

2017-18

**Research
Programme**





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Introduction

The world today looks very different to how it looked just 12 months ago. The US election has changed the geopolitical dynamics for the European Union. Together with Brexit and the French elections, it has brought new impetus to the debate on EU integration. As a result, Europeans are engaging in wide-ranging policy discussions on how to recalibrate Europe, the European Union and our place in the world.

The areas that our research program comprises reflect topics we consider to be crucial to the future of Europe: macroeconomic policy and governance, global economic relations, finance and regulation, competition and innovation and finally energy and climate. Naturally our end-objective is to identify economic policies that promote growth, jobs and welfare and increase Europe's resilience in a global system riddled with uncertainties.

We will be actively promoting the discussion on whether and how to advance EU integration. The governance of the euro area, the EU and Europe as well as the relations between those that are more integrated and those that are less will remain the central pillar of our research. How do we protect the principle of subsidiarity, i.e. preventing unnecessary "interference" from Brussels whilst ensuring that competence is exercised at European level where and when it actually matters, i.e. overcoming national "protectionism"? Which competences need to be exercised at EU level and which do not? We will focus on the design and implementation of already agreed matters and the deeper architectural questions. Part of our work will therefore be about monitoring and holding existing institutions to account: to what extent does the EP exercise its right to hold the banking supervision system to account? How well is the EC, the ECB or the new banking supervisor doing compared to objectives? Last but not least, Brexit negotiations will require further research towards understanding its implications.

Changes in Europe are not only generated by political developments. However, perhaps more important than politics are the disruptive changes induced by technology and by global trade and investment. Developments, for example, on digital platforms profoundly change the way we live and do business. Artificial intelligence is an opportunity but also a challenge. Understanding the social implications of technological innovation is fundamental for inclusive development, citizens, and new and old business. How do we regulate markets that may not be there quite yet but we know are coming, like fintech? Will the sharing economy change the nature of self-employment?

The US election outcome has forced the EU to rethink global alliances. We have invested significantly in the study of options for EU-China relations. And while it is natural to think of how to strengthen relations with China, it is also clear that China's economic and political model will continue to differ from the "Western" one. How can these two models co-exist while allowing to reap the benefits of globalisation? We will also undertake an evaluation of the G20 against global challenges and assess progress toward collective commitments, including the reduction of global imbalances.

Last, a significant part of our work covers energy and climate policies – both being issues with major implications for Europe and the world. The future of the Paris agreement, urbanisation and the transformation of the transport sector from a European point of view are but two of many interesting projects in this area.

Our overall aim was to craft a research programme that builds on our strength: connecting governance and politics with hard economic research. As in previous years, the programme describes continued work streams and adds new areas in which to invest. It allows for flexibility to react to events in real time but emphasises, perhaps more than previously, the need to focus on long-term structural issues. Among those longer-term issues, we highlight the euro area, EU, European and global governance as well as profound technological transformation. All of these topics raise significant questions for the welfare state and the social contracts on which our societies are built. An exciting year lies ahead of us.

Guntram Wolff and Maria Demertzis, 27 June 2017

A. Research Area: European macroeconomics and governance

Participants:

- *Scholars: Grégory Claeys, Zolt Darvas, Maria Demertzis, Alicia Garcia-Herrero, Silvia Merler, André Sapir, Alessio Terzi, Nicolas Veron, Guntram Wolff, ,*
- *Non-resident and visiting scholars: Emmanuel Murlon-Druol, Marek Dabrowski, Stavros Zenios*

The European economy continues to recover while at the same time a number of problems continue to persist. The European Central Bank is prolonging its quantitative easing (QE) programme but discussions on the timing and nature of exit from QE are picking up. Fiscal policies remain broadly neutral but controversial. Progress with structural reforms varies among countries. Private and public indebtedness remain high and deleveraging is slow. However, progress in resolving non-performing loans has allowed the creation of new credit growth. By contrast where this problem persists new credit remains weak.

The recovery that we observe remains vulnerable to factors that were relevant also last year. The euro area remains imbalanced, production is still below potential and unemployment is high in a number of EU member states; core inflation is low; high public, private and external debts persist despite protracted deleveraging. All of these constrain or even prevent highly indebted sectors and countries from growing, while institutional weaknesses in some countries lead to weaker trust and/or corruption.

Unfavourable demographic changes impact consumption and saving patterns and jeopardise the sustainability of European welfare systems. Last but not least, economic growth is not inclusive enough to offer equal opportunities for personal wellbeing to different segments of society. Unemployment, and in particular for the young, remains the problem to beat. Yet the structural reforms needed to address these problems are slow to design and implement.

The political risks that the European economy faced last year have, however, changed in certain ways. On the one hand, the process of Brexit is less of a disruption. Even if riddled with uncertainties, it is a path that does not now pose immediate threats to the viability of the rest of the EU. More importantly, electoral outcomes in other countries, like France and the Netherlands, have not brought euro sceptic parties to power. An appetite to discuss architectural issues for EMU is beginning to emerge, in realisation of the need to increase the system's resilience. On the other hand, events outside its borders, in the US, Russia, Turkey and Africa are forcing Europe to coordinate actions. Such policy discussions have started with the allocation and governance of central funds to cover issues like security and defence.

Brexit itself continues to raise important questions, ranging from the size of the divorce bill to the future relationship that can eventually be agreed upon. Brexit remains important to the Bruegel policy discussions. The future relation between euro area and non-euro area countries will equally remain central.

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, migration and the welfare state.

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. Brexit will also span across different research themes.

1. Macroeconomic policies and adjustment in Europe

This research theme will continue with a renewed focus in 2016/17. We will continue to work on **monetary policy** of the euro area. With the recovery in the Euro area picking up, a key issue will be the potential exit from ECB unconventional monetary policies once inflation increases sustainably. We will discuss the best strategy and optimal sequencing of this exit in order to understand the implications of monetary policy normalisation. We will also continue to work on **fiscal policies**, including the actual and desirable aggregate fiscal stance (a topic that has implications for the EU fiscal framework), and the issue of a possible euro area fiscal union. Given the slow

recovery of investment in Europe, we will also work on **investment policies** in the EU. There is a key puzzle between talks about a 4th industrial revolution and increased scope for robotisation on the one hand, and the low productivity growth and low investment on the other hand. We aim to shed light on this puzzle. We will also continue our assessment of the Juncker plan which has already been in place for 2 years, to determine if the plan fulfils its original objectives. Last, we will investigate European citizens' perceptions about the euro.

- Macroeconomic policies in the euro area (partly A1).
- Economic and political perspective of the euro (A2).

2. Economic governance of the euro area and the EU and Brexit

The issue of economic governance of the euro area and the EU will continue to be central in our research. Ensuring that nascent recovery continues and financial stability is maintained are key objectives behind our attempts to contribute to the effective governance of the EU.

One important issue is the implementation of agreed principles. After our previous work focusing more on the European Semester and the fiscal surveillance, we now intend to look at the macroeconomic imbalances procedure. We will continue our work on Brexit and investigate how this affects the rest of the EU, and the future EU budget. 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 the central issue of governance developments between the euro and the non-euro area countries. We will also explore the options and implications of rendering sovereign debt state-contingent and introducing (soft) large exposure rules on the holdings of sovereign debt. Last but not least, we will revisit social policies and how the welfare state can be strengthened.

This year we will also pay emphasis on the extent to which EU internal market integration is increasingly a function of the pooling of regulatory enforcement authority, especially in regulated services sectors that represent an increasing share of the European economy – such as finance, energy, and digital services.

- Economic governance in the EU, the euro area and Brexit (A3).
- Challenges of the EU Single Market (A4).

3. Productivity, investment and growth

With the crisis fall-out gradually being resolved, factors determining long-term economic performance will increase in importance. We will also continue our work accompanying the performance of the Juncker plan.

- Productivity, investment and growth (partly A1).

4. Inclusive growth, migration and welfare

We will continue our work on inclusive growth as an imperative component of sustainable growth. On the topic of immigration, we will examine the economic impact of immigration on the EU. At the same we will investigate the level of financial inclusion of immigrants and the policy implications. To that end it would be important to also understand what private sector initiatives can help foster further integration. We will also add a second topic on the macroeconomic implications of health care systems in the EU. Our proposed study aims to examine the role of healthcare systems in public finances and macroeconomic developments, focusing on European Union countries in a global context. How are government decisions on public sector healthcare spending taken today? What are the economic values of investing in healthcare in particularly in an aging society? How can cost-effectiveness and sustainability be ensured? What does it mean to keep a healthier population in the long term? We will take an upstream perspective, e.g. impact on economic growth.

- Impact and integration of migrants in the EU (A5).
- Macroeconomic implications of health care systems in the EU (A6).

B. Research Area: Global economics and governance

Participants:

- *Scholars: Zolt Darvas, Maria Demertzis, Alicia Garcia-Herrero, Silvia Merler, André Sapir, Nicolas Véron, Guntram Wolff,*
- *Non-resident and visiting scholars: Suman Berry, Uri Dadush*

The new administration in the US has changed the nature of the US's global role and its relationship with the EU. This results in risks in terms of how much the EU can rely on US global leadership to promote issues like defence, rules-based trade, climate change, and multilateralism more generally. The EU is having to think about upping its game on the global scene as it re-thinks the nature of its alliances. In this respect, it is important to also understand how European citizens view the process of globalisation and the way the balance of powers has shifted.

Bruegel will continue to explore how such risks may affect Europe's role and what progress can be made to strengthen its governance and economic performance. We will continue our three main lines of research: global governance, Asia initiatives and the relation between the EU and the EU's neighbourhood. This year we will begin to consider our relations with Latin America by organising an EU-Latin America forum in Brussels. This may be an area for future development.

1. 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. Moreover, we will examine economic convergence between the EU and the US and how Europeans perceive the process of globalisation.

We will investigate two more topics that are of importance at the current juncture. First, the future of protectionism. Despite the severity of the recession and the escalation in anti-trade rhetoric, protectionism appears to have been contained so far. Is this in fact the case? How much of the recent world trade slowdown is attributable to protectionism? Why has protectionism apparently been kept at bay? Or is there now such a large a vested interest in free trade that protectionist policies are economically unviable and/or politically impossible? How are these forces likely to play out in the future?

Second, we will assess the first decade of the G20 leaders process. In the altered global and European landscape today, and uncertain prospects for the coming decade, is there a common interest of European members in 'repurposing' the G20? How best does or can the G20 reinforce other multilateral institutions to assist in achieving its policy and diplomatic goals?

- Europeans and globalization (B1).
- Economic convergence in Europe and the US (B2).
- The future of Protectionism (B3).
- The G20 leaders' summit at 10- A first assessment (B4).

2. Asia initiatives

The Asia Europe Economic Forum co-founded by Bruegel will continue its activities in 2017/18. Bruegel has advanced its position on being a leading European voice in Asia. With a number of senior fellows active in the field, it has established itself as a globally recognised hub for Asia-Europe economic discussions and exchanges.

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 examine the impact of Belt and Road initiative that goes beyond trade. Similarly, we would want to understand better the economic spillovers from China on employment and costs. Also, in this context we will examine the merits and scope for creating a committee on Foreign Investment in the EU (to mimic CFIUS).

- China and Europe: links and spillovers (B5).

3. Major regional players

Europe's neighbours remain crucial to its ability to foster stable economic relations. Last year we contributed to the G20 agenda on the compact with Africa. We will continue to examine the economic challenges that arise from the Mena region and the African continent and the role that Europe can play. The trade dimension will have to consider both encouraging bilateral trade with Europe but more importantly how Europe can help encourage trade between the countries themselves. 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). We will also produce an update of our previous analyses on the economic developments in Ukraine and the performance of the EU's financial assistance. Last but not least, we are exploring the EU's economic and especially energy relations with Turkey.

- Promoting regional trade in the MENA region (partly B3).
- Financial assistance to Ukraine
- Dialogue on energy relations with Turkey (see E3)

C. Research Area: Finance and Financial Regulation

Participants:

- *Scholars: Gregory Claeys, Maria Demertzis, Silvia Merler, André Sapir, Dirk Schoenmaker Nicolas Véron, Guntram Wolff*
- *Non-resident and visiting scholars: Alexander Lehmann*

Bruegel played an important role in the debate on how to design the architecture of the European financial system. We will continue to investigate architectural issues that relate to the Banking union, but importantly also the Capital Markets Union. In evaluating architectural structures, like regulation, it is crucial to consider how they are financed to ensure cost-effectiveness. We will continue our work on sustainable finance and ways of implementing it. We will address issues concerning 'Fintech', an important dimension in digital economy will be looked at from the perspective of how it can promote capital markets union and what regulatory challenges it might present.

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. Capital Markets in the EU27 after Brexit

The aim behind the CMU initiative is to reduce the EU's dependence on standard bank finance. This is crucial both for encouraging growth but importantly also for diversifying the sources of finance and thus protecting financial stability. However, progress in creating and deepening capital markets is slow and difficult, if not because of all the different steps that need to precede it. Single supervision is arguably an important pre-condition for a more integrated capital market in the EU. Following Brexit, our intention is to explore how ESMA can be expanded towards a SEC-type body for an integrated EU27 capital market. This is part of the wider policy debate on supervisory and institutional architecture that Bruegel has pursued in the past years.

- Capital markets in EU27 after Brexit (C1).

2. Promoting banking integration in the EU

Despite big advances towards a Banking union in the EU, banks remain still very national in nature, a fact that creates obstacles to further integration. Aiming to promote banking integration has several dimensions that we aim to explore: 1) How will EU banking structures evolve; supervisory and regulatory incentives; 2) (Lack of) cross-border M&As and competition; removing obstacles to competition; 3) Governance and business models in the banking sector; sovereign exposure limits and how they need to adapt in a post crisis world. Also, there remains the issue of how integration will evolve in light of the divide between the Banking Union and the rest of the EU. Also, we will continue our work on bank non-performing loans and examine how the EU can promote the creation of a secondary market for these loans. This is an important step in order to progress with removing such loans from

banks' balance sheets and safeguarding financial stability. A focus will be on the political economy of bank resolution.

- Banking integration [C2].

3. How to implement sustainable finance

As part of our aim to provide sustainable solutions, Bruegel scholars have developed a framework for thinking and approaching sustainable finance. We will contribute with an event to the further discussion and possibly add to the debate with blog posts.

- Implementing sustainable finance [C3].

4. Understanding Fintech: regulatory challenges and promoting the capital markets union

. Over the past years, “fintech” has become a buzzword – indicating a broad range of technology-enabled and innovative financial activities. Fintech is a significant opportunity to disrupt a financial system, increase its efficiency and enlarge its scale to the European level. But policy-makers are concerned about the uncertain impact that this new disruptive sector may have on the established banking business model. Equally, they are concerned about the potential financial stability. The European regulatory initiative – as it currently stands – shows significant fragmentation and national idiosyncrasies. First we will take stock of the size of fintech in financial intermediation and then examine how fintech in Europe can leverage the objectives of capital market union. We will examine the difference aspects of fintech and the different opportunities they present in this respect.

- Fintech and capital markets union [C4].

D. Research Area: Innovation and competition policy

Participants:

- *Resident scholars: Georgios Petropoulos, Reinhilde Veugelers, J. Scott Marcus, Simone Tagliapietra and Georg Zachman*
- *Non-resident and visiting scholars:*

Innovation, competition and market structures will continue to provide important developments for our research. The speed of digital innovation provides a range of opportunities to increase efficiency in current processes as well as provide new services. However, tapping into what is largely unknown carries important risks for producers and consumers alike. Ensuring the level playing field will be the one challenge that regulation will have to face as producers face disruptive new entrants. Protecting the consumer from intrusive technologies and helping them adapt to new products and services will be some of the consumer protection concerns. The social implications of corporate developments will be a new dimension in our research. We will also continue to investigate the digital economy, AI (Artificial Intelligence) and the future of work. Our projects fit roughly into two broad themes.

1. The market and social implications of corporate R&D

Recent research has looked at how divergent the corporate landscape has become. Both technological change, especially the digital revolution and globalisation are predicted to lead to “winner takes most” industries, dominated by a few superstar firms. This prediction is made most prominently for digital sectors where technological change is rapid. This suggests that a positive productivity-concentration relationship will most likely account for rising industry concentration. What are the implications of such developments?

This makes it important to look at the R&D concentration and its trends separately from sales- and employment-concentration and study how the three phenomena correlate. A better understanding of the trends in concentration of corporate R&D in a few super-mega firms and who they are, where they are from and how many of them are “incumbents” versus “new champions” is important for understanding the overall corporate R&D landscape and how it will evolve, the pace and scope for technological progress at the frontier and for catching up.

The social implications of such developments remain largely unstudied. Does increasing concentration necessarily lead to job destruction as frequently shown? We deem it important to identifying how changes in the corporate landscape as a result of innovation affect established welfare systems.

- Increasing inequality in the corporate R&D landscape (D1).

2. Competition and Innovation

Innovation can be an important force of market performance that is potentially affected by a merger which can influence the level of competition in any given sector. Our research will review the recent advances in academic and policy literature to examine the impact of mergers and acquisitions on innovative activity. We will analyse recent cases on how innovation was approached by DG COMP, and the remedies it proposed. Also, we will examine how relevant markets have performed after a merger and evaluate whether it has been beneficial for both merging as well as non-merging parties. Particularly the latter effects have been neglected in competition policy analysis.

We will continue our work on the European Digital Single Market. The digitization of the European economy is now proceeding at a fast pace. Relative to both domestic and cross-border digital commerce, the policy decisions that are made today are likely to cast a long shadow going forward. We will continue to research what constitutes optimal regulatory intervention in such markets and whether it adapts at the necessary pace.

But there are broader implications of digitization that extend to labour markets. Indeed, the need to reform labour markets in ways that will allow countries to meet future challenges is well known in Europe. Technological development in digitization and automation has major implications for labour markets. We will study how the disruptive forces of new technologies have affected the labour force, pointing out associated risks and policy options to address them. One issue in this context is the nature of self-employment.

- Competition, innovation (D2).
- Competition and Market structures (D3).
- Digitalisation, automation and employment (D4).
- The ongoing evolution of the European Digital Single Market (D5).

E. Research Area: Energy and climate policies

Participants:

- *Resident scholars: Scott Markus, Georgios Petropoulos, Simone Tagliapietra, , Georg Zachmann,*
- *Non-resident and visiting scholars:*

Bruegel has been expanding its research on energy and climate in the past years. With the US withdrawing from the Paris agreement, the EU's commitment to pursue responsible climate and energy policies becomes even more important in the global scene. Energy sectors are in the process of a deep transformation. Digitalisation, decentralisation, decarbonisation and convergence of energy, transport, heating and telecommunication services will not only challenge the business model of incumbents. They will also pose new questions on regulators, competition authorities and policy makers. We will continue our work on analysing these disruptive trends. Brexit will affect EU climate policy and the internal energy market. We will contribute to the discussion on which items the EU should prioritise in the negotiations and how its policies should adapt to Brexit.

Beyond that, we will expand this research agenda to include specific geographic areas, in particular Turkey and sub-Saharan Africa as well as exploit ways to cross over to other themes like the relationship between digitalisation and decarbonisation and the effect on European transport. Our questions of interest fall in three broad themes. Our focus and value added comes from aiming to identify policies that promote sustainable outcomes and promote growth and development from an EU perspective.

1. Updating the 2050 Energy Roadmap

The EU's 'Roadmap for moving to a competitive low-carbon economy in 2050' is an important policy document, bringing a long-term outlook to the EU's decarbonization transition while promoting consistency with science, addressing energy-security and ensuring opportunities for growth and jobs. The EU needs an updated long-term roadmap, not only to maintain consistency with longer-term objectives and for the 2018 Facilitative Dialogue, but

also to ensure the long-term policy predictability necessary for enabling and maintaining the low-carbon transition and linked investments. The objective of this project is to set the agenda for revising the Roadmap, increase ownership of the Roadmap and analyze the methodological basis of the 2050 Roadmap: how targets might need to be adjusted, and which assumptions need to be updated. In seeking to provide advice on how to revise the agenda, we need to consider both the macroeconomic impact of policies as well as discuss financing challenges that might arise.

- How should the 2050 Energy Roadmap be updated? (E1).

2. Distributive effects of electricity policies

All elements of the electricity market design (network tariffs, renewable subsidies, taxes, state guarantees, ...) have distributive consequences along and across the value chain. The overall size of the electricity sector represents 2-3 percent of GDP. We intend to analyse what the aggregate distributive effects of the energy sector in the Member States are. Based on empirical assessment we want to describe potential inefficiencies and discuss first principles to minimise them in the context of the Energy Union objectives

- Distributive effects of electricity policies (E2).

3. Other energy and climate issues

The EU-Turkey Energy and Climate relations beyond the EU Accession Process (E3)

The aim of this project is to explore the future options for EU-Turkey energy and climate cooperation, beyond the EU membership process. We will organise a high-level platform of dialogue, that gathers relevant policy makers, academic and industrial stakeholders from both Europe and Turkey. A Policy Contribution will also be published on this topic, that will analyse different models of cooperation in the field between the EU and Third Countries, and explore potentially more suitable solutions for the EU-Turkey case.

The future of European Transport between digitalisation and decarbonisation (E4)

The European transport system of the future will be the result of the interaction between two important trends in digital innovation and decarbonisation policies. On the one hand, industry-driven technological innovation is progressively opening up new and potentially disruptive opportunities for evolving transport systems. On the other hand, decarbonisation policies are already affecting the transport system, particularly at urban level. With this project, Bruegel seeks to understand both its industrial policy as well as European public policy aspects.

Evaluating the socio-economic impact of electrification in sub-Saharan Africa (E5)

Access to electricity represents a key prerequisite for socio-economic development. Despite strong praise for action and several programs at both national and international level, few impact evaluation studies try to shed light on the causal relationship between access to electricity and development, by also allowing decision-makers to rigorously assess cost-effectiveness and efficiency of policies and programs. This work attempts to contribute to the existing, limited, literature by providing and exploring the causal impact of electricity access on important metrics of well-being in a specific Sub-Saharan African country case-study.

Tracking the development of global climate policy (E6)

With the withdrawal of the United States from the Paris Agreement, new uncertainty has arisen for the outlook of global climate change cooperation. Europe, China and India have already signaled their intention to stay on course with their commitments and, on this basis, they might create new cooperation schemes to advance the Agreement. Bruegel will continue to track these important developments and research ways in which the EU can play a role.