, and Consumer Choice	Perloff—Ch. 4
Oct. 4—Wednesday (Professor Reschovsky)	From Consumer Choice to Demand Curves: Income and Substitution Effects	Perloff—Ch. 5, 106-122
Week 5 EconWeb Assignment: EconWeb has an ‘advanced’ segment on this topic; it will be helpful.		
<i>Week 6</i>		
Oct. 9—Monday (Professor Haveman)	Some applications of consumer theory: In-kind transfers, school vouchers, excise subsidies, paying for trash	Perloff—Ch. 4, 99-102 RP 5
Oct. 11—Wednesday (Professor Haveman)	<u>Continued:</u> Some applications of consumer theory: In-kind transfers, school vouchers, excise subsidies, paying for trash	Perloff—Ch. 4, 99-102 RP 6
<i>Week 7</i>		
Oct. 16—Monday (Professor Reschovsky)	Some applications of consumer theory: The effect of taxes and transfers on labor supply	Perloff, Ch. 5, 129-139
Week 7 EconWeb Assignment: Work through EconWeb: Factor Markets; Labor Supply [incl: indifference curve analysis]		
Oct. 18—Wednesday	FIRST MIDTERM EXAM (covers material through Oct. 16)	
<i>Week 8</i>		
Oct. 23—Monday (Professor Reschovsky)	From inputs to outputs to costs to supply—The short run supply curve of the firm	RP 7
Oct. 25—Wednesday (Professor Haveman)	Perfect competition in the short- and long-run; The process of ‘general equilibration’	Perloff, Ch. 8 RP 8
Week 8 EconWeb Assignment Work through EconWeb: Production Costs; all parts; Perfect Competition; 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.]		
<i>Week 9</i>		
Oct. 30—Monday (Professor Haveman)	Some applications of the competitive model: regulation-deregulation; airline deregulation; taxi medallions	Perloff, Ch. 9, 279-284 RP 9
Nov. 1—Wednesday (Professor Reschovsky)	Monopoly and oligopoly: The effects of market power	Perloff, Ch. 11, 345-353; Ch. 13, 419-442
Note: The regular class will meet from 1:20 to about 2:30; this will be followed by a game theory ‘primer’ session that will be given by Michael Malcolm.		

Week 9 EconWeb Current Events Assignments: <u>DE BEERS TO REDUCE DIAMOND HOARDING</u> <u>MICROSOFT SUED BY DEPARTMENT OF JUSTICE</u> <u>Microsoft Found Guilty of Antitrust Violations</u>		
<i>Week 10</i>		
Nov. 6—Monday (Professor Haveman)	Risk, Uncertainty and Insurance	Perloff, Ch. 17, 574-594
Nov. 8—Wednesday (Professor Reschovsky)	Adverse Selection, Moral Hazard, Lemons	Perloff, Ch. 19, 636-647 RP 10
<i>Week 11</i>		
Nov. 13—Monday (Professor Reschovsky)	Wage determination; The role of compensating variations	RP 11
Nov. 15—Wednesday	SECOND MIDTERM EXAM (covers material through Nov. 13)	
Week 11 EconWeb Current Events Assignments: <u>HEAT BASED SODA PRICES</u>		
<i>Week 12</i>		
Nov. 20—Monday (Professor Reschovsky)	Capital market, discounting, and present value	Perloff, Ch. 16, 542-558
Nov. 22—Wednesday (Professor Haveman)	Economics of Higher Education	RP 12, 13
Week 12 EconWeb Current Events Assignment: <u>DEPARTMENT OF LABOR REPORTS PRODUCTIVITY INCREASE FOR U. S. WORKERS</u>		
<i>Week 13</i>		
Nov. 27—Monday (Professor Reschovsky)	The Financing of Higher Education: Loans, Student Aid, Tuition, Public Support	RP 14, 15, 16, 17
Nov. 29—Wednesday Professor Haveman	Taxes, Transfers, and Labor Supply Disincentives	RP 18, 19
<i>Week 14</i>		
Dec. 4—Monday (Professor Haveman)	Free Trade: Some Policy Issues	RP 20, 21, 22
Dec. 6—Wednesday (Professor Reschovsky)	Externalities; Public Goods; Policy Responses	Perloff, Ch. 18, 602-620
Week 14 EconWeb Assignment: Work through EconWeb: Trade; all parts		
<i>Week 15</i>		
Dec. 11—Monday (Professor Haveman)	Policies toward Environmental Pollution: Emissions Charges and Tradeable Permits	Perloff, Ch. 18, 602-620 RP 23, 24, 25
Dec. 13—Wednesday (Professor Haveman)	<u>Continued:</u> Policies toward Environmental Pollution: Emissions Charges and Tradeable	Perloff, Ch. 18, 602-620 RP 23, 24, 25

	Permits	
Week 15 <u>EconWeb Assignment:</u> Work through EconWeb: Externalities; all parts		

READING PACKET CONTENTS

Reading Number	Reference	Page Number
1.	Paul Heyne, "Moral Criticisms of Markets," <u>Senior Economist</u> , pp. 2-6, April, 1995.	1
2.	John Tierney, "At the Intersection of Supply and Demand," <u>New York Times Magazine</u> , May 4, 1997.	5
3.	"Myths of Economics: Rent Controls," from Gwartney and Stroup, <u>Microeconomics</u> , Dryden Press, 7th ed., 1995, pp. 80-81.	15
4.	"Can Higher Wages Be Legislated?" from Gwartney and Stroup, <u>Microeconomics</u> , Dryden Press, 7th ed., 1995, pp 378-381.	17
5.	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, <u>Microeconomics: Theory and Application</u> , Wiley, 2002, pp. 283-291.	21
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, <u>Microeconomics: Theory and Application</u> , Wiley, 2002, pp. 118-128.	30
7.	Robert Haveman and Kenyon Knopf, <u>The Market System: An Introduction to Microeconomics</u> , fourth edition, pp. 94-132.	41
8.	Robert Haveman and Kenyon Knopf, <u>The Market System: An Introduction to Microeconomics</u> , fourth edition, pp. 171-180.	81
9.	Chapter 10, sections 10.3 (Airline Regulation and Deregulation) and 10.4 (City Taxicab Markets), from Edgar Browning and Mark Zupan, <u>Microeconomics: Theory and Application</u> , Wiley, 2002, pp. 274-282.	91
10.	Chapter 14, sections 14.4 (Asymmetric Information) and 14.5 (Adverse Selection and Moral Hazard), from Edgar Browning and Mark Zupan, <u>Microeconomics: Theory and Application</u> , Wiley, 2002, pp. 397-403.	101
11.	Chapter 17, section 17.4 (Why Wages Differ), from Edgar Browning and Mark Zupan, <u>Microeconomics: Theory and Application</u> , Wiley, 2002, pp. 468-472.	109
12.	Michael R. Edgmand, Ronald L. Moomaw, and Kent W. Olson, "College Education: Is It Worth the Cost?" <u>Economics and Contemporary Issues</u> , Dryden, 1994.	115
13.	Robert Haveman and Barbara Wolfe, "Does Education Matter: More Last Words" <u>Milken Institute Review</u> , 2 nd Quarter, 2003, pp. 84-90.	127
14.	Alan B. Kruger and William G. Bowen, "Income-Contingent College Loans," <u>Journal of Economic Perspectives</u> , Summer 1993.	135

15.	Sandy Baum, “Student Financial Aid Policies Do They Promote Universal Education?” <u>Ford Policy Forum</u> , 2004.	145
16.	Katharine Lyall, “A Call for the Miracle Model,” <u>Carnegie Perspective</u> , April 2005.	153
17.	John D. Wiley, “Why We Won’t See Any Public Universities ‘Going Private’”, Ronald Ehrenberg, ed., <u>What’s Happening to Public Higher Education</u> , 2006.	157
18.	Nancy Cauthen, “When Work Doesn’t Pay: What Every Policymaker Should Know.” National Center for Children in Poverty, Research Brief, June, 2006.	169
19.	Robert Haveman, “When Work Alone is Not Enough.” In <u>One Percent for the Kids: New Policies, Brighter Futures for America’s Children</u> . Edited by Isabel Sawhill. Washington, DC: The Brookings Institution, 2003.	177
20.	Paul Krugman, What do Undergrads Need to Know about Trade?” Chapter 8, <u>Pop Internationalism</u> , MIT Press, 1997.	191
21.	Council of Economic Advisers, <u>Economic Report of the President</u> , 2006, GPO, pp. 149-171.	197
22.	Federal Reserve Bank of Dallas, “Racing to the Top: How Global Competition Disciplines Public Policy.” 2005 Annual Report, pp. 4-18.	221
23.	Issue 17, “Should Pollution be Put to the Market Test?” from T. Swartz and F. Bonello, <u>Taking Sides: Clashing Views on Controversial Economic Issues</u> . Dushkin/McGraw-Hill, 2000, pp. 336-357.	237
24.	<u>New York Times</u> , 2/6/93, “A New, Unregulated Market: Selling the Right to Pollute.”	249
25.	Jeff Goodell, “Capital Pollution Solution.” <u>New York Times Magazine</u> , July 30, 2006.	251