

# Readings in Market Imperfections and Rationales for Government Intervention

Spring 2017

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Room TBD  
Mondays 2-4pm

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Canvas course page: <https://canvas.harvard.edu/courses/22922>

## Overview

This course discusses basic questions in economics like: When can markets be inefficient? When do such inefficiencies generate a rationale for the government to intervene? By what methods should the government intervene?

We begin the course by reviewing the basic welfare theorems that suggest markets should work well. The first welfare theorem suggests market outcomes are always Pareto efficient – there are no policies the government can do to make everyone better off relative to what the market allocation provides. The second welfare theorem suggests that any desired Pareto efficient outcome can be achieved by the government through an appropriate set of lump-sum transfers. Taken together, these two theorems have been traditionally hailed as rationales for the absence of government intervention in markets.

Yet, there are many conditions under which the assumptions underlying these fundamental theorems fail. We discuss the workings of markets and rationales for government intervention in a wide range of settings. These include equality of opportunity and intergenerational mobility, insurance markets and the Affordable Care Act, the rise in top 1% inequality and implications for taxation of labor and capital, patent protection and innovation, social insurance, and high frequency trading. The goal is to generate principled discussion about the potential market failures operating in these settings, to critique the current methods of government intervention, and to discuss the pros and cons of alternative policies.

## Requirements

The main requirement for the course is a 20-25 page research paper that analyzes a particular government policy and discusses its theoretical and empirical rationale (or lack of rationale). All research topics need to be approved by the professor. The research paper topic should relate to a market imperfection. As we will discuss in class, this includes a very broad set of potential topics and students should feel free

to “think out of the box” on potential topics and analyses. Papers are generally expected to have a strong data analysis component focused on identifying the potential market imperfection. However, students seeking to write a purely theoretical paper can do so with professor approval. The paper should also briefly discuss rationales for government intervention.

Students will submit a 500-word research proposal due on February 27. Students will meet with the professor during the subsequent week to discuss their proposal. A longer 5-7 page report outlining the topic, argument for government intervention, and proposed data analysis will be due on March 27. On April 10, students will submit a 1-page memo to me outlining their progress. On April 17 and 24 students will provide a 15 minute presentation of their work during class. Finally, the research paper is due on May 1.

In addition to the research paper, students will be expected to read the papers each week prior to coming to class and provide a 2-page response to the readings (12 pt font, 1.5 space). These responses should (a) critically assess the methodology and results in the paper and (b) discuss the implications for the economic policy in question or rationale for government intervention. **The responses are due by 8pm on Sunday evening prior to class.** Responses should be submitted on the Canvas course page. Students will be graded on the best 7 of their reviews, and are therefore able to choose to not submit some reviews. Links to the readings are provided on the syllabus and all readings are also located in the Canvas course page, under “Files.”

### **Late Policy**

Students are expected to provide assignments on time. Out of fairness to those who abide by this policy, I will be very firm in the case of late work. If assignments are turned in late, they will lose 1/3 of a letter grade per 24 hours late. For example, a review submitted at 8:01pm will receive 1/3 letter grade off. Exceptions are given in the case of medical or personal emergencies. I respect your privacy in such cases and do not need to know any details on your particular emergency, but I ask that you provide me with a certification of the emergency from a doctor or resident dean (e.g. an email to the professor from your resident dean will suffice).

### **Collaboration Policy**

Discussion and the exchange of ideas are essential to academic work. For assignments in this course, you are encouraged to consult with your classmates on the choice of paper topics and to share sources. You may find it useful to discuss our chosen topic with your peers, particularly if you are working on a similar topic as a classmate. However, you should ensure that any written work you submit for evaluation is the result of your own research and writing and that it reflects your own approach to the topic. You must also adhere to standard citation practices in this discipline and properly cite any books, articles, websites, lectures, etc. that have

helped you with your work. If you received any help with your writing (e.g., feedback on drafts), you must also acknowledge this assistance.

### **Assignment list**

- Weekly: 2-page (12 pt font, 1.5 space) response to readings due 8pm on Sundays before class
- February 27: 500-word proposal due
- March 27: 5-7 page report due that outlines topic, argument for government intervention, and proposed data analysis
- April 10: 1-page progress report due
- April 17/24: 15 minute discussion of project in class
- May 1: Research paper due

### **Grading**

The course grade will be determined as follows:

- Class participation and weekly responses (25%)
- 500-word proposal (10%)
- 5-7 page report (5%)
- 1-page progress report (5%)
- In-class discussion of project (15%)
- Final Research paper (40%)

### **Schedule and Readings**

#### **Week 1 (January 23) Introduction and Welfare Theorems**

#### **Week 2 (January 30) Redistribution and taxation**

Alvaredo, Facundo, Anthony B. Atkinson, Thomas Piketty, and Emmanuel Saez. 2013. "The Top 1 Percent in International and Historical Perspective." *Journal of Economic Perspectives*, 27(3): 3-20, <https://www.aeaweb.org/articles.php?f=s&doi=10.1257/jep.27.3.3>

Mankiw, N Gregory. 2013. "Defending the One Percent." *Journal of Economic Perspectives*, 27(3): 21-34. <https://www.aeaweb.org/articles.php?f=s&doi=10.1257/jep.27.3.21>

Diamond, Peter, and Emmanuel Saez. 2011. "The Case for a Progressive Tax: From Basic Research to Policy Recommendations." *Journal of Economic Perspectives*, 25(4): 165-90. <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.25.4.165>

### **Week 3 (February 6): Equality of opportunity and redistribution across generations**

Corak, Miles. 2013. "Income Inequality, Equality of Opportunity, and Intergenerational Mobility." *Journal of Economic Perspectives*, 27(3): 79-102.  
<https://www.aeaweb.org/articles.php?doi=10.1257/jep.27.3.79>

Chetty, Raj, Nathaniel Hendren, Patrick Kline, and Emmanuel Saez. "Where is the land of Opportunity? The Geography of Intergenerational Mobility in the United States." *The Quarterly Journal of Economics* 129.4 (2014): 1553-1623.  
<https://qje.oxfordjournals.org/content/129/4/1553.full.pdf+html>

Chetty, Raj, David Grusky, Maximilian Hell, Nathaniel Hendren, Robert Manduca, Jimmy Narang, "The Fading American Dream: Trends in Absolute Income Mobility Since 1940". *NBER Working Paper #22910*  
<http://www.nber.org/papers/w22910>

### **Week 4 (Feb 13): Trade and immigration**

Autor, David, H., David Dorn, and Gordon H. Hanson. "The China syndrome: Local labor market effects of import competition in the United States." *The American Economic Review* 103.6 (2013): 2121-2168.  
<https://www.aeaweb.org/articles?id=10.1257/aer.103.6.2121>

Peri, Giovanni. "Immigrants, Productivity, and Labor Markets." *The Journal of Economic Perspectives* 30.4 (2016): 3-29.  
<http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.30.4.3>

Two articles on the Trans-Pacific-Partnership (TPP):  
<http://blogs.wsj.com/briefly/2015/10/05/trans-pacific-partnership-at-a-glance-2/?mod=e2fb>  
<http://www.economist.com/blogs/economist-explains/2016/11/economist-explains-14>

**Feb 20: President's day – NO CLASS**

### **Week 5 (Feb 27): Minimum wages and monopsony**

Card, D. and B. Krueger. "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania." *The American Economic Review* 84.4 (1994): 772-793.  
<http://www.jstor.org/stable/2118030>

Clemens, J. and M. Wither, "The Minimum Wage and the Great Recession: Evidence of Effects on the Employment and Income Trajectories of Low-Skilled Workers", *RESEARCH BRIEFS IN ECONOMIC POLICY NO. 22, CATO Institute*

<https://www.cato.org/publications/research-briefs-economic-policy/minimum-wage-great-recession-evidence-effects>

Council of Economic Advisors, "Labor Market Monopsony: Trends, Consequences, and Policy Responses". October 2016. *(Copy and paste link into browser)*

[https://www.whitehouse.gov/sites/default/files/page/files/20161025\\_monopsony\\_labor\\_mrkt\\_cea.pdf](https://www.whitehouse.gov/sites/default/files/page/files/20161025_monopsony_labor_mrkt_cea.pdf)

### **Week 6 (March 6): Neighborhoods, Place, and Segregation**

New York Times video: Where Does the American Dream Live?

<https://www.nytimes.com/video/us/100000004655947/where-does-the-american-dream-live.html>

Chetty, Raj, Nathaniel Hendren, and Lawrence F. Katz. "The effects of exposure to better neighborhoods on children: New evidence from the Moving to Opportunity experiment." *The American Economic Review* 106, no. 4 (2016): 855-902.

<https://www.aeaweb.org/articles?id=10.1257/aer.20150572>

The Pruitt Igoe Myth (watch first 30 minutes):

<https://www.youtube.com/watch?v=xKgZM8y3hso>

Ludwig, Jens, et al. "What Can We Learn About Neighborhood Effects from the Moving to Opportunity Experiment." *American Journal of Sociology* 114.1 (2008): 144-188. <http://home.uchicago.edu/ludwig/papers/AJS-Ludwig-2008.pdf>

### **March 13: Spring Break – NO CLASS**

### **Week 7 (March 20): Environmental Externalities and Property Rights**

Greenstone, Michael. "The Impacts Of Environmental Regulations On Industrial Activity: Evidence From The 1970 And 1977 Clean Air Act Amendments And The Census Of Manufactures," *Journal of Political Economy*, 2002, v110(6,Dec), 1175-1219.

<http://www.jstor.org/stable/10.1086/342808>

Keiser, D. and J. Shapiro, "Consequences of the Clean Water Act and the Demand for Water Quality", Yale Working Paper. June 2016.

[http://www.econ.yale.edu/~js2755/CleanWaterAct\\_KeiserShapiro.pdf](http://www.econ.yale.edu/~js2755/CleanWaterAct_KeiserShapiro.pdf)

## Property Rights and Innovation

Williams, Heidi L. "Intellectual Property Rights and Innovation: Evidence from the Human Genome." *Journal of Political Economy* 121.1 (2013): 1-27.

<http://economics.mit.edu/files/8647>

J. Feng and X. Jaravel, "Who Feeds the Trolls? Patent Trolls and the Patent Examination Process", *Harvard Working Paper*

<http://scholar.harvard.edu/files/xavier/files/trolls.pdf>

Short ratio discussion of patent trolls (click on the link and you should be able to listen to the 3-minute segment):

<http://www.npr.org/sections/alltechconsidered/2013/08/30/217272814/taking-the-battle-against-patent-trolls-to-the-public>

## Week 8 (March 27): Health Insurance

Akerlof, George A. "The Market for "Lemons": Quality Uncertainty and the Market Mechanism." *The Quarterly Journal of Economics* (1970): 488-500.

<http://www.jstor.org/stable/1879431>

[Read only intro and Discussion/Conclusion Section at end of paper].

Hendren, Nathaniel. "Private information and insurance rejections." *Econometrica* 81.5 (2013): 1713-1762

<http://onlinelibrary.wiley.com/doi/10.3982/ECTA10931/abstract>

Finkelstein, Amy, et al. "The Oregon Health Insurance Experiment: Evidence from the First Year." *The Quarterly journal of economics* 127.3 (2012): 1057-1106.

<http://economics.mit.edu/files/8139>

Finkelstein, Amy, et al. "The Oregon Experiment — Effects of Medicaid on Clinical Outcomes" *The New England Journal of Medicine* (2013).

<http://www.nejm.org/doi/pdf/10.1056/NEJMsa1212321>

## Week 9 (April 3) Disability and Unemployment Insurance

Gordon B. Dahl, Andreas Ravndal Kostøl, and Magne Mogstad. "Family Welfare Cultures" *The Quarterly Journal of Economics* (2014) 129 (4): 1711-1752

<http://qje.oxfordjournals.org/content/129/4/1711>

This American Life (1 hour radio program): <http://www.thisamericanlife.org/radio-archives/episode/490/trends-with-benefits>

Hendren, Nathaniel, "Knowledge of Future Job Loss and Implications for Unemployment Insurance" (2016) Revise and Resubmit, *American Economic Review* [http://scholar.harvard.edu/files/hendren/files/unemployment\\_insurance.pdf](http://scholar.harvard.edu/files/hendren/files/unemployment_insurance.pdf)  
[Required reading only through Section 3]

Katz, Lawrence F., and Bruce D. Meyer. "The impact of the potential duration of unemployment benefits on the duration of unemployment." *Journal of public economics* 41.1 (1990): 45-72.  
<http://www.sciencedirect.com/science/article/pii/004727279290056L>

### **Week 10 (April 10): Financial regulation: high frequency trading and TARP**

Budish, Eric, Peter Cramton, and John Shim. "The high-frequency trading arms race: Frequent batch auctions as a market design response." *Quarterly Journal of Economics*, Vol. 130 (4)  
<http://qje.oxfordjournals.org/content/130/4/1547.full.pdf+html>

Lewis, Michael. *Flash boys: a Wall Street revolt*. WW Norton & Company, 2014.  
(Chapters 1 & 2)

### **Week 11 (April 17): In-class presentations**

### **Week 12 (April 24): In-class presentations**