



2016-17 RESEARCH PROGRAMME

INTRODUCTION

Looking at the current research year, Bruegel has contributed to and shaped major policy debates in Europe and globally. We have worked on monetary and fiscal policies, published papers on fiscal union and capital markets union and also taken stock of the first 18 months of European banking supervision. We published an essay reviewing the historical experience of building the US fiscal federation and drew lessons for the EU. We discussed the relations between euro area countries and non-euro area countries and we analysed in particular the possible consequences of the UK leaving the European Union, including reflections on what strategic response would be appropriate. We also reflected on global and European income inequality. Volatility in China put our expertise on China and the global economy in high demand. Meanwhile, we intensified our work on energy relations in the Mediterranean, we discussed climate policies in Europe, including a paper on climate finance for the informal ECOFIN. We looked at the sharing economy and compared innovation policies across EU countries. Finally, we explored various aspects of competition policy and the digital economy.

All of these debates are crucial to the performance of the European economy. Yet, a new meta-trend has emerged in Europe and around the world: it is one of questioning the ability of “the elite” to deliver prosperity and peace. Time is of the essence to convince citizens that progress is being made. In fact, the meta-trend manifests itself in rising discontent, populist movements and less political stability suggesting that much work remains to be done. The decision by UK citizens to leave the European Union can also be seen in this light. This meta-trend paired with the many unresolved and difficult economic challenges in Europe and around the world leaves researchers and policy analysts with a complex and difficult to discern picture. Bruegel clearly has a role to play bring clarity to this complexity and clearly explain trade-offs and choices.

An important part of our research of the last months and the coming year(s) will concern the implications of Brexit. One important dimension is the possible future relation between the EU and the UK. Another question is how to improve the functioning and cohesiveness of the EU itself. There is a long array of questions ranging from regulation of the single market to competition policy, data protection rules and deeper governance questions.

We also plan research on how the EU should shape globalisation. This concerns questions of external trade policy as much as questions of the internal policies to ensure that the benefits of trade can be enjoyed by all.

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.

Guntram Wolff, August 2016

A. RESEARCH AREA: EUROPEAN MACROECONOMICS AND GOVERNANCE

Participants:

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

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

However, there are major underlying weaknesses and a number of outright risks and both pose threats to economic recovery. On the side of weaknesses, the euro area remains imbalanced, production is still well 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 in some parts of the global economy, especially EMEs, 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. This assessment has barely changed from one year ago.

More important has been the increase in political risks. While last year the debate was heavily influenced by the Greek situation, this year much policy attention is focused on the possible consequences of the United Kingdom leaving from the European Union. After the decision taken by British citizens in referendum, politics not only in the UK and but also in other EU countries could turn more hostile towards the openness of our economies and towards further integration within the EU. Radical political changes could also happen in the United States. These political risks are deeply concerning for citizens, companies and the European Union and will have effects on economic performance, on income inequality, on economic governance and on politics more broadly. Bruegel will continue to shape debates on political risks, approaches to address them with better economic policies not least with a view to ensure inclusiveness and more appropriate economic governance.

Brexit is raising major governance questions, which we aim to address. One concerns the possible future relations between the EU and the UK as well as the process of divorce itself. Another question concerns the possible EU reforms that Brexit possibly triggers. One particular area of concern is the future relation between euro area and non-euro area countries. After Brexit, non-euro area countries will only contribute around 15% to the EU's GDP. How can the evolving governance of the EU ensure an appropriate voice to matters that concern the single market and not primarily the euro area to countries outside of the euro area? More broadly, the institutional reforms of the EU in the last years have led to a complicated and incomplete economic governance framework, whose effectiveness is doubted by many. Mistrust between countries and between citizens and the EU will make it more difficult to revise the current institutional setup and design new instruments.

Brexit also raises major questions other than governance questions. For example, it will be important to understand how a new trade agreement of the UK with a country like China could shape and re-direct trade flows between the EU and China. Other important questions concern issues such as standards and regulations that the EU and the UK may wish to keep as well as a framework for their enforcement.

We plan to continue a number of research themes followed in previous 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 and Brexit, 3. Productivity, investment and growth and 4. Inclusive growth, labour income shares and migration.

A number of projects in European macroeconomics and governance are highly connected with research in other areas. For example, analysing the EU's macroeconomic policy stance cannot be done in isolation to an analysis of the financial system and its regulatory framework.

1. Macroeconomic policies and adjustment in Europe

This research theme will continue with a renewed focus in 2016/17. 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 and raise important questions of how to deal with that debt overhang. We plan a major conference and a paper on the issue of debt overhang and NPLs and how to best deal with it. Low inflation throughout the EU, and in particular in the euro area, is making debt sustainability and intra-euro competitiveness adjustment more difficult, while price divergence and high current account surpluses give testimony to the still substantial euro area imbalances. We will work on two broad research clusters:

- Macroeconomic policies, in particular monetary and fiscal policies
- Macroeconomic adjustment and structural reforms

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. A central topic during the research year will be the consequences of the UK leaving the EU as well as how the divorce could be organised and how a future relationship could look like. Specifically, our focus will be on (i) how negotiations between the EU and the UK could and should unfold and on (ii) how the remainder of the EU will have to adapt its internal governance, not least in response to the fact that the euro area will become even more dominant relative to non-euro area countries. and on (iii) the dependency of the rest of the EU on the UK, specifically London, financial centre and whether the fragmentation of this centre would lead to a sub-optimal outcome for both the UK and firms and companies in the EU. The last question overlaps with important questions of financial regulation and capital markets union. Irrespective of the UK decision, questions of how to deal best with the existing heterogeneity and diversity in Europe and what implications this might have for the appropriate balance between subsidiarity and centralisation warrant deeper analysis. Beyond the UK question, we will focus on what changes in euro area governance should be prioritised and how to achieve them; the implementation of the current governance framework; and finally the central issue of governance developments between the euro and the non-euro area countries. For example, the issue of fiscal union remains part of the debate and Bruegel will produce a paper. 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.

- Economic governance in EU and EMU

3. Productivity, investment and growth

With the crisis fall-out gradually being addressed, factors determining long-term economic performance will increase in importance and we plan to contribute with a number of pieces. We will focus on productivity growth, the single market, long-term investment and potential output. We also plan to undertake one study on the operations of the European Investment Bank in order to see how (long-term) investment can be boosted.

- Productivity, investment and growth
- Potential output

4. Inclusive growth, labour income shares and migration

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 may not just undermine social cohesion but may 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 looking specifically at falling labour income shares and what they mean for the EU. The issues are also linked to the broader topic of what kind of vision the EU should develop to regain citizens' trust.

- Inclusive growth, labour income shares and EMU adjustment
- Migration and the European Union

B. RESEARCH AREA: GLOBAL ECONOMICS AND GOVERNANCE

Participants:

- **Scholars:** Zsolt Darvas, Alicia Garcia-Herrero, André Sapir, Nicolas Véron, Karen Wilson, Guntram Wolff
- **Non-resident and visiting scholars:** new non-resident scholar

The interactions between Europe and the international economy are manifold. The US financial crisis, the euro area crisis and the recent volatility in China all showed that global interdependences are structural and substantial. This interdependence has also raised concerns among citizens and a renewed interest has emerged as to how the EU and its members can shape globalisation. 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 the EU's neighbourhood.

1. Asia initiatives

The Asia Europe Economic Forum co-founded by Bruegel will continue its activities in 2016/17 with a conference in Beijing. Bruegel has advanced its leadership on being a leading European voice in Asia. With a number of senior fellows it has established itself as 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.

In terms of research, we will continue to analyse developments in the Chinese economy and their implications for the European economy. In particular, we will put an accent on the EU-China economic and strategic relationship for the next 10 years. Moreover, we will start to have a regular series of blogs reflecting on India's economy and its relations with the European and global economies.

2. Global economy and governance

Primarily, we will reflect on what role the European Union can play in shaping globalisation. This question concerns both the approach the EU can and should have towards global trading partners as well as the approach the EU and its member states should and could develop internally to address possible distributional issues arising from globalisation in its various dimensions. We will also reinforce our work on trade policies, not least in relation to Brexit.

Bruegel is also working on G7/G20 governance issues. Moreover, we plan to co-organize a conference on transatlantic financial governance questions.

3. Major regional players

Bruegel has devoted increasing attention to the EU's neighbourhood and has had, with limited resources, a significant impact on the economic debate regarding Ukraine. We will also continue our focus on non-EU Mediterranean countries. We have developed links with a number of foundations and think tanks in the region. We will host/co-organise a number of events 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).

C. RESEARCH AREA: FINANCE AND FINANCIAL REGULATION

Participants:

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

Four main directions are identified for the forthcoming year whilst still allowing Bruegel the flexibility to react to major financial market developments as it has done in the past.

1. Financial instability

Unconventional monetary policy was a logical response to persistently low inflation rates. But low interest rates resulting from QE monetary policies may produce certain financial instabilities. At the same time, but not implementing unconventional monetary policies could produce other forms of financial instabilities. These instabilities could affect banks, insurances and pensions. The question is how significant the respective potential risks are and what kind of policy measures could be taken to address them.

2. Capital flows and financial risk sharing

Bruegel has built up 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. One special aspect on which a research project will focus is looking at the capacity of financial markets to share risks across borders.

3. Banking and capital union

Europe's banking union continues to evoke many different policy debates. The ECB took up its new role as banking supervisor on 4 November 2014, 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 the agenda is moving rather slowly. Significant policy debates focus on banking supervision, the progress made with bank resolution, possible changes to the regulatory system and others. A particularly important question will be how Brexit impacts a possible future Capital Markets Union design. Bruegel scholars will also respond to requests for expertise from the European Parliament on bank resolution questions.

4. Financial sector policy evaluation

Nine years have passed since the start of the systemic financial turmoil in Europe in the summer of 2007. Bruegel will study the new landscape of EU financial regulatory agencies and the EU's commitment to global financial standards.

D. RESEARCH AREA: INNOVATION AND COMPETITION POLICY; ENERGY AND CLIMATE POLICIES

Participants:

- Resident scholars: Georgios Petropoulos, Simone Tagliapietra, Reinhilde Veugelers, Karen Wilson, Georg Zachmann
- Non-resident and visiting scholars: Carlo Altomonte, J. Scott Marcus

Bruegel's work in this research area focuses on how Europe can 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.

1. The future of European industry in 2030

We plan a blueprint publication on the future of European industry. The blueprint will cover various dimensions of the transformation of European industry and explore in particular the possible policy responses to changes resulting from technological progress, digitalisation, innovation, climate goals, energy policy and competition policy.

2. Competition, innovation policies and the digital single market

An important strand of research focuses on competition, innovation, and research policy as well as on what policies will be most suited to unlock the full benefits of the digital single market. One dimension is the approach of competition policy to online platforms. Another research project will look at the impact of disruptive technologies using a new microeconomic data set prepared by the Banca d'Italia, which is particularly suited for the question.

3. Energy and Climate policies

One important dimension in this work stream is the European energy transition. A second dimension concerns energy investments in Africa, which we will undertake in collaboration with a partner. The security of energy supply will remain a relevant topic and we will also document the main sources of energy imports for different EU countries. We will continue to closely monitor Europe's energy security situation, notably in relation to the developments in the Eastern and Southern neighborhoods. In this context, the evolution of large energy infrastructure projects such as Nord Stream 2 and Turkish Stream will also be analysed. Other questions concern the development of gas and electricity networks. Finally, we will continue to work intensively on the impact of climate policies and renewable technologies on European industry and competitive advantages. We will also monitor progress with the implementation of Paris Agreement in Europe.