Unit Outline*

ECON7405

Public Economics

Semester 2, 2011
Campus: Crawley

Unit Coordinator
Associate Professor Paul McLeod

Business School
www.business.uwa.edu.au

* This Unit Outline should be read in conjunction with the Business School Unit Outline Supplement available on the Current Students web site http://www.business.uwa.edu.au/students
UNIT DESCRIPTION

Introduction
Welcome to Public Economics 7405 and to the world of public economics and policy. This course builds on conventional microeconomics and welfare economics theory to develop the theoretical and applied tools required in modern public policy economics.

Unit content
The basic theory of welfare economics, Pareto Optimality and resource allocation efficiency are the building blocks for this subject. Much of this will already be familiar to students who have undertaken previous economics studies such as third year Microeconomics. For students who have not had the same exposure, this material will be reviewed in the first part of the course and the associated reading will allow the core theory to be developed to an appropriate level.

Beyond the review of economic principles, the main focus of the course will be specific issues in public economics and the models that have been developed to analyse these and evaluate the associated policy initiatives. These include: income distribution and equity, externalities and public goods, optimal taxation, asymmetric information and monopoly regulation.

Particular applications of the theory will be developed as each topic is discussed. Some case studies will be used to further understanding of the role of economics in policy.

The goal of the unit
The course is designed to ensure that participants have an understanding of the economic theory that is the basis for the role of Government policy in a market economy. The course does this in three ways.

First an in depth analysis of the theory of welfare economics; Pareto optimality, resource allocation efficiency, market failure and the theory of second best, social welfare functions and distributive justice. This will develop an understanding of the theoretical basis for policy intervention and an understanding of the issues relating to our ability to define optimal policy interventions.

Second an analysis of the principles and techniques of cost benefit analysis. This is the dominant framework used in assessing policy options designed to achieve increases in social welfare. It is now a requirement in many jurisdictions that a cost benefit analysis be undertaken as part of any change to legislation and policies and as part of the case for introducing new legislation, regulation and policies.

The third part of this course is designed to enhance understanding of the welfare theory foundations developed in part one and the cost benefit analysis of part 2 through the investigation of various topics relating to the application of the theory. The applications will draw on basic welfare economics theory, theories of externalities, public goods, welfare change measurement and regulation to allow a fuller understanding of the economics approach to developing and assessing policy interventions.

Learning outcomes
- An understanding of the basic Pareto model of efficient resource allocation, and the way that this underpins economic thinking in formulating and evaluating public policy;
- An understanding of market failure and of government failure in achieving the most efficient allocation of resources and of the role that both government and markets can play in implementing appropriate policy solutions;
- An understanding of the role that cost benefit analysis and the valuation of non market benefits and costs plays in policy decisions;
• An understanding of the trade off between equity and efficiency in formulating public policy; and based on this knowledge:
• An ability to identify classes of public policy problem and to match the appropriate theory to the problem in the design of appropriate policy solutions.

Educational principles and graduate attributes

The study of Public Economics in this unit will provide you with an opportunity to:
• “Critically evaluate a range of public policies”;
• “Develop skills in identifying classes of public policy problem and selecting the appropriate theory to use in the design of appropriate policy solutions”;
• “Write analytically on the application of economic theory to a current public policy problem”.

TEACHING AND LEARNING RESPONSIBILITIES

Teaching and learning strategies

Beside lectures, the main learning instrument in this course is the essay where you will have an opportunity to develop your interpretative and analytical skills in public economics.

The essay is to be chosen from a number of topics that will be provided to you during the third week of class.

The topics will be of an applied nature. The idea of the essay is to allow students to demonstrate how well they have mastered the application of economic theory to the nominated policy area. In particular the essay will require you to:
• Select an applied topic (eg voting as a basis for policy formulation);
• Choose an appropriate theoretical construct (eg. Arrow theorem and related models);
• Demonstrate why the chosen theory is appropriate; and
• How it can be used to develop policy solutions to dealing with the nominated problem;
• How it has been applied in designing policy solutions dealing with the nominated problem.

The list of topics provided are suggestions. You will also be free to nominate a topic of your choice but approval for the nominated topic will be required. If you nominate your own topic, the exact topic must be agreed with me prior to commencing work on the essay.

Note: Results may be subject to scaling and standardisation under faculty policy and are not necessarily the sum of the component parts.

Teaching and learning evaluation

You may be asked to complete two evaluations during this unit. The Student Perception of Teaching (SPOT) and the Students’ Unit Reflective Feedback (SURF). The SPOT is optional and is an evaluation of the lecturer and the unit. The SURF is completed online and is a university wide survey and deals only with the unit. You will receive an email from the SURF office inviting you to complete the SURF when it is activated. We encourage you to complete the forms as your feedback is extremely important and can be used to make changes to the unit or lecturing style when appropriate.
Attendance

Participation in class, whether it be listening to a lecture or getting involved in other activities, is an important part of the learning process. It is therefore important that you attend classes. More formally, the University regulations state that ‘to complete a course or unit students shall attend prescribed classes, lectures, seminars and tutorials’. Students should not expect to obtain approval to miss more than two classes per unit unless there are exceptional circumstances.

CONTACT DETAILS

We strongly advise students to regularly access their student email accounts. Important information regarding the unit is often communicated by email and will not be automatically forwarded to private email addresses.

<table>
<thead>
<tr>
<th>Unit coordinator/lecturer</th>
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<tbody>
<tr>
<td>Name: Paul McLeod</td>
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<tr>
<td>Email: <a href="mailto:paul.mcleod@uwa.edu.au">paul.mcleod@uwa.edu.au</a></td>
<td></td>
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<tr>
<td>Phone: 6488 2498</td>
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<td>Consultation hours: TBA</td>
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<td>Lecture times: Please check: <a href="http://www.timetable.uwa.edu.au">http://www.timetable.uwa.edu.au</a></td>
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<td>Tutorial times: <a href="http://www.olcr.uwa.edu.au/">http://www.olcr.uwa.edu.au/</a></td>
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TEXTBOOK(S) AND RESOURCES

Unit website

A variety of material for the course will be made available through WebCT. This will include;

- Reading lists for each topic;
- Essay topics and guide;
- Reading material in PDF format;
- Lecture slides (powerpoint or other).

All students in Public Economics (ECON7405) will be authorised for the site. You access WebCT via http://www.webct.uwa.edu.au using your WebCT student login and the course should be available to you.
Recommended/required text(s)

There will be chapters from this book prescribed for nearly all sections of the course.

Additional resources and reading material

We will also use material from:


This is an advanced welfare economics book with excellent coverage. It is out of print. Photocopies of the relevant chapters will be available for reading.

A useful supplementary text is;


Students are encouraged to review basic work on Pareto optimality and resource allocation from a standard microeconomics text such as:


For the cost benefit section we will use material from


For some models and for Australian policy information we will draw on parts of


This book has an extensive coverage of Australian public policy areas.

We rely on journal articles and government reports to supplement the basic theory covered in Boadway and Bruce and related texts. Most of these will be accessible through online data bases such as www.jstor.org which you can access via the Library. The implementation of almost all public policy occurs via legislation and in this regard law and economics become very closely associated. A major source of reviews for many topics covered in the course is the Encyclopaedia of Law and Economics and we will use several reviews from it. The encyclopaedia can be found at http://encyclo.findlaw.com/index.html.
<table>
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<tr>
<th>Week #</th>
<th>Topic</th>
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| 1      | Introduction to Welfare Economics: Pareto Optimality and the Pareto Criterion  
Pareto criterion defined  
production and consumption efficiency  
product mix efficiency  
top order conditions and the efficiency of perfect competition |
| 2      | Theories of the Public Sector  
rationale for Policy and Government Involvement |
the compensation principle  
the reversal paradox  
intransitive rankings  
introduction to social orderings and the social welfare function |
| 4      | Political Economy I: Social Welfare Functions, Fairness and Distributive Justice  
optimality and comparability  
types of social welfare function  
arrows's impossibility theorem  
Rawl's theory of justice |
| 5      | Political Economy II: Voting  
impossibility  
majority rule  
paradox of voting  
rent seeking |
| 6      | Public Goods  
market failure and the theory of second best  
criteria for defining a public good  
optimal provision  
funding  
Club Goods  
single product clubs  
clubs and the economy  
local public goods |
| 7      | Externalities  
classifications and consequences of externalities  
externalities as an absence of markets  
space and non convexity in the theory of externalities  
externality policy and climate change |
| 8      | Imperfect Competition, Monopoly Pricing and Regulation  
trade practices legislation  
monopoly price regulation and the application of RPI-X and rate of return price controls in regulated monopolies  
electricity and gas price regulation |

**STUDY BREAK**  
26 September – 30 September
Optimal Taxation
  income taxation
  commodity taxation

Asymmetric Information
  screening, signalling and moral hazard
  health Policy

Inequality and Poverty
  measuring income and inequality
  equivalence scales
  poverty measures

Fiscal Federalism
  multi level government
  efficiency versus stability
  risk sharing

**ASSESSMENT MECHANISM**

**The purpose of assessment**

There are a number of reasons for having assessable tasks as part of an academic program. The assessable tasks are designed to encourage you to explore and understand the subject more fully. The fact that we grade your work provides you an indication of how much you have achieved. Providing feedback on your work also serves as part of the learning process.

**Assessment mechanism summary**

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<tr>
<th>Item</th>
<th>Weight</th>
<th>Due date</th>
<th>Remarks</th>
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<tbody>
<tr>
<td>Essay</td>
<td>30%</td>
<td>TBA</td>
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</tr>
<tr>
<td>Final exam</td>
<td>70%</td>
<td>TBA</td>
<td>3 hours</td>
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**Note 1:** Results may be subject to scaling and standardisation under faculty policy and are not necessarily the sum of the component parts.

**Note 2:** Your assessed work may also be used for quality assurance purposes, such as to assess the level of achievement of learning outcomes as required for accreditation and audit purposes. The findings may be used to inform changes aimed at improving the quality of Business School programs. All material used for such processes will be treated as confidential, and the outcome will not affect your grade for the unit.

**Assessment components**

The nominated essay topic is designed to allow you to undertake an evaluation of a policy. The focus is the application of relevant economic theory to the policy problem. Marking will be based around how well you have mastered the application of economic theory to a public policy problem and how well the theory is integrated into the analysis.

In particular the essay will require you to:
- Select an applied topic and choose the appropriate theoretical construct for its analysis;
- Demonstrate why the chosen theory is the most appropriate;
• Demonstrate how it can be used to develop policy solutions for dealing with the nominated problem; and
• Illustrate how it has been applied in designing policy solutions dealing with the nominated problem.

**Note:** Results may be subject to scaling and standardisation under faculty policy and are not necessarily the sum of the component parts.

**Submission of assignments**

Essays are lodged online through the WebCt course page.

**Student Guild**

Phone: (+61 8) 6488 2295  
Facsimile: (+61 8) 6488 1041  
E-mail: enquiries@guild.uwa.edu.au  
Website: [http://www.guild.uwa.edu.au](http://www.guild.uwa.edu.au)

**Charter of Student Rights and Responsibilities**

The Charter of Student Rights and Responsibilities outlines the fundamental rights and responsibilities of students who undertake their education at UWA (refer [http://handbooks.uwa.edu.au/undergraduate/poliproc/policies/StudentRights](http://handbooks.uwa.edu.au/undergraduate/poliproc/policies/StudentRights)).

**Appeals against academic assessment**

The University provides the opportunity for students to lodge an appeal against assessment results and/or progress status (refer [http://www.secretariat.uwa.edu.au/home/policies/appeals](http://www.secretariat.uwa.edu.au/home/policies/appeals)).