Universidad Carlos III de Madrid

Economics of European Integration

June 2nd, 2010

EXAM VERSION A

INSTRUCTIONS

1. Turn off your mobile phones and remove everything but writing utensils, calculator, and an ID from your table.
2. Make sure your name is on all three sheets!
3. Total time for completing the exam is 120 minutes.
4. The exam consists of two parts:
   - 15 multiple choice questions: 6 points.
     Each question has exactly one correct answer. Each correct answer is worth 0,4 points, each wrong answers takes of 0,1 points. An answer left blank counts as 0.
     Answer the multiple choice questions on the special sheet for optical character reading handed to you.
   - 2 exercises: 4 points.
     Each exercise has 4 parts, every part is worth 0,5 points.
     Answer the exercises on the seperate sheet handed to you.

First name: ____________________

Last name: ____________________

Group: ____________________

Signature: ____________________

DNI or Passport Nº: ____________________

PART 1: Multiple Choice Questions

1. Comparing the effects of a quantitative import restriction (import quota) with the use of an equivalent import tariff in perfect competition,
   (a) they have identical price effects.
   (b) they have identical quantity effects..
   (c) they have identical effects on prices and quantities.
   (d) they have identical effects on quantities but not on prices.
2. Which one is the correct answer?
   (a) The legislative process begins with a European Parliament proposal; Community law cannot be made without one. In devising its proposals, European Parliament has three constant objectives: to identify the European interest, to consult as widely as necessary and to respect the principle of subsidiarity.
   (b) The legislative process begins with a Council of Minister proposal; Community law cannot be made without one.
   (c) The legislative process begins with a Commission proposal, Community law cannot be made without one. In devising its proposals, Commission has three constant objectives: to identify the European interest, to consult as widely as necessary and to respect the principle of subsidiarity.
   (d) None of the above is correct.
3. Referring to *Objective 1 Areas* of the old regional policy in the EU-25, which one is the correct answer?
   (a) Objective 1 promotes the development and structural adjustment of regions whose development is lagging behind, i.e. whose average per capita GDP is less than 75 % of the European Union average.
   (b) Objective 1 excludes the most remote regions (the French overseas departments, the Azores, Madeira and the Canary Islands) as well as the areas eligible under the former Objective 6 (areas with low population density) created by the Act of Accession of Austria, Finland and Sweden.
   (c) 10 % of the Structural Fund operations concentrate on Objective 1.
   (d) None of the above is correct.
4. Which of the following are among the arguments in favor of public intervention in agricultural markets?
   (a) The demand for food is very income elastic, therefore it is important to guarantee a sufficient supply of foodstuffs.
   (b) Limited political power of farmers' lobbying groups.
   (c) Food supply is very variable and at the same time, food demand is very income inelastic.
   (d) Large power of farmers' trade unions, which guarantees a stable supply of foodstuffs.

5. Which one is the correct answer?
   - (a) Common markets are trading blocks where the member nations remove all trade impediments among themselves but retain their freedom with regard to the determination of their commercial policies vis-a-vis the outside world.
   - (b) Customs unions are free trade areas in which the members agree on a complete unification of the external tariffs.
   - (c) Customs unions are trading blocs where the participants become literally one nation.
   - (d) None of the above is correct.
6. One of the convergence criteria established by the Treaty of Maastricht, which the Member State must meet in order to participate in the third stage of Economic and Monetary Union, is:
   - (a) The inflation rate must not exceed the average of the three best-performing Member States in terms of price stability during the year preceding the examination of the situation in that Member State.
   - (b) The Member State must have participated in the exchange-rate mechanism of the European monetary system during the two years preceding the examination of the situation and without severe tensions. In addition, it must not have devalued its currency during the same period.
   - (c) The nominal long-term interest rate must not exceed by more than 2 percentage points that of the three Member States with the lowest interest rates during the year preceding the examination.
   - (d) The growth rate of gross government debt to GDP must not exceed 3 % during the preceding financial year. If this is not the case, the growth rate must remain close to 3 % while representing only an exceptional and temporary excess.
7. The countries that are applying for full membership in the EU (e.g. Turkey, Macedonia) have factor endowments that are much more labor-rich and capital-poor than those of the current EU members. Does this fact suggest any presumption about the amounts of trade creation and diversion associated with their accession?
   - (a) The New Member Countries are considering forming a free trade area within Eastern Europe, which would not eliminate their tariffs on products imported from the area.
   - (b) Prior to joining the EU, the countries should join a free trade area, which applies a common tariff to all imports regardless of source. Their supply curves for the imported product would shift to the left after joining the European Union.
   - (c) The welfare effects associated with each of the above are minimal in the real world.
   - (d) None of the above is correct.

8. Which one is the correct answer?
   - (a) Monetary Unions are very similar to free trade areas, except that member nations must ensure that every reference in a legal instrument to national currency shall be replaced by a reference to single currency at the exchange rate in the open market of the single currency against the ECU.
   - (b) Arguments for a regional policy include: Economic integration decreases the trade cost. The persistence of limiting forces to the regional dispersion like low wages flexibility. The fact that certain companies do not have incentives to abandon the center.
   - (c) The difference between an irrevocably fixed exchange rate and a single currency is that fiscal policy must be completely unified before arriving to the single currency.
   - (d) None of the above is correct.
9. Which one is the correct answer?
   - (a) Trade creation is a shift from a high cost source to a low cost source, a shift that would imply an overall increase in productive efficiency in the world.
   - (b) Trade diversion is a shift of a low cost producer to a high cost producer in response to the formation of a customs union, which would imply an overall decrease in productive efficiency in the world.
   - (c) Answers a and b are correct.
   - (d) None of the above is correct.
10. The Stability and Growth Pact
    - (a) forces all member countries of the EU to have the same rates of inflation.
    - (b) sanctions countries who's public debt is more than 70 % of GDP with a non-interest-bearing deposit to the EC.
    - (c) sets out the rules for joining the Monetary Union (i.e., for adopting the Euro).
    - (d) allows a public deficit exceeding 3 % of GDP in times of economic recession.
11. There are different adjustment mechanisms for an economy affected by an asymmetric shock. If the economies that are affected asymmetrically are part of a Monetary Union, which of the following mechanisms can restore the production level to what it was before the shock hit?
    - (a) A currency devaluation for the economy affected negatively.
    - (b) Labor mobility: emigration towards the economy affected negatively.
    - (c) Monetary policy: adjusting the central interest rate in order to encourage demand and investment.
    - (d) Flexible salaries: reducing real wages in the economy that was affected negatively, raising them where the shock was positive.

12. Reasons for the invalidity of the Fleming-Corden theory conclusion include:
    (a) Assumptions made by Fleming and Corden are extremely controversial: In practice there would never be a separation between the exchange-rate union and market integration. Devaluation is nothing but a temporary adjustment device as the discussion of the monetary approach to the balance of payments has shown.
    (b) The monetary union is not forgoing the availability of exchange rate variations relative to the outside world, and the Stability and Growth Pact establishes rules that do not allow interest rates to exceed by more than 2 percentage points that of the three best performing' EU-15 member countries. But budget deficits should be in any case less than 3 % of GDP and public debt not exceeding 60 % of GDP.
    (c) Answers a and b are correct.
    (d) None of the above is correct.
13. Due to the CAP (and not to its comparative advantages), the EU has turned from an net importer into a net exporter of agricultural goods. This leads to
    (a) a world market equilibrium with lower prices.
    (b) a world market equilibrium with no change in prices.
    (c) a world market equilibrium with higher prices.
    (d) a world market equilibrium with higher demand.
14. Which one is the correct answer?
    (a) Technical progress allows farmer to increase food prices.
    (b) The Common External Tariff increases the import price of agricultural products until the threshold level reaching the intervention price.
    (c) Answers a and b are correct.
    (d) None of the above is correct.
15. Which of the following statements about the effects of the opening of capital markets in the New EU Member States is **false**?
    (a) Since they are relatively poor in capital, the New Member States will become a destiny for direct investment, which reduces their interest rates and increases their total production.
    (b) Capital movements will lead to an income redistribution to the disadvantage of workers in the New Member States.
    (c) Direct investment in these countries will often go together with a transfer of advanced technology, improving the marginal product of capital, attracting more investment etc.
    (d) As members of the EU, international investors will have more confidence in the stability of political institutions and economic policy in the New Member States, which will give additional incentives to direct investment.

PART 2: Excercises

1. Suppose that the average cost per kilogram of cheese is 2,50 € in Spain, 4,00 € in France, 4,40 € in Italy, and 3,50 € in Germany. The current ad valorem import duty for cheese is 25 % in Spain, 30 % in France, 100 % in Italy, and 60 % in Germany.

   a) Which countries import cheese? Which countries export cheese?

   b) Italy and Germany form a free-trade association. They eliminate all import duties on their mutual trade but retain tariffs on imports from third countries. What is the pattern of the cheese trade now? Does the formation of the free-trade area give rise to trade creation or trade diversion?

   c) Italy and Germany convert their free trade association into a tariff union. The common external tariff is set at 50 %. What is the new pattern of trade? Does the creation of the tariff union give rise to trade creation or trade diversion?

   d) France joins the tariff union between Italy and Germany, adopting the common external tariff of 50 %. All tariffs between the three countries are eliminated. What is the new pattern of trade? Is there trade creation or trade diversion as a result of the tariff union's enlargement?

2. In countries H and F there are two production factors, capital and labour, that are used to produce a single non-tradable good. Labour is immobile. The marginal product of capital in each country depends on the total units of capital used in the following way:

Units of capital used in production	0	1	2	3	4	5	6	7	8	9	10	11	12
Marginal product of the last unit of capital in H	0	30	29	28	27	26	25	24	23	22	21	20	19
Marginal product of the last unit of capital in F	0	25	23	21	19	17	15	13	11	9	7	5	3

   Initially, there are 10 units of capital in country H and only 4 units of capital in country F .

   a) What are the interest rates and production in both countries in the absence of capital mobility?

   b) How is total output distributed between capital and labor in both countries in the absence of capital mobility?

   c) Suppose capital moves freely between borders now, but technology is specific to each country. What are the interest rates and production in both countries in the presence of free capital movements? How is total output distributed between capital and labor in both countries?

   d) Answer part c) of this question, assuming that technology can be transferred between countries.