

# The Economics of European Integration

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Lectures: Thursdays, 09.00-11.45. (Tuesdays 13.15-16.00)  
Room: See course outline  
Visit hours: Thursday, 11.45 (after lectures)

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We start with an *overview* of the European integration process and the history of the European Union. **European Integration has foremost relied on economic integration**: Deeper economic integration would **draw Europeans into ever-closer and intricate economic** exchanges, producing gains to trade, investments and migration that eventually would promote a shift to closer political integration. Closer political integration, in turn, would ensure a peaceful and stable future Europe.

We start with the benefits of “**real integration**”. We first investigate the sources of gains to trade in standard *comparative advantage* driven trade models (such as the *Ricardian model* and the *Specific factors* model). We also look at the Heckscher-Ohlin model which shows how comparative advantage can emerge out of factor endowments (originating from two professors at the Stockholm School of Economics).

An important lesson from these models is that while embracing integration creates overall gains to trade, there will in general be **winners and losers**. We therefore turn to investigating how countries regulate international trade. We relate these findings to the European integration process, which involves specific features such the economics of preferential trade liberalization. We also learn how to examine the welfare effects of standard trade policy tools such import tariffs and quotas and export subsidies.

Standard trade models emphasize how differences between countries in factor endowments or productivity explain trade patterns. While such models are useful to understand the most recent **Eastern Enlargement of the EU**, where newcomers such as Bulgaria and Romania have significantly lower productivity and income than old member states such as Germany and France, these models tell us little of what the gains from integration are between large developed countries such as Germany and France. We therefore turn to more recent models of trade with scale economies and imperfect competition. Indeed, this “**new trade theory**” emerged out of a need to better understand the strong growth in trade and income that followed the initial integration in Europe in the 1950ies and 1960ies.

Having showed how integration leads to a more efficient resource allocation and higher income, we explore how this process can promote economic growth. This is the so-called “medium run **growth bonus**” of European integration which we illustrate using the classic “Solow model”. We then turn to integration of labor markets, where we emphasize that European labor markets (much more so than the US labor market) are characterized by collective wage bargaining, and discuss what trade-offs this system involves. We also relate this to the recent refugee crises and the challenges arising from globalization and automation in terms of so-called job polarization. We relate these findings to the recent **Brexit** with rising resistance against **migration**.

In the last part of the course, we turn to **monetary integration**. We discuss the **Maastricht Treaty**, and the later adoption of the **EURO**.

We review basic macro concepts such as interest parity, purchasing parity and the determination of exchange rates in the short-run and the long run. We explore how the choice of the exchange rate regime affects a government’s possibilities to pursue independent economic policy, and relate this to the creation of **the EURO**. We use the theory of optimal currency areas to **assess** the creation of the EURO. This will highlight why many economists have been critical to the EURO project. We conclude with a discussion of the **financial crises**, how it spread to Europe and why the financial crises had such a **strong negative impact on the EURO zone**.

Upon completion of this course, you will be able to:

- Explain **why economic integration** was chosen in Europe in favor of political integration.
- Show how **Europe has gained from integration** using economic theory (use, for instance, Ricardian comparative advantage, new trade theory models of imperfect competition and scale economies and Solow type growth models).
- Explain how integration can still make **some groups worse off** and how this shapes **EU policies**.
- Discuss particular policies in the EU. For instance, the **Common Agriculture policy** which takes up 50% of the EU budget.
- Assess the EURO project using the theory of **optimal currency areas**.
- Discuss why the aftermath of the **financial crises** has been **worse in Europe** than in the US
- Discuss the **current crises in Greece and in the Southern European** countries and make comparisons to the **Swedish crises** in the early 1990s.
- Discuss **UK’s Brexit** (with a perspective of migration and job polarization)

## Practical Information

**Examination:** The examination consists of three parts. Firstly, all students will have to do 5 mandatory problem sets during the course. Active participation in class is also required. Secondly, there will be a mid-term exam, as well as an end-term exam. 40% of the grading will be based on the problem sets, 30% on the mid-term exam and 30 % on the end-term exam.

### *Problem sets*

Students may cooperate when doing problem sets, but you will need to submit your own solution. Remember that problem sets are learning experiences. Try to do it on your own first, and then ask your classmates. This strategy will help you on the mid-term exam and the final exam – if you just copy what somebody else did, you won't know what to do on the exams! You should hand in solutions to a problem set on the next lecture (that is, normally, you will have one week to do them).

### *Grading:*

In total, there will be 100 points available for grading. To give you an incentive to work with problem sets, 40 points are attainable from the problem sets. Problem sets are graded on a “pass or not pass-basis”. If you pass all of them, you thus obtain 40 points. 30 points can be attained in the mid-term exam and 30 points on the final-exam.

### *Lecture notes*

- Lecture notes will be posted on course web:  
<https://sites.google.com/a/swedishprogram.org/europe-in-the-world-economy/>
- Lecture notes are used as additional material. I will present most of the material on the whiteboard.

### *Literature*

**“The Economics of European Integration”**, by Richard Baldwin and Charles Wyplosz, fifth the Edition.

**“International Economics”**, by Robert C. Feenstra (University of California, Davies) and Alan M. Taylor (University of California, Davies), Worth Publishers, third edition, 2014.

## Course Outline: preliminary!

- 26/1 (Room 120) Lecture 1: Economy. Overview of the economic integration process in Europe. The Ricardian model, autarchy. **(F/T 2)**.
- 2/2 (Room 120) Lecture 2: The Ricardian model, continued **(F/T 2)**. *Problem set #1 handed out.*
- 9/2 (A975A) Lecture 3: Gains and losses from Trade in the Specific-Factors Model **(F/T 3)**. *Problem set #2 handed out.*
- 16/2 (Room 138) Lecture 4: **(F/T 4)**: Trade and Resources: The Heckscher-Ohlin model
- 23/2 (Room 120) *Mid-term-exam.* (Material: **FT 2-FT3, BW 1-2**)
- 2/3 (Room 536) Lecture 5: **(F/T 6 and B/W 6)**. Trade with increasing returns to scale and imperfect competition *Problem set #3 handed out.*
- 9/3 (Room 120) Lecture 6: **(F/T 7)**. Offshoring of Goods and Services
- 16/3 (Room 120) Lecture 7: Import Tariffs and Quotas Under Perfect Competition. *(Problem set #4 handed out)*. **(FT 8)**
- 23/3 (Room 350) Lecture 8: Export subsidies in Agriculture and High-tech industries” **(FT 10)** *Problem set #5 handed out*
- 6/4 (Room 120) Lecture 9: “The impossible trinity” **(BW 13-14)** *Optional problem set handed out*
- 20/4 (Room 120) Lecture 10: The EURO and optimum currency areas. Swedish crises. **(BW 13-16)**
- 27/4 (Room 120) Lecture 11: Fiscal policy, the Stability pact. The Financial Markets and the Euro, the EURO zone in crises. **(BW 16-19)**.
- 4/5 (Room 120) *Final exam.*