

# Incentives

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Economics rests on the principle that incentives matter. Changing incentives or the costs and benefits of making decisions alters people's behavior.

Most of economics can be summarized in four words, says economist Steven Landsburg. "People respond to incentives. The rest is commentary."

Incentives can be seen on every level from simple family decisions, to corporate decisions, to government decisions, to international trade.

Markets work because incentives influence buyers and sellers to change their behavior. If buyers want to purchase more stereos, the price will rise. As the price increases, sellers will be more willing to provide stereos. Eventually, the higher price will bring the amount demanded and the amount supplied into balance.

Profits are another example of a powerful economic incentive. Businesses pursue profits so they produce what consumers demand and try to cut costs. Investors invest in companies that are profitable. Profits direct businesses toward action that increases wealth.

There are other, non monetary incentives, which may overwhelm our monetary incentives. In the United States, businesses encourage employees with reserved parking spaces. Athletes compete for the honor of winning trophies and prizes. Even love or altruism can motivate actions that have significant economic effects.