

ECO 407 – L0101
Competing Views in Macroeconomic
Theory and Policy

Possible Test Questions – F2018

Critically comment on the following 10 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. 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.
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. Some economists argue that investment is determined by savings. At the same time, they consider savings to be an increasing function of the rate of interest. Therefore, it must be concluded that an increase in the rate of interest will increase investment.
5. Orthodox economists consider that labour demand is a decreasing function of the real wage rate. Therefore, a decrease in real wages must result into an increase in overall aggregate output.
6. Fiscal austerity has emerged from the debate on the euro crisis as the main strategy to restore growth and employment. According to this view, reducing public debts reduces interest rates and injects confidence in the private sector, freeing the basic instincts to invest and consume.
7. 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.
8. 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.
9. 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.
10. 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.