

UNIVERSITY OF TORONTO
Faculty of Arts and Science

June Examinations 2017

ECO 407H1F

Duration: 2 hours

No Aids Allowed

Instructions:

- Answer any SIX of the following EIGHT questions.
 - Clearly identify the SIX questions you are answering. If you answer more than six questions, only the first six will be marked.
 - 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!
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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 any SIX of the following EIGHT 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. All countries cannot run trade surpluses. A deficit country is the counterpart of surplus one — and a country with a surplus ends up with a claim on debtor countries in the form of government bonds, bank loans, etc. If one country is in quasi-permanent surplus, and the other in deficit, these bonds and loans can never be

repaid; is this the fault of the irresponsible debtor or is it the creditor (saver) that is being irresponsible?

3. 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.
4. 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.
5. Orthodox economists consider that an economy's output is a decreasing function of the real wage rate. To the contrary, heterodox economists argue that an increase in real wages might result into an increase in overall aggregate output.
6. 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.
7. 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.
8. 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.