
ECONOMIC ANALYSIS OF PUBLIC POLICY
API 102 B/C/D, Spring 2008
Kennedy School of Government
Harvard University

- Time and Place:** Section B: Monday & Wednesday, 8:40 AM -10:00 AM, Starr Auditorium
Section C: Monday & Wednesday, 11:40 AM - 1:00 PM, L230
Section D: Monday & Wednesday, 1:10 PM -2:30 PM, L230
- Instructors:** Prof. Brigitte C. Madrian (Course Head — contact for general issues)
Office: Room R-317
Phone: 495-8917
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Office Hours: Thursdays, 1-2:30 and by appointment

Ass't: Jamie Georgia, Room B-418, 496-3440
E-Mail: jamie_georgia@ksg.harvard.edu
- Prof. Monica Singhal
Office: Room L-103
Phone: 496-5062
E-Mail: monica_singhal@ksg.harvard.edu
Office Hours: Tuesday, 2-4 PM, and by appointment

Ass't: Camiliakumari Wankaner, Room L-201, 495-5994
E-Mail: camiliakumari_wankaner@harvard.edu
- Prof. Robert Z. Lawrence
Office: Room L-316
Phone: 495-1118
E-Mail: robert_lawrence@harvard.edu
Office Hours: TBD

Ass't: Jennifer Shultis, Room L-319, 496-8054
E-Mail: jennifer_shultis@ksg.harvard.edu
- Prerequisites:** Microeconomics at the level of API-101 or equivalent. The course is intended for first-year students in the Kennedy School's MPP program, and is open to others only through permission of the instructors.
- Texts:** There is no required text for the course. Rather, extensive use will be made of other materials which will be available in the Course Materials Office (CMO, Belfer G-6), on reserve in the Kennedy School Library, or will be available for downloading from the course web site. Readings should be completed prior to class sessions.
- Course web site:** The course web site will be located on the KSG intranet. Contact Jamie Georgia (jamie_georgia@ksg.harvard.edu) with any access issues.

Overview:

API-102 builds on the foundation of API-101 to develop microeconomic tools of analysis for policy problems, with emphasis on benefit-cost analysis, cost-effectiveness analysis, distributional analysis, incentive effects of government policies, and economic analysis in international contexts. The course covers both conceptual and methodological topics, as well as current policy applications such as education, energy, environment, health, international trade, safety, taxation, transportation, and welfare.

The course is divided into three parts. Sections B, C, and D are identical, as each section is taught by all three faculty members. The first part of the course, taught by Professor Madrian, focuses on benefit-cost analysis. Topics covered include the mechanics of benefit-cost analysis; the principals of net present value analysis and alternative approaches to benefit-cost analysis; and concepts and empirical approaches to measuring costs and benefits, especially in a non-market context.

The second part of the course, taught by Professor Singhal, focuses on equity and distributional analysis, with examples drawn from taxation, public assistance, and health. This section of the course emphasizes the tradeoffs between equity and efficiency in the design or financing of public programs.

The third and final part of the course, taught by Professor Lawrence, focuses on international dimensions of efficiency and equity analysis. This section evaluates the arguments for and against free trade. Among the topics examined are: the gains from trade, explanations for trade, winners and losers from trade, trade policy instruments, and optimal policies when markets fail in an open economy.

Grading:

Course grading will be on the following basis:

Problems of the Day	12%
Segment I Exam (February 29)	14%
Segment II Exam (March 21)	14%
Final Exam (May X)	60%

The Problems of the Day (PODs) are small, daily assignments. There will be 5 for each segment of the course (15 total), of which 4 (12 total) will count for your grade. Due dates are listed with the daily readings for the course. The PODs will be available on the course website by the class period before which they are due. **Late assignments will not be accepted.** Solutions will be posted on the course website after the PODs are graded.

There will be two segment exams, 8:30-10:00 am on Friday, February 29th, and 8:30-10:00 am on Friday, March 21st.

The final exam will take place at 9am on Tuesday, May 20th. Location TBA.

Review sections: Review sessions will be conducted weekly by the teaching fellows. These review sessions are scheduled as follows:

Fridays 8:40 AM-10:00 AM (L140)

Fridays 11:40 AM-1:00 PM (L140)

Fridays 1:10PM-2:30 PM (Land Hall)

There will be **no review section the first week of class.**

In addition to the review sections, the course assistants will hold weekly office hours. The times and locations of these office hours will be posted on the course web page.

Teaching fellows: Segment 1: Onur Mumcu (onur_mumcu@ksgphd.harvard.edu)
Segment 2: Sebastien Bauhoff (sebastien_bauhoff@ksgphd.harvard.edu)
Segment 3: David Elmaleh (david_elmaleh@ksg08.harvard.edu)

Course assistants: Alok Chopra (alok_chopra@ksg08.harvard.edu)
Lin Johnson (lin_johnson@ksg07.harvard.edu)
Zahara Niazi (zahra_niazi@ksg08.harvard.edu)
Josh Lee (joshua_lee@ksg08.harvard.edu)
Michael McClendon (michael_mcclendon@ksg08.harvard.edu)

**API-102B/C/D: ECONOMIC ANALYSIS OF PUBLIC POLICIES
COURSE OUTLINE**

- I. Efficiency and Benefit-Cost Analysis: Foundations and Methods** (Madrian)
- A. Theoretical Foundations (*Jan 30*)
 - B. Net Present Value Analysis and Discounting (*Feb 4*)
 - C. Alternative Approaches to Project Evaluation (*Feb 6*)
 - D. Measuring Costs and Benefits Indirectly (*Feb 11*)
 - E. Measuring Costs and Benefits Indirectly (*Feb 13*)
 - F. Measuring Costs and Benefits Using Market Prices (*Feb 20*)
 - G. Measuring Costs and Benefits Using Market Prices (*Feb 25*)
 - H. Partial vs. General Equilibrium Effects (*Feb 27*)
 - I. Segment Exam I (*Feb 29*)
- II. Equity and Distribution: Incentives, Income Distribution, and Social Insurance** (Singhal)
- A. Tax Policy I: Incentive Effects of Taxes (*March 3*)
 - B. Tax Policy II: Distributional Effects of Taxes and Tax Reform (*March 5*)
 - C. Welfare Policy I: Budget Sets and Incentive Effects (*March 10*)
 - D. Welfare Policy II: Design of Transfer Systems (*March 12*)
 - E. Health Policy I: Adverse Selection and Moral Hazard (*March 17*)
 - F. Health Policy II: The Equity-Efficiency Tradeoff (*March 19*)
 - G. Segment Exam II (*March 21*)
- III. International Dimensions of Efficiency and Equity Analysis** (Lawrence)
- A. Comparative Advantage and Explanations for Trade (*March 31*)
 - B. Winners and Losers From Trade (*April 2*)
 - C. Basic Instruments of Trade Policy I: Tariffs (*April 7*)
 - D. Basic Instruments of Trade Policy II: Quotas (*April 9*)
 - E. Free Trade when Markets Fail (*April 14*)
 - F. Optimal Intervention When Open Markets Fail (*April 16*)

API-102B/C/D: ECONOMIC ANALYSIS OF PUBLIC POLICY ASSIGNMENTS

SEGMENT I: EFFICIENCY AND BENEFIT-COST ANALYSIS

JANUARY 30: THEORETICAL FOUNDATIONS

Arrow et al, "Is There a Role for Benefit-Cost Analysis in Environmental, Health, and Safety Regulation?" *Science*, Vol. 272: 5259, April 12 1996, pp. 221-222.

Stokey and Zeckhauser, *A Primer for Policy Analysis*. New York: Norton, 1978. Chapter 9, "Project Evaluation: Benefit-Cost Analysis," pp. 134-142, 146-156, and Chapter 10, "The Valuation of Future Consequences: Discounting," pp. 159-167, 170-173.

Zerbe and Bellas, *A Primer for Benefit-Cost Analysis*. Cheltenham, UK: Edward Elgar, 2006. Chapter 3: "Standing in Benefit-Cost Analysis," pp. 40-60.

FEBRUARY 4: NET PRESENT VALUE ANALYSIS AND DISCOUNTING

Zerbe and Bellas, Chapter 9: "Discounting and Net Present Value," pp. 215-227, 233-254.

Bazon and Smetters, "Discounting Inside the Washington DC Beltway," *Journal of Economic Perspectives*, Vol. 13:4, Fall 1999, pp. 213-228.

Arrow, "Global Climate Change: A Challenge to Policy," *Economist's Voice*, June 2007, pp. 1-5.

Mendelsohn, "A Critique of the Stern Report," *Regulation*, Winter 2006-2007, pp. 42-46.

Optional (on-line only): Stern Review on the Economics of Climate Change, HM Treasury, http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/sternreview_index.cfm

Optional (on-line only): Weitzman, "The Stern Review of the Economics of Climate Change" <http://www.economics.harvard.edu/faculty/weitzman/files/JELSternReport.pdf>

Optional (on-line only): U.S. Environmental Protection Agency. *Guidelines for Preparing Economic Analyses*. Washington, D.C.: U.S. Environmental Protection Agency 2000 [hereafter *Guidelines* 2000], Chapter 6, "Analysis of Social Discounting," pp. 33-39, 46-52. [http://yosemite.epa.gov/ee/epa/eed.nsf/webpages/Guidelines.html/\\$file/Ch6-7.pdf](http://yosemite.epa.gov/ee/epa/eed.nsf/webpages/Guidelines.html/$file/Ch6-7.pdf)

FEBRUARY 6: ALTERNATIVE APPROACHES TO PROJECT EVALUATION

Manning et al., "The Taxes of Sin: Do Smokers and Drinkers Pay Their Way," *JAMA*, Vol. 261:11, March 17, 1989, pp. 1604-1609.

Zerbe and Bellas, Chapter 10: "Risk and Uncertainty," pp. 255-289.

Zerbe and Bellas, Chapter 9: "Discounting and Net Present Value," pp. 228-233.

FEBRUARY 11: MEASURING COSTS AND BENEFITS USING INDIRECT METHODS

[Due at start of class: Problem/s of the Day #1]

Gomez-Ibanez, "Bridge over the Tempisque River," Kennedy School of Government Case Program.

EPA Guidelines, "Chapter 7: Analyzing Social Benefits"

[http://yosemite.epa.gov/ee/epa/eed.nsf/webpages/Guidelines.html/\\$file/Ch6-7.pdf](http://yosemite.epa.gov/ee/epa/eed.nsf/webpages/Guidelines.html/$file/Ch6-7.pdf)

Portney, "The Contingent Valuation Debate: Why Economists Should Care," *Journal of Economic Perspectives*, Vol. 8:4, Fall 1994, pp. 3-17.

Hanemann, "Valuing the Environment Through Contingent Valuation," *Journal of Economic Perspectives*, Vol. 8:4, Fall 1994, pp. 19-43.

FEBRUARY 13: MEASURING COSTS AND BENEFITS USING INDIRECT METHODS

[Due at start of class: Problem/s of the Day #2]

Averill, "Arsenic in Drinking Water," Kennedy School of Government Case Program.

"The Arsenic Controversy," *Regulation*, Fall 2001, pp. 42-54.

Tengs and Graham, "The Opportunity Cost of Haphazard Social Investments in Life Saving" in *Risks, Costs, and Lives Saved*, edited by Robert W. Hahn, New York: Oxford University Press, 1996, pp. 167-182.

Boardman et al, *Cost-Benefit Analysis: Concepts and Practice*, Upper Saddle River: Prentice Hall, 2001. Chapter 13: "Valuing Impacts from Observed Behavior: Indirect Market Methods," pp. 266-304.

FEBRUARY 20: MEASURING COSTS AND BENEFITS USING MARKET METHODS

[Due at start of class: Problem/s of the Day #3]

Zerbe and Bellas, Chapter 5: "Valuing Inputs Using Market Prices," pp. 96-128.

FEBRUARY 25: MEASURING COSTS AND BENEFITS USING MARKET METHODS

[Due at start of class: Problem/s of the Day #4]

Currie, "Early Childhood Education Programs," *Journal of Economic Perspectives*, Vol. 15:2, Spring 2001, pp. 213-238.

Kotchen and Burger, "Should We Drill in the Arctic National Wildlife Refuge? An Economic Perspective," NBER Working Paper No. 13211.

FEBRUARY 27: PARTIAL VS. GENERAL EQUILIBRIUM EFFECTS

[Due at start of class: Problem/s of the Day #5]

Rappaport and Wilkerson, "What Are the Benefits of Hosting a Major League Sports Franchise?" <http://www.kc.frb.org/publicat/econrev/PDF/1q01rapp.pdf>

Optional (on-line only): C.H. Johnson Consulting, "Economic Impact Analysis of the Proposed Ballpark for the Boston Red Sox" <http://www.fenwayaction.org/>

Optional (on-line only): Sargent, Rob, "Major League Steal: The Economic Folly of Public Subsidies for a New Red Sox Stadium" <http://www.fenwayaction.org/>

FEBRUARY 29: SEGMENT EXAM I

SEGMENT II: EQUITY AND DISTRIBUTION

MARCH 3: TAX POLICY I: INCENTIVE EFFECTS OF TAX POLICIES

[Note: No Problem of the Day]

Feldstein, Martin, "The 28% Solution," *Wall Street Journal*, February 16, 2001.

Krugman, Paul, "The Tax-Cut Con" *New York Times Magazine*, September 14, 2003.

Feldstein, Martin, "The Case for Dynamic Analysis," *Wall Street Journal*, December 14, 1994.

Tyson, Laura, "Dynamic Scoring: Not Ready for Prime Time," *Wall Street Journal*, January 12, 1995.

Optional: Gruber, Jonathan. *Public Finance and Public Policy*. 1st edition. New York: Worth Publishers, 2005; Chapters 20, 21.

MARCH 5: TAX POLICY II: DISTRIBUTIONAL EFFECTS OF TAX POLICIES AND TAX REFORM

[Due at start of class: Problem/s of the Day #1]

Mack, III, Connie and John Breaux, et al, *Simple, Fair, and pro-Growth: Proposals to Fix America's Tax System, Report of the President's Advisory Panel on Federal Tax Reform*, Washington: President's Advisory Panel on Tax Reform, November 2005. "Tax Basics," Chapter 3 (pp. 19-40) and "Executive Summary," (pp. xii-xvii)

Lazear, Edward P. and James Poterba. "A Golden Opportunity," *Wall Street Journal*, November 1, 2005.

Optional: Gruber, chapters 18, 19.

MARCH 10: WELFARE POLICY I: BUDGET SETS AND INCENTIVE EFFECTS

[Due at start of class: Problem/s of the Day #2]

Blank, Rebecca M. and David T. Ellwood, "The Clinton Legacy for America's Poor," in *American Economic Policy in the 1990s*, Jeffrey Frankel and Peter Orszag, editors, 2002, pp. 749-782.

Optional: Gruber, chapter 17.

MARCH 12: WELFARE POLICY II: DESIGN OF TRANSFER SYSTEMS

[Due at start of class: Problem/s of the Day #3]

Liebman, Jeffrey B, "The Impact of the Earned Income Tax Credit on Incentives and the Income Distribution," *Tax Policy and the Economy*, 12, 1998.

MARCH 17: HEALTH POLICY I: ADVERSE SELECTION AND MORAL HAZARD

[Due at start of class: Problem/s of the Day #4]

Newhouse, Joseph P., "Medical Care Costs: How Much Welfare Loss?", *Journal of Economic Perspectives*, Summer 1992, pp. 3-21.

Optional: Gruber, chapter 12.

MARCH 19: HEALTH POLICY II: THE EQUITY-EFFICIENCY TRADEOFF

[Due at start of class: Problem/s of the Day #5]

Cutler, David, "Equality, Efficiency, and Market Fundamentals: The Dynamics of International Medical-Care Reform," *Journal of Economic Literature*, September 2002, pp. 881-906.

Optional: Gruber, chapters 15, 16.

MARCH 21: SEGMENT EXAM II

SEGMENT III: INTERNATIONAL DIMENSIONS OF ANALYSIS

MARCH 31: COMPARATIVE ADVANTAGE AND EXPLANATIONS FOR TRADE

[Note: No Problem of the Day]

Bastiat, Fredric, "A Petition from the Manufacturers of Candles," *Sophismes économiques*, 1845 available at <http://bastiat.org/en/petition.html>

Lecture Supplement: Sykes, Alan, "A Primer on Comparative Advantage and Normative Economics," *Journal of International Economic Law* Volume 1; Number 1, pp. 49-82.

APRIL 2: WINNERS AND LOSERS FROM TRADE

[Due at start of class: Problem/s of the Day #1]

Krugman, Paul, "The Trouble with Trade," *New York Times*, December 28th 2007. Available at <http://www.nytimes.com/2007/12/28/opinion/28krugman.html>

Lawrence, Robert Z., “The Globalization Paradox” VoxEU.org September 4th 2007.
available at <http://voxeu.org/index.php?q=node/524>

Alt, James E. and Michael Gilligan “The Political Economy of Trading States: Factor Specificity ,
Collective Action Problems and Domestic Political Institutions” reprinted in Jeffery A. Frieden
and David A. Lake (eds) *International Political Economy: Perspectives on Global Power and
Wealth*, (Thomson Wadsworth) 2000, pp. 327 – 334.

Lecture supplement: Dixit, Avinash, “Trade Based on Factor Endowment Differences,” *Lecture
Notes on International Trade*, Princeton, 1994, pp. 76 –89.

APRIL 7: INSTRUMENTS OF TRADE POLICY-TARIFFS

[Due at start of class: Problem/s of the Day #2]

Hufbauer, Gary Clyde and Kimberly Ann Elliot, *Measuring the Costs of Protection in the United States*,
Washington DC: Institute for International Economics January 1994, pp. 1 -13.

Postrel, Virginia, “What Happened When Two Countries Liberalized Trade? Pain, Then Gain” New York
Times January 27th 2005
http://www.nytimes.com/2005/01/27/business/worldbusiness/27scenes.html?_r=1&oref=slogin

Lecture Supplement: Kreinen, Mordechai, “Protection of Domestic Industries: The Tariff,” Chapter 4
in *International Economics* pp. 85-112.

APRIL 9: INSTRUMENTS OF TRADE POLICY: QUOTAS.

[Due at start of class: Problem/s of the Day #3]

Chang, Ha-Joon Chang, Protectionism ...the truth is on a \$10 bill,” *The Independent* on Sunday, 25th
August 2007.

Panagariya, Arvind, “Free Trade Sceptics: Wrong Again” *Economic Times of India* Economic Times
January 25, 2006 January 25, 2006 available at
http://www.columbia.edu/~ap2231/ET/et86_January25-06.htm

Lecture Supplement: Kreinen, Mordechai, “Nontariff barriers (NTBs) to Trade,” Chapter 5 in
International Economics pp. 133-142.

APRIL 14: FREE TRADE WHEN MARKETS FAIL

[Due at start of class: Problem/s of the Day #4]

Bhagwati, Jagdish , Lecture 1, “Confronting Conventional Threats to Free Trade: The Postwar Revolution
in the Theory of Commercial Policy,” *Free Trade Today*, Princeton University Press, 2002, pp 3-
44.

Corden, W Max, "The Theory of Domestic Divergences" pp. 7 –16. (Sections 2.2,2.3 and 2.4) and pp. 21-23 (Section 2.8) in W Max Corden *Trade Policy and Economic Welfare*. New York: Oxford University Press, 1997.

Lecture Supplements: Salvatore, Dominick, "Economic Integration: Customs Unions and Free Trade Areas" Chapter 10, pp. 327-336. *International Economics*, New York: John Wiley and Sons 2001.

APRIL 16: OPTIMAL INTERVENTION IN THE PRESENCE OF MARKET FAILURE.

[Due at start of class: Problem/s of the Day #5]

Cooper, Richard N. "Economic Assumptions of the Case for Liberal Trade." Chapter 1 in C. Fred Bergsten, ed., *Toward a New World Trade Policy*. Lexington Books, 1975, pp. 19-31.

Lecture Supplement: Dixit, Avinash, "Externalities," *Notes on International Economics*. Princeton, 1994, pp. 124-129.