UNIVERSITY OF TORONTO
Faculty of Arts and Science

December Examinations 2017

ECO 407H1F

Duration: 2 hours

No Aids Allowed

Instructions:

- Answer the following SIX questions.
- All questions are of equal weight.
- Please write legibly. If I can't read your handwriting, I can't award you any marks!
- Manage your time properly!

Hand in this Question Paper Please

Do not enter any answers on this yellow question paper. It will be destroyed after the exam.

Answers on this question paper will **not** be marked. All answers must be provided in the answer booklets included with your examination.

Critically comment on the following SIX statements:

1. Individual banks are not constrained in making loans in the short run, as they can always borrow needed reserves from other banks. If they do so that will put upward pressure on the overnight interest rate, and the Bank of Canada will thus supply the needed reserves to maintain the target for the overnight rate.

2. 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.

3. In Canada and many other developed countries, the risk is not of higher wages rising unemployment; it is rather of stagnating wages causing household demand to remain depressed or grow only sluggishly, thereby deterring businesses from investing.

4. The government runs a balanced budget at the initial equilibrium income. Now it increases the income tax-rate on the rich and reduces the income tax-rate on the middle class while still maintaining total taxes unchanged at the initial equilibrium income. Therefore, equilibrium income and the government budget surplus will both remain unchanged.

5. 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.

6. Monetary policy alone is ineffective when economies are stuck in a deflationary debt trap. But if loose monetary policy facilitates fiscal expansion, it can still help stimulate the economy, making it possible to run large deficits without provoking interest-rate hikes.