

THE UNIVERSITY OF MICHIGAN
Center for International Business Education
School of Business Administration

HONG KONG ADMINISTRATIVE OFFICERS DEVELOPMENT PROGRAM

BENEFIT-COST MODULE

Subject of the Course:

The aim of this course is to teach you the elements of benefit-cost analysis. On one level, this is simple: just add all the benefits of a program and subtract all the costs. If net benefits are positive, the program is a winner; if they are negative, it is not. In choosing among programmatic options, take the one with the highest level of net benefits.

But obviously there are complications. First, it is usually not easy to measure benefits and costs, and it turns out that tools of microeconomics can be very helpful here. Second, benefits and costs can occur at different times, and you have to adjust for that problem. Third, benefits and costs are received and borne by different people, and both the economics and the politics of dealing with distributional issues can get tricky. Fourth, there are many different types of programs for which a public servant might want to do a benefit-cost analysis. This list goes on, and it would easily fill a semester for us to cover it thoroughly.

Instead, we have only four weeks to do it, and we will therefore have to compress the material somewhat in order to cover the most important issues. However, given a choice between a cursory treatment of a large number of techniques and examples and a more in depth treatment of the fundamental topics in benefit-cost, I will opt for the latter. My goal is that you will leave the course with a thorough understanding of both what benefit-cost analysis can do and what it cannot do. I would like you to learn both the remarkable power of the techniques when they are used properly, but also their limitations. With that in mind, we will take the time to look carefully at the economic underpinnings of the tools of analysis used in benefit-cost.

Organization:

The course meets twice a week, Mondays and Wednesdays, 2:30-4:30 PM, in room K3318 in the Kresge Business Library. I will hold regular office hours:

458 Lorch Hall
(next to Business School)

Tuesdays and Wednesdays, 10:30 - 11:30 AM

Also, feel free to call or e-mail me for an appointment. I may be reached as follows:

764-6817

alandear@umich.edu

Home Page:

Whenever possible, materials for the course will be posted on the course home page:

<http://www.econ.lsa.umich.edu/~alandear/courses/AODP/AODP.html>

Requirements:

There will be three problem sets handed out the second, third and fourth Wednesdays and due the following Monday at the beginning of class. These will be graded and returned to you within the week. There are no other written assignments. You will also be expected to participate actively in class discussion.

Text:

The textbook for the course is *A Guide to Benefit-Cost Analysis*, 2nd edition, by Edward M. Gramlich, Prentice Hall, 1990 (reissued by Waveland Press 1998). A coursepack containing the supplementary required readings has also been prepared.

COURSE OUTLINE AND READING LIST

- Lecture 1, September 9:** Micro-foundations of Benefit-Cost Analysis
- Gramlich, Ch 1, 2, 3
- Lecture 2, September 14:** Consumer and Producer Surplus
- Gramlich, Ch 4, pp. 48-51
Tarr, David G. and Morris E. Morkre, "Sugar," Chapter 4 in *Aggregate Costs to the United States of Tariffs and Quotas on Imports*, Federal Trade Commission, December 1984, pp. 75-100.
- Lecture 3, September 16:** Using Markets to Infer Costs and Benefits
- Gramlich, Ch 4, pp. 51-66
Porter, Richard C., "Michigan's Experience with Mandatory Deposits on Beverage Containers," *Land Economics*, May 1983
- Lecture 4, September 21:** Valuing Benefits and Costs Over Time
- Gramlich, Ch 6
Gramlich, E., "Evaluation of Education Projects: The Case of the Perry Preschool Program," *Economics of Education Review*, 1986.
Problem Set 1 due
- Lecture 5, September 23:** Benefit-Cost in the Presence of Risk or the Absence of Markets
- Gramlich, Ch 4, pp. 66-75
- Lecture 6, September 28:** Cross-Market Effects
- Gramlich, Ch 5, pp. 79-83
Problem Set 2 due
- Lecture 7, September 30:** Income Distribution
- Gramlich, Ch 7
- Lecture 8, October 5:** Critique of Benefit-Cost Analysis
- Gramlich, Ch 13
Railton, "Cost-Benefit Analysis as a Source of Information about Welfare"
Problem Set 3 due