

Economics of European Integration

November 24/26, 2021

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Problem Set 4

References: BW (6.ed) The Economics of European Integration Ch. 6

Exercise 1: The Basics of Market Size and Scale Effects

Use a three-panel diagram, like Figure 1 to show how the number of firms, mark-up and firm size would change in a closed economy if the demand for the particular good rose, i.e. the demand curve shifted out.

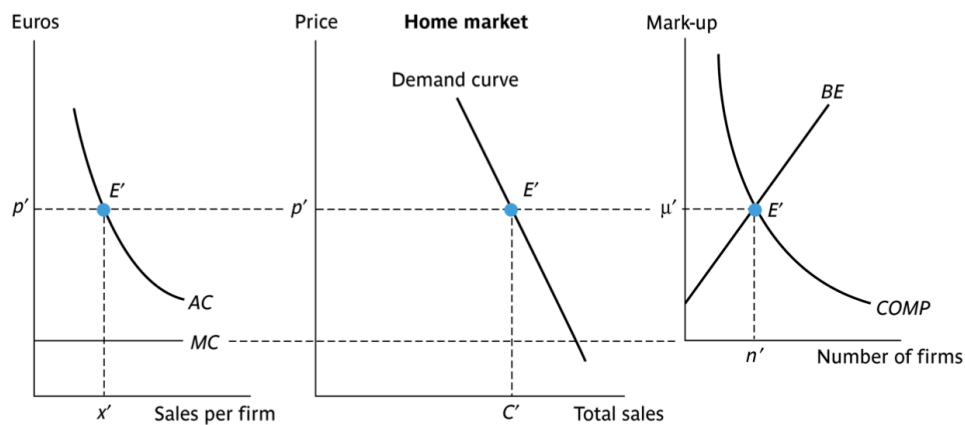


Figure 1: Prices, output and equilibrium firm size in a closed economy

Exercise 2: Large Versus Small Country Dynamics

Using your findings from the previous question, consider the no-trade-to-free-trade integration between a large and small nation, where size is defined by the position of the demand curve (the demand curve in the large nation is further out). Assume that the small country is half the size of the large country.

- Show that the large nation has more firms pre-integration.
- Show what happens to the number of firms and mark-up when the two markets become integrated.
- What does your analysis tell you about how integration affects firms in small nations versus large nations?
- Who gains more in proportion to size - the large or the small country?

Exercise 3: Market Size, Scale Effects and the Single Market

- a. When the Single Market Program was launched in the mid-1980s, European leaders asserted that it would improve the competitiveness of European firms vis-à-vis US firms. Explain how one can make sense of this assertion by extending the reasoning in this chapter.