

Class Notes 1: Policy Evaluation*

Public Economics (ECO336)

September 13, 2011

This note builds on our class discussion of a hypothetical policy to ban smoking in public places. (In truth, it is not that hypothetical: New York City recently introduced a ban on smoking in all its parks (including Central Park) and many other public places.)

We gathered reasons for and against introducing such a policy. In passing, I made three general remarks:

1. In a democracy, one gets to help decide which policies are implemented: it a neat thing (one might argue). Some policies are better than other rival policies, and it is worth thinking about why, as a citizen as much as a student in a Public Economics class.
2. Decisions about policy usually involve value judgements that go beyond economics. As an example, a classic debate focuses on how one should weigh efficiency relative to equality – very much a matter of political philosophy. This debate will show up later in the course.
3. While acknowledging that philosophical issues may be involved, economics can still be useful when evaluating policies, not least because economists are interested in quantification, and some aspects of given policies are readily quantifiable (for instance, how much enforcement costs are likely to be).

1 The Evaluation Process

Let us now try to place more structure on the policy evaluation process, building on the class discussion. In doing so, I will anticipate various things we will be covering in more detail over the coming months.

1.1 Objective(s)

At the outset, it is helpful if a clear policy objective can be stated. In the case we considered, the government might wish to reduce exposure to second-hand smoke, or reduce smoking more generally. Given that resources are finite, the government will also typically want to meet the stated objective at reasonable cost.

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1.2 Cost-Benefit Analysis

The most widely-used approach to evaluate policies is called ‘cost-benefit’ analysis. The basic approach is intuitive and works as follows – we will provide a careful justification when we discuss public goods.

Costs: What are the likely costs associated with the policy? Here, one draws up an exhaustive list. And how big are each of the costs likely to be, quantified if possible in dollar terms?

Benefits: Similarly, what are the likely benefits of implementing the policy, and how much are they (in dollars)?

This sort of enumeration has a speculative component, given that the full causal effects of the policy cannot be known with absolutely certainty in advance. Not least, it is hard to know exactly how much second-hand smoke consumption will fall. It turns out that one can still *estimate* the likely effects. And here, we will spend time later on considering ways economists have devised of quantifying benefits and costs: this is where econometrics will come in useful.

Further, some costs and benefits are inherently very difficult to quantify. Consider ‘reductions in freedom’ associated with the policy, for example: we do not have a very good way of putting dollar values on such reductions, and there is certainly no market on which freedom is bought or sold that would give us the ‘price’ of freedom.

Aside 1: Defining rights (including property rights)

Here, I will echo the very good point someone made in class: when talking about reductions in freedom associated with the policy, it is worth considering whose freedom is being infringed. It differs before versus after the policy has been implemented. Prior to the policy, non-smokers who are in proximity to smokers will end up consuming second-hand smoke, quite possibly against their will and quite likely to their detriment. Once the policy has been introduced, smokers are prevented from smoking in public, so their actions are curtailed (assuming they comply), and their freedom goes down. But do they have the right to expose other people in public spaces to risks of lung cancer? Legal scholars, plus a lot of regular people, would say not, on the basis that one does not (typically) have the right to do something that directly harms other people.

Aside 2: Consistent policy

An observation, as an aside, about the consistency of current policy: much of the legislation that has sought to limit smoking in public is framed in terms of the need to reduce second-hand smoke, given that second-hand smoke can kill, and non-smokers have *the right* to clean air. Suppose we were to generalize that principle into something like, “The public has a right to clean air, and so should be protected from air pollution of all forms,” rather than just merely air laden with second-hand smoke. This might lead to policies that curtailed the amount of diesel fuel burned in cities: diesel from buses is really quite toxic. But at this stage, we (or should I say, policy makers?) do not seem to mind, perhaps because there are few alternatives. It is somewhat inconsistent.

1.3 Decision Rule

Having quantified the relevant costs and benefits as carefully as possible, we then add them all up. If some are in the future, they should be discounted (at an accepted rate of time preference). And if there is uncertainty as to the size of given costs and benefits, it is possible to conduct sensitivity analysis, varying the size of the component in question.

A sensible necessary condition for proceeding with the policy might than be that the net (discounted) benefit of the policy should be positive – that is, the benefits should outweigh the costs, relative to doing nothing (the ‘status quo’).

If we wanted to push further, we might insist on something stronger: namely that we should enact the policy if it yielded the highest net benefit among *all* policies we might consider. That is clearly a higher bar to clear.

2 Policies in Practice

In practice, some bad policies can be enacted¹ – welcome to the actual world! This might occur for a variety of reasons:

First, the political process is imperfect. In an election, political parties will present a package of policies to voters, and policies are not voted on individually. So voters might let a few bad policies by as a compromise on the way to getting most of what they want – their party of choice being elected.² Also, special interests may have an undue influence, swaying what politicians do by making campaign contributions.

Second, the underlying economic analysis may have been inadequate. Costs and benefits may have been carelessly quantified, or may be just hard to quantify. (Coming up, as we will see in the case of global warming, uncertainty can be very difficult to gauge in practice. This makes cost-benefit analysis unreliable.)

Third, *distribution*: policies typically produce winners and losers, and a minority who are likely to lose a lot may be able to block a policy that would benefit the majority slightly. Politicians tend to be sensitive to this sort of difference in the strength of preferences.

We will see later on that the issue of how to weight individuals is a fundamental one in welfare economics, and economics alone offers no good solution. The standard utilitarian approach weighs everyone equally, and doing so has a certain appeal. But the determination of welfare weights is tricky.

Question: Alcohol ‘Prohibition’

Please attempt the following sample question, relevant to the first Term Test:

¹We will have occasion to discuss a more than a few in this course.

²In the case of referenda, things are different: there is just one issue being voted on.

Suppose the Government of Ontario sought to introduce a complete ban on drinking alcohol, on the basis that alcohol has adverse health effects. Let the objective in implementing this policy be to reduce alcohol consumption at reasonable cost.

What do you anticipate would be the primary costs of the policy? How successful would you anticipate the policy to be, and why?

[The historical experience is instructive. It may be worth considering the effects of Prohibition in the United States (which ran from 1919 to 1933) as a parallel historical experiment, and also in Ontario, prior to the founding of the LCBO in 1927. Prohibition produced all sorts of unforeseen undesirable consequences.

Answer to follow...