

Correction manual

EU-Economics

15 DEC 2015

In the evaluation it will be a focus point that the student in answering the questions demonstrate the capability of applying the readings to the particular topic raised in the question in a structured and well-informed manner trying to give as many consistent economic arguments as possible.

Question 1

1.1 Describe the level of European Economic Integration in the area of labour market policies. Include in your description a comparison between the level of European Economic Integration in the area of labour market policies and a policy area where you find more European Economic Integration than in the labour market policy area. Use either qualitative or quantitative descriptive measures (or both) of the level of integration in your answer.

Used approximately one session on the overall topic of labour markets during the course.

Chapter 8 in Baldwin & Wyplosz is the reference chapter.

In this subquestion the student should combine the information about the labour market policies of the EU with the theoretical framework from the notes by Dahl. In particular, the student should use the framework on measuring the dependent variable in this case one the one side, European Economic Integration in labour market policies and on the other side for example European Integration in the field of agricultural policies.

As regards facts, the most important thing is of course that the student is clear about the labour market policy area, but if the student choose another area of European Economic Integration from the readings, it will also count that this information is precise in reflecting the readings.

The following indicators would be relevant to include:

Decision-making mode: Shared competence, i.e. neither exclusive competence with almost full integration nor area where EU only can support, coordinate and supplement.

Common market: No common market as in goods and services.

Social services: Each country has its own social services.

Mobility of labour: Relatively low compared to e.g. US, use for instance results on proportion of EU15 and EU 10 workers in EU15 countries (percentage of population) on page 232 in Baldwin & Wyplosz.

Net-inflow of labour (of course related to mobility of labour above): Use for instance results from table 8.3 on net immigration before and after enlargement. Net-outflows have declined in all EU 12 member states (new member states) whereas net-inflows have declines.

Long-term unemployment: Indicators in Figure 8.6 of large differences in unemployment figures – also among EU member states.

Employment ratio: E.g. Figure 8.2 Employment to population ratios and unemployment rates in 2005-08: Situation varies considerably from country to country.

1.2 In the appendix, Figure 1, you find a graph from a recent European Commission report regarding labour cost and productivity in the euro area from 2007-2013. Analyze the development in the light of the development of the economy in the euro area in this period.

In supplement to the references on the labour market in Baldwin the economic development of the EU in the period is well documented in De Grauwe.chapter 8 and chapter 9.

The time period chosen is the year of the financial crisis (2007-2008) and the following bank liquidity crisis (2008-2009) followed again by the debt crisis (2010-2012).

At the same the EU has experienced low growth level.

What at first catches ones attention is of course the outswings of respectively the labour productivity and the unit labour costs from 2007 to 2010, clearly caused by the increased unit labour costs coming from the contraction in the economy.

The demand contraction led to fewer orders, less output, but still with high fixed cost from the labour market due to low flexibility on the labour market in many EU countries, especially in the first years after the financial crisis.

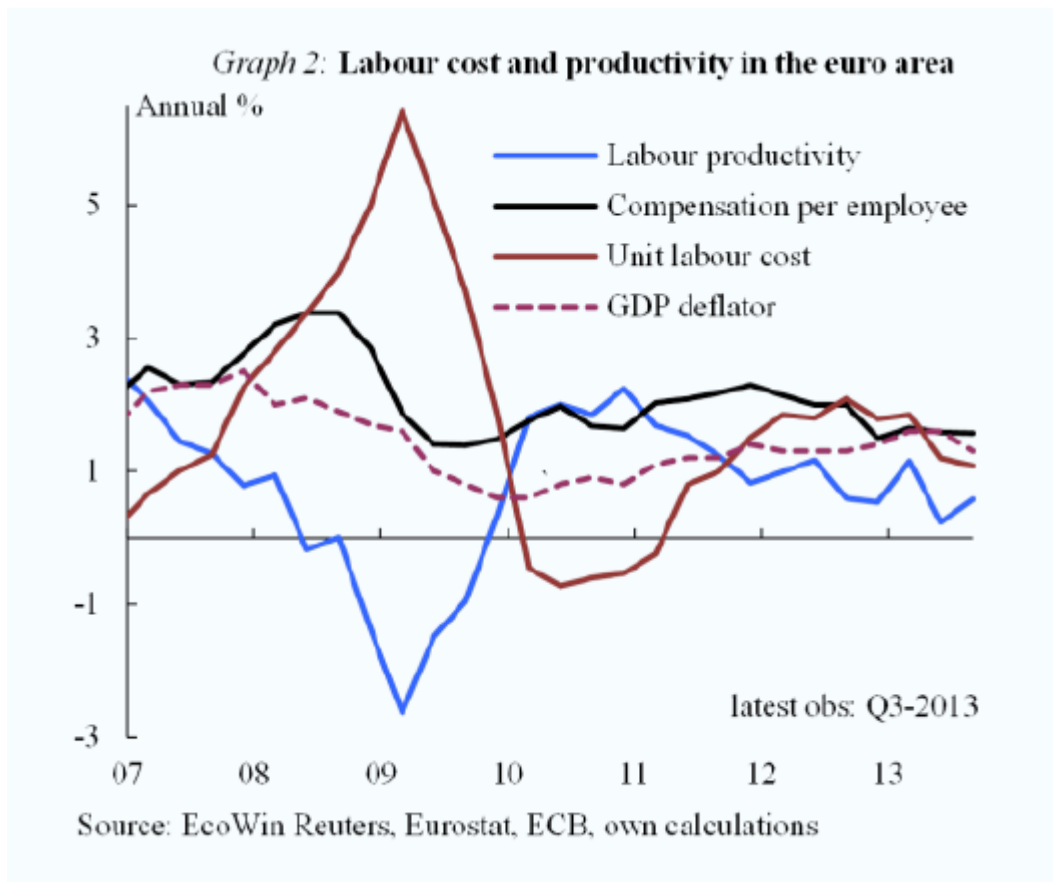
Interestingly enough the compensation per employee also increases initially until end 2009 whereafter the reforms on the labour market – primarily individually member state driven – caused the compensation per employee to fall again.

In is exactly in end 2009, that the growth rate of the economy and the inflation again begins to pick a little bit.

The unit labour cost and the productivity moves in opposite directions – note that the Y-axis uses annual percentage - which must be annual percentage changes judging from the variables.

It is not before 2012-2013 where the EU has both survived its financial crisis and the debt crisis that one sees a positive increase in both the unit labour cost and the productivity, however with a lower increase in labour productivity than unit labour costs.

If the productivity rises regardless of an increase in unit labour costs there must be other factors determining the productivity of labour that more than equals out the rise in unit labour costs.



1.3 One of the major aims of the common market has been to create full mobility of labour. Analyze the economic consequences of migration on the wages, the employment and the welfare in a simple framework with a home and foreign country. First, in a scenario without migration, second, in a scenario with migration.

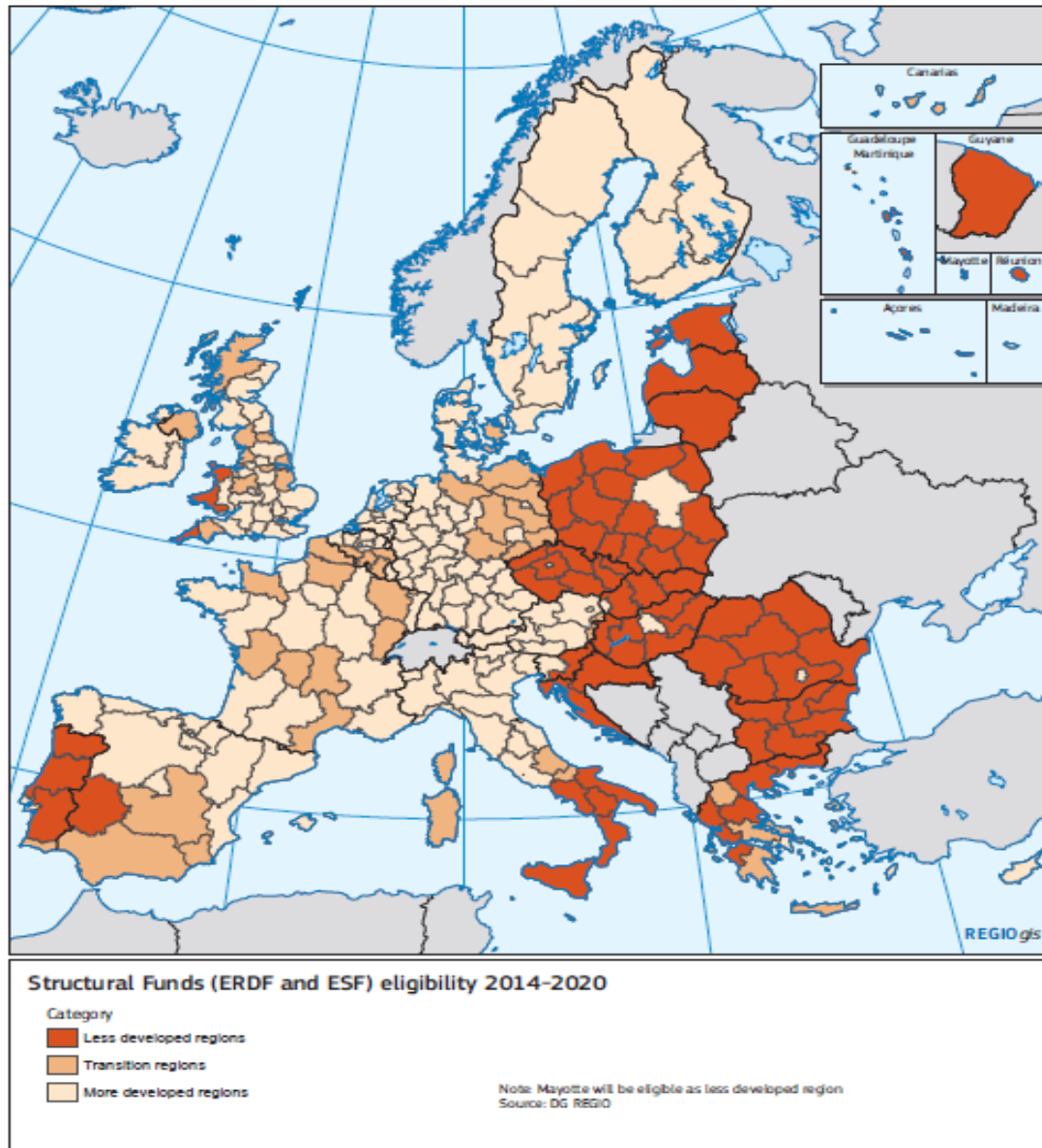
Use the framework in Baldwin and Wyplosz chapter 8, section 8.4.2 on the Economics of Labour Market Integration, page 226-227. Clearly, the question should be “First, in a scenario without migration, second in a scenario with migration”. This has been clarified during the exam for the students.

Question 2

2.1 Describe the expenditures of the European Union in the area of regional policies: the different aims of regional policy, the different objectives, instruments and guiding principles. You should preferably refer to the readings, but you are also welcome to include information about objectives and programs from 2014-2020 as well in your answer using for instance Figure 2 in Appendix.

The expenditures are in overall economic and percentage shares of total budget described in e.g. Baldwin and Wyplosz chapter 2 Facts, Law, Institutions and the budget, in particular, page 76-81. It would be a good idea to give us the overall main shares of regional policies of EU total budget as a start.

EU's regional policy is described in detail in chapter 10 in Baldwin and Wyplosz, in particular, page 291-297.



2.2. Analyze the possible effects on economic growth of a hypothetical increase of 50% in annual funding to the regional policy area using for instance a Solow diagram framework on growth.

The students are here asked to combine the knowledge from chapter 10 and chapter 7. The specific answer to the question cannot be found in the readings. Importantly, the student should apply the knowledge from the two chapters to answer the question.

A hypothetical increase in regional spending would lead to a boost in the percentage share of regional spending of the total EU-budget.

The effect of regional spending cannot be said with certainty empirically.

However, theoretically, the Solow diagram can be used to describe the effects.

The idea in the Solow diagram is that when the economy experiences increased efficiency from e.g. regional integration projects regarding infrastructure, research and innovation, production capabilities, the higher the GDP/L becomes leading to higher investment per worker, and the economy's capital/labour ratio starts to rise towards a new higher equilibrium value giving faster growth of output per worker during the transition from the old to the new capital/labour ratio.

But there can also be a direct effect going into the "higher investment per worker" – which comes directly as an effect of an initiative as the one mentioned in the question with a 50% increase in regional funding, because regional funding by and large can be said to be investment.

Importantly, one should also remember that an increase in regional funding with 50%, will also be followed by a likewise – not in percentage but in absolute terms – increase in local, regional – but non-EU financed increase in investment, so the effect of this increase will necessarily be higher.

One thing is crucial is of course that the investment from the regional funding really leads to increased efficiency. When the investment as in this case is driven by regional funding there will always be an uncertainty about the effect, a little bit like the challenges in development policy regarding the impact of aid.

2.3 Describe the risks and uncertainties related to achieving aims of increased growth from regional spending.

This might have been described also in the answering of question 2.2.

- Still a very small amount of total investment
- Depends on overall investment and economic climate.
- Fraudulent activity.
- Depends on similar funding from national or regional authorities in most cases.
- Projects are very different in economic value-added and do also hold different risks.
- Always an uncertainty to create an effect that is longer lasting and not only a one time increase in output.

2.4 Compare the economic rationale behind the aim of achieving higher absolute welfare in all regions in the European Union and the aim of reducing the disparities among regions. How economically effective are these two aims compared to each other.

One might say that from the beginning the aims were formulated as aims going hand in hand. EU member states and regions should become more prosperous thus giving rise to an overall – absolute – increase in welfare – that then can be redistributed the way each member state finds it most properly done. The last part is however not official EU policy.

The problem with an aim of only creating absolute prosperity and wealth is that it will lead to increased regional differences if not combined with the aim of reducing the regional disparities.

More specifically, this can be compared to the traditional dilemma we know from trade theory – e.g. Viner – in chapter 5 in Baldwin and Wyplosz – that the positive effect of e.g. a free trade area or a customs union becomes larger – or comes with a higher probability – the more alike the economies are.

Taking this argument further on, we see in the theories of monetary integration, the problematic feature arising, the more asymmetric shocks hit the different member states. Thus also from here, reducing the asymmetries across the EU becomes important.

While reducing the asymmetries among the EU, without creating absolute welfare increase will not be compatible with regional policies, it is clear, that when reducing regional disparities also leads to increases in absolute wealth, it will be regarded as more effective as an instrument.

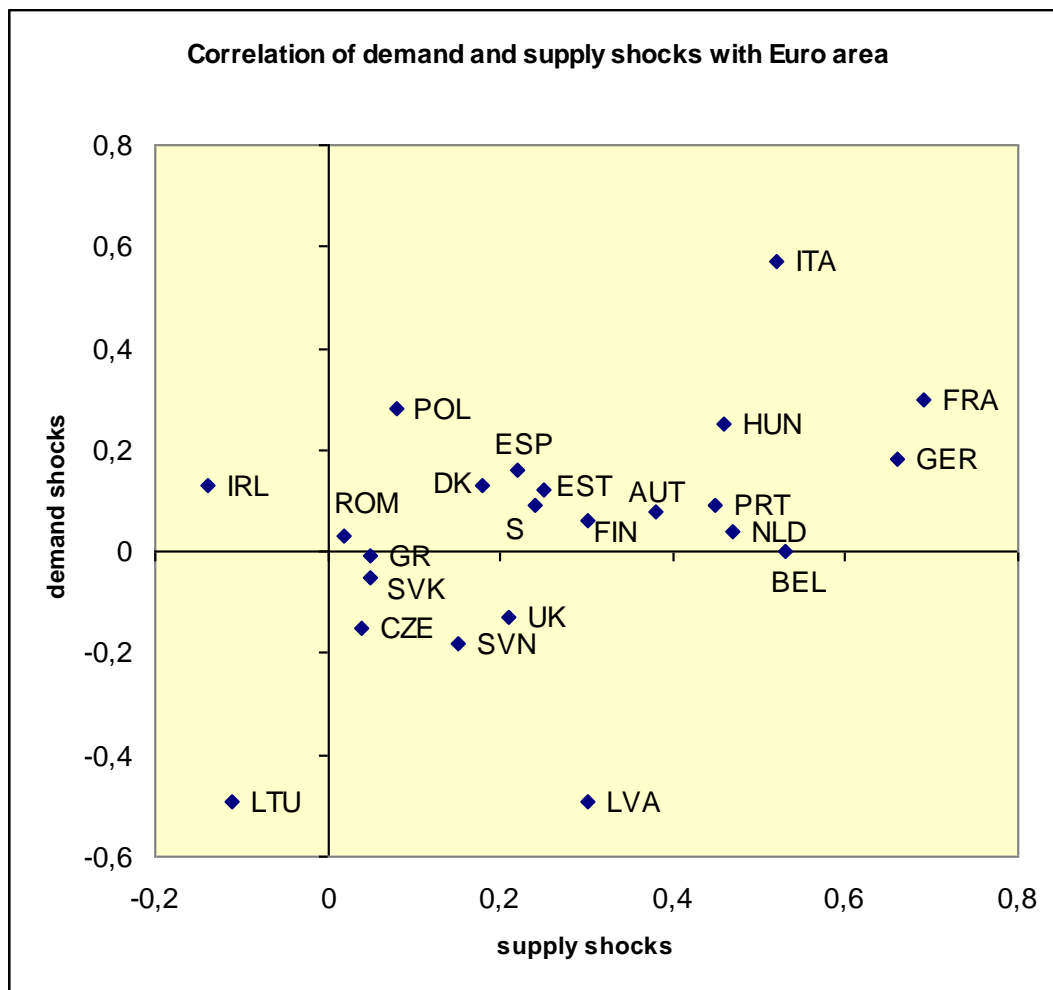
Question 3

3.1 Analyze whether or not the Euro area, the EU area or any smaller part of the Euro area is an optimum currency area measured on the ability to absorb asymmetric shock. You could preferably include Figure 3 in the Appendix in your analysis.

This first subquestion follows the readings very closely, especially, chapter 4 in the Grauwe on costs and benefits of monetary union. The Figure shown in the exam question is actually a reproduction of Figure 4.5 on page 76 in DeGrauwe.

Even if parts of the EU, the Euro area for instance, are to be considered an optimum currency area, it is important to notice, that De Grauwe still considers it an incomplete monetary union, as long as it does not include a budgetary union.

The important thing in the students presentation is that the student combines the information, e.g. from the figure in appendix with the OCA theory – in this respect the student could also include figure 6.3 and Figure 6.4 in De Grauwe.



3.2 Analyse the different possibilities of endogeneity of monetary unions. Focus on whether or not these endogeneity mechanisms have been present in the development of the EMU until now.

The question on endogeneity is covered in section 4.5 in De Grauwe regarding costs and benefits in the long run. It has also been covered in the slides for the lectures posted on Absalon.

Endogeneity can be caused by increased trade integration coming from the forming of the EMU, among others by following the theoretical and empirical evidence that a monetary union enhances trade integration which thus will lead to a movement towards an optimum currency union, or a “more” optimum OCA.

3.3 Analyse whether or not an EU budgetary union could be the solution to avoiding as negative developments in the future of European Economic integration as those present under and after the financial crisis and debt crisis of the EU. Include in your analysis an assessment of the creation of such a budgetary union.

Extensively covered in DeGrauwe in particular in section 1.5 and in section 6.5. as well as in slides.