

# ECONOMICS 120

## ECONOMICS OF THE PUBLIC SECTOR

Winter 2000

Professor Demmert

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### COURSE DESCRIPTION

This course focuses on the economic role of the public sector (i.e., government) in a market economy. This role includes government provision of certain "public" goods and services (either as a direct producer or as an intermediary source of tax-based financing) and regulation of private market activity. The latter include the regulation of natural monopoly (e.e., public utilities), regulations affecting competitive conditions (antitrust), and environmental regulation. We conclude with an economic analysis of the democratic political process. In all of this, we shall be concerned with both the *normative* question of what government *should* do and the *positive* question of how and why government *actually does* what it does.

Our perspective will be that of microeconomics. Throughout the course we will use microeconomic tools and concepts such as demand and supply analysis, cost curves, consumers' and producers' surplus, etc. Consequently, *Microeconomics 014 or 012 or my special permission is a prerequisite.*

### READING

The main text for the course will be *Public Finance: Theory and Practice* by Michael L. Marlowe. It will be supplemented by a paperback, *Beyond Politics: Markets, Welfare, and the Failure of Bureaucracy* by William C. Mitchell and Randy T. Simmons, both of whom are political scientists. Reading assignments from both sources (abbreviate as PF for *Public Finance* and BP for *Beyond Politics*) are listed on the course outline which follows. There will also be a few other articles in a readings packet that will be available at Copy Craft.

My lectures do not duplicate the material in these readings, nor are they intended to. However, the general topics are the same and the order of the reading assignments conforms, more or less, to the order in which we cover topics in class.

## HOMEWORK

I will distribute a packet of homework problems that apply the material developed in class. I will announce when each is due when I assign it and I will review the solution in class at the time each is turned in. (If the homework takes you more than one page, you should staple the pages together--no paper clips, no origami folded corners, please. If you don't have a stapler, invest in one now.) Each homework will be graded on a 5 point scale and the total number of possible homework points will be a little less than the number of points on a midterm exam. I have no objection to your working together on homework assignments--indeed, I encourage it--but if you simply copy someone else's homework, I can almost guarantee that you will be unable to do the similar problems on the exams.

**The homework must be completed and turned in on time.** At the end of the course, I will deduct 1/3 of a grade (e.g., from a B to a B- in the course) for each missing homework assignment. The penalty for lateness will be half that for missing the assignment completely.

## EXAMS

There will be a two midterms and a final. The questions will be essay questions and numerical problems similar to the homework (but shorter due to obvious time constraints on exams).

If, for good reason, you cannot take an exam as scheduled, I expect to be notified in advance. I will not reschedule an exam without a prior, approved excuse.

## COURSE OUTLINE

### I. Introductory material: the public sector and the private sector

*Reading: PF, Ch. 1,2*

### II. The analytical framework

- A. Normative criteria
- B. Basic benefit-cost analysis
- C. Competitive markets and economic efficiency
- D. Some applications

*Reading: PF, Ch.3 (skip appendix)*

### III. Why government?

- A. The "minimal state": government as protector of rights
- B. Government as a solution to "market failure"

- C. The logic of collective action
  1. Low transactions costs and voluntary collective action
  2. High transactions costs and the role of government

*Reading:* BP, Ch. 1, 2

- IV. An introduction to public choice theory
  - A. The political marketplace and political exchange
    1. Citizen-voters, elected officials and government bureaucrats as economic agents
    2. Rent seeking behavior
  - B. Political market failure
    1. Rational ignorance and rational abstention
    2. Interest groups versus the public interest
    3. The political time horizon
    4. The basic economics of bureaucracy

*Reading:* PF, Ch. 6, 7 (pp. 200-210), 8  
BP, Ch. 3, 4, 6, 7

\*\*\*First Midterm Exam\*\*\*

- V. Externalities and public policy: Pollution control and environmental regulation
  - A. Externalities and the absence of property rights
  - B. Alternative public policies for dealing with externalities
    1. Direct regulation: "command and control"
    2. Pollution taxes
    3. Marketable pollution rights

*Reading:* PF, Ch. 4 (skip appendix)  
BP, Ch. 9  
Stavins, "What Can We Learn from the Grand Policy Experiment? Lessons from SO<sub>2</sub> Allowance Trading" *Journal of Economic Perspectives*, Summer 1988 (in readings packet)

- VI. Public goods and collective consumption
  - A. Pure public goods
  - B. Median voter model of public goods provision
  - C. Quasi-public goods and the economics of congestion
  - D. Private provision of public goods

*Reading:* PF, Ch. 5, 7 (pp. 187-92 on median voter model)  
BP, Ch. 5

Shliefer, "State versus Private Ownership" *Journal of Economic Perspectives*, Fall 1998 (in readings packet)

\*\*\*Second Midterm Exam\*\*\*

- VII. Government regulation of the market
- A. Regulated monopolies: public utilities
  - B. Other regulated industries
  - C. Antitrust: government vs. Microsoft
  - D. Theories of regulation
  - E. Government and the health care industry

Reading: PF, Ch. 13

BP, Ch. 6, 8

Keeler and Foreman, "Regulation and Deregulation" from *The New Palgrave Dictionary of Economics and the Law* (in readings packet)

Winston, "U.S. Industry Adjustment to Economic Deregulation" *Journal of Economic Perspectives*, Summer 1998 (in readings packet)

DeLong, "The New Trustbusters: What's behind the resurgence of antitrust activism—and why it's bad for consumers" *Reason* March 1999

- VIII. Voting and political decisions
- A. Choosing collective decision rules
  - B. Collective choice in direct democracy
    - 1. Some economics of majority rule
    - 2. Other voting rules and their economic implications
  - C. The Arrow paradox
  - D. Economic analysis of some problems of democratic politics
  - E. An economic theory of constitutions

Reading: PF, Ch. 7 (remainder)

BP, Ch. 12, 13

Neimi & Riker, "The Choice of Voting Systems," from *Scientific American*, June 1976