Pehr-Johan Norbäck / Swedish Program

Course: The Economics of European Integration

The course starts with an *overview* of the European integration process and the history of the European Union (EU) ─ from the end of WW2 up to the present. We introduce the main European institutions, their roles and evolution. We describe the enlargement from the original six members to the present 28 (soon 27 with Brexit coming up), highlighting Britain's ambivalent relation to Europe.

European Integration has foremost relied on *economic integratio*n: 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.

To investigate the sources of gains to economic integration, we investigate the sources of gains to trade in standard ***comparative advantage*** driven trade models (such as the *Ricardian model* and the *Specific factors* model).

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 provide limited information on the early gains from integration process 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 an 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, off-shoring 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 then discuss why the financial crises had such a **strong negative impact on the EURO zone**. We conclude with a discussion of whether the core problem with the Euro lies in the philosophical differences between the founding countries of the Eurozone, particularly Germany and France. We also discuss how the omission of the financial sector and financial stability from the Maastricht Treaty contributed to EURO crises, which is really a banking crisis, a cost crisis and a sovereign debt crises.

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

- Explain **why economic integration** was chosen in Europe in favor of political integration.
- Have a basic understanding of the **main EU institutions** and **the historical evolution** of the EU institutions.
- Explain 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 make **some groups worse off** and how this shapes **EU policies**.
- Assess 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**.
- Explain 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
- Discuss reasons for and consequences of **Brexit**

Practical Information

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Lectures: Thursdays, 14.15-17.15 (Solutions to problem sets when due, 14.00-14.15)
Room:
Visit hours: Thursday, 17.15 (after lectures)

Examination and Grading: A maximum of 100 points can be achieved in the course.

All students will have to do **5 mandatory problem** sets during the course. There will be a **mid-term exam**, as well as an **end-term** exam. **Active** participation in class is also required.

40 points will be based on the problem sets, 30 points on the mid-term exam and 30 points on the end-term exam.

Students can also write **two optional small papers** which gives 5 points each in order to increase their grade (100 points will still be the maximum amount).

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). I will then go through the solutions 14.00-14.15, in order not to take time from class which starts at 14.15. The run through of solutions is voluntary to attend.

Lecture notes

- Lecture notes will be posted on course web: https://classroom.google.com
- 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.

The EURO and the battle of ideas, by Markus Brunnermeier, Horald James and Jan-Pierre Landau. Princeton University Press, 2016.

Course Outline: preliminary!

30/8	(Room 550)	Lecture 1: Overview of European integration and European Institutions. (**BW 1-3).**
6/9	(Room 328)	Lecture 2: Gains and losses from Trade The Ricardian model, **(F/T 2).** The Eastern Enlargement. *Problem set #1 handed out.*
13/9	(Room 328)	Lecture 3: Gains and losses from Trade in the Specific-Factors Model (**F/T 3**). *Problem set #2 handed out.*
20/9	(Room 133)	Lecture 4: (**F/T 6** and **B/W 6**). Trade with increasing returns to scale and imperfect competition. The gravity model. *Problem set #3 handed out.*
27/9	(Room 138)	Lecture 5: (**F/T 7, BW 7**). Offshoring of Goods and Services. Globalization and Digitalization, Labor markets.
4/10	(Room 328)	*Mid-term-exam*. (Material: **FT 2-FT3, BW 1-3, F/T 6** and **B/W 7**
11/10	(Room 328)	Lecture 6: Import Tariffs and Quotas Under Perfect Competition.(*Problem set #4 handed out).* **(FT 8). UK, Brexit. CAP**
18/10	(Room 350)	Lecture 7: Growth effects of European Integration **B/W 7**
25/10	(Room 328)	Lecture 8: European Monetary integration. "The impossible trinity" (**BW 13-14)** *Optional problem sets handed out*
15/11	(Room 328)	Lecture 9: European Monetary integration The EURO and optimum currency areas. Swedish crises. (**BW 13-16, BHL 1-2)**
22/11	(pending)	Lecture 10: Maastricht Treaty and the EURO, Financial markets. The EURO zone in crises. (**BHL 5-8, 10)**
29/11	(Room 138)	Lecture 11: Summing up. Future of European Economic Integration. **(BW 16-19, BHL 1, 5-8, 10)**.
6/12	(Room 328)	*Final exam*. (on material covered after midterm)