

BOSTON COLLEGE
Department of Economics

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Fall 2000

Economics 894.01
Urban Economics II

There have traditionally been four core topics in urban economics: location and land use, urban transportation, housing, and local public finance. It is natural and normal to start with location theory since this provides the conceptual framework within which the other topics can be integrated. This and urban transportation are the topics treated in Urban Economics I (Economics 893.01). This year, due to scheduling constraints, Urban Economics II will be offered before Urban Economics I. To deal with this, I shall start off the course with a presentation of the "monocentric city model" that is only as deep as is needed for its application in the rest of the course. Prof. Kraus will provide a deeper and more thorough treatment in Urban Economics I in the spring.

The character of urban economics has changed significantly over the last decade. Two developments have been particularly important. The first has been the integration of the real side of real estate economics (in contrast to the financial side which is primarily concerned with the pricing of secondary real estate securities) into the field. To some extent, this is old wine in new bottles. The real side of real estate economics looks at much the same set of topics as does housing economics but from a different perspective - - to put it rather crudely, how to make money rather than how to help the poor -- but there are some new topics treated. One is land development under uncertainty. Land development is usefully regarded as the exercise of a "real option". Real option theory integrates the theory of options pricing and of irreversible investment under uncertainty. Another is real estate cycles, which has generated a lot of interesting work though not yet an integrated body of theory. The second important development has been the "new economic geography", which was pioneered by Paul Krugman. This body of theory focuses on agglomeration at the regional level, and overlaps with the theory of urban agglomeration which is perhaps the most exciting research area in conventional urban economic theory at the present time. There is a third topic which, while perhaps as important as the other two, has not been developed to the same extent -- the theory of urban labor markets.

Local public finance is concerned with public finance issues at the city or metropolitan level. There are two main strands to local public finance theory. The first concerns how job mobility, residential mobility, and capital mobility influence the effects of local government policies, and therefore the design of optimal policy at the local level. There are two topical policy issues where these considerations are particularly important, local public education policy including school vouchers, and policy to combat the deterioration of downtown areas. The second concerns what has come to be known as fiscal federalism -- the fiscal relations between different levels of government, including the assignment of tax and spending powers, intergovernmental grants, and revenue sharing. Interestingly, these two strands of theory have recently received considerable academic

attention in the context not of local public finance but of the economics of European integration.

A hot policy topic at the moment is the competition between national governments in Europe for industry. This topic lies at the intersection of local public finance theory (as adapted to the economics of European integration) and the new economic geography.

The course will cover six topics.

1. Summary presentation of the monocentric city model
2. Housing economics
3. The real side of real estate economics
4. The new economic geography and the economics of agglomeration
5. Local public finance
6. Urban labor markets

Reflecting my competence and incompetence, the emphasis of the course will be on theory. I do however intend to relate the theory to policy issues and to draw on relevant empirical work (though I will not be able to comment expertly on the applied econometrics).

There is no up-to-date book dealing with all the above topics at the graduate level. However, I shall draw heavily on two books:

DiPasquale, D. and W. Wheaton, *Urban Economics and Real Estate Markets* (Englewood Cliffs, N.J.: Prentice-Hall, 1996)

Fujita, M., P. Krugman, and A. Venables, *The Spatial Economy: Cities, Regions, and International Trade* (Cambridge, MA: MIT Press, 1999)

The DiPasquale and Wheaton book provides an excellent treatment of many topics in real estate economics, while FKV presents the state of the art in the new economic geography. For the other topics, I shall use book chapters and journal articles.

One of the features I find particularly attractive about urban economics is that it deals with issues and phenomena that we encounter on a day-to-day basis. Largely for this reason, I think, the theory in the field is very strongly empirically-driven. To do good urban economic theory, it helps a lot to know the stylized facts and the policy issues. For this reason, I would like you to become conversant with urban economics at a more mundane, practical, and policy-oriented and less rarefied level. To achieve this goal, I strongly urge you to buy an undergraduate textbook in urban economics, and read the parallel material there. I recommend:

O'Sullivan, A. *Urban Economics*, 4th edition (Boston, MA: McGraw-Hill, 2000)

The grade for the course will be determined as follows:

Problem Sets	20%
Essay	40%
Final Exam	40%

There will be five problem sets. Each problem set will be given out on a Friday, due in class the following Wednesday (no late problem sets will be accepted), and returned and commented on on that Friday. You are encouraged to work with other students on the problem sets, but must write up your answers on your own.

For the essay, explore an idea that could form the basis of a thesis chapter. The essay may be empirical or theoretical. I prefer essays that are well-written, polished, and focused (though I realize that these desiderata rather conflict with the goal of exploring a topic) and have a strong aversion to literature reviews.

The final exam. will be in the assigned time slot.

My office is Carney 231.

My office hours for the term are Monday and Wednesday 5:00 - 6:30 p.m.

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