ECONOMICS 340

Test #3

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#### 2. How does inflation impact consumer spending behavior?

* Inflation erodes the purchasing power of consumers, making goods and services more expensive. This reduces the quantity of goods consumers can afford.
* As prices rise, consumers tend to substitute more expensive items with cheaper alternatives to maintain their standard of living.
* High inflation may cause consumers to delay non-essential purchases, expecting prices to stabilize or drop in the future.
* Inflation often leads to higher interest rates, increasing the cost of borrowing and discouraging consumer spending on big-ticket items like homes and cars.
* Inflation decreases the real value of savings, prompting consumers to either spend now or seek higher-yield investments, potentially reducing the overall savings rate.
* Fixed-income earners, such as retirees, are particularly affected as their incomes do not adjust with inflation, reducing their purchasing power significantly.
* Anticipation of future price increases can lead to a surge in current spending as consumers try to buy before prices go up further, potentially leading to hoarding and supply shortages.

#### 5. Discuss the economic impacts of a minimum wage increase.

* Raises the earnings of the lowest-paid workers, enhancing their purchasing power and potentially reducing poverty levels.
* Higher disposable income for low-wage workers can lead to increased consumer spending, boosting demand for goods and services.
* Some businesses may reduce their workforce or cut hours to offset the increased labor costs, potentially leading to higher unemployment or underemployment among low-wage workers.
* Businesses may pass on the higher labor costs to consumers through increased prices for goods and services, contributing to inflation.
* Higher wages can lead to better employee morale, reduced turnover, and increased productivity as workers feel more valued and motivated.
* Helps reduce income inequality by increasing the earnings of the lowest-paid workers relative to higher earners.
* The impact can vary significantly by region, depending on the local cost of living and economic conditions. Areas with a higher cost of living may see more pronounced effects.
* Small businesses might struggle more with increased labor costs compared to larger corporations, which could lead to business closures or reduced business growth.

#### 6. What are the potential effects of government debt on an economy?

* Higher government debt leads to increased spending on interest payments, which can reduce the funds available for other public services and investments.
* Government borrowing can lead to higher interest rates as it competes with the private sector for available funds, potentially reducing private investment and slowing economic growth.
* Excessive government debt, if monetized, can lead to higher inflation rates, eroding purchasing power and destabilizing the economy.
* High levels of debt may necessitate future tax increases to service the debt, potentially reducing disposable income and consumer spending.
* A high debt-to-GDP ratio can lead to a downgrade of the country's credit rating, increasing borrowing costs and reducing investor confidence.
* If debt is used for productive investments (e.g., infrastructure, education), it can stimulate economic growth and enhance the country's future economic potential.
* Current borrowing may impose a financial burden on future generations, who will have to bear the costs of repaying the debt.
* Sustainable levels of government debt can help stabilize the economy during downturns, but excessive debt can lead to financial crises and loss of economic stability.