

**School of Public and Environmental Affairs
Indiana University**

**V517: PUBLIC MANAGEMENT ECONOMICS
Fall 2004, Section 10983,
Monday and Wednesday 4:00-5:15pm
PV278**

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COURSE DESCRIPTION

This course focuses on applications of the principles and concepts of intermediate microeconomic theory to public sector management decisions and policy analysis. This is a course that is designed to help current and prospective professional managers and practitioners in the public, private and non-profit sectors address real-world issues and problems from an economic perspective.

The following topics will be considered in this course: consumer theory and demand analysis, the theory of production and cost analysis, the theory of markets and distribution, market failure and cost-benefit analysis, etc. A combination of theory on the one hand with application on the other using case studies and empirical materials and problems based on real-world situations demonstrates to students the power of microeconomics theory as an aid to decision-makers in the private, public and nonprofit sectors of the economy.

REQUIRED READINGS

The required texts are *Managerial Economics: Applications, Strategy, and Tactics* (Ninth edition) by McGuigan, Moyer, and Harris, and a packet of case studies available at the bookstore. There also is a website for the textbook that has information and materials you may find useful. The URL is <http://mcguigan.swcollege.com>. In addition, regular reading of *The Economist* is required. *The Economist* provides a British perspective on current events throughout the world in the public, private and non-profit sectors and frequently makes uses of applied economics to provide insight into these events. Their web address is <http://www.economist.com>. You can order *the Economist* using a credit card by visiting www.EconomistAcademic.com. It is also possible to sign up in class and pay by check. If you choose not to subscribe, issues are usually available at the Main Library. We

will draw on examples from *The Economist* in class discussions.

Case studies are an integral part of the course. They allow you the opportunity to apply economic concepts to real-world issues. The Nicholson text, problems, and lectures provide a foundation of microeconomics principles, but it is the application of those principles in a policy and management context that is the main objective of this course. Thus, six case studies are assigned and are a key element of the course. The purpose of the case studies is to give students an opportunity to recognize the economic dimensions inherent in the public policy problems they may face and to develop an analytical problem solving orientation.

COURSE SCHEDULE

Aug. 30	Introduction and Overview Chapters 1 & 2
Sept. 1	Basic Concepts and Application and Mathematics Tools web chapter A http://www.swcollege.com/bef/mcguigan/mcguigan9e/mcguigan9e.html
Sept. 6	Individual Tastes and Demand Appendix 3A
Sept. 8	Demand Analysis Chapter 3
Sept. 13	Elasticity and Market Demand Applications Chapters 3 & 4
Sept. 15	Production Analysis Chapter 7
Sept. 20	Quiz One Chapters 1-4, Appendix 3A
Sept. 22	Cost Analysis Chapter 8
Sept. 27	Applications of Cost Analysis Chapter 9
Sept. 29	Profit Maximization and Supply Chapters 9 & 10
Oct. 4 & 6	Pure and Monopolistic Competition Chapter 10
Oct. 11 & 13	Monopoly Chapter 12
Oct. 18	Quiz Two Chapters 7-10
Oct. 20	Oligopoly and Imperfect Competition Chapter 13
Oct. 25	Case Study 1: California Water Pricing
Oct. 27	Pricing Techniques and Analysis Chapter 16

Nov. 1	Case Study 2: Avon Corporation
Nov. 3	Government Regulation Chapter 17
Nov. 8	Application: Taxation, Government Subsidy, and Economic Development Policies
Nov. 10	Case Study 3: Competitive Bypass of Pacific Gas and Electric
Nov. 15	Quiz Three Chapter 12-13, 16-17
Nov. 17	Economic Externality and Market Failure Appendix 17A
Nov. 22	Case Study 4: Department of Transportation and Airport Landing Slots
Nov. 24	Thanksgiving Recess (No class)
Nov. 29	Case Study 5: Champion International Corporation
Dec. 1 & 6	Investment/Cost-Benefit Analysis Chapter 18
Dec. 8	Case Study 6: Saving the Tuolumne
Dec. 17 (Friday)	Final Examination 5:00pm - 7:00pm (Comprehensive final)

COURSE REQUIREMENTS AND GRADING

There will be three quizzes, six case memos, journals, and a comprehensive final examination. The course grade in V517 is based on the points received on each of the activities given the weights as shown below.

Quizzes	(best two out of three)	30%
Case Memorandums	(best five out of six)	30%
Journals		10%
Final Examination		30%

Quizzes and Exam: There will be three quizzes during the semester and a comprehensive final examination. The quizzes and exam will consist of problem-solving questions, multiple choice and true-false questions. This course moves at a fast pace and you will be expected to have read the referenced chapters prior to the classes on the topics. You should

work out the problems at the end of the chapters. In addition, you will also be responsible for four problem sets I will pass out. It is to your advantage to work through the problem sets on a timely basis because they will form the basis for quizzes and exams. The problem sets, along with brief answers can be found on the Oncourse page. You will find Oncourse at <http://oncourse.iu.edu/bl/>. You might want to take a tour or look at FAQ at <http://oncourse.iu.edu/help/>.

Journals: A critical element in the course is applying the economic concepts covered in lectures, the problems, and the case studies to real world situations as they emerge. A measure of how well each student makes the connection between these concepts and real world events will be the journal each class participant submits on the last day of class (**December 8, 2004**). The journal must contain, at a minimum, ten entries that explain how an article (or portion of an article) uses a concept or concepts presented in this course. The articles may be drawn from a wide variety of sources, including *The Economist*, *The Wall Street Journal*, *U.S. News & World Report*, etc. At least three of the articles must be from *The Economist*. The journal entry will include a proper bibliographical citation for the article, a brief (one or two paragraph) explanation how the article is relevant to a concept or concepts covered in the course, and a photocopy of the relevant article with the pertinent portion of the article highlighted. Each journal entry must involve a separate article. Your grade on the journal will be based on how well you explain the economic concept covered, using the correct citation form, etc. In addition, the number and quality of your entry choices will be compared to other class participants' entries. Part of your grade will be based on how well your choices "compare" to those of your peers.

The Case Memorandums and Case Discussions: Each student will be expected to analyze each of the six cases and be prepared to discuss each in detail in class. Each student will also prepare a written case memo for each of the cases. **Case memos are to be typed, double spaced, and no longer than one page** (They should also be 12 pt font and have 1 inch margins). The focus of the memo should be on the decision to be made or the action to be taken by the principal person in the case. The opening sentence of the memo should present the recommendation with the remainder of the memo providing justification regarding why that recommendation is the best course of action. You may attach additional pages that contain appendices, tables, calculations, etc. However, the one page memorandum must be able to "stand on its own."

Each case will be discussed during a designated class period. All students will be expected to thoughtfully participate in the discussion and be prepared to share his/her analysis or approach with fellow students during the discussion. Students are encouraged to work with other members of the class to discuss and analyze the cases. However, each student should prepare her or his case memorandum individually and must fully understand the process used to arrive at the recommendation.

There are specific grading guidelines for each case study that will be used to grade the memorandums. The grading scale follows:

0 points	no memorandum handed in or memorandum handed in late
1 point	memorandum is not satisfactory
2 points	memorandum is satisfactory
3 points	memorandum is above satisfactory

You will hand in the memos in class the day the case is discussed. **No late memorandums will be accepted.**

CASE STUDIES

The case studies in the TIS Reader describe real situations in which a public or private decision maker must sift through often voluminous information in order to determine which course of action is most appropriate. Each case is self-contained and do not require any outside reading or research to supplement the information provided. Each case study is different and there is no single approach that will always be effective. Nevertheless, there are some questions that should help focus your thinking.

Who are the principal actors in the case?

What are the long run goals of each?

What are the short run incentives of each?

How is each rewarded?

What are the options available?

What is the decision to be made?

Are the apparent constraints really constraints or might some be loosened?

Are the long run alternatives different than those in the short run?

What are others likely to do in response to each alternative?

What are the advantages and disadvantages of each option?

Which are quantifiable?

What bounds can you put on those that are not quantifiable?

Can the problem be broken into several simpler problems?

Finally, unlike the assigned problems, there is no unique "right" answer. Usually there are several different approaches to solving the problem. Some of these differing approaches may be equally valid while others may be less valid.

The questions below are designed to raise some of the questions you might find it useful to think about in developing your recommendation.

Case 1: California Water Pricing

1. How should water be priced in California? (Your recommendation)
2. If the current pricing scheme is to be changed, how should the changes be implemented?
3. Which farmers would be most severely damaged by significantly higher prices for water?
4. Which crops and which regions of California would be most affected by a change in the pricing of water?
5. Marginal cost pricing will most likely cause a shift of water usage away from

agricultural pursuits toward urban uses. Is such a shift appropriate? Why?
6. If farmers were allowed to sell the water they are using on the open market, how would this compare to marginal cost pricing?

Case 2: Avon Corporation

1. What is Avon's position in the market?
2. How would you compare Avon's new EAS with the other types already in the market?
3. What principle does economic theory suggest Avon should use in setting the price?
4. *What price should Avon charge? (Your recommendation)*
For simplicity's sake, assume returns on investment and accounts receivables are included in manufacturing costs.

Case 3: Competitive Bypass of Pacific Gas and Electric

1. What is bypass?
2. Why did Congress decide to encourage cogeneration?
3. How did PURPA encourage cogeneration and bypass?
4. How big is the difference between rates cogenerators are being paid by PG&E and the rates PG&E charges its own customers?
5. What are the major arguments in favor of encouraging cogeneration? What are the major arguments against encouraging cogeneration?
6. Use evidence from the case to evaluate these arguments in the case of PG&E.
7. What avoided cost rates should PG&E pay to cogenerators? Would your answer change if you expected a surge in demand for electricity?
8. Should the CPUC continue to encourage cogeneration?
9. How should PG&E respond to CPUC's decision (Your recommendation)?

Case 4: The Department of Transportation and Airport Landing Slots

1. Should Secretary Dole accept the FAA's recommendations to strengthen scheduling committees or instead establish a market for slots? (Your recommendation)
2. If you support a market for slots, what form should the market take?
3. How do you evaluate the arguments that a market in slots will reduce competition and service to small communities?
4. What are the purposes of establishing a market in slots and what do they imply for the form or design of that market?

Case 5: Champion International Corporation: Timber, Trade, and the Northern Spotted Owl

1. How do you explain the government's intervention in the Northwest timber markets?
2. Do you think this is good policy?
3. Is Champion making any money in its western mills?
4. Is forestry a good investment at Kapowsin?

5. How does the owl change the economics of tree farming?
6. What have the government's actions in this case done to the market for forest products in the Northwest?
7. What are Champion's options in both the short and long term?
8. How should the company respond (your recommendation)?
9. To whom is the company responsible?

Case 6: Saving the Tuolumne

1. What are the advantages of the Clavey-Wards Ferry project?
2. What constitutes the value of the Tuolumne River in its pristine state? Can all of these factors be quantified? If not, how does this impact the analysis?
3. What are the strengths and weaknesses of the EDF analysis? What parts of the analysis "drive" the conclusions?
4. Should all the issues raised by the case be quantified? If not, how should you treat these non-quantifiable items?
5. Should the proposed hydroelectric development on the Tuolumne be allowed? (Your recommendation).

In analyzing cases, there are several mistakes that are commonly made. One common mistake is to make recommendations that are too general. The recommendations need to be as specific as possible. The more specific the recommendation, the easier it will be to see the advantages and disadvantages of the chosen course of action. A second common mistake is to make recommendations or statements that are not supported by facts provided in the case. A third common mistake is to believe analysis is not necessary to make a recommendation. In fact, almost all of the cases will involve using economic principles and require data manipulation. Analysis of a case is **INCOMPLETE** without these components. Finally, don't forget what you are trying to accomplish with the memorandum. Do not include extraneous sentences or ideas. Your memorandums should **always** address the question of what the principal actor in the case should do. Delaying a decision is **never** a good recommendation in this course.