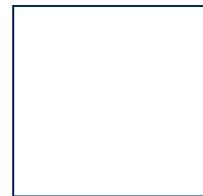
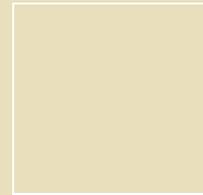


# Incentives and Trade-offs

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# Incentives and Trade-Offs

- Minimum wage increased from \$5.85 per hour to \$6.55 on July 24<sup>th</sup>
  - Wage of \$5.85 = \$12,200 per year.
  - \$6.55 = \$13,600.
    - In either case, below the poverty line
    - A \$1,400 per year salary increase certainly seems needed
- But will the increase help low-income individuals and families?



# Incentives and Trade-Offs

- Worker producing only \$6.00 worth of goods may suffer
- Employer likely to abide by two principles:
  - People do what's best for them
  - People change their behavior when their incentives change
- Employer may well fire this employee
- Worker is made worse off by law intended to help him
- Legislators must take into account these two principles – and their ramifications





# Incentives and Trade-Offs

- Tax policy also must take into account the principles
- Best level of social welfare spending?
- France: high taxes and high welfare spending
  - High unemployment
- U.S.: low taxes and relatively low welfare spending
  - Low unemployment



## Incentives and Trade-Offs

- Individuals also must consider the principles in their economic decisions
- *Caveat emptor* is often forgotten
- Could this have played a role in recent foreclosure problems?



# Incentives and Trade-Offs

- One additional principle economists emphasize:
  - If you want more of something, you must give up something else
  - In other words, we always face trade-offs
- This seems obvious, but we all – individuals and policymakers – sometimes ignore the trade-offs



# Incentives and Trade-Offs

- Individual example
  - I can save gas (at \$4.00 per gallon) by driving 55 m.p.h.
    - Slower is also greener
    - But must give up time, which may be even more valuable
- Policymaker example
  - Can reduce greenhouse gases – gain cleaner environment -- by legislating greener production
  - But consumers must give up something else
    - Higher cost of electricity, food, and housing will mean cutbacks
    - Especially painful for low-income individuals