

Economics Aspects of European Integration – Exam January 2012

Question 1 (20 points, 10 points each sub question)

In the following sub-questions you are supposed to use the PTA diagram

- When the EEC customs Union was formed in the 1960s, EEC countries also lowered their tariffs as a result of the GATT Kennedy Round. Show that it is possible for Home and Partner to form a customs union and lower their common tariff against RoW to the point where the new border price faced is the same as it was before the liberalization. Show that this adjustment ensures that Home and Partner gain while RoW does not lose from this customs union.
- Suppose that signing a customs union treaty between Home and Partner produces a growth effect that raises their income level and thus shifts their MD curves upwards. Use the PTA diagram to show that a sufficiently big upward shift in Home and Partner MD curves would ensure that RoW did not lose from this customs union.

Question 2 (15 points)

When the German re-unification took place, Germany's labor force rose much more than its capital stock (since much of East Germany's capital stock was useless in the market economy). Use the Solow diagram to analyze the growth effects of such integration.

Question 3 (15 points, 5 points each sub-question)

- Discuss how new economic geography models explain migration of capital. Does capital flow necessarily flow from rich- to poor regions?
- Use your answer to sub question a. to justify a role for EU wide regional policy. What other justifications have been put forward? Briefly explain whether you think these justifications are valid.
- Briefly outline the main successes and failures of EU regional policy?

Question 4 (15 points, 5 points each subquestion)

- In recent months interest rates on Greek government bonds have risen sharply in response to the Greek debt crisis. In order to prevent a Greek sovereign, debt default, the EU created the European Stability Mechanism (ESM), which is supposed to be a permanent bailout fund for member states in trouble and which will start its operations in the summer of 2012. Use fiscal federalism arguments to discuss the merits and demerits of the ESM's creation.
- The Delors Report argued that EMU could work if control of the single currency was kept from politicians and left to independent technocrats at the ECB, to be modeled on Germany's Bundesbank. The report gave warning though that to prevent large trade imbalances, reforms would be needed to make prices and wages more flexible and workers and capital more mobile. Discuss why these reforms were necessary. What if no reforms would be introduced?
- From an OCA perspective, discuss the merits and demerits of the Greek accession to the euro.

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