
Class day/time: M/W – 12:50-2:05 p.m.
Location: B36 Ruttan Hall

Professors
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Office hours: M/W/F – 9:00-9:30 a.m. and by appointment
Office hours: M 10-12, Th 9-10:30 and by appointment

Course Description

This course is an applied approach to welfare economics and its application to issues of public policy.

The introduction considers the development of the new welfare economics in relation to economic theory as a whole and its intellectual importance for work in applied economics. The major themes of the course are introduced.

A brief overview of the key problems of applied welfare economics and its intellectual history follows, notably the problem of social welfare measurement, the choice of appropriate welfare criteria, and the tension between market and non-market allocation of resources.

Following this brief overview, the course is divided into three main sections. The first examines the basic concepts underlying the measurement of welfare change at a technical level, including the compensation principle, consumer and producer surplus, willingness to pay measures, welfare over time and under uncertainty, and the question of Second Best optima. The second explores market failure, including externalities, public goods, and the free-rider problem. The last covers social welfare functions, impossibility theorems and incentives, and coordination games. We finish with three case studies in applied welfare economics at an empirical and policy level.

The central theme of the course is that despite the difficulties of making inferences from market and non-market data concerning social welfare, these judgments will continue to be demanded and supplied. The basic problems associated with the use of price information, and measures that rely primarily on inferences from market data, suggest that a richer information set is required to formulate public policies. This information includes judgments about social welfare, fairness, and distribution. This finding, far from diminishing the role of the economist, enriches it.
Grading and Examinations

Grading will be based on three examinations: two in-class exams and a take-home final. The in-class exams will be given 30% weight each, the final 40%. There will be no papers assigned, although some problem sets may be suggested. Regular attendance is strongly encouraged, since examinations will be based on both readings and lecture results. Grading will follow the University Grading Standards, found on the web policy.umn.edu/Policies/Education/Education/GRADINGTRANSCRIPTS.html.

Readings

Readings designated with an asterisk (*) are primary, others are secondary. Both will form the basis of examination questions, although the weight given to primary readings will be approximately twice that of the secondary readings.


Readings not in the text can be accessed at the Wilson library’s online reserve. The web address is https://reserves.lib.umn.edu/. Access to the site will require your X.500 userid and password. Due to copyright restrictions the readings are not to be shared with anyone not enrolled in the course.

### Topic Summary and Schedule

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<thead>
<tr>
<th>Date</th>
<th>Topic</th>
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<td>Jan 22</td>
<td>Welfare economics and policy analysis</td>
<td>Runge</td>
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<tr>
<td>Jan 27</td>
<td>Competitive equilibrium, social welfare, and compensation</td>
<td>Runge</td>
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<td>Jan 29</td>
<td>Three problems: measurement criteria, market failure, distribution</td>
<td>R/C</td>
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<tr>
<td>Feb 3</td>
<td>Consumer’s surplus and the variation measures</td>
<td>Runge</td>
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<td>Feb 5</td>
<td>Consumer’s surplus and the variation measures continued</td>
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<td>Feb 10</td>
<td>Producer’s surplus and the variation measures</td>
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<td>Feb 12</td>
<td>WTP v.s. WTA</td>
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<td>Feb 17</td>
<td>Intertemporal allocation and uncertainty</td>
<td>Runge</td>
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<td>Feb 19</td>
<td>General theory of the second best</td>
<td>Runge</td>
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<td>Feb 24</td>
<td>First exam</td>
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<td>Feb 26</td>
<td>Causes of market failure: an overview</td>
<td>Runge</td>
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<td>Mar 3</td>
<td>Externalities</td>
<td>Runge</td>
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<td>Mar 5</td>
<td>Externalities continued</td>
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<td>Mar 10</td>
<td>Public goods</td>
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<td>Mar 12</td>
<td>Public goods and incentives</td>
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<td>Mar 12</td>
<td>Public goods under uncertainty</td>
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<td>Mar 17-21</td>
<td>Spring break</td>
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<td>Mar 24</td>
<td>The free-rider problem</td>
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<td>Mar 26</td>
<td>Social welfare functions</td>
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<td>Mar 31</td>
<td>Social welfare functions continued</td>
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<td>Apr 2</td>
<td>Coordination norms</td>
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<td>Apr 7</td>
<td>Second exam</td>
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<td>Apr 9</td>
<td>Fairness theory and distributive justice</td>
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<td>Apr 14</td>
<td>Cardinality, comparability, and equity</td>
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<td>Apr 16</td>
<td>Social choice and Arrow’s theorem</td>
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<td>Apr 21</td>
<td>Gibbard-Satterthwaite: Incentives and mechanisms</td>
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<td>Apr 23</td>
<td>Trade policy</td>
<td>Runge</td>
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<td>Apr 28</td>
<td>Property rights and development policy</td>
<td>Runge</td>
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<td>Apr 30</td>
<td>Cost-benefit analysis and the Clean Air Act</td>
<td>Coggins</td>
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<td>May 5</td>
<td>Additional material as time permits</td>
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<tr>
<td>May 7</td>
<td>Additional material as time permits</td>
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Course Outline 1.

I. INTRODUCTION AND HISTORICAL OVERVIEW

A. Welfare Economics and Policy Analysis


B. Competitive Equilibrium, Social Welfare, and Compensation

*Text Chapter 3, pp. 61-102.


Schotter, Chapter 1 (pp. 1-19) and Chapter 5 (pp. 149-173) in The Economic Theory of Social Institutions, 1981.

C. Three Problems: Measurement Criteria, Market Failure, and Distribution


II. MEASURING WELFARE CHANGE

A. Consumer's Surplus and the Variation Measures

*Text, Chapter 2, pp. 31-60.


Chipman and Moore, "Compensating Variations, Consumer Surplus and Welfare,"

B. Consumer's Surplus and the Variation Measures (cont.)

*Text, Chapter 7, pp. 195-220.
Just, Hueth, Schmitz, Appendix to Ch. 5.

C. Producer's Surplus and the Variation Measures

*Text, pp. 220-223. (Chapter 7)

D. Willingness to pay vs. willingness to accept


E. Intertemporal Allocation and Uncertainty

*Text, pp. 84-95; pp. 223-234. (in Chapters 3 and 7)

F. The General Theory of the Second Best

*Text, pp. 131-135. (Chapter 4)

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FIRST EXAM
III. MARKET FAILURE

A. Causes of Market Failure: An Overview


*Text, pp. 103-136. (Chapter 4)


B. Externalities


C. Externalities (cont.)


D. Public Goods
E. Public Goods and Incentives


F. Public Goods Under Uncertainty


G. The Free-Rider Problem


IV. DISTRIBUTION AND SOCIAL CHOICE

A. Social Welfare Functions
*Text, pp. 137-169. (Chapter 5)


B. Social Welfare Functions (cont.)


C. Coordination Norms


D. Fairness Theory and Distributive Justice

*Text, Chapter 6, pp. 170-191.


E. Cardinality, Comparability, and Equity


E. Arrow’s Theorem


F. Gibbard-Satterthwaite: Incentives and Mechanisms


V. APPLIED WELFARE ECONOMICS IN PRACTICE: EMPIRICAL AND POLICY ISSUES

A. Trade Policy


B. Property Rights and Development Policy


C. Cost-Benefit Analysis and the Clean Air Act


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FINAL EXAM DUE
Wednesday, May 14, 2014
8:00-10:00 a.m.
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