

## Chapter 1

1. People respond to incentives. Governments can alter incentives and, hence, behaviour with public policy. However, sometimes public policy generates unintended consequences by producing results that were not anticipated. Try to find an unintended consequence of each of the following public policies.

- a. To help the "working poor," the government raises the minimum wage to €25 per hour.

Answer:

Many would want to work at €25/hour but few firms would want to hire low productivity workers at this wage; therefore it would simply create unemployment.

- b. To help the homeless, the government places rent controls on apartments restricting rent to €50 per month.

Answer:

Many renters would want to rent an apartment at €50/month, but few landlords could produce an apartment at this price. Therefore this rent control would create more homelessness.

- c. To reduce its budget deficit and limit consumption of petrol, the government raises the tax on petrol by €1.00 per litre.

Answer:

Higher petrol prices would reduce the miles driven. This would reduce the number of car accidents, put less wear and tear on roads and cars, and reduce the demand for cars and road repairs.

- d. To reduce the consumption of drugs, the government makes drugs illegal.

Answer:

This raises the price of drugs and makes selling them more profitable. This creates more gangs and organized crime.

- e. To raise the population of a rare bird of prey, the government prohibits the killing of the birds and the collecting of their eggs.

Answer:

Restrictions on killing the birds leads to a reduction in the population of animals upon which the birds feed —rabbits, mice, etc.

- f. To improve the welfare of European sugar beet growers, the EU bans imports of sugar from South America.

Answer:

South American growers have difficulty repaying their bank loans, some of which are owed to the subsidiaries of EU banks. They turn to more profitable crops such as coca leaves and marijuana.

2. Opportunity cost is what you give up to get an item. Since there is no such thing as a free lunch, what would likely be given up to obtain each of the items listed below?

- a. Susan can work full time or go to university. She chooses university.

Answer:

She gives up income from work (and must pay tuition).

- b. Susan can work full time or go to university. She chooses work.

Answer:

She gives up a university degree and the increase in income through life that it would have brought her (but she doesn't have to pay tuition).

- c. Farmer Jones has 100 hectares of land. He can plant wheat, which yields 5 tonnes per hectare, or he can plant potatoes, which yield 35 tonnes per hectare. He chooses to plant wheat.

Answer:

He gives up 3,500 tonnes of potatoes.

- d. Farmer Jones has 100 hectares of land. He can plant wheat, which yields 5 tonnes per hectare, or he can plant potatoes, which yield 35 tonnes per hectare. He chooses to plant potatoes.

Answer:

He gives up 500 tonnes of wheat.

- e. In (a) and (b) above, and (c) and (d) above, which is the opportunity cost of which – college for work or work for college? Potatoes for wheat or wheat for potatoes?

Answer:

Each is the opportunity cost of the other because each decision requires giving something up.