

STOCKHOLM UNIVERSITY
Department of Economics

Course name: Economic Integration
Course code: EC7311
Examiner: Rikard Forslid
Number of credits: 7,5 credits
Date of exam: 8 January 2016
Examination time: 3 hours (9.00-12.00)

Write your identification number on each paper and cover sheet (the number stated in the upper right hand corner on your exam cover).

Do not write answers to more than one question in the same cover sheet. Answer in a concise fashion. Explain notions/concepts and symbols. If you think that a question is vaguely formulated, specify the conditions used for solving it. Only legible exams will be marked. No aids are allowed.

The exam consists of 4 questions, 100 points in total. For the grade E 45 points are required, for D 50 points, C 60 points, B 75 points and A 90 points.

Results will be posted on "mitt.su.se" 29th of January, at the latest.

Good luck!

Question 1 (25p)

The European integration has led to lower trade costs between its members. At the same time this implies that countries outside EU are disfavoured in the European market. Analyse the effects of this type of preferential tariff liberalisation. What are the welfare consequences? How are the welfare effects affected by a very elastic import demand?

Question 2 (25p)

Analyse the effects of economic integration in a model with two sectors: X and Y. The X-sector is characterized by increasing returns to scale, free entry, and Cournot competition. The Y-sector has constant returns to scale and perfect competition. Utility of the representative consumer is given by

$$U=(nX)^{\alpha}Y^{1-\alpha}$$

,and the cost function of X-sector firms is

$$C=f+cX,$$

where all notation has its usual meaning.

Question 3 (25p)

- a) Show formally the gains from trade in a standard model of monopolistic competition (the Dixit-Stiglitz model).
- b) What are the effects of economic integration if it is assumed that firms are heterogeneous in productivity, and that there are fixed entry costs in the domestic and the foreign market? (the Melitz model)

Question 4 (25p)

- a) Compare the effects on the domestic economy of a shock to the foreign interest rate when the exchange rate is fixed and when the exchange rate is flexible.
- b) What is the impossible trinity?
- c) Under what condition is a speculator likely to be able to break a fixed currency peg of two currencies, when both countries defend the peg?