



2012 Research Programme



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Introduction

The crisis will remain one of the top priorities throughout 2012. The central priorities concern the best way to address immediate market tensions, the broader macroeconomic policy response in the EU, policies to foster macroeconomic adjustment and the more fundamental question of how to reform European governance to ensure effectiveness and legitimacy. Growth is a further central ingredient to a successful resolution of the crisis and new thinking is needed on policy avenues to foster it. Finally, the crisis poses strong challenges for the EU members outside of the euro area and their economic, political and institutional relation with the euro area. Bruegel will work on all these policy issues.

The European debate is of course embedded in the broader debate about crisis responses for the global economy and global governance. Indeed, one may argue that the crisis is really a crisis of advanced economies more generally. Bruegel will therefore continue to accompany developments at global level, G-20 level and it will perform a major research study on the global trading system, a topic that has recently gained relevance due to the unpromising developments of the Doha round. We also intend to continue and seek to develop our research on, and outreach in Asia.

Bruegel will continue to contribute to the discussion on financial regulation at global and regional levels. A major research effort will be devoted to the regulation, supervision and resolution of global financial firms. Another key research topic will be on the changing financial landscape in Europe in a context of growing pressure to re-nationalize financial policy and on the link between the sovereign and the banking crisis in Europe.

Finally, it is intended to assign a growing share of our efforts to the study of the determinants of economic performance. The firm-level underpinnings of growth, innovation, internationalisation and competitiveness are at the core of Bruegel research in this area and their relevance is stronger than ever. We will also address the role of information technology and conduct a major study on the future of manufacturing in Europe. We also intend to pursue research undertaken on energy and climate policies and their implications for economic performance.

The 2012 research programme is in line with the medium-term research strategy of Bruegel. Consistent with it, we will keep on focusing on four core research areas. While "European macroeconomics" will likely remain the most prominent among the four, we will devote additional resources to the research area "competition, innovation and sustainable growth" for which we are opening a position with a special focus on competition and regulation and related single market issues. Our research area "finance and financial regulation" has just been strengthened by two new visiting fellows. Finally, we plan to expand in our research area "global economics" by raising funds for a fellow who would work specifically on Asia.

Jean Pisani-Ferry and Guntram Wolff, March 2012

A. Research Area: European macroeconomics

Coordinator: *Zsolt Darvas*

Participants:

- *Resident scholars: Zsolt Darvas, Benedicta Marzinotto, Jean Pisani-Ferry, André Sapir, Nicolas Véron, Reinhilde Veugelers, Guntram Wolff, Georg Zachmann*
- *Nonresident and visiting scholars: Phillipe Aghion, Alan Ahearne, Shahin Vallée, Jakob von Weizsäcker, Jürgen von Hagen, Michael Grajek, Gianmarco Ottaviano*
- *External contributors: Mark Hallerberg (Hertie School Governance), Martin Rhodes (University of Denver)*

In 2012 again, the bulk of our macroeconomic research effort will be focused on the euro area. Despite ECB initiatives, improvements in the economic climate and the January agreement on the new treaty on stability, coordination and governance, its crisis cannot be considered to have been overcome and it remains a major cause for concern at European and global level. Uncertainty as regards the economic outlook, the banking crisis-sovereign crisis nexus, the risks of a credit crunch, the difficulties of economic adjustment in Southern euro-area countries and, finally, the tense situation in Greece lead us to continue focusing on the analysis of the euro-area crisis and options for reform. At the same time, we will make a significant research effort related to non-euro-area countries economic performance and their relation to the euro area set-up and economy.

As in 2011, Bruegel would like to keep a fair degree of flexibility in order to be able to react to crisis developments and policy responses, but we also wish to address medium- and longer-term issues: macroeconomic policy and adjustment in the EMU; the euro area's governance; the sovereign bond market and the banking sector (which we investigate in a project in research area C); economic growth; and last but not least, the EU budget.

1. Macroeconomic policy and adjustments in EMU

The recent crisis has brought to the fore the need for major budgetary and macroeconomic adjustment in many euro zone countries, as well as for a significant rebalancing of real exchange rates. Whether and how this adjustment can be conducted, and how its potentially detrimental effects on growth can be minimised, is a priority issue for the euro area and countries with fixed exchange rates.

To investigate the issue we are planning to launch two umbrella projects, which encompass several specific investigations.

- Concerning adjustment, major issues are current account developments and the determinants of their changes; a reassessment of the measurement of potential output in countries with high current account deficits; private sector debt overhang and deleveraging; correction to the emerged price competitiveness divergences, including the assessment of price and wage flexibility; the potential of the excessive imbalances procedure to foster adjustments; the role of social pacts in macroeconomic adjustment; and the lessons to be

learned from those non-euro-area countries that have undergone major current account adjustments.

- Beyond the immediate adjustment and its asymmetric effects, lessons from the crisis are being drawn for the policy system. We will address challenges to monetary as well as to fiscal policies and discuss the need for changes in the policy set-up as regards, e.g., the role of the ECB as regards financial stability and the coordination of budgetary policies among euro-area members.

The two umbrella projects are:

- *A11. Macroeconomic adjustment in EMU (Zsolt Darvas and others)*
- *A12. Macroeconomic policy in EMU (Zsolt Darvas and others)*

2. Governance of the euro area

The governance reform of the euro area is unlikely to be over and it involves several dimensions. We intend to continue playing a leading role in policy debates on:

- Recent initiatives and measures, such as the fiscal pact and the ESM;
- The European Semester, which has turned age two this year;
- The desirability of a fiscal union and the lessons to be learned from the theory and practice of fiscal federations. On these issues we will interact with political scientists to also tackle the issue of democratic legitimacy and political institutions;
- The ongoing debate on Eurobonds;
- The remaining risks for Greece and more generally countries undergoing severe adjustment
- The effectiveness of conditional financial assistance as provided by the Troika.
- The governance relation between euro area and non-euro-area countries

Research in this area will combine studies and the organisation of events to discuss policy challenges and options. The structure of the corresponding projects is the following:

- *A21. The emerging governance of the euro area and the EU (Guntram Wolff and others)*
- *A22. Evaluation of financial assistance programmes in the euro area (Jean Pisani-Ferry and others)*

3. How to revive growth in Europe

The attention of policymakers and the media has rightly shifted toward the bleak economic outlook of Europe and the policy initiatives at national and European level that are required to revive growth. Building on our 2011 works in this area, Bruegel aims gather contributions from several of its fellows and prepare a major report on (and for) European growth. We wish to combine macro and micro perspectives and address the various dimensions of the policy challenges, i.e. economic reforms, innovation, budgetary and tax policies, EU2020, and the implications for investment of the transformations of the European financial system. The research project is allocated in the research areas A and D.

- *A31: How to revive growth in Europe (Philippe Aghion and others)*

4. What role for the EU Budget?

As the discussions of the 2014-2020 Multiannual Financial Framework are intensifying, Bruegel wishes to shape the debate through two major projects.

The first one assesses the role of the EU Budget at the current European juncture and the potential it has for being an instrument of solidarity, competitiveness, growth and financial stability, by focusing on three major aspects: a reassessment of CAP; an analysis of the goals and instruments of a more efficient cohesion policy, including the potential role of project bonds; and the possible uses of the EU Budget as an instrument for financial stability.

The other project deals with the lack of independent evaluation of EU budget expenditures. It will review different existing models for evaluation, establish a typology and an assessment of the strengths and weaknesses of the different models and recommend an EU approach.

- *A41. What role for the EU Budget? (Benedicta Marzinotto)*
- *A42. Proposal for an independent evaluation of EU budget expenditures (Benedicta Marzinotto and others)*

Research Area B: Global economics and global governance

Coordinator: *André Sapir*

Participants:

- *Resident scholars: Zsolt Darvas, Jean Pisani-Ferry, André Sapir, Nicolas Véron, Reinhilde Veugelers, Guntram Wolff, Georg Zachmann*
- *Non-resident and visiting scholars: Ignazio Angeloni, Henrik Horn, Gianmarco Ottaviano, Shahin Vallée*
- *External contributors: TBD*

The interactions between Europe and the international economy are manifold. The crisis of the euro area has been an opportunity for the world to discover the importance of interdependence in the same way the financial crisis of 2007-2008 highlighted the magnitude of spillovers from the US onto the rest of the world. The fact of the matter is that such interdependence is a structural feature of the world economy that needs to be analyzed as such rather than simply in its short-term manifestations. At the same time, 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 and there is growing awareness of the fact that the crisis has been a major accelerator of this shift.

In 2012, Bruegel will continue to devote a fair share of its resources to analyzing developments in the world economy, with 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 global governance, Asia, and the relations between the EU and major regional players.

1. Global governance

One of the consequences and signs of the shift in economic power towards emerging countries has been the elevation of the G20 to a leaders' level at the start of the economic and financial crisis in 2008. While there is a common feeling is that the London summit of spring 2009, at the height of the crisis, was perhaps the high point of the G20, there is also an acceptance of the view that G20 summits are there to stay and could turn into an important forum of global governance even during gentler times. What is clear in any case is that the gentler times that hopefully lie ahead will be very different from the gentle times experienced before the crisis and that the voice of emerging economies that are represented at the G20 table (and perhaps others in the future) will count for more than in the past. Besides continuous monitoring of G20 initiatives, Bruegel also aims to have a major conference on G20 related issues.

The crisis in Europe and the need for IMF assistance will inevitably also have consequences for the balance of power in international organizations. Europe needs more than ever to form clear views about its global aims, the challenges it faces, and its priorities. Bruegel research will aim at contributing to the analysis of challenges and to the formulation of priorities for Europe in the context of the G20.

Another consequence of the rise of emerging countries is that the old Quad (the EU, the US, Japan and Canada) that could once hammer multilateral trade deals at the GATT/WTO has less relevance. Partly as a result of this development, the Doha Round has become the longest-ever GATT/WTO multilateral trade negotiation and its conclusion is far from certain. Yet, in spite of this apparent weakness of the global trading system, WTO rules resisted the recent economic and financial crisis, with relatively little increase in protectionism despite the current difficulties that compound the massive structural changes associated with the unprecedented (both in size and in speed) rise of emerging countries, in particular China. What explains this apparent paradox and whether it will continue in the future is the subject of the research project on the world trading system.

One of the developments that the world trading system will need to deal with in the coming years is the fact that developed countries like those in the EU are introducing carbon emission controls without equivalent measures being taken by some major emerging countries such as China and India. This is bound to give rise to growing trade tensions and to border carbon adjustment measures on the part of countries that choose to introduce carbon emission controls. This topic is the subject of the 2011 research project on border carbon adjustment measures, which did not give rise to publications in 2011 but is expected to yield results in 2012.

- *B11: G20 initiatives (Ignazio Angeloni)*
- *B12: The world trading system (André Sapir)*
- *B13. Border carbon adjustment measures (Henrik Horn and others)*

2. Asia initiatives

At the global level, the shift of economic fortunes in favour of emerging countries means first and foremost the rise of Asia. 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 is expected to continue its activity in 2012.

From its very beginning, Bruegel has been keen on developing contacts in Asia and collaborating with economists from the various parts of Asia. In addition to the AEEF, significant initiatives in this field include two G-20 conferences in India in cooperation with a major Delhi institute; partnerships and joint research projects with Korean research institutes; and research work for the ASEAN and the Chinese leadership. But in the absence of a specialized team, our involvement in Asian and Euro-Asia affairs lacks continuity.

To build on its successes, Bruegel should now consolidate its leadership and become a globally recognized hub for Asia-Europe economic discussions and exchanges. Located in Brussels, this hub will provide expertise on Asia and the Asia-Europe relationship in the global context to policy makers, corporations and the media. This project cannot be financed out of regular contributions. A specific fund-raising effort is being initiated for a Bruegel Asia programme. It is hoped that we will be able to launch it in 2012.

In addition, Bruegel is actively involved in two projects with Korea and China.

- *B21: Asia-Europe Economic Forum (Jean Pisani-Ferry and others)*

- *B22: Korea and China initiatives (Zsolt Darvas and others)*
- *B23: Asia programme (Guntram Wolff and others)*

3. Major regional players

In the past Bruegel has devoted relatively little resources to the EU neighbourhood more generally including Turkey, Ukraine and others. An exception was the project on the Southern Mediterranean Countries that came in the wake of the Arab Spring. At the moment, Bruegel lacks resources to be able to contribute significantly to research on the EU neighbourhood. Yet there is little doubt that this is an important, perhaps even vital, issue for the EU both economically (linked to energy and migration issues) and politically (linked to the potential volatility of the region) . As a result, Bruegel has decided to invest some effort in keeping abreast of developments in the non-EU Mediterranean region, covering not only the Southern Mediterranean Countries but also other Mediterranean countries, in particular Turkey. Contacts have already been taken with a Turkish think tank with a view to organizing some seminars aimed at analysing scenarios not only for the future EU-Turkey bilateral relationship but also the relationship between the two partners in the other non-EU Mediterranean countries, in particular Egypt. Some fellows are scheduled to participate in regional events.

- *No specific research project at this stage*

C. Research Area: Finance and financial regulation

Coordinator: Nicolas Véron

Participants:

- *Resident scholar: André Sapir, Nicolas Véron, Guntram Wolff*
- *Nonresident and visiting scholars: Michiel Bijlsma, Elliot Posner, Jörg Rocholl, Shahin Vallée*

The proposals made here are broadly in the continuity of Bruegel's research in this area in 2011. In parallel to the research endeavours described below, the successful Finance Focus Breakfast series of about-monthly events at Bruegel will be continued and help shed light on specific challenges for EU financial policy.

1. Financial Regulation in a Global Context

Bruegel aims at being seen as the leading European think tank for expertise on the global dimensions of financial regulation (possibly on a par with the London-based International Centre for Financial Regulation) and a leading think tank in this area globally (alongside Brookings and the Peterson Institute among others).

This involves a multifaceted analysis of technical, political, and institutional aspects of regulatory debates both at the global level (including the Financial Stability Board, the International Monetary Fund, and specialized standard-setters such as the IASB and Basel Committee) and at the level of key jurisdictions.

The main research investment, started in 2011, will be on the regulation of global financial intermediaries with an emphasis on supervision, resolution, and related issues of "structural" regulation. This research will be continued in 2012, with the aim of a book publication towards late 2012 or early 2013.

In parallel, Bruegel will continue to analyse specific dimensions of the international regulatory debate, especially those concerning financial disclosures and their role in the broader financial system (including accounting standards, credit ratings, government accounting and risk disclosures by regulated financial firms). In terms of geography, attention will be devoted to developments in the United States and in Asia, especially to the extent to which they provide relevant benchmarks for European regulatory discussions.

This research effort dovetails with Bruegel's broader work on the global dimensions of economic policy and related governance challenges, addressed under Research Area B of this Research Programme.

Individual projects proposed in 2012:

- C11. *Regulating transnational financial firms* (Nicolas Véron)
- C12. *Challenges of financial disclosure policy* (Nicolas Véron)
- C13. *Financial reform in Asia* (Nicolas Véron, with Changyong Rhee)

2. The transformation of the European financial system

The financial crisis since 2007 has redefined the terms of the policy debate on European financial integration, with contradictory trends of accelerated EU integration of financial policy (illustrated by the creation of the three European Supervisory Authorities in 2011) and partial renationalization of credit conditions (especially, but not only, in the Eurozone context).

Bruegel will aim at better mapping the European financial landscape and identifying evidence of recent trends affecting it; and at providing insight on the underlying factors, including political and institutional drivers. Reference to regulatory capture, financial repression, and the role of individual public authorities has become widespread in the analysis of the financial system in the United States, but comparatively little similar policy-oriented research is available on Europe. Among other items of interest, attention will be devoted to assessing the early developments of the European Supervisory Authorities which constitute an important recent addition to the EU financial policy framework.

As in previous years, this effort partly overlaps with other segments of Bruegel's research agenda. Specific attention will be devoted to the role of the financial system in the ongoing Eurozone crisis (under Research Area A) and the impact of financial system developments on Europe's long-term growth potential (under Research Area D).

Individual projects proposed in 2012:

- C21: *The changing European financial landscape (Michiel Bijlsma and others)*
- C22: *The political economy of European finance (Nicolas Véron and others)*

3. Governments and banks'

The banking-sovereign nexus is at the core of the euro area's crisis. To address sovereign bond market stress, policy makers have embarked on a large number of policy initiatives. Stress has, however, not come down enough to guarantee stability. A re-assessment of the factors driving sovereign bond markets is therefore needed. This project will monitor developments in the market and analyse the determinants of sovereign bond spreads. The roots and evolution of the vicious circle of the interdependence of banks and sovereigns is investigated. A specific research effort will be devoted to gathering European bank-level data on home bias in sovereign debt portfolios in order to better assess the evolution of such exposures since the start of EMU. The debate will also link closely to the regulatory discussions ongoing in the euro area and globally at the moment as they have direct implications for sovereigns, banks, and the governance of Europe.

Individual projects proposed in 2012:

- C31: *The euro area sovereign bond market and the banking sector (Guntram Wolff and others)*

D. Research Area: Competition, Innovation and Sustainable Growth

Coordinator: *Reinhilde Veugelers*

Participants:

- *Resident scholars: Benedicta Marzinotto, André Sapir, Nicolas Véron, Reinhilde Veugelers, Georg Zachmann*
- *Non-resident and visiting scholars: Philippe Aghion, Carlo Altomonte, Gianmarco Ottaviano, Dalia Marin, Bruno van Pottelsberghe*
- *External contributors: Mark Huberty (Berkeley), EFIGE project team, SIMPATIC project team*

While many governments are struggling with their public budget deficit and debt position, attention is more and more shifting towards the structural underpinnings of economic performance, competitiveness and growth. This was the topic for important policy discussions before the crisis and it has only gained importance as a consequence of it.

Accordingly, Bruegel plans to devote increasing resources to its “competition, innovation and sustainable growth” research area. In 2011 it intends to pursue five research avenues focusing on innovation, Information & Communication Technologies (ICT), energy & climate, future of manufacturing and firm internationalization.

1. Policies for innovation in Europe

Innovation is rightly at the top of the policy agenda in the EU and in many member states. With population growth restrained, growth will increasingly be coming from productivity growth. And with most of Europe no longer in the catching-up mode, this productivity growth needs to come from shifting the knowledge frontier through innovation. Bruegel in 2012 intends to sustain its focus on new innovation-based markets and firms and their constraints, most notably the financing of new, innovative high growth companies, and on a discussion of the role of policy to create the framework conditions for innovation based growth, such as competition policy and IPR systems. In addition projects undertaken in 2011 will be completed.

- *D11. Mergers and Innovation* (Reinhilde Veugelers)
- *D12. European Venture Capital* (Reinhilde Veugelers and others)
- *D13. Socio-Economic Impact Assessment of Research Policies* (Reinhilde Veugelers and others)

2. ICT for growth

In its EU2020 strategy, the European Union set out an ambitious mission to make information and communication technologies the driving force of a more innovative, competitive, connected, inclusive and greener EU economy, with the Single Digital Market as one of its cornerstone policy instruments to achieve this ambition. But with the evidence from the past where ICT is largely responsible for the EU’s lagging growth performance relative to the United States, one can wonder how realistic these ambitions are. There are three basic channels through which ICT can impact economic growth: directly, through the investment in ICT capital by the business sector; indirectly, through productivity improvements resulting from ICT investments in ICT-using sectors; and through the contribution of ICT-producing sectors. The lagging performance of Europe holds in all three channels, but especially in the last two. Fast-growing entrants with ICT-enabled innovations are a crucial missing link in the EU’s ICT-growth nexus. Building further on previous Bruegel work in this area (see Research Area Program 2011, for which results will be published in 2012), Bruegel intends to further examine how strong the ICT-growth nexus can be for Europe in the near future and what policies need to be in place to ensure such a nexus.

- *D21. ICT for Growth* (Michal Grajek and others)

3. Energy policy, climate policy and economic performance

Despite the crisis and the continued failure to establish a global agreement on greenhouse gases, the EU stays committed to its climate policy goals. In 2012 Bruegel intends to study how decarbonisation policies relate to short and long-term economic growth. This should be achieved by mapping the various growth effects (innovation, Keynesian stimulus, “green” government revenues, mitigation cost) that European climate policies entail. In this context it should be analysed how instruments can be shaped to make decarbonisation as “growth friendly” as possible. Thereby, special emphasis should be put on the energy sector, which will have to deliver the most significant greenhouse gas reductions. Bruegel wants to analyse whether energy policies implemented at the European level and in the member states are efficiently addressing the decarbonisation challenge.

- *D31. Green Growth* (Georg Zachmann)
- *D32. Energy Market Development in Europe* (Georg Zachmann)

4. The future of manufacturing

The future of Industry in Europe faces many challenges, with globalization as one of the top challenges, particularly in the form of competition in and from emerging markets. Other important challenges are rising material and energy costs and regulatory inconsistencies and competition, including in the environmental area. The main aim of Bruegel’s research in this area is to have a more evidence based policy discussion on the future of industry in Europe in the coming decade and the design of a new industrial policy.

- *D41. The future landscape for Manufacturing in Europe* (Reinhilde Veugelers and others)
- *D43. Market and Technology Leadership in the EU* (Reinhilde Veugelers)

5. Firm internationalization and competitiveness

Competing in a globalizing environment, the manufacturing sector has been looking at improving the efficiency of its value chains, organizing them increasingly through outsourcing and offshoring. Production activities are offshored, in search for lower operating costs, but also increasingly activities higher up in the value chain, including R&D are offshored to emerging markets. As the EFIGE project reaches its conclusions, the focus will be on drawing implications for policy of the findings from the original firm-level data gathered. A more specific study will analyse the determinants of the strength of the German industry with a view to draw lessons for other countries in the EU.

- *D51: EFIGE: Lessons from firm-level analysis of internationalisation and performance* (Gianmarco Ottaviano)
- *D52: Explaining the strength of the German industry* (Dalia Marin)