Examination: 1557 European Integration **Wintersemester: 2004/2005**
Examiner: Dr. G. Groh
The following aids can be used: Dictionary

Student number: ____________________ Faculty: ______________________________

Name: ____________________________ First name: ____________________________

Date: ______________________________

Important hints:

- This exam consists of 25 questions.
- General rule for all questions: From the 4 given answer proposals, exactly one is correct.
- Valuation:
  - correct answer: 1 point
  - no answer: 0 points
  - wrong or more than one answer: $-\frac{1}{3}$ point
- The intersection point of the crosses has to be *within* the boxes, not outside (☒ instead of ×☐). Crosses outside the boxes will *not* be counted!
- Use a ball-point pen or s.th. similar but *not* a lead pencil!
- If you have made a cross at the wrong alternative and want to correct it, please write this

1. The centerpiece of the Werner-Plan was

   - ☐ a guideline for the abolition of the remaining tariff barriers among the EC-countries.
   - ☐ a proposal to achieve smaller bands of fluctuations for the exchange rates between the currencies of the EC-countries.
   - ☐ the creation of the European Currency Unit (ECU).
   - ☐ a proposal for the completion of the common market by removing all non-tariff barriers between the EC-countries.

2. The following statement is correct:

   - ☐ In 1969 the EFTA was founded and the Merger Treaty came into force.
   - ☐ Denmark became a member of the European Community in 1995 and joined the European Monetary Union in 1999.
   - ☐ In 1958 the European currencies became convertible and the European Monetary Institute (EMI) was founded.
   - ☐ Spain entered the European Community in 1986 and joined the European Monetary Union in 1999.

3. The following countries (among others) have joined the European Union on 1^{st} May 2004:

   - ☐ Poland, Hungary, Czech Republic, Bulgaria, Lithuania.
   - ☐ Slovenia, Croatia, Poland, Hungary, Czech Republic.
   - ☐ Slovenia, Slovakia, Malta, Lithuania, Latvia.
   - ☐ Poland, Hungary, Estonia, Moldavia, Lithuania.

4. The new EU-25 in its present form is

   - ☐ a complete common market.
   - ☐ an incomplete common market.
   - ☐ a free trade area.
   - ☐ an economic and monetary union.

5. In order to enter the EU, a candidate country has

- ☐ to adopt not only the treaties of the EU, but also secondary EU-legislation.
- ☐ to precisely fulfill all of the "convergence criteria" laid down in the Maastricht Treaty.
- ☐ to equalize its corporate tax rates to the level of the other EU-countries.
- ☐ to adopt the Euro within a transitional period of seven years.

6. The European Commission

- ☐ has the final say in EU-legislation.
- ☐ can be dismissed by the Council of Ministers.
- ☐ appoints the members of the "Economic and Social Committee" and of the "Committee of Regions."
- ☐ is accountable to the European Parliament.

7. For the voting rules in the Council of Ministers the following statement is correct:

- ☐ According to the European Constitution voting by unanimity will still apply in some policy areas.
- ☐ According to the Maastricht Treaty most decisions are taken by simple majority.
- ☐ According to the Treaty of Nice voting by qualified majority has been extended to tax policy and justice and home affairs.
- ☐ According to the Treaty of Amsterdam voting by unanimity has already been completely abolished.

8. Which of the following conditions does <u>not</u> belong to the convergence criteria of the Maastricht Treaty?

- ☐ A member country must have taken part in the European Monetary System (EMS) in the last 2 years prior to entry in the European Monetary Union without devaluation.
- ☐ A member country's inflation rate is not more than 1.5 % higher than the average of the three lowest inflation rates in the EMS.
- ☐ A member country's short-term interest rate is not more than 2 % higher than the average observed in the three lowest-inflation countries.
- ☐ A member country's government debt shall not exceed 60 % of its GDP.

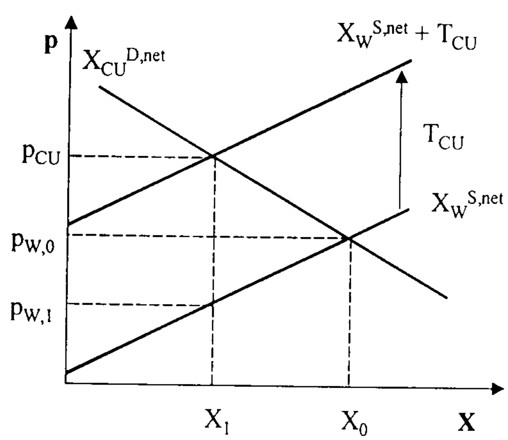
9. The Treaty of Amsterdam introduced the requirement, that

- ☐ each EU member country has to be represented by one commissioner.
- ☐ a designated president of the European Commission has to be confirmed by the European Parliament.
- ☐ two third of the EU member countries delegate a commissioner by rotation.
- ☐ all members of a new Commission are subject to an approval of the European Parliament.

10. The European System of Central Banks (ESCB) comprises

- ☐ the European Central Bank (ECB) and the national central banks of the euro area, i.e. only of those EU-countries, which have adopted the euro.
- ☐ the European Central Bank (ECB) and the national central banks of all EU-countries, whether they have adopted the euro or not.
- ☐ the European Central Bank (ECB) and the national central banks of all European countries, whether they belong to the EU or not.
- ☐ the national central banks of all EU-countries, but not the European Central Bank (ECB).

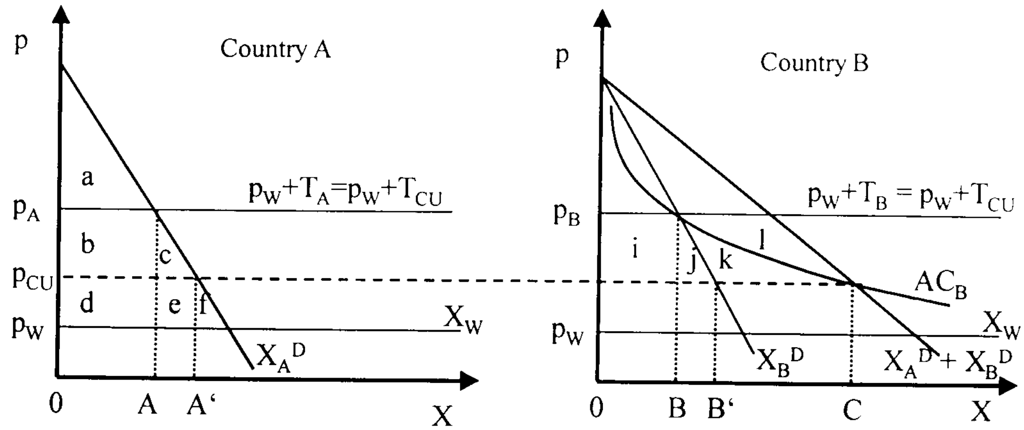
11. Consider a large customs union imposing a tariff on imports from third countries:



Remember that $X_{CU}^{D,net} = X_{CU}^{D} - X_{CU}^{S}$ and $X_{W}^{S,net} = X_{W}^{S} - X_{W}^{D}$. Among other effects, the imposition of the tariff T_{CU} by the large customs union

- ☐ increases producers' surplus in the large customs union as well as consumers' surplus in third countries (W).
- ☐ reduces producers' surplus as well as consumers' surplus in third countries (W).
- ☐ reduces producers' surplus and increases consumers' surplus in the large customs union.
- ☐ reduces consumers' surplus in the large customs union as well as consumers' surplus in third countries (W).

12. Have a look at the following picture:



In the initial situation country A imports the quantity $0A$ of good X from the world market at price $p_A = p_W + T_A$. Country B produces the quantity $0B$ by itself at the same price ($p_B = p_W + T_B = p_W + T_A = p_A$). After the formation of a customs union between both countries, country B takes over the entire production for the whole customs union due to its falling average cost curve (AC_B). It is assumed, that both countries maintain their previous tariff ($T_A = T_B$) as the common external tariff T_{CU} for the customs union. In comparison to the initial situation, the customs union leads to the following aggregate welfare effects for the two countries:

- ☐ Country A's aggregate welfare changes by $b + c$, and country B's aggregate welfare changes by $i + j$.
- ☐ Country A's aggregate welfare changes by c, and country B's aggregate welfare changes by $-k$.
- ☐ Country A's aggregate welfare changes by c, and country B's aggregate welfare changes by $i + j + k + l$.
- ☐ Country A's aggregate welfare changes by $c - d$, and country B's aggregate welfare changes by $i + j$.

13. In a 2-country model with 2 goods and 2 production factors (labour and capital) the following statement is correct:

- ☐ Without free mobility of labour between these two countries, an equalization of the real wage rates between these countries can never occur.
- ☐ An equalization of the real wage rates between the two countries always requires the free mobility of at least one factor, labour or capital.
- ☐ Under all circumstances, free trade in goods between the two countries already fully suffices to equalize the real wage rates between these countries, even if labour and capital are not internationally mobile at all.
- ☐ Free mobility of capital between the two countries does not always suffice to equalize the real wage rates between these countries.

14. Consider the 2-country-version of the Barro-Gordon-model. Assume

- a "hard-nosed" central bank in country A, which aims at an inflation rate $\hat{p}_A$ of 2 % and does not care about unemployment at all ($\Rightarrow$ corresponding loss function e.g.: $L_A = (\hat{p}_A - 2\%)^2$) and
- a "wet" central bank in country B, which prefers an inflation rate $\hat{p}_B$ of 5 % and an unemployment rate U_B of 3 % ($\Rightarrow$ corresponding loss function e.g.: $L_B = (\hat{p}_B - 5\%)^2 + (U_B - 3\%)^2$).

Assume furthermore, that the Phillips-curve has the same functional form and the same inclination in both countries and that also the natural rate of unemployment $\bar{U}$ is the same with a level of 7 %.

If the two countries now form a monetary union with the common central bank being exactly of the same type as the former central bank of country A, the new long-run equilibrium will be characterized by:

☐ $\hat{p}_A = \hat{p}_B = 5\%$ and $U_A = \bar{U} = 7\%$ whereas $U_B = 3\%$.

☐ $\hat{p}_A = \hat{p}_B = 2\%$ and $U_A = \bar{U} = 7\%$ whereas $U_B = 3\%$.

☐ $\hat{p}_A = \hat{p}_B = 2\%$ and $U_A = U_B = \bar{U} = 7\%$.

☐ $\hat{p}_A = 2\%, \hat{p}_B = 5\%$ and $U_A = U_B = \bar{U} = 7\%$.

15. Assume the same scenario as in question 15. The adjustment process to the new long-run equilibrium

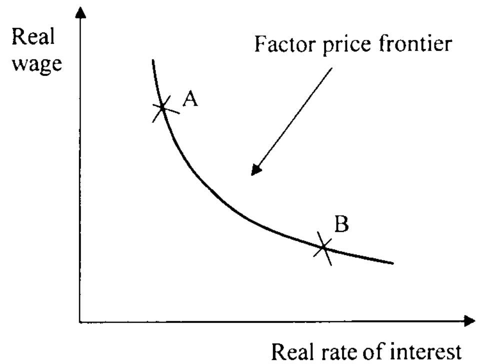
☐ will necessarily be characterized by unemployment rates temporarily exceeding the new equilibrium levels in both countries.

☐ will in both countries depend on the expectations of the private agents with regard to the actual policy of the new common central bank.

☐ will be a direct jump into the new equilibrium, independently of what private agents expect.

☐ will be a direct jump into the new equilibrium in country A, but inevitably associated with a temporarily higher rate of unemployment in country B.

16. Have a look at the points A and B, lying on the same factor price frontier, which is based on a linear homogeneous production function. Assume in the following always full employment of the two production factors, labour and capital, and that they are paid according to their marginal products.



A transition from point A to point B is possible, if

- ☐ both capital and labour input decline at the same rate.
- ☐ the capital stock remains constant whereas labour input decreases.
- ☐ the capital stock increases by a smaller rate than labour input.
- ☐ both capital and labour input increase at the same rate.

17. According to the theory of optimum currency areas, a monetary union between two countries

- ☐ is only advisable if both wage flexibility and labour mobility between these countries prevail.
- ☐ can also work in a satisfactory way if wages are flexible in both countries whereas labour is fully immobile between them.
- ☐ should be avoided in the case of wage flexibility or labour mobility between these countries.
- ☐ is advisable in the case of labour mobility between these countries but not in the case of wage flexibility.

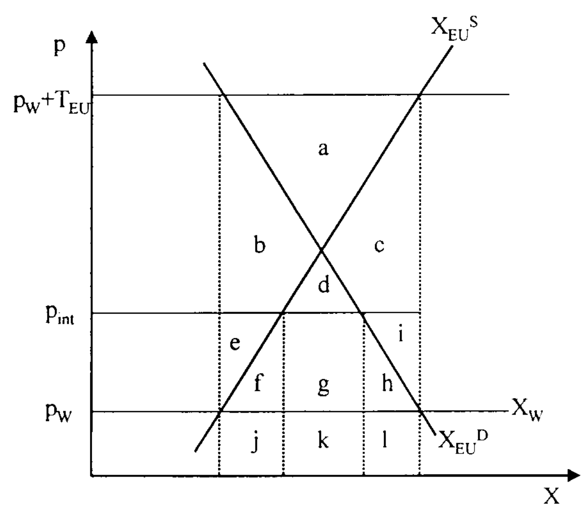
18. According to the European Commission a higher degree of trade integration

- ☐ increases the costs of a monetary union, since it leads to higher current account deficits in all member countries.
- ☐ reduces the costs of a monetary union, since it leads to more intra-industry trade and thus to a lower probability of a asymmetric shocks.
- ☐ increases the costs of a monetary union, since it leads to more specialization and thus to a higher probability of asymmetric shocks.
- ☐ reduces the costs of a monetary union, since it leads to an automatic reduction in government deficits of the member countries.

19. A link between the payments that farmers in the EU receive from the Common Agricultural Policy and their compliance with environmental improvements was firstly introduced in conjunction with

- ☐ the Mansholt plan.
- ☐ the reforms after 1988 and prior to 1992.
- ☐ the MacSharry reforms.
- ☐ the Agenda 2000.

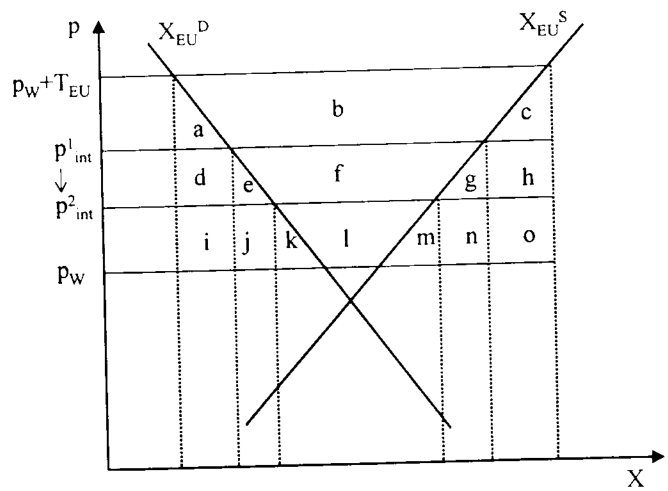
20. Have a look at the following picture, which describes the situation on the market for an agricultural good X in the EU:



Let p_w denote the world market price for this product and T_{EU} the common external tariff levied by the EU on potential imports. Furthermore p_{int} is the intervention price guaranteed to EU-producers in conjunction with the Common Agricultural Policy. If intervention is necessary, assume that surpluses can be sold by the intervention authorities on the world market at price p_w. In the above situation, the budgetary costs for intervention buying

- ☐ are zero.
- ☐ are equal to $a + b + c + d + e + f + g + h + i$.
- ☐ are equal to g.
- ☐ are equal to $g + k$.

21. Now assume the following constellation on the market for an agricultural product in the EU:



Once again, p_{int} is guaranteed to EU-producers, p_w is the world market price and T_{EU} denotes the common external tariff of the EU. In the case of intervention buying, it is again assumed, that surpluses can be sold by the intervention authorities on the world market at price p_W. Assume now, that in the course of the CAP-reforms the intervention price is reduced from p^1_{int} to p^2_{int}. Taking together the changes in consumers' surplus, producers' surplus and the costs for the intervention authorities, the overall increase in welfare due to this measure is equal to

- ☐ $e + g - (k + l + m)$.
- ☐ $e + g$.
- ☐ $e + j + g + n$.
- ☐ $a + d + e + c + g + h$.

22. The following statement is correct:

- ☐ Any deviation from perfect competition necessarily reduces the gains from a common market.
- ☐ The extension of a common market to a monetary union requires a harmonization of the income taxes in the member countries.
- ☐ A monetary union can lead to net gains for the participating countries also in the absence of a common competition policy.
- ☐ Competition policy and tax harmonization are complements in a common market, i.e. an intensified competition policy requires a higher degree of tax harmonization and vice versa.

23. The following statement is correct:

- ☐ The European Commission is always automatically involved, if a merger between two or more European firms is planned, independently of the size of the firms involved.
- ☐ Under specified circumstances, large companies are subject to EU merger regulation, even if they are incorporated outside the EU, provided that a merger between them threatens to distort competition on the Common market.
- ☐ According to EU-legislation national authorities play no role any more in conjunction with merger control.
- ☐ Any maintainance of a dominant position is prohibited in the EU.

24. Assume, a firm in country A produces a good at value 1000,- and exports it to another firm in country B. The latter firm adds a value of 500,- and sells the final product directly to a consumer in country C. The VAT-rates (value-added-tax) are 10 % in country A, 20 % in country B and 30 % in country C. For trade between country A and country B the <u>destination principle</u> applies, whereas between country B and country C the <u>origin principle</u> is valid. Then the following statement is correct:

- ☐ The consumer in country C has to pay 1800,- for the product (incl. VAT). Country A gets no VAT-revenues, country B receives 300,- VAT and country C gets no VAT-revenues.
- ☐ The consumer in country C has to pay 1920,- for the product (incl. VAT). Country A gets 100,- VAT, country B receives 320,- VAT and country C gets no VAT-revenues.
- ☐ The consumer in country C has to pay 1800,- for the product (incl. VAT). Country A gets no VAT-revenues, country B receives 200,- VAT and country C 300,- VAT.
- ☐ The consumer in country C has to pay 1950,- for the product (incl. VAT). Country A and country B get no VAT-revenues, country C receives 450,- VAT.

(<u>Hint</u>: The above question can be answered even without any computations!).

25. For the regulations concerning the value-added-tax (VAT) in the EU the following statement is correct:

- ☐ The destination principle has completely been abolished and substituted by the origin principle.
- ☐ The destination principle is basically still in force with exceptions for purchases of private citizens abroad.
- ☐ The distinction between the destination and the origin principle has become obsolete, since VAT-rates have been fully equalized among the EU member countries.
- ☐ The destination principle applies for imports from outside the EU and the origin principle for the whole trade among the EU countries.