Economics 105: Principles of Macroeconomics

Assignment set #6 answer key

1. Consider an economy with two labour markets, neither of which is unionized. Now suppose a union is established in one market.

   (a) Show the effect of the union on the market in which it is formed. In what sense is the quantity of labour employed in this market an inefficient quantity?
   (b) Show the effect of the union on the non-unionized market. What happens to the equilibrium wage in this market?

2. Explain how each of the following changes the money supply.

   (c) the Bank of Canada buys bonds
   (d) the Bank of Canada raises the bank rate
   (e) the Bank of Canada raises the reserve requirement

3. Describe the two things that limit the precision of the Bank of Canada's control of the money supply and explain how each limits that control.

4. Draw a simple T-account for First National Bank of Commerce, which has $5,000 of deposits, a required reserve of 10 percent, and excess reserves of $300.

5. What is the difference between the reserve ratio and the reserve requirement? Which is generally larger?

6. Economists argue that the move from barter to money increased trade and production. How is this possible?

Answer:
1.
When one labour market is unionized, the wage rises and the quantity of labour demanded declines. Since the wage is higher, the quantity supplied of labour increases. The quantity of labour employed in this market is inefficient, since more workers would like to have jobs at the existing wage.

Those workers who become unemployed in the union sector seek employment in the non-unionized market. As a result, the supply of labour in the non-unionized market shifts to the right. The result is a decline in the wage in the nonunionized sector and an increase in employment in the nonunionized sector.

2.
a. If the Bank of Canada buys bonds, it pays for them with money. So there is more money.

b. If the Bank of Canada raises the bank rate, banks will borrow less from the Bank, and so have fewer reserves, which decreases the money supply.
c. If the Bank of Canada raises the reserve requirement, banks will have to hold more of their deposits as reserves and so will have less to lend out. With less to lend out, deposits and the money supply decrease.

3.
First, the Bank of Canada does not control the amount of currency that households choose to hold relative to deposits. If households decide to hold relatively more currency, banks have fewer reserves and the money supply decreases. Second, the Bank of Canada cannot control the amount banks choose to hold as excess reserves. If bankers decide to lend out less of their deposits, the money supply will decrease.

4.

Assets		***Liabilities***	
Reserves	***$800***	***Deposits***	***$5,000***
Loans	***4,200***		

5.
The reserve ratio is the percent of deposits that banks hold as reserves. The reserve requirement is the minimum percent of deposits that banks must hold in reserve by law. To maintain some liquidity, banks generally hold more reserves than required so that the reserve ratio is larger than the reserve requirement.

6.
The use of money allows people to trade more easily. When it is easier to trade what one produces, people specialize. The specialization creates greater production.