Managerial Economics and Policy Analysis (PUBP 720)

PRELIMINARY SYLLABUS: Schedule subject to change!

Instructor: John S. Earle (earle@gmu.edu)
Office: Founders Hall 533, (703)993-8023
Office hours: Tuesdays, 2-4 (and by appointment)

“I can't believe that!” said Alice.
“Can’t you?” the Queen said in a pitying tone. “Try again: draw a long breath, and shut your eyes.”
Alice laughed. “There's no use trying,” she said, “one can't believe impossible things.”
“I daresay you haven't had much practice,” said the Queen. “When I was your age, I always did it for half-an-hour a day. Why, sometimes I've believed as many as six impossible things before breakfast.”

From Through the Looking Glass, by Lewis Carroll.

“I know not ‘seems’.”

From Hamlet, Act I, Scene 2, by William Shakespeare.

This course introduces the sometimes hard-to-believe, but frequently useful and always aiming-to-be-precise world of microeconomic theory and its application to decision-making and policy analysis. The theoretical topics include consumer choice, production and firm behavior, factor (labor and capital) markets, market equilibrium and interactions, market failures, and basic welfare economics. The assumed context is usually a “mixed economy” with market (price-based) allocation of most goods and services but also a significant role for government intervention. While the quantity and difficulty of the material dictate an emphasis on theory, we will illustrate important principles with public policy examples. The course serves both as part of the core MPP curriculum and as a bridge into doctoral-level economic analysis.

Learning Outcomes
The main goal of this course is to enable students to use the basic tools and vocabulary of microeconomic theory as crucial inputs in the design and evaluation of public policies. The title “managerial economics” reflects the emphasis on optimal decision-making in policy design and implementation. The most important aspect of policy evaluation we will consider is the theoretical prediction of the effects of a policy on one or more outcome variables. But the course also aims to develop understanding of the normative arguments used, especially by economists, as the basis for policy recommendations. Unfortunately, the course will only refer in passing to the crucial third aspect of policy evaluation – empirical estimation of the magnitude of policy impacts – which is the main topic of courses on statistics, econometrics, program evaluation, and several applied fields of economics.

To take a recent example, we could ask the following set of questions:
- Would a reduction in the payroll tax for new hires raise employment?
- How are wages affected by the tax reduction?
- How is the employment of incumbent workers affected?
- How large are the effects, and on what factors do the magnitudes of the effects depend?
- Should the policy be adopted?

The analytical tools of economic theory you will learn in this course cannot alone answer these questions, but they can provide predictions about the directions of the effects and some indications of the magnitudes. These tools are frequently used in policy discussions, and they serve to guide the empirical research necessary to determine whether such effects exist in the real world. The tools can also help to clarify the factors determining the answer to the last question in this list – the normative question.

Even for students who do not intend to carry out their own policy analysis and evaluations, understanding the contributions and viewpoints of economists is essential for participating in almost any policy discussion. The material in this course can be viewed as an introduction to the vocabulary and repertoire of arguments employed by economists. Furthermore, we will discuss some of the limitations and criticisms of the theory that are important for anyone involved in policy to know.

Requirements and Organization

Pre-requisites for the course include the SPGIA Math Camp (PUBP 555) (or permission of the instructor) and completion of the SPGIA math tutorials (https://schar.gmu.edu/current-students/masters-student-services/masters-101/math-for-economics) before the beginning of the semester. Neglecting mathematical preparation will make this course risky and unproductive.

Course grades will be based on the following components:
1. Homework to be solved on-line (25%)
2. Mid-term Exam (20%)
3. Policy Memo (10%)
4. Quality of class participation (5%)
5. Comprehensive Final Exam (40%)

Regular homework assignments will be made available through the virtual learning tool MyLab during the term. When this is available, you may register for Microeconomics Spring 2019:
1. Go to pearsonmylabandmastering.com
2. Under Register, click Student.
3. Enter the course ID (earle01616), and click Continue.
4. Sign in with an existing Pearson account or create an account:
   · If you have used a Pearson website, enter your Pearson username and password. Click Sign in.
   · If you do not have a Pearson account, click Create. Write down your new Pearson username and password to help you remember them.
5. Select an option (the course ID is earle01616) to access the online course:
   · Use the access code that came with your textbook or that you purchased separately.
   · Buy access using a credit card or PayPal.
   · If available, get 14 days of temporary access. (Look for a link near the bottom of the page.)
6. Click Go To Your Course on the Confirmation page. Under MyLab & Mastering New Design on the left, click Microeconomics Fall 2019 to start your work.

To keep everything together, I also use this website as the course homepage for announcements, document sharing, and discussion board. The homework tool provides a number of innovative aids, including instant feedback, the option to work through similar problems, and links to the relevant section of the E-text. It also allows multiple attempts on each question; see below. It will be much easier to do the homework if you have carefully read the relevant textbook chapters. I also recommend that you solve the problems in the Study Guide section of MyLab, many of which are similar to those in the homework; many students find it most productive to first read the chapter, next work through the relevant Study Guide, and only then turn to the homework. You may work on and discuss the homework in a group.
prior to submitting your answers, and you may also discuss them with each other using the Discussion Board I have set up on the course (MyLab) website, but – in your own interest – the answers you submit should reflect your own understanding of the question. The assignment will usually be available and you can start working for a week before the deadline.

The purpose of the homework is to help you learn the basic material and give you the opportunity to work through policy problems with actual numbers; the latter usually involves some tedious arithmetic, but this is bread-and-butter for policy economists, and even if your ambitions lie elsewhere it is valuable to have a taste of carrying out such analyses. I have organized the homework so that you are permitted 3 attempts for most questions (most open-ended questions; you are permitted only 1 for true-false, and only 2 for some multiple choice). For full credit, the homework questions must be correctly answered by the deadline each week; after the deadline you can still work but there will be a 20% penalty on each late answer (simply to provide some incentive to keep up with homework). When calculating the contribution of the homework to the final grade, I will drop the lowest score to take into account sickness, busyness, or simply a “bad week.” With this combination of permitting multiple attempts, allowing late submission with a small penalty, and dropping the lowest score, I have never given an extension on a homework assignment to any student for any reason, nor do I plan to do so in the future.

In addition to the ten “required” homework sets (including the one I will drop with the lowest score), there will also be two “bonus” homework sets that are optional and can raise (but not lower) the course grade by as much as five percentage points (2.5 points each). These bonus problems will tend to be a bit more involved, including the kinds of calculations that policy economists carry out regularly, but they are all feasible based on the material in the lectures and textbook.

The exams will include further questions to test your ability to apply the theoretical tools. To help with exam preparation and give you more opportunities with applications, sample problems will be distributed in advance, and some class time will be set aside to discuss any questions on them and to review the material. Exams are closed book, closed notes; the course involves little or no rote memorization, but emphasizes internalization of the logic. The exams are designed to last 90 minutes but you will be permitted the full class period (150 minutes). The final exam is cumulative.

The Policy Memo should be carried out in groups of 3-5 students. You must let me know your group membership in class by the fourth week of the semester; anyone unaffiliated at that point will be randomly assigned. Guidelines for the memo will be made available by the second week. The memos will be presented (10 minutes for each) at the end of the semester.

No screens (phones, tablets, laptops) may be used in class or exams.

Questions and discussion during class are strongly encouraged as is providing feedback to the instructor.

**How can you succeed in this course?**

For nearly all students, the answer is simple: “By really trying.” Many students consider PUBP 720 demanding, and some consider it extremely demanding. This is not because the material itself is extraordinarily difficult, and indeed much of it is common sense and implicit (sometimes explicit) in popular articles on economic policy issues that you have been reading all your adult lives. But for many students economic theory does involve a new way of thinking – very carefully – through the logic of an argument. We always start from careful statement of assumptions (frequently hard-to-believe) and work step-by-step to precise conclusions about behavior (usually more believable).

To become comfortable with this clear way of thinking – without ‘seems’ – requires a weekly average of at least 6-8 hours of preparation outside class for most students. For some students, 12-15 hours per
week may be necessary. This time includes reading the assigned chapter prior to lecture, reviewing notes on lectures and class discussions, re-reading – sometimes several times – the textbook, and repeatedly solving problems to test understanding. The good news is that the effort has a high payoff, for understanding economic reasoning is essential for anyone involved even tangentially in public policy, and mastering it is invaluable for anyone who aspires to be a policy maker.

One of the best bits of advice I can give you is to form a study group that meets regularly (ideally, weekly) from the beginning of the semester to discuss the material in the book, lectures, and problems. If you have difficulty finding study group partners, let me know, and I’ll try to match you with others.

The design of this course does not assume you have studied any microeconomics before. But it does assume that you are doing all of the following:

- reviewing and refreshing mathematical tools prior to and throughout the semester
- reading the book thoroughly prior to lectures in class; reviewing the material afterward
- solving homework problems and using the on-line resources regularly
- asking me questions about the material – in class, in office hours, by appointment, over email – whenever you have them
- behaving as mature graduate students who take responsibility for learning and who care much more about learning than grades (which are irrelevant for most graduate students)

The course also assumes no fluency in calculus, but you should be comfortable with the basic concepts reviewed in the “math camp” and “math tutorials.” We will use notation from calculus because it is the professional standard and anyone with an MPP should be able to understand the basic concepts. The essential mathematics needed for the course include these basic concepts plus arithmetic, basic geometry (2-dimensional graphs), and basic algebra (solving simple equations, including 2-variable, 2-equation systems). Any students doubting their preparation in these areas should remedy them as quickly as possible during this semester or postpone this course until they are remedied.

**Readings and MyEconLab**
The textbook is *Microeconomics* (2018), Robert Pindyck and Daniel Rubinfeld, Prentice Hall, 9th edition (referred to as “PR” below). The new edition is expensive, but it is fine with me if you use an earlier edition. You should check however that it is compatible with MyLab, an on-line learning tool including study guides, practice problems, and homework I will assign, as described in detail above. You will need to purchase an access code to MyLab. There is a package with an unbound version of the book and access code that is cheaper and that I will order from the bookstore, but you may be able to find a good deal for it on-line. The MyLab registration process is discussed above. Once registered, you will have access to the course website where assignments, readings, class notes, and discussion will be posted. I believe the site also permits you free access for a few weeks in case you think you might drop the course.

The subject matter of class meetings and readings will frequently overlap, and for some of the course the former will follow the latter rather closely. But they should be regarded as complements rather than substitutes in the production of knowledge in this course: this statement means that while there will be an incomplete overlap between readings and lectures, you are expected to know sections of the book that we do not have time to cover in class (if in doubt, you may always ask). Finishing the assigned reading prior to the class meeting will facilitate questions and discussion about the material.

The homework assignments, exams, and Policy Memo are also complementary: the homework is intended to help you learn the basics of the material, the exams give you the opportunity to apply and extend this knowledge, and the Policy Memo allows you to go a little deeper into a topic of your own choosing.
In case it’s useful, there are also 2 copies of the text on reserve at the Arlington Library. They may be borrowed for 2 hours at a time. To borrow a copy, you will need to give the call number (HB172 .P53 2017) and your GMU ID to the library's circulation desk.

I will also discuss some policy applications of the theory in class, sometimes using the short articles like those on the reading list below, but the choice of topics and articles will depend on current events and class progress; these articles are not “required.” Although time scarcity unfortunately implies we cannot allocate much of our time budget to the empirical details of these applications, I will expect you to understand the theoretical analysis of the policies discussed in class.

Preliminary Schedule of Topics, Readings, and Assignments (subject to revision)

Preparation
Math Review: Homework 0 (diagnostic, ungraded) due January 24
“E-ducation: A long-overdue technological revolution is at last under way,” Economist (Jun 29, 2013)

1. (January 27): What is economics? Definitions, motivations, and basic market analysis
   PR Chapters 1-2
   "Alcohol policy: On the Floor,” Economist (March 31, 2012)
   Policy applications: price controls (ceilings and floors); the minimum price for alcohol in the UK
   HW 1 (graded) due Sunday February 2 at 10 p.m.

2. (February 3): Consumer behavior
   PR Chapter 2-3
   “NJ weight threat to water quality vs. development dollars.” WaPo, Jan 5, 2014.
   Policy applications: food stamps, income taxes, housing subsidies, rationing, policy tradeoffs
   Can women (or men) “have it all”?
   HW 2 due following Sunday at 10 p.m.

3. (February 10): Demand
   PR Chapter 4 (skim 4.6; read rest carefully)
   “14 Ways an Economist Says: ‘I love you’”
   Policy applications: uses and abuses of consumer surplus in measuring the effects of policies on social welfare, the deadweight loss of Christmas
   HW 3 due following Sunday at 10 p.m.

4. (February 17): Uncertainty and Behavioral Economics
   Announce group membership in class.
Chapter 5 (skim 5.4)
Homework 4 due following Sunday at 10 p.m.
Policy applications: investing in risky projects; crime and punishment
Bonus Homework 1 available

5. (February 24): Production and costs
PR Chapters 6, 7 (skim 7.6, 7.7, and Appendix; read rest), 14.1
Policy applications: R&D tax credit, small business loans, mandated benefits, regulatory costs
Homework 5 due following Sunday at 10 p.m.
Sample midterm exam available (on website).

6. (March 2): Profit maximization and supply in competitive markets
PR Chapter 8
Policy applications: profit tax, entry barriers, do free markets minimize costs?
Homework 6 due following Sunday at 10 p.m.
Midterm review

SPRING BREAK (March 9)

7. (March 16): Midterm exam

8. (March 23): Competitive market analysis
PR Chapter 9, 14.2
“Milking the farm bill for far too long.” By Charles Lane, WaPo, December 17, 2013.
Video on Gov. Walker’s “Kohl’s Curve” and “Laffer Curve”: http://video.wpt.org/video/2365538452/
Policy applications: tax and subsidy incidence, energy subsidies, tariffs and quotas, quantity controls, transactions in human organs, export restrictions
Homework 7 due following Sunday at 10 p.m.

9. (March 30): General equilibrium and welfare
PR Chapter 16
Policy applications: international trade, conditions for free markets to achieve Pareto efficiency
Bonus Homework 2 available.

NO CLASS (April 6)

10. (April 13): Imperfect competition in output and input markets
   PR Chapters 10, 11 (focus on 11.1 and 11.2), 14.3-4
   “That turkey on your plate could use some more industry competition.” *WaPo*, Nov 22, 2013.
   Policy applications: antitrust, mergers and acquisitions, regulation
   Homework 8 due following Sunday at 10 p.m.

11. (April 20): Externalities and public goods
   PR Chapter 18 (skim 18.3 and 18.7; read rest)
   “Infrastructure funding: Roads less travelled.” *Economist* (Oct 19, 2013)
   “Climate change: While Congress sleeps, Barack Obama offers stopgap measures to slow global warming.” *Economist* (June 29, 2013)
   Policy applications: pollution, congestion, public transport, theory of the “2nd best”
   Homework 9 due following Sunday at 10 p.m.

12. (April 27): Asymmetric information
   PR Chapter 17
   Sample final exam distributed
   Policy applications: health insurance, incentive pay in public and private organizations
   Homework 10 due following Sunday at 10 p.m.
   Deadline for optional submission of draft Policy Memo to receive comments: April 28, 10 pm

13. (May 4): Presentations of Policy Memos and Final Review
   Policy Memo due Dec 2 at noon.
   Possible topic make-up.
   Review for final exam
   Bonus homework 2 due following Sunday at 10 pm

15. Final exam (May 11, in class)

Other readings
Academic Accommodation for a Disability
If you are a student with a disability and you need academic accommodations, please see me and contact the Disability Resource Center (DRC) at (703) 993-2474. All academic accommodations must be arranged through the DRC as early as possible in the term.

Schar School Policy on Plagiarism
The profession of scholarship and the intellectual life of a university as well as the field of public policy inquiry depend fundamentally on a foundation of trust. Thus any act of plagiarism strikes at the heart of the meaning of the university and the purpose of the Schar School. It constitutes a serious breach of professional ethics and it is unacceptable. Plagiarism is the use of another’s words or ideas presented as one’s own. It includes, among other things, the use of specific words, ideas, or frameworks that are the product of another’s work. Honesty and thoroughness in citing sources is essential to professional accountability and personal responsibility. Appropriate citation is necessary so that arguments, evidence, and claims can be critically examined. Plagiarism is wrong because of the injustice it does to the person whose ideas are stolen. But it is also wrong because it constitutes lying to one’s professional colleagues. The faculty of the Schar School takes plagiarism seriously and has adopted a zero tolerance policy. Any plagiarized assignment will receive an automatic grade of “F.” This may lead to failure for the course, resulting in dismissal from the University. This dismissal will be noted on the student’s transcript. For foreign students who are on a university-sponsored visa (eg. F-1, J-1 or J-2), dismissal also results in the revocation of their visa. The policy on plagiarism is supplementary to the George Mason University Honor Code; it is not intended to replace it or substitute for it.