

Written Exam for the B.Sc. or M.Sc. in Economics winter 2015-16

The Economics of the European Union

Final Exam

December 15, 2015

(3-hour closed book exam)

Please note that the language used in your exam paper must correspond to the language of the title for which you registered during exam registration. I.e. if you registered for the English title of the course, you must write your exam paper in English. Likewise, if you registered for the Danish title of the course or if you registered for the English title which was followed by “eksamen på dansk” in brackets, you must write your exam paper in Danish.

This exam question consists of 3 pages in total including this page

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Number of questions: This exam consists of 3 questions.

1. Which of the following statements are correct? Remember to provide a brief explanation.

- (a) The objective of ECB is to target inflation.
- (b) If UIP holds and countries allow free capital mobility, a government can target the exchange rate or the interest rate but not both independently.
- (c) PPP states that the exchange rate appreciates when foreign inflation exceeds domestic inflation.
- (d) The General Council of ECB is comprised of central banks of monetary union members.
- (e) Automatic stabilizers make fiscal policy counter-cyclical.

2. Fiscal Policy and the Stability and Growth Pact

- (a) Describe the Stability and Growth Pact.
- (b) According to the article by Larch, van den Noord and Jonung, there are a number of shortcomings of the Stability and Growth Pact. State their main arguments and motivations.
- (c) What are the main arguments for restricting fiscal policy in a monetary union?
- (d) Summarize the empirical evidence on supranational as well as national fiscal rules.

3. Costs of a currency area

- (a) Explain the difference between symmetric and asymmetric shocks and explain why this distinction is important for countries forming a monetary union.

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- (b) Outline the IS-LM-IRP framework illustrating the aggregate demand and aggregate supply in the output gap—real exchange rate plane. Explain the basic underlying assumptions of this model. Use this framework to describe the effects of asymmetric shocks in a two-country model. Compare two cases: First under the assumption that the countries do not belong to a currency union and second under the assumption that the two countries form a currency union.
 - (c) Is it possible that symmetric shocks can have asymmetric effects? Motivate your answer.
 - (d) It is often argued that the European Monetary Union is not an optimum currency area. Is it possible that the union will become an optimum currency area in the future?