ECO 407 – L0101

Competing Views in Macroeconomic Theory and Policy

Possible Exam Questions – F2019

Critically comment on the following 12 statements:

1. It is generally accepted that markets work poorly in developing countries. However, while heterodox economists make a case for the implementation of industrial policy to address market failures, orthodox economists argue that industrial policy is an invitation to corruption and rent-seeking behaviour.

2. Fiscal austerity has emerged from the debate on the euro crisis as the main strategy to restore growth and employment. According to this view, decreasing fiscal deficits reduces interest rates and injects confidence in the private sector, freeing the basic instincts to invest and consume.

3. The Task Force on Competitiveness, Productivity and Economic Progress concluded that Ontario is settling into a troubling era of stagnant growth that could be alleviated if businesses stop sitting on ‘dead money’ and ramp up investments.

4. Ontario’s minimum hourly wage was raised from $11.60 to $14 in January 2018 (an increase of slightly over 20 percent). As a result, unemployment must have increased, aggregate demand and income must have fallen, while inflation must have risen.

5. All of today’s developed countries have become rich through free-market policies, especially through free trade with the rest of the world. As David Ricardo demonstrated almost two centuries ago, specialization and trade based on the principle of comparative advantages makes all countries better off. Therefore, developing countries should fully embrace free-trade policies in order to close the income-gap with developed countries.

6. Given the strong correlation between the value of the Canadian dollar and the price of oil, it is argued that Canada should adopt a fixed-exchange rate regime to avoid the so-called Dutch disease. Some supporters of this view go even further and suggest that Canada should adopt the U.S. dollar as its currency.

7. Adjusted for inflation, the price of oil increased from about $30 a barrel in 2002 to about $100 a barrel in 2008 and (except for 2009-10) remained around that level until mid-2014. Being Canada an oil exporter, some observers concluded that this dramatic increase in the price of oil was ‘unambiguously good’ for Canada.

8. Capital inflows increase the pool of savings available for investment. Therefore, it appears that calls for capital account regulations are not justified.

9. Financialization is often a symptom of a larger disease — the curse of too much foreign money. The cure, therefore, is for governments to counteract capital inflows by buying foreign assets: If they send you money, maybe the right thing to do is to send it right back to them.

10. Many politicians and observers state that the large US trade deficit with China is the result of China's manipulation of its exchange rate. But the US also has a trade deficit with over 90 other countries, most of them having flexible exchange-rate systems.

11. Fixated on inflation targeting in a world without inflation, central banks have lost their way. With benchmark interest rates stuck at the dreaded zero bound, monetary policy has been transformed from an agent of price stability into an engine of financial instability.

12. Even in normal times, the financial sector generally prefers higher interest rates and lower employment than the vast majority of citizens would choose. Most people want the economy to be closer to full employment, and appreciate rising wages. A central bank that is 'independent' of the public's needs and wants, and caters primarily to those of the financial sector, is therefore going to cause a lot of needless suffering.