SEEK 470:  
PUBLIC ECONOMICS FOR BUSINESS LEADERS  

Spring Quarter 2008 Syllabus: Section 81  

Kellogg School of Management  
Northwestern University  
Spring Quarter 2008  

Tuesday, 6:30 – 9:30 p.m., Evanston Campus  

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Course Overview and Goals:

- **Externalities and Environmental Policy:** In early February 2007, the Intergovernmental Panel on Climate Change of the United Nations issued a report concluding unequivocally that global warming was occurring. The panel further stated that it was 90 percent certain that global warming was being driven by human activity resulting in heat-trapping greenhouse gases. Given this background, why then have power plants and other heavy industrial facilities located in the European Union been allocated permits to emit carbon dioxide (the most important greenhouse gas)? And why have the owners of these power plants and factories been given the right to profit from these permits by selling them in an open market?

- **Public Provision and Education Policy:** Since the 1970s, states have been increasingly involved in equalizing revenues for elementary and secondary education across localities. Beginning with Minnesota in 1991, states have also passed charter school laws authoring the establishment of alternative public schools to increase parental choice. More recently, federal intervention has risen to unprecedented levels through the No Child Left Behind legislation. Why has provision of elementary and secondary education been shifting away from traditional locally-funded neighborhood schools? Has student achievement improved since these state and federal interventions?

- **Insurance Market Failures and Health Care:** The rapid rise in medical spending and concerns about rising pools of uninsured have made health care reform a hotly debated campaign issue. All of the major Democratic candidates for the Presidency have proposed reforms requiring employers to either provide coverage to employees or cover the costs of coverage. For anyone not insured by their employer, the government would create purchasing pools to ensure the availability of reasonably-priced insurance, subsidizing the costs for lower income individuals. Republican candidates prefer expanding choice and competition in the market, breaking the link between employment and coverage, and enhancing the subsidies available through the tax code. Why is government intervention in this market needed? What are the pros and cons of the various proposals?

- **Insurance Market Failures and Social Security:** The Social Security program faces an impending fiscal crisis. Why is the federal government involved in providing pensions and what is the nature of the crisis? In what ways should the program be reformed?

- **Taxation and Federal Tax Reform:** Since the President’s Advisory Panel on Tax Reform submitted its report in November 2005, there has been renewed attention to the need to make the federal tax code simpler, more equitable, and more supportive of economic growth. The two plans proposed by the Panel were designed to meet these goals, with one revamping the income tax and the other representing a partial move to a consumption tax. Why were the proposals designed by the experts pronounced DOA?
Leaders in business firms, not-for-profit organizations, and government agencies need to be knowledgeable about public policy to be effective. It may seem obvious that this would be a requirement for leaders in the public sector, and it is plausible that leaders of not-for-profits or NGOs would also need to be well informed on the public policy issues of the day. But why do business leaders need to know anything about public policy?

Public policy choices, whether in the area of environmental policy, education or health insurance, can have an important impact on a firm’s shareholders and its employees. Some of these impacts are fairly clear, sometimes they are more subtle. When firms are directly affected by a particular public policy, well-informed leaders are able to frame the issues that will affect their business within the broader context to more productively educate the public and Congress. Even if firms are not directly affected, the opinions of business leaders are often solicited. In light of this, an ability to discuss public policy with intelligence and clarity is an essential part of leadership training. Having a framework to think about public policy questions can give you an important leg up in doing your job.

The purpose of this course is to give you the knowledge, frameworks, and tools that you need to:

- Understand why markets may “fail” and why government intervention may be needed.
- Identify the array of possible public solutions to society’s problems.
- Evaluate the costs and benefits of alternative public policy options.

Public finance is the branch of economics that deals with the questions of when and how government should intervene in the private marketplace and how government interventions affect economic outcomes.

**Prerequisites:** MECN 430 (Microeconomic Analysis) is a prerequisite for this course. Public finance is built on the foundation of microeconomics, the material you studied in MECN 430. Much of the economics you will study in this course will be familiar from MECN 430. However, there will also be new microeconomic theory taught in the class.

**Textbook and Readings**

- Case packet of readings.
- Additional required readings may be handed out in class.
- Supplementary readings and support materials will be provided on the course Blackboard web site.
Grading

Grades will be based on participation in class discussions and activities, 4 brief policy position reports, a midterm exam, and a final exam. There are 200 possible points, divided up as follows:

1. Class participation in discussion/in-class activities ........................................... **10 points (5%)**
2. Policy position reports ........................................................ (15 points per report) **60 points (30%)**
3. Midterm Exam ......................................................................................... **60 points (30%)**
4. Final Exam ................................................................................................. **70 points (35%)**

TOTAL POSSIBLE POINTS .................................................................................. **200 points (100%)**

Policy position reports

Four times during the quarter, you will be randomly assigned to either support or oppose a specific public policy. You will be asked to write a one-page report (single-spaced) outlining justifications for your assigned position and providing supporting evidence. These one-page reports are due at the beginning of class on the assigned dates. By virtue of having written these reports, there should be a high level of engagement and a rich discussion in class.

Midterm and final exams

The exams will be closed-book/closed-notes exams. Each exam will consist of true-false questions, problems, and essay questions. The midterm will take place during the first 90 minutes of class on **Tuesday, May 6**. It will cover material from the first five weeks of the course. The final will take place during finals week at a day and time to be determined. The final will be written to take 2 hours. It will be cumulative, but skewed in coverage toward the last five weeks of the course. More information about the exams will be made available as the dates approach.

Class Etiquette

Students are expected to adhere to the general principles of Kellogg’s Classroom Etiquette Policy, as described on page 21 of the Policies and Procedures manual for Kellogg students: [http://www.kellogg.northwestern.edu/stu_aff/images/PoliciesProcedures08.pdf](http://www.kellogg.northwestern.edu/stu_aff/images/PoliciesProcedures08.pdf).

Specific adjustments to this policy for this class are listed below:

- If other commitments cause you to arrive late or leave early, please let me know ahead of time by sending an e-mail.

- To minimize distractions and facilitate discussion, please do not use laptop computers, personal digital assistants, or iPods during class sessions, and please turn cellular phones off.
**Course Outline:**

**Week 1:** Tuesday, April 1

1.1 Introduction to Public Economics and the U.S. Public Sector

   Reading:
   - Gruber, Chapter 1.

1.2 Microeconomic Underpinnings of Public Economics

   Reading:
   - Gruber, Chapter 2, pp.25-37, 43-52, 55-56.

**Week 2:** Tuesday, April 8

2.1 Public Goods

   Readings:
   - Gruber, Chapter 7.
   - Gruber, Chapter 9, pp.225-228.

2.2 Externalities: Problems and Private Sector Solutions

   **In-Class Activity: Private Sector Solutions to Externalities**

   Reading:
   - Gruber, Chapter 5, pp.120-133.

**Week 3:** Tuesday, April 15

**Policy Position Report #1 Due:** A carbon tax is a better/worse policy than a cap-and-trade system.

**Guest Lecture by Professor David Besanko**
3.1 Externalities: Public Sector Solutions

Reading:
- Gruber, Ch. 5, pp.133-147.

3.2 Externalities: Application – Environmental Policy

Readings:
- Gruber, Chapter 6, pp.150-163.

**Week 4:** Tuesday, April 22

→ **Policy Position Report #2 Due:** Congress should/should not reauthorize No Child Left Behind.

4.1 Public Provision: Optimal Fiscal Federalism

Reading:
- Gruber, Chapter 10, pp.256-270.

4.2 Public Provision: Application – Education

Readings:
- Gruber, Chapter 10, pp.277-280.
- Gruber, Chapter 11.

**Week 5:** Tuesday, April 29

**5.1 Insurance Market Failure: Social Insurance Role**

→ **In-Class Activity:** Health Insurance Market Simulation

**Reading:**
- Gruber, Chapter 12.

**5.2 Insurance Market Failure: Application – Health Care Background**

**Readings:**
- Gruber, Chapter 15.
- Gruber, Chapter 16, pp.443-466.

**Week 6:** Tuesday, May 6

**6.1 MIDTERM EXAM**

**6.2 Insurance Market Failure: Application – Health Care Reform**

☞ **Guest lecture by Professor Leemore Dafny**

**Readings:**
- Gruber, Chapter 16, pp.466-474.
- J.D. Foster, “Benefits of the President’s Proposed Standard Deduction for Health Insurance,” The Heritage Foundation Web Memo No. 1799 (February 6, 2008).


**Week 7:** Tuesday, May 13

**7.1 Insurance Market Failure: Application – Social Security Background**

Reading:
- Gruber, Chapter 13, pp.348-369.

**7.2 Inequity: Role for Transfer Programs**

**→ In-Class Activity: Preferences over Income Distributions**

Readings:
- Gruber, Chapter 2, pp.52-55, 56-57.
- Gruber, Chapter 17, pp.478-85.

**Week 8:** Tuesday, May 20

**8.1 Inequity: Transfer Program Design Issues**

Readings:
- Gruber, Chapter 2, pp.37-43.
- Gruber, Chapter 17, pp.488-506

**8.2 Inequity: Application – Transfer Programs and Policy in the U.S.**

Readings:

**Week 9:** Tuesday, May 27

**→ Policy Position Report #3 Due:** The Social Security system should be brought into budget balance by __________.

### 9.1 Insurance Market Failure: Application – Social Security Reform

**Guest lecture by Professor Deborah Lucas**

**Readings:**
- Gruber, Chapter 13, pp.369-380.

### 9.2 Taxation: Incidence, Efficiency and Equity

**Readings:**
- Gruber, Chapters 19 and 20.

**Week 10:** Tuesday, June 3

**→ Policy Position Report #4 Due:** The federal government should/should not replace the federal income tax system with a national retail sales tax.

### 10.1 Taxation: Application – Tax Policy and Federal Tax Reform

**Readings:**
- Gruber, Chapters 18 and 25.

10.2 Course Wrap-up

**Week 11**

⇒ **FINAL EXAM**
Specific day and time during exam week is yet to be determined.