UNIVERSITY OF TORONTO
Faculty of Arts and Science

June Examinations 2018

ECO 407H1F

Duration: 2 hours

No Aids Allowed

Instructions:

- The total time for this exam is 2 hours. **Manage your time properly!**
- Answer any **six** of the seven questions below. If you answer all seven questions, only the first six will be graded.
- Each Question is worth one-sixth of the total grade.
- No aids allowed.
- **Please write legibly.** If I can't read your handwriting, I can't award you any marks!

Critically comment on SIX of the following SEVEN 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. Unemployment is simply an excess supply of labour caused by policies or attitudes preventing wage rates from adjusting as smoothly as prices do in any well-functioning market. If the unemployed were willing to work at lower wage rates, the problem would simply disappear.

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. In periods of economic boom, it is argued that unrestricted cross-border movements of capital contribute to exchange rate appreciation, current account deficits, and/or excessive accumulation of foreign exchange reserves. Therefore, it appears that capital account regulations might be somehow justified.

6. 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.

7. 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.