Examination questions:

1. (20 points: (a): 12, (b): 3, (c): 5)

   (a) What are the main tasks of the European Commission?

   (b) How is this body composed and to whom is it responsible?

   (c) Who are the members of the European Council (not Council of Ministers) and what is the major task of this body?

2. (30 points: (a): 20, (b): 10)

   (a) Sketch briefly (!) the historical process of European integration with regard to the most important steps in this direction (no lengthy novels, please!).

   (b) Which are the "convergence criteria" laid down in the Maastricht Treaty?

3. (15 points: (a): 3, (b): 6, (c): 6)

   (a) What can be said in general from an empirical point of view about the importance of the static welfare effects (trade creation and trade diversion) and the dynamic ones (competition effects, economies of scale etc.) with regard to the actual integration process in Europe?

   (b) Describe graphically and verbally, in which way the welfare account of a country (in terms of the trade creation and the trade diversion effect) is affected, if all firms in that country which produce the good under consideration are owned by residents from third countries. Assume first an importing country.

   (c) Now carry through the same analysis as in (b) for the case, that the country exports the good under consideration.

4. (15 points: (a): 7, (b): 6, (c): 2)

   (a) Derive in a graphical way the concept of the "factor price frontier" and give a brief verbal explanation for it. Which property of the underlying production function is of especial importance in this regard?

   (b) Consider now the case of two countries. Show – again graphically – the different outcomes that are possible, if only capital is allowed to move freely between the countries whereas labor is not. Make again use of the factor price frontier derived in (a).

   (c) What can be said about the development of factor prices (i.e. wages and interest rates) in the EU?

5. (20 points: (a): 7, (b): 5, (c): 8)

(a) Consider the situation of two countries which are characterized by fixed nominal wages and the absence of labor migration between them. Assume furthermore, that each country produces only one good but that demand also refers to the other country's good. Now let an asymmetric shock occur. Which consequences will arise from this if

- the exchange rate between the currencies of the two countries can be adjusted
- the two countries join a monetary union.

(b) The problem discussed in (a) immediately raises the question about the relationship between trade integration and the probability of asymmetric shocks. Describe in a few words (and with two simple graphs) the different positions of

- the European Commission and
- Paul Krugman

with regard to this issue and discuss briefly the pros and cons of the two views.

(c) Describe in a formal way the consequences which may arise in a monetary union, if the wage bargain is centralized and countries differ with regard to their growth rates (Hint: Start with the definition of the real exchange rate).