

## 2008 RESEARCH PROGRAMME

The research programme is organised around five broad research areas<sup>1</sup>:

- *Growth Drivers for Europe* is devoted to analysing the deep determinants of the European economic performance. Research here aims at uncovering the factors that will shape growth five of ten years ahead.
- *Europe and the Global Economy* focuses on the role of Europe as a player in a rapidly transforming global economy, with the goal is to determine where the priorities or the governance of the EU's external economic relations need rethinking.
- *Companies and Competitiveness* is centred on the patterns of internationalisation of European companies and how they affect competitiveness and performance.
- *Institutions and Policies* concentrates on the interplay between institutions and policies, including but not exclusively at the macroeconomic level.
- *Interdependence and Regulation* covers the design of regulation at EU and national level and its impact on stability and performance in regulated sectors.

The programme comprises 22 individual research projects, some of which follow up on projects launched in 2007. A significant innovation in comparison to 2007 is the launch of research in three fields where Bruegel had not been very active:

- Innovation and its determinants (projects A2 on the R&D objectives, E1 on intellectual property and E5 on telecom regulation);
- The effects of globalisation on inequality (project B4 on globalisation and the rise of executive pay)

Other noteworthy proposed changes are:

- The more comprehensive approach to energy and climate change, beyond the limited contributions made in 2007 (projects A3 on clean technology and growth, E3 on European climate change policies and E4 on the European electricity market);
- A broader approach to the consequences of labour mobility (project D2 on economic policies and labour mobility);
- The introduction of an explicitly geographic dimension with the project on neighbourhood (B4).
- A stronger emphasis on issues of specific interest to the new member states (projects C1, D2, and D4)
- The proposal to enter more explicitly into the evaluation of EU policies (project D3 on policy evaluation in the EU).

In accordance with current practice, the Bruegel team will seek to implement its research agenda flexibly, taking into account new research questions arising from economic developments. This is especially imperative in 2008 as a consequence of rapid changes in the global economic landscape. One strategy to address new developments as they unfold without jeopardising the execution of the research programme will be to draw on the findings of projects conducted in 2006-2007 as well as on existing research projects to derive conclusions of relevance for contributing to current policy discussions. This for example concerns the functioning of the euro area in an deteriorating environment; the role of the services sector as a growth driver against the background of sharp

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<sup>1</sup> There is one significant change in the 2008 broad research areas compared to those of 2007: the area *European and Global Integration* has, for clarity reasons, been split into two separate areas that focus respectively on the macro and firm-level dimensions of the interaction between European and global integration.

currency appreciation; or the impact of a commodity scarcity on the design of agricultural policies and consequences for the EU budget. But more significant reallocations or resources may be required as the environment continues transforming.

In the same spirit, Bruegel will take on board issues raised by policymakers, including requests coming from EU presidencies.<sup>2</sup> It will also continue to devote effort to ensuring appropriate dissemination of its research through extensive outreach.

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For each of the five broad research areas, this document provides below:

- A short summary of the objectives in each research area and a brief recap of recent research and upcoming publications,
- An outline of ongoing projects where we propose to continue work in 2008,
- An outline of proposals for new projects to start in 2008.

#### **A. Growth Drivers for Europe**

The research area Growth Drivers for Europe was introduced in 2006 (at the time under the name Europe's Reform and Growth Strategy) to address EU and national policies with a bearing on employment, productivity and growth.

**Research in 2007** was mainly devoted to two projects: higher education, resulting in a Policy Brief on universities in September, and in a more comprehensive report for the Slovenian presidency scheduled for Spring 2008; and the role of access to capital in company growth resulting in a Policy Brief inspired by a request from the Slovenian presidency, published in January 2008.

**Research is ongoing** on two projects:

- **A1. *Services and growth.*** Services are crucial for Europe's economic performance and growth potential, yet productivity growth in this sector lags behind that of the US. Performance within the EU, however, is very uneven. This project explores the evolution, performance and changing role of Europe's services sector and its contribution to overall economic growth. Services that are predominantly private and services such as health care and education that are predominantly provided and/or finance by government will be examined separately. For the former, the key question is whether liberalisation, regulatory reform and cross-border competition have the potential to improve economic performance. For the latter, the focus is on the effects on performance of different methods for providing and financing these activities. The project will draw the consequences of the analysis for the EU and the euro area.

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- **A2. *R&D objectives and policies in a diverse Europe.*** One of the main objectives of the Lisbon agenda is to improve Europe's competitiveness through a higher level of research and development (R&D) spending. It was intended that R&D intensity (expenses divided by GDP) in the EU should jump from less than 2% in the late 1990's to about 3% by 2010. However, the determinants of private R&D effort and the policy instruments designed to achieve the target were not explicitly identified. Nearly ten years later, R&D intensity in the EU remains close to 2%. The objective of this project is to assess whether common R&D targets make economic sense in an EU where levels of development and industrial specialisations differ, to identify what are the main drivers of private research and development, and to discuss what policy levers should be used to foster innovation-based growth. This project has resulted in a Policy Brief published in February 2008.

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<sup>2</sup> In 2008, Bruegel will respond to demands from the Slovenian and French presidencies.

### One new project is introduced for 2008:

- **A3. Can clean tech be a driver for growth?** Traditional analyses of the economic impact of climate policies emphasise their costs and their potentially negative impact on growth. However, these policies, through their impact on demand and technologies, also affect the pattern of economic development and may thereby have positive medium-and long-term implications for growth. According to this view, countries should eventually benefit from taking the lead in adapting to climate change and developing alternative technologies. The project will revisit the macroeconomic implications of climate change and the dynamic costs and benefits of various approaches CO<sub>2</sub> emissions limitation.

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### B. Europe and the Global Economy

Bruegel has from the start put emphasis on the interplay between integration at regional level and globalisation. At a time when the role of Europe as a global player is becoming central to the European Union's narrative, this remains the focus of the research area *Europe and the Global Economy*.

**Research in 2007** resulted in a major publication; the book entitled *Fragmented Power*, edited by André Sapir. A further Blueprint presenting the outcome of research on skilled and unskilled migration and a working paper on the mobility cost of limited portability of pension rights are scheduled for early 2008.

**Research is ongoing** on two projects which are expected to result in publications in the first half of 2008:

- **B1. Changing patterns of international integration in Europe and America.** This project focuses on the interaction between global and regional integration in Europe and North America as evidenced by changing patterns of trade and foreign direct investment. It examines how both the European and North-American 'hubs' are being restructured by these changes and how this is affecting the relationship between, on the one hand, the US and Mexico and, on the other hand, Western and Central and Eastern European countries.

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- **B2. The scope of regional trade agreements.** Lack of progress at the multilateral level has led participants in world trade to rely increasingly on regional arrangements. Furthermore, regional trade agreements (RTAs) often go beyond the mere replication of existing trade commitments to include non-trade dimensions (in fields like investment, competition and environmental protection) and even non-economic dimensions (such as terrorism, drugs and human rights). However, the question remains whether they provide an alternative or a complementary form of integration to traditional trade multilateralism. To shed light on the issue, the project relies on a systematic comparison of the RTAs notified to the WTO.

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### Two new projects for 2008 are:

- **B3. Sovereign wealth funds.** Sovereign funds have become a prominent policy issue since mid 2007 and attitudes to be adopted towards their equity investments are being debated in Europe and the US. This project will attempt a facts-based assessment of the threats and opportunities foreign investment by state-owned entities may represent for Europe, and will examine what policy responses may be suited to best protect European interests.

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- **B4. Europe and its neighbourhood.** The purpose of the project is to evaluate the EU's economic policy towards its neighbourhood, a region encompassing the former Soviet Union, the Middle East and North Africa. The EU's neighbourhood is both economically vital to the EU and highly volatile, and the EU and its neighbours are strongly intertwined through trade, energy flows and migration. The idea is not to evaluate the EU's policy towards all neighbours but to focus on a case study. There are essentially two options. One option is to focus on the economic dimension of the EU's neighbourhood policy and to assess the policy of

the EU towards one European country (probably Ukraine) and one country in the North Africa/Middle East region (probably Egypt). The other option is to focus instead on Russia.

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### C. Companies and Competitiveness

Over the last two years, Bruegel has acquired experience with, and started to become identified with, firm-level analysis of internationalisation. Research has been conducted both on major listed companies ('corporate champions') and on exhaustive or representative samples of individual firms. In both cases, the underlying assumption is that both from a policy and from a research standpoint, analysis of competitiveness and structural change gains from being based on firm-level rather than traditional aggregate data.

**Research in 2007** resulted in the publication of the Blueprint *The Happy Few* which presented the outcome of the project *European Firms and International Markets* coordinated by Bruegel and the Centre for Economic Policy Research.

**Research is ongoing** on one project which started in 2007 as part of the project on changing patterns of international integration and which should result in a significant publication in Spring 2008:

- **C1. The industrial organisation of enlarged Europe.** Traditional analyses provide a potentially misleading picture of the trade integration between the 'new' and the 'old' member states. This project seeks to deliver a reassessment of the effects of enlargement on the basis of indicators derived from the detailed composition of trade. Attention will be devoted to analysing the way firms in Germany, more than in other countries, are using fragmentation across the eastern border in order to enhance their competitiveness.

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#### **Four new projects are introduced in 2008:**

- **C2. The euro's effects on firm cross-border activity** (joint project with the Centre for Economic Policy Research, London). Building on the findings presented in *The Happy Few*, the Bruegel team and its partners in the EFIM (European Firms and International Markets) network intend to use firm-level analysis to uncover the effects of the introduction of the euro on patterns of trade and foreign investment both within the euro area and with other countries. This will allow the investigation to go beyond the aggregate estimates of the trade effects of the single currency and to determine the effect it has had on smaller firms and the channels (firm entry, productivity improvement, cost reduction) through which the euro has affected integration.

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- **C3. European firms in a global economy.** In cooperation with other institutions<sup>3</sup>, many of which were already partners in the EFIM network, Bruegel has applied for European Commission funding for a multiannual project which builds on the findings presented in *The Happy Few*. The goal is, first, to conduct a multi-country survey of European firms in order to create a database allowing systematic comparisons across countries. Second, to use this database for a series of research projects on the interaction between firm internationalisation and firm characteristics such as size, productivity, organisation, skill intensity, and innovation effort, as well as on the impact of financial constraints and macroeconomic shocks, such as the appreciation of the euro. The project should start in the second half of 2008 and extend over four years. Resources for the project and for the management of the network will be provided through Commission funding.

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- **C4. Corporate nationality and economic nationalism.** In spite of longstanding policies to level the European and international playing field, the notion that the interests of 'national' companies are aligned

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<sup>3</sup> Partners: University Carlos III (Madrid), CEPII (Paris), CEPR (London), HAS (Budapest), IAW (Tübingen), Ld'A (Milan), UniCredit (Milan). Several European central banks and the OECD are associate partners in the project.

with the national interest remains deeply rooted in many policymakers' thinking, especially but not only for industries that are deemed strategic. Building on earlier research (*Farewell National Champions*, 2006), this project will entail an assessment, against various criteria, of the 'nationality' of large companies in Europe and elsewhere. It will consider the possible arguments (welfare, competitiveness, national security) and counterarguments for differential policy treatment of 'national' or 'European' companies, how they may evolve over time, and implications for public policy.

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- **C5. Globalisation and the rise of executive pay.** CEO compensation has increased six-fold between the 1980s and the 2000s in the US and to a lesser extent in Europe. Most of the discussion about this rise dwells on a corporate governance approach. Without excluding the possibility of weaknesses in the internal control mechanisms of firms, the project will seek to put emphasis on the impact of changes in the global market environment in which firms operate. Specifically, two factors whose importance is to be assessed are the changing nature of the corporation in the context of globalisation and the global competition for talent.

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#### **D. Institutions and Policies**

Institutions shape policy outcomes and feature among the key determinants of economic performance. Research in this area aims to analyse the interplay between institutions and policies.

**Research in 2007** was mainly devoted to global imbalances, resulting in the March joint Policy Brief with the Peterson Institute and the Korea Institute for International Economic Policy; to the euro area, resulting in the euro area task force report to be published as a Blueprint in early January 2008; and to the links between structural reform and macroeconomic policies, on which a Policy Brief is scheduled for early March 2008.

**Ongoing research** focuses on one project:

- **D1. The reform of the EU budget.** Research so far has concentrated on the EU's structural funds and resulted in a Policy Brief in February 2008. The next steps address the spending perspectives for the medium term, implications for resources, and the institutional dimensions of EU budgeting. On spending, the focus will be on determining which of the new policy priorities of the EU need to translate into actual spending at EU level and which can be attained through regulatory or incentives means. In outlining priority outlays for the EU budget, attention will be given to the alternative between EU spending and national or sub-national spending. On resources, the question we will address is what bearing spending priorities for the medium term may have on the nature of resources. Finally, research will address the institutional dimensions of the budget, including the budgetary process. The three dimensions (spending, resources and institutions) will finally be brought together to make proposals for the budget review.

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**Four new projects are introduced for 2008:**

- **D2. Economic policies and labour mobility.** Soon, EU citizens will enjoy freedom to travel and work within the entire EU27, almost as if the EU were one country. However, the diversity of attitudes to migration, migration policies, and migration outcomes that member states are experiencing in the run up to this date (2014 at the latest) remain striking. Some of the new member states such as Poland, the Baltic States and Romania have experienced massive outflows (and increasingly inflows from non-EU neighbours). Some of the old member states such as Spain, UK and Ireland have adopted pro-mobility policies and have attracted large numbers of migrants. Others, such as Germany, Austria, and France, have been pursuing more restrictive policies in recent years. Building on the expertise accumulated over the last two years, this project will look at the interaction of inward or outward labour migration, migration policy, and economic performance. It will assess the benefits, costs and risks of alternative mobility policy choices. Specifically, policy options with regard to third country nationals will be evaluated and schemes currently contemplated, such as circular migration, will be discussed.

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- **D3. Policy evaluation in the EU.** Evaluation of EU policies is still in infancy. This makes it impossible to assess whether policies are successful or whether they should be transformed to better meet their stated objectives or to do so in a more cost-effective fashion. The current absence of evaluation is detrimental both from an efficiency standpoint and from a democratic point of view. The purpose of the project is to examine in the light of international experience what the options are for improving policy evaluation at EU level. Several alternatives are to be examined, drawing on the experience of both the EU (with OLAF and the European Court of Auditors), national governments (where parliamentary evaluation offices often play an important role) and international institutions such as the IMF and the World Bank (where independent evaluation offices have been created).

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- **D4. Institutions and policies in the new member states.** Macroeconomic policies in the new member states raise specific challenges. How best to design rules and institutions that contribute to shaping these policies is an important issue, not least in anticipation of these countries' future membership of EMU. Recent research has emphasised the need to tailor budgetary rules and institutions to a country's political and institutional context. The project will seek to assess recent changes in the new member states' macroeconomic policy framework and the impact of these changes on economic and budgetary performance.

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- **D5. The governance of international financial reporting standards.** The IFRS represent a unique experiment in global private-sector-led policymaking, which they have undergone momentous development in 2007 (planned adoption in countries including Japan, South Korea and India, recognition in the US). Building on the study published in 2007, Bruegel intends to continue contributing to the debate on the governance of this endeavour. The International Accounting Standards Foundation's planned 'Constitution Review' in the course of 2008 will be an opportunity for such a contribution.

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## **E. Interdependence and Regulation**

This research area was introduced in 2007 in response to demands by members. It seeks to contribute to the design of appropriate regulation at EU and national level, and to highlight the impact this can have on stability and performance.

**Research in 2007** was focused on energy (which resulted in the Blueprint *Energy: Choices for Europe*) and on financial regulation (with the Blueprint *The Global Accounting Experiment* and the Policy Brief on banking supervision). A major conference was also organised on investment and innovation in network industries.

### **Research is ongoing on two projects:**

- **€1. Financial regulatory and supervisory arrangements in Europe.** Financial regulation and supervision in the EU involve the international, European and national levels. The market turmoil that started in Summer 2007 has stimulated new thinking about how these dimensions interact and about the benefits and shortcomings of different models. Building on research done in 2007 on banking supervision (*Is Europe Ready for a Major Banking Crisis?*), the project will aim at an assessment of Europe's strengths and weaknesses in the financial crisis, and consequences for regulatory and supervisory arrangements within the governance framework of the EU and its member states, including the subsidiarity principle.

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- **€2. European approaches to climate policies.** Making EU climate policy feasible and credible requires the definition of a solid policy framework. Following the agreement of the European Council in Spring 2007 to reduce carbon emissions by 20 percent, increase the share of renewables up to 20 percent of the energy consumption and to increase energy efficiency by 20 percent in 2020, the European Commission has

recently made a legislative proposal aiming to implement such targets. The proposal improves substantially the design of the EU Emissions Trading Scheme and increases the sectoral scope of carbon mitigation policies. However, the proposal fails to establish priorities between the objective of emissions reduction and the renewables (and biofuels) target and it postpones addressing the competitiveness issues resulting from potentially asymmetric application of climate policies. The project focuses on two aspects: first, the assessment of the European Commission proposal and of its economic impact and, second, the analysis of the synergies and trade-offs of the different targets and instruments (e.g. emission abatement policies, energy efficiency and R&D policies, support for renewables, biofuels policies). The aim of the project is to discuss how a policy framework can be both effective in fighting climate change and cost-efficient.

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### Three new projects for 2008 are:

- **E3. Intellectual property and innovation.** Patent systems have been created to stimulate innovation through the incentive to invest in research and through the new products they provide to the innovators. However, European patents are more costly than their US or Japanese counterparts and controversies have arisen as regards their scope, their design, and the quality of the examination process. The aim of the project will be to evaluate how patents affect R&D and innovation and to formulate proposals for improving the European patent system. On this basis, special attention will be focused on the case of specific innovation-intensive sectors such as telecoms and pharmaceuticals.

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- **E4. The gains from an integrated electricity market.** The purpose of this project – whose launch is dependent on data availability - is to assess the benefits from the expansion of a wholesale electricity market throughout Europe. Relying on detailed data patterns of output throughout the year and over days, the project will compare the cost of meeting demand in Europe under a fragmented and integrated wholesale market regime. If transmission constraints across countries do not limit ability of the lowest cost generation units to sell electricity regardless of their location, the total variable cost reductions from the expansion of the geographic scope of the wholesale market can be significant.

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- **E5. Regulation, investment and innovation in the telecom sector.** The experience from both industrialized and developing countries is that competitive telecommunications markets provide substantial benefits to consumers. However, it is unclear precisely how to achieve a competitive telecommunications sector. Some forms of vertical separation have been suggested as means to achieve this goal, but there are various types of arrangements in place in countries with competitive telecommunications sectors. This outcome raises the question of precisely what the initial conditions are necessary to achieve a competitive telecommunications sector as quickly as possible. The project will use the experience from countries around the world to determine the initial conditions necessary for a competitive telecommunications market that provides tangible and lasting benefits to consumers.

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