

Increase in future income (chapter 8)

The president-elect pledged in the run up to the pivotal 2020 presidential election that Joe Biden would boost the federal minimum wages to 15 dollars per hours, from its current level of 7.25 dollars. It can be implied about the rise in the future income on chapter 8.

Assuming we are the saver, as the future income increases, the budget line shifts upwards from BL_1 to BL_2 . Current consumption rises and future consumption also rises. The amount of current consumption increase is not equal to the future income increase as people want to save money to spend in future consumption. It is called consumption smoothing as people want to balance consumption every year. As current consumption increases, supply of loanables also rises. Then, S_p shift left from S_{p1} to S_{p2} . There is an excess demand for the credit market. To adjust the market, the interest rate will increase from r_1 to r_2 . Current consumption will decrease until back to S_{p1} . In a good market, an increase in interest rate makes the slope of the budget line steeper as $(1+r)$ is a slope of budget line. For substitution effect, rising interest rate causes the fall in current consumption but the rise in future consumption. For income effect, $s(1+r)$ increase means income rise. It causes the increase in both current and future consumption. Assuming the stronger substitution effect, rising interest rates cause the decrease in current consumption but increase in future consumption. The current consumption decreases back to C_1 .

