



# 2015-16 Research Programme



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### Introduction

Looking back at last year's research programme and looking forward to next year's draft, one cannot help but realise that Europe's problems remain very present. There was a legitimate hope last year that the EU could gradually move on and focus more of its policy attention on the long-term structural policy agenda – while still working on the incomplete set-up of monetary union. The election of a new Greek government brought speculations about Greece leaving the Euro to the front-page. And while 'Grexit' has been prevented for now, another exit discussion after the re-election of the UK prime-minister is taking centre stage with far-reaching implications. Other countries, in turn, also saw the percentage of voters sceptical about the EU on the rise. All these debates show that EU governance needs to be re-thought. Should the EU endorse a more explicit two-tier membership model? Should it be accepted that the euro area deepens further, but only with those willing? These important questions will keep Bruegel busy throughout 2015/16. Beyond governance, we will continue to contribute to the debate on macroeconomic policies in the EU. It is clear that governance and macroeconomic policies are closely linked in the EU and it is these linkages that will be one of the focal points of our work. And we will certainly not lose sight of the important structural transformations taking place in our economies.

We are strengthening our work on the global economy and Asia with a new senior researcher – the recent Chinese crisis and the slowdown of many other emerging economies raises many profound questions on the implications for Europe. We are investing in research on energy and climate economics; a paper on climate finance will be presented to EU finance ministers ahead of the Paris climate summit. Our work on Europe's neighbourhood has also increased, as recent events have once again reminded Europe and Europeans that we exist in a global community. We have published on Ukraine and will continue with this work.

Perhaps the best cure for Europe's post-crisis hangover will be a stronger focus on how developments in microeconomics can contribute to growth. The building of the team is ongoing. We are currently looking into a project that brings together the various strands of our work on economic growth, innovation and digitalisation, both from a macroeconomic perspective as well as from a microeconomic perspective.

As in previous years, we have designed a programme which aims to maintain current valuable work streams whilst adding appropriate new elements. We have, hopefully, found the right balance between planned work and the ability to respond flexibly to policy developments that will inevitably affect us all during the research year. Bruegel's ability to respond quickly to such developments has helped us build our reputation and it will remain an important part of our output during the next research year.

In finalising our research programme, I very much would like to thank you for your insightful feedback, which greatly helped us focus on the most relevant subjects. I hope you can agree with me that the new Research Programme reflects Bruegel's values, builds on its strengths and will make a valuable contribution to improving economic policy in Europe.

*Guntram Wolff, August 2015*

## **A. Research Area: European macroeconomics and governance**

Participants:

- *Scholars: Grégory Claeys, Zsolt Darvas, Alicia Garcia-Herrero, Silvia Merler, André Sapir, Alessio Terzi, Guntram Wolff*
- *Non-resident and visiting scholars: Massimo Bordignon, Marek Dabrowski, Ashoka Mody, Rainer Münz*

The European economy started to recover on the back of low oil prices, a weaker Euro, the European Central Bank's quantitative easing, broadly neutral fiscal policies and supportive global economic developments. Progress with structural reforms is visible in a number of countries, while financial fragmentation eased. There are some signals of renewed money and credit growth and cross-border financial activities.

However, there are major underlying weaknesses throughout the EU, which pose threats to economic recovery. Production is still below potential while unemployment is high in a number of EU member states; growth, investment and inflation are low; high public, private and external debts prefigure protracted deleveraging, constraining the growth of highly indebted sectors and countries, institutional weaknesses in some countries leading to weaker trust and/or corruption. The design and implementation of structural reforms pose major challenges in several EU countries; unfavourable demographic changes impact consumption patterns and the sustainability of European welfare systems. The cooling down of the international environment is a further break to the subdued recovery. Last but not least, economic growth is not widespread and inclusive enough to offer equal opportunities for personal wellbeing to different segments of society.

Major institutional reforms in the EU have led to a complicated yet still incomplete economic governance framework, whose effectiveness is still to be tested. Mistrust between countries and between citizens and the EU will make it more difficult to revise the current institutional setup and design new instruments. Addressing UK demands ahead of the forthcoming UK referendum on EU membership will create special challenges. The economic performance of non-euro-area countries and the implications for them of the new euro-area institutional framework is a major issue that we will also consider.

We plan to continue a number of research themes followed in the past years, focusing on medium- and longer-term issues too, while preserving some degree of flexibility in order to be able to react to new developments and policy issues. We organise research in this area into four main themes: 1. Macroeconomic policies and adjustment, 2. Economic governance, 3. Low investment and secular stagnation, and 4. Inclusive growth and inequality.

A number of projects cover research adjacent to European macroeconomics and are presented in the subsequent sections of this research programme.

### **1. Macroeconomic policies and adjustment in Europe**

This research theme has been one of the core areas of our European macroeconomic research for the past few years, and will continue with a renewed focus in 2015/16. While progress has been made with budget adjustments and current account deficits, high public, private and external debts pose serious threats in a number of EU countries. Low inflation throughout the EU, and in particular in the euro area, is making debt sustainability and intra-euro competitiveness adjustment more difficult. We will work on two broad research clusters:

- Macroeconomic policies, in particular monetary and fiscal policies (A1)
- Macroeconomic adjustment, agglomeration effects and structural reforms (A2)

## **2. Economic governance of the euro area and the EU**

European economic governance is incomplete and the discussion is ongoing about how to develop it further. We will focus on three key issues: the debate on what changes in euro area governance should be prioritised and how to do this; the implementation of the current governance framework and possible improvements to make it more effective; the question of who should apply flexibility, with what democratic accountability and how, and finally the central issue of governance developments between the euro and the non-euro area countries – a question that has received particular urgency with the upcoming UK referendum. Research related to the banking union, macro-prudential policies and capital markets union is presented in research area C but there are numerous and obvious connections.

## **3. Low investment and secular stagnation**

Investment in Europe is low, savings are high and interest rates are consequentially low. Our research will focus on the structural determinants of this weakness in the European economy and on an assessment of current policy responses such as the Juncker plan. We will also continue our recognised work on secular stagnation.

## **4. Inclusive growth and inequality**

There is a growing recognition that economic growth in itself may not offer equal opportunities for personal wellbeing to different segments of society. Growth that leads to increased inequality in different aspects of life might not just undermine social cohesion but could also be unsustainable, leading to economic and financial volatility. Inequality and youth unemployment in turn undermine growth and productivity and have major implications for migration, social security systems, debt and economic performance more broadly. We will explore these issues and link them to the broader topic of what kind of vision the EU should develop to regain citizens' trust. We will also look into social impact investment.

## **B. Research Area: Global economics and global governance**

Participants:

- *Scholars: Zsolt Darvas, Alicia Garcia-Herrero, André Sapir, Nicolas Véron, Karen Wilson, Guntram Wolff*
- *Non-resident and visiting scholars: Alan Ahearne, Guonan Ma, Ashoka Mody,*

The interactions between Europe and the international economy are manifold. The crisis in the euro area has been an opportunity for the world to discover the level of interdependence in the same way the financial crisis of 2007-2008 highlighted the magnitude of spillovers from the US to the rest of the world. This interdependence is a structural feature of the world economy that needs to be analysed as such, rather than simply in its short-term manifestations. The main structural feature of the world economy in its current historical phase is the shifting of economic dynamics from the Atlantic to the Pacific Ocean and from the developed to the emerging economies.

In 2015/16, Bruegel has strengthened its expertise in this area with the hiring of Alicia Garcia-Herrero, a senior expert on emerging markets and Asia. We will put special attention to the interactions between, on the one side, European (or European-based) actors and, on the other side, global actors and actors located in the EU's neighbourhood. The three main lines of research will be Asia, global governance and relations between the EU and major regional players.

### **1. Asia initiatives**

From its very beginning, Bruegel has been keen on developing contacts in Asia and collaborating with economists from various parts of the continent. Together with European and Asian partners, Bruegel established in 2006 the Asia Europe Economic Forum (AEEF) to serve as a high level forum, giving Asian and European policy experts an occasion for in-depth research-based exchanges on global issues of mutual interest. This important forum will continue its activities in 2015/16. After the successful previous conference in Tokyo, the next conference is scheduled to take place in Paris.

Bruegel has advanced its leadership in this area and intends to become a globally recognised hub for Asia-Europe economic discussions and exchanges. Bruegel has recently hosted and will continue to host visiting scholars from China and Japan. Conferences in Asia and Europe are planned for 2015/16, including for example an event about the Chinese Silk Road initiative. Our research output on Asia and China will also be strengthened.

### **2. Global economy and governance**

In spite of the apparent weakness of the global trading system, WTO rules resisted the recent economic and financial crisis with relatively little increase in protectionism. Yet trade protectionist calls have become more vocal recently, in particular in relation to China. Moreover, more bilateral trade agreements have been struck and numerous new negotiations have started. Bruegel will continue work on the global trading system and on the current TTIP negotiations, mostly in the form of events.

Bruegel is also working on G7/G20 governance issues and will contribute to the topic with comments and other contributions. We plan a comparative study on monetary policy across the world.

### **3. Major regional players**

Bruegel has devoted increasing attention to the EU neighbourhood and has had, with limited resources, a significant impact on the economic debate on Ukraine. We will also continue our focus on

Turkey and non-EU Mediterranean countries. Last year, we held a workshop in Turkey in partnership with a local think-tank and earlier this year we hosted an event in Brussels focused on the region and the implications for Europe. There is little doubt that this is an important, perhaps even vital, issue for the EU both economically (with links to energy and migration issues) and politically (with links to the potential volatility of the region). As a result, Bruegel will dedicate more resources to this area. In early 2016, we will organise a workshop on Turkey and non-EU Mediterranean countries in partnership with a Moroccan think-tank to further exam these issues.

## **C. Research Area: Finance and Financial Regulation**

Participants:

- *Scholars: Zsolt Darvas, Alicia Garcia-Herrero, Pia Hüttl, Silvia Merler, André Sapir, Nicolas Véron, Karen Wilson, Guntram Wolff*
- *Non-resident and visiting scholars: Michiel Bijlsma, Elliot Posner*

Work in this area would build on earlier Bruegel research. As before, Bruegel will also maintain flexibility to react to any major financial markets developments. Three main directions are identified for the forthcoming year.

### **1. Ongoing EU financial sector policy development**

Europe's banking union is in the implementation phase, after the ECB took up its new role as banking supervisor on 4 November 2014 and before the key transfer of resolution authority from national entities to the Single Resolution Board on 1 January 2016. The capital markets union is still under discussion and initial steps are expected later in 2015 and in 2016. Also on the EU's strategic policy agenda is a review of the governance and funding of the new agencies established in 2011, namely the European Banking Authority, the European Insurance and Occupational Pensions Authority, the European Securities and Markets Authority, and the European Systemic Risk Board. Some resources will be dedicated to analysing state aid given to banks in the last 5 years with the aim to draw policy conclusions. Bruegel will also look at the financing of growth, in particular SMEs and high-growth firms, inter alia with a number of events.

Bruegel will engage in these and other ongoing policy debates, building on its recognised leadership in shaping the discussion of banking union and, more tentatively, capital markets union. It will be both proactive on issues deemed structural, and responsive to demand from the European Parliament and other policy bodies.

### **2. Financial sector policy evaluation**

Eight years have passed since the start of the systemic financial turmoil in Europe in the summer of 2007. In this context, it is appropriate to intensify past efforts deployed by Bruegel to evaluate major past policy steps with the benefit of experience. As far as is relevant, this will integrate a comparative perspective with other regions affected by the financial crisis: the US, of course, but also Asian jurisdictions. Synergies might also be gained from the involvement of one Bruegel scholar (Nicolas Véron) in the evaluation of the International Monetary Fund (IMF) role in the euro area crisis, currently being conducted by the IMF's Independent Evaluation Office.

### **3. Capital flows in the EU**

Bruegel has built up recognised expertise in monitoring and assessing capital flows in the EU and in EMU in particular. We will continue our work on this and use the rich database that has been developed for further research, including on issues such as macro-prudential and micro-prudential policies.

#### **4. Technological disruption in the financial sector**

The increasingly ubiquitous use of information and communication technology is starting to prompt significant changes in the operation of financial firms and financial markets. This development is emergent and not yet as spectacular as in some other industries, yet Bruegel intends to monitor it closely so that we can be proactive on the ways European and international policy frameworks may need to adapt.



#### **D. Research Area: Innovation and Competition Policy; Energy and Climate**

Participants:

- *Resident scholars: Reinhilde Veugelers, Georg Zachmann, Karen Wilson, new scholar(s)*
- *Non-resident and visiting scholars: Carlo Altomonte, Damien Neven, Simone Tagliapietra*
- *External contributors: Mapcompete project team*

Bruegel's work in this research area is guided by one question: how can Europe improve its economic growth and competitiveness? The weak growth performance in Europe – both before and during the crisis – calls for a re-think of Europe's growth strategy and more rigorous implementation and monitoring of available tools. This requires analysing, on the one hand, the macro-economic obstacles to growth and, on the other hand, the microeconomic and structural impediments to competitiveness in all of their dimensions. We are increasing our resources and expertise in the energy area and we have opened a position for a scholar working on the digital economy. Work on entrepreneurship and the conditions for business entry and growth is ongoing. More specifically, the team's multiple skills allow them to address various facets of the structural impediments to improved economic performance: innovation policy, competition policy, entrepreneurship, energy policy.

##### **1. Long term economic growth, secular stagnation and Europe's competitiveness drivers**

With the crisis, the level of potential output has shifted downward in many advanced countries and in most of them the potential growth rate is also reduced. Bruegel contributes to the topic of long-term drivers of growth and secular stagnation (see research area A). We are currently completing a research project, MAPCOMPETE, funded by FP7 resources, which is developing a European competitiveness map. The project has led to follow-up research by some of the best scholars in the field on competitiveness and growth and a blueprint publication by the MAPCOMPETE team is scheduled for September/October. We will also look at innovation policies across the EU and explore differences and potential implications for innovation performance.

##### **2. Entrepreneurship, Innovation, the role of R&D policies and universities, and the digital economy**

A further important research strand is on entrepreneurship and innovation. Here our various projects look into the reasons for Europe's weak innovation performance, the needed funding and skills for innovative and young firms to grow and the regulatory and administrative barriers holding back entrepreneurship in Europe. With the hiring of a new research fellow working on disruptive innovation, digitalisation and the impact on labour markets and industry, we expect to give new impetus to this discussion. The memos to the new Commission published in September 2014 have shaped the debate on the single digital market and we will build on this success.

##### **3. Energy and climate policies**

Bruegel will continue its recognised work on European energy and climate policies. One important dimension is the security of energy supply, a topic that has become particularly relevant in the context of the Ukrainian crisis and one with significant implications for the Southern European neighbourhood as well. Other questions concern the development of gas and electricity networks. The climate summit in Paris in the autumn of 2015 is a key event that may shape climate policies for some time. Bruegel has been asked to prepare a paper for the informal ECOFIN in Luxembourg on climate finance.

##### **4. Competition policy, European network industries and national fragmentation**

We will continue our work on competition policy, market structure and growth, although at a reduced speed. One project continues the work of this year on comparing competition policy across the EU and China to provide a comparison with the US – a project undertaken with a Chinese visiting fellow. Other projects are to be determined.