Arizona State University **Fall 2009**
School of Public Affairs **PAF 504**

Public Affairs Economics

Instructor Contact Information

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Course Description and Objectives

The goal of this course is to provide a graduate-level introduction to some key principles of microeconomics. Particular emphasis is placed on developing the analytic tools of economic reasoning and using these tools to examine policy interventions of interest to public managers. As such, this course is divided into three sections. First, we begin by developing a basic understanding of how a perfectly competitive market allocates good and services in society. Next, we explore the ways in which this "ideal" model can break down, necessitating government intervention in markets. Specifically, such topics as equity/efficiency, monopolies, externalities, and public goods are discussed in detail. In the final section of the course, we turn our attention to the "tools" of public action that are used to correct market failures.

An advantage of taking a policy tools approach to economic analysis is that, increasingly, government interventions are moving away from a command-and-control-style of direct provision of goods and services and toward a large menu of indirect approaches implemented through a complex system of third-party actors. Indeed, government intervention in private markets now entails loans and loan guarantees, grants-in-aid, contracts, vouchers, social/economic regulation, and many other policy tools. Each of these instruments, moreover, involves vastly different behavioral distortions, policy technologies, political considerations, and technical sophistication. Although the number of policy tools is large—between 10 and 63, depending on the estimate—our task is far less ambitious. Specifically, our aim is to analyze the economics of five interventions (economic regulation, social regulation, grants, tax expenditures, and vouchers) in a single policy domain (social welfare policy). An overview of each tool is provided, including its key design features and characteristics, followed by a detailed discussion of a specific policy/program that uses each tool. This part of the course, then, combines economic theory with background information on how public policies actually operate.

Course Materials

Required textbooks

Salamon, L. (Editor). (2002). *The Tools of Government: A Guide to the New Governance*. Oxford: Oxford University Press.

Sharp, A., Register, C., & Grimes, P. (2008). *Economics of Social Issues (18th Edition)*. New York, NY: McGraw-Hill Irwin.

Supplemental and recommended textbooks

Pindyck, R. & Rubinfeld, D. (2004). *Microeconomics (6th Edition)*. Upper Saddle River, NJ: Prentice Hall.

Weimer, D. & Vining, A. (2004). *Policy Analysis: Concepts and Practice (4th edition)*. Upper Saddle River, NJ: Pearson/Prentice Hall.

Journal Articles

From time to time, students are assigned published articles or working papers. References for all assigned papers are found at the end of the syllabus, and may be accessed through on-line retrieval services such as JSTOR (www.jstor.org), popular search engines such as Google Scholar (www.scholar.google.com/), or the National Bureau of Economic Research website (www.nber.org).

Evaluation and Grading

Evaluation in the course is based on class participation, a group presentation, a policy/economic debate, three critiques of economic concepts in the news, a final exam, and a paper. Each component is weighted as follows:

Class participation and preparation: 15%
Group presentation: 15%
Policy/economic debate: 20%
Economic critiques: 15%
Final exam: 15%
Paper: 20%

Please abide by all ASU policies, including those for academic integrity, the Student Code of Conduct and computer use. See the links below for additional information.

Academic Integrity: http://www.asu.edu/studentaffairs/studentlife/judicial/academic_integrity.htm
Student Code of Conduct: http://www.abor.asu.edu/1%5Fthe%5Fregents/policymanual/chap5/
Electronic Communications Policy: http://www.asu.edu/aad/manuals/acd/acd125.html

Please be sure to turn off all pagers, cell phones, and other electronic devices before class begins. Also, students are prohibited from using computers in class. Please leave them at home, at work, or in your bag, and plan to take notes the "old fashioned" way: using notebooks and pencils.

Course Schedule: Topics, Readings, and Assignments

Week 1: August 26, 2009

- Introduction to the course and each other
- Topic(s): The role of economic theory in public decision-making; resource allocation
- Reading(s): SRG: Chapter 1, 13, 14
- Assignment(s):

Week 2: September 2, 2009
- Topic(s): The basics of supply and demand
- Reading(s): SRG: Chapter 2
- Assignment(s):

Week 3: September 9, 2009
- Topic(s): Consumer behavior in competitive markets
- Reading(s): Handouts
- Assignment(s):

Week 4: September 16, 2009
- Topic(s): Producer behavior in competitive markets
- Reading(s): Handouts
- Assignment(s):

Week 5: September 23, 2009
- Topic(s): Market failures and government intervention I: Monopoly/monopsony
- Reading(s): SRG: Chapter 8, 9
- Assignment(s): Policy paper proposal due

Week 6: September 30, 2009
- Topic(s): Market failures and government intervention II: Externalities and public goods
- Reading(s): SRG: Chapter 4, 5, 6
- Assignment(s): Economic critique #1 due

Week 7: October 7, 2009
- Topic(s): Market failures and government intervention III: Asymmetric information/adverse selection
- Reading(s): Handouts
- Assignment(s):

Week 8: October 14, 2009
- Public Policy and Economics Debate I: Cash for Clunkers Program

Week 9: October 21, 2009
- Public Policy and Economics Debate II: Universal Public Pre-Kindergarten Programs

Week 10: October 28, 2009
- Topic(s): Economic regulation/price controls: Minimum wage
- Reading(s): Salamon: Chapter 4; SRG: Chapter 3
- Assignment(s): Economic critique #2 due; Policy tools presentation

Week 11: November 4, 2009
- Topic(s): Grants-in-Aid: Aid to Families with Dependent Children (AFDC)/Temporary Assistance to Needy Families (TANF)
- Reading(s): Salamon: Chapter 11; Moffitt (2002); SRG: Chapter 7
- Assignment(s): Policy tools presentation

Week 12: November 11, 2009
- Topic(s): Social regulation: Work requirements, time limits, and benefit sanctions
- Reading(s): Salamon: Chapter 5; Moffitt and Pavetti (2000)
- Assignment(s): Policy tools presentation

Week 13: November 18, 2009
- Topic(s): Tax expenditures: Earned Income Tax Credit (EITC)
- Reading(s): Salamon: Chapter 13; Hotz & Scholz (2001)
- Assignment(s): Policy tools presentation

Week 14: November 25, 2009
- Topic(s): Vouchers: Child care subsidies
- Reading(s): Salamon: Chapter 14; Blau (2000)
- Assignment(s): Economic critique #3 due; Policy tools presentation

Week 15: December 2, 2009
- Final Exam

Week 16: December 9, 2009
- Final Paper Due

References for Course Readings

Blau, D. (2000). Child care subsidy programs. Working Paper No. 7806. Cambridge, MA: National Bureau of Economic Research.

Hotz, J. & Scholz, J. (2001). The earned income tax credit. Working Paper No. 8078. Cambridge, MA: National Bureau of Economic Research.

Moffitt, R. (2002). Welfare programs and labor supply. Working Paper No. 9168. Cambridge, MA: National Bureau of Economic Research.

Moffitt, R. & Pavetti, L. (2000). Time Limits. In Rebecca Blank & David Card (Eds.) Findings Jobs: Work and Welfare Reform. New York, NY: Russell Sage Foundation.

Short Papers Analyzing Economic Concepts in the News

Throughout the semester, students will prepare three, short papers (three pages, double-spaced, 12-point-font) critiquing a piece of public policy using economic theory and analysis. Students are free to choose any three topics they desire, irrespective of the point of origin (e.g., domestic or foreign policy), level of government (e.g., federal, state, or local policy), policy tool (e.g., taxes, subsidies, or regulation), and market failure it is intended to address. It is perfectly acceptable to analyze policies that are already codified into law, or proposals to alter current legislation that are on the public agenda. Students may consult newspapers/magazines, policy research institutes, and quasi-academic publications. For example, the New York Times, Wall Street Journal, and The Economist have dedicated columns in which economic analyses of policy problems are discussed. A number of policy research institutes (or think tanks) publish shorter pieces summarizing lengthy reports. Excellent analyses can be found at the New America Foundation, Brookings Institution, Center on Budget and Policy Priorities, Urban Institute, Heritage Foundation, and American Enterprise Institute. Finally, you should consider reading such quasi-academic publications as *Democracy* (http://www.democracyjournal.org/), *Foreign Affairs* (http://www.foreignaffairs.org/), *National Journal* (http://www.nationaljournal.com/njonline/), and *American Spectator* (http://www.spectator.org/). It is important to discuss the policy problem that is addressed by each intervention, the specific market failure that exists, whether there are unintended consequences associated with the intervention, and whether you believe the policy problem could be addressed more effectively through another approach. Please submit these as hard-copies, in class.

Public Policy and Economic Debate

During weeks 8 and 9, students will engage in a debate on two policies that have received intense public interest: the cash for clunkers program and universal public Pre-K programs. The class will be split up into two groups, with one group debating the merits of cash for clunkers and the other group debating early education policy. There will be approximately four to five students per team.

Each debate will be structured as a traditional Policy, or Cross-Examination, Debate, in which small teams promote positions for and against a given policy intervention. One set of students presents the Affirmative Constructive, so called because it defends government policy; the other group of students presents the Negative Constructive, or key arguments against the policy. Affirmative and negative arguments are then buttressed by brief periods of cross-examination, which allows each team to question some of the central arguments articulated by the opposition.

The format of the debate is as follows:

- *First Affirmative Constructive* (7 minutes): opening statement that attracts the audience and motivates the policy problem; present key economic arguments in favor of government intervention, along with all supporting evidence; conclude effectively with a cogent summary of central propositions.
- *First Cross-Examination by the Negative Constructive* (3 minutes): Rigorous, but courteous, questioning by the Negative Constructive of the Affirmative Constructive's previous arguments.
- *First Negative Constructive* (7 minutes): opening statement that attracts the audience and motivates the policy problem; present key economic arguments against government intervention, along with all supporting evidence; conclude effectively with a cogent summary of central propositions.
- *First Cross-Examination by the Affirmative Constructive* (3 minutes): Rigorous, but courteous, questioning by the Affirmative Constructive of the Negative Constructive's previous arguments.

- *Second Affirmative Constructive* (7 minutes): opening statement that attracts the audience and motivates the policy problem; present <u>new</u> economic arguments in favor of government intervention, along with all supporting evidence; and respond to any remaining Negative arguments.
- *Second Cross-Examination by the Negative Constructive* (3 minutes): Rigorous, but courteous, questioning by the Negative Constructive of the Affirmative Constructive's previous arguments.
- *Second Negative Constructive* (7 minutes): opening statement that attracts the audience and motivates the policy problem; present <u>new</u> economic arguments against government intervention, along with all supporting evidence; and respond to any remaining Positive arguments.
- *Second Cross-Examination by the Affirmative Constructive* (3 minutes): Rigorous, but courteous, questioning by the Affirmative Constructive of the Negative Constructive's previous arguments.

- *Negative Rebuttal and Closing Statement* (7 minutes): Rebuild the Negative case, and summarize key arguments; present arguments both in favor of the Negative case and against the Positive case; no new arguments; conclude clearly and persuasively
- *Affirmative Rebuttal and Closing Statement* (7 minutes): Rebuild the Positive case, and summarize key arguments; present arguments both in favor of the Affirmative case and against the Negative case; no new arguments, and conclude clearly and persuasively.

At the close of each debate, there will be 15 to 20 minutes allocated to a question-and-answer period in which the audience can inquire about specific arguments made by the Affirmative and Negative teams.

Here are some thoughts on how to prepare for the debate:

- One of your goals is to *inform* the audience about the topic under debate. Therefore, you should become quite fluent with the policy's history, how the policy currently operates and its design characteristics, where its funding comes from, and at what level of government the policy is administered.
- Teams are expected to ground their arguments using economic principles. It is important to understand the economics on both sides of the debate—no matter which side you're defending—so that you can anticipate opposing arguments and prepare rebuttals using economic theory. Specifically, students should be attentive to the economic rationales underlying government intervention, the incentives created by each proposal (and its alternatives), unintended consequences (positive or negative) associated with the intervention, opportunity costs, and cost-benefit calculations.
- It is often the case that policy debates are cast in all-or-nothing terms. That is, there are only two worlds under consideration: a world with the policy enacted and a world without *any* policy. Think carefully about alternative approaches to policy reform and how your position stacks up against these alternatives.
- There is no need to use Powerpoint for the debates. Face the other team and your audience while presenting key arguments and rebuttals. Teams may utilize other visual aids, however, if they add to the substance of the argumentation.
- Rigor is good. Rude is bad. Please be attentive to the distinction between making forceful arguments in favor of a policy position and being discourteous to those with whom you are debating.

Policy Tools Presentation

During weeks 10-14, our focus is on applying economic theory to the study of five policy tools: economic regulation, grants, social regulation, tax expenditures, and vouchers. To facilitate this part of the course, students will form small groups (of four or five individuals) and make a 45-minute introductory presentation on each week's tool. Students may sign up to present any policy intervention they desire, provided space is available, and so it is advisable that students spend time deciding which tool is of particular interest. Although Salamon's text should be an important source of material for the presentation, it is expected that you supplement Salamon with your own research on the tool. Be sure to consult published papers, book chapters, and other sources as you prepare the presentation. As "experts" on a given policy intervention, your goal is to come up with creative and useful ways of presenting this material so that it can be easily digested by the rest of us. The goal of the presentation is to develop a deep understanding of a government policy intervention and communicate this understanding to your colleagues. Here are some guidelines on what should be addressed during each presentation:

- How is the policy tool structured, and what are its unique design characteristics?

- How is the policy tool implemented, and what does its delivery system look like?
- What are the intended outcomes or goals of each intervention? Describe and critique the specific market failures that the tool is supposed to address.
- Are there any unintended consequences of which public managers should be aware? If so, discuss these in relation to the efficacy of each tool's intended outcomes.
- What are the political implications of a given tool choice? Which interest groups, agencies, and institutions are likely to be involved in planning and implementing the intervention? Inter-governmental? Private for-/non-profit?
- As public managers, what, if any, are the key hurdles to administering each policy tool? How might these challenges be overcome?

Feel free to discuss specific policies/programs in order highlight characteristics of a given policy tool, but the presentation's focus should be on the tool (e.g., grants-in-aid) rather than the policy that exemplifies it (e.g., Aid to Families with Dependent Children). Finally, be prepared to engage in a brief question-and-answer session (approximately 15 minutes) following the presentation.

Economic Analysis of a Public Policy Intervention

A key ingredient of this course is a paper, prepared by each student, which uses economic theory to analyze a current public policy intervention at the local, state, or national level. In many ways, this project is tailored to be complimentary to the policy tools presentation: the tools presentation aims to provide students with a detailed understanding of the broad menu of government choices for tackling public problems, while the research paper allows students to analyze the economic impact of a specific policy/program. Students are free to choose any public policy, with some examples being Medicaid, Medicare, food stamps, the Americans with Disabilities Act, the Clean Air Act, Fannie Mae/Freddie Mac, the Alcohol Beverage Labeling Act, and Parental Notification laws (for minors seeking to have an abortion). Be creative, and write about something that interests you! Each student should prepare a 12-page paper (double-spaced, 12-point-font), and should provide a critical assessment of the following:

- A full legislative history of the policy intervention, emphasizing the political conditions under which the law was passed, how the policy was structured when it was first implemented, and any changes/amendments to the law since its passage. Provide a sense of the ways in which this policy has changed or matured over time.
- A detailed discussion of how the policy/program is designed and implemented. What kind of policy tool is it? What are its key design features, and at what level of government (if at all) is it implemented? How is eligibility determined? What are its key benefits, and how are they distributed? What is the policy's intended target group, and is there any leakage in this regard?
- A thorough analysis, using economic theory, of the impact of the policy on the intended outcome(s). Is the policy meant to be distributive? Re-distributive? Efficiency improving? Is it aimed at dealing with information asymmetries? What market failure is the policy supposed to correct? Also, use economic theory to discuss any unintended consequences associated with the policy. In other words, does the policy lead to behavioral distortions or changes other than those for which it is intended? Why should we care about these? Be sure to support your arguments with graphs, tables, and figures, as appropriate.
- A critique of the economic model's effectiveness in highlighting the key design features, anticipated goals, and unintended consequences associated with the policy intervention. In your estimation, where does economic theory fall short as a tool for analyzing the impact of public policy? Keep in mind the role of interest groups, policy entrepreneurs, and institutions as you develop your critique. Also, think about the equity-efficiency trade-off, and assess whether

economic theory provides an understanding of where these trade-offs exist and how they might be reconciled.

Papers will be graded according to the following criteria: (1) Diligence, depth, and breadth of the research. Is the legislative history thorough and accurate? Is the economic analysis well-grounded and comprehensive? (2) Intellectual rigor of the critiques and arguments. Is the analysis internally consistent and well-planned? Does it show a facility with complex ideas and concepts? (3) Appropriate use and citation of economic theory and/or empirical literature. Are statements of fact or opinion other than your own properly cited, both in the text and in the reference section at the end of the paper? Are arguments appropriately and amply documented with references from the literature? (4) Logic, organization, and clarity of expression. Are the paper's sections arranged logically? Are the arguments and presentations with the sections easy to follow and arranged logically? Is the writing clear and the grammar correct? Are the citations made correctly and consistently?

A one-page proposal of the policy to be examined is due on **September 23**. The final paper is due on **December 9**. Please submit the proposal in hard-copy form, in class. Submit the final paper via email.