Annex

Theme I: Medium-term growth perspectives

Historical evidence shows that economic recoveries after financial crises tend to be slow and sluggish; typically, the need for financial deleveraging, demands for higher risk premia, inevitable fiscal consolidation to restore sustainable public finances and persistent labour market weaknesses combine to weigh on growth for a prolonged period of time. But already before the crisis, the euro area faced growing macroeconomic imbalances, sluggish productivity growth, and the overall challenges of globalisation, ageing population and climate change. All these factors must be expected to impact on potential growth in the EU over this decade and probably beyond. Against that background, fellowship proposals under this theme should promise to offer fresh analytical insights on medium-term economic growth perspectives and appropriate economic policy strategies for Europe.

Issues to be addressed under this theme could include

- **From crisis to secular stagnation? A critical review of demand and supply side narratives**. Worries are running high in some quarters that the 'new economic normal' for the major advanced economies may be one of "secular stagnation". The Keynesian version of the hypothesis rests upon a long-lasting shortfall of aggregate demand due to an excess of private savings over private investments, which can only be eliminated by a significantly negative real interest rate. At the same time, a sobering supply-side story can also be told as faltering innovation confronts headwinds such as demography, technological change, education gaps, inequality, globalization, energy/environment, and the overhang of private and public debt. Possible questions are:

  - Provide a critical assessment of these alternative, yet not mutually exclusive narratives: how relevant are the respective arguments when confronted with data for the EU?

  - What are the drivers and risks of such scenarios to materialise, and what are the respective policy options to avoid such an outcome.

- **EU growth set against international economic developments in major advanced and emerging economies.** Tectonic shifts in the international economic environment, including the development of cheaper energy resources in the US and reshaping the Chinese growth model will have a significant spillover effect on the rest of the world. These medium-term evolutions coupled with short-term volatility in many emerging market economies' performance will affect Europe's growth and competitiveness in the coming years. Possible questions are:

  - What would the estimated impact on the EU be?

  - How could Europe respond best to these changes (including through trade and investment agreements with third countries)?

  - How to extract economic advantages from rising international interdependence while simultaneously addressing anxieties about potentially harmful social and environmental impacts?

- **Patterns and drivers of productivity growth within and across EU Member States**. Already before the crisis, sluggish productivity growth and growing internal imbalances weighed on Europe's potential to face the overall challenges of globalisation ageing populations, growing resource limitations and climate change. And even on an optimistic note with respect to convergence and catching-up, structural productivity differences and only slowly closing per-capita income gaps are likely to persist over the medium-term. Possible questions are:

- What are the main foreseeable patterns and drivers of productivity growth in the EU over the medium-term? How to inject new dynamism into the EU economies while continuing with the necessary adjustment, rebalancing, and private and public deleveraging?

- What are the main features of specific growth models for different groups of countries/regions, given that one-type is unlikely to fit all, and how do they interact with each other?

- **Investment patterns and the benefits of integration.** By eliminating obstacles to the free establishment of firms and creating scale economies, a truly integrated internal market would increase investment incentives across Europe. European firms would take advantage of the size and potential of the market which becomes a driver of investment and growth. However, despite progress towards a single market, evidence suggests that few companies have taken advantage and have an EU dimension. Possible questions are:

  - Is the Single Market giving EU companies the scale, scope and tools needed to become global players?

  - If integration is an important driver for investment, why are we not seeing more EU companies profiting from it? Does EU have the right policy tools/approach to maximize the incentives for firms to invest and consolidate their presence across the board? Could EU-level competition policy/tools have a role in creating right incentives to investment?

  - Are non-EU multinationals profiting more from the (EU) internal market than EU companies? If so, what could be behind such patterns?

- **(New) strategies for structural reforms: design, coordination and demand management**. Deep structural reforms together with large and differentiated fiscal adjustments underway in EU countries require credible strategies, including a growth-friendly approach to package design. While some consensus appears to be gradually emerging on the questions of how much, how fast and by what means of public deficit and debt reduction, the optimal interaction (and sequencing) of fiscal consolidation and structural reforms is still open to debate. Possible questions are:

  - What are the main synergies/trade-offs in the design of packages of fiscal consolidation and structural reforms? What are the main considerations with respect to sequencing and the possibility of time-inconsistencies?

  - Given the strong element of political choice in the design of such packages, what, if any, is the role of EU institutions in such a process?

- **New manufacturing around the corner? Longer-term challenges for European manufacturing and the role of industrial policies.** The manufacturing sector has undergone a tumultuous decade, both globally and at the EU level. It remains critically important in advanced economies such as the EU as a vital source of innovation and competitiveness, making outsized contributions to research and development, exports and productivity growth, and growing increasingly interconnected with high-skill services. Possible questions are:

  - What are the defining features of the role of manufacturing in advanced economies such as the EU? What are the specific drivers of success in a changing global landscape?

  - Does the re-industrialisation debate in the US apply to the EU?

- What are the key priorities for governments and business to support manufacturing, and tradable activities in general, in its quest for global competitiveness?

-Are energy and climate change policy an obstacle or a driver of change in these debates?

Theme II: The architecture of financial systems

The financial sector, even after the regulatory reform efforts of recent years, still needs to be managed so as to best facilitate economic recovery. Some elements of policy will act to re-enforce each other, while others have the potential to conflict, perhaps in turn creating new risks that threaten the recovery. And even after the initial phases of the recovery have become engrained, other reform elements will be needed to ensure that the recovery is sustained and the economy is able to respond to any shocks much better in the future. Against this background, fellowship proposals under this theme should offer well-grounded and insightful analysis on how financial elements of the economy can managed – both in the near and medium terms – to best facilitate sustained recovery.

Issues to be addressed under this theme could include

- **Depressurising the balloon in time: the withdrawal of extraordinary policy stimulus.** While macroeconomic monetary policy stimulus is set to remain for some time, the distortion to the economy from an extended period of policy stimulus may create new and little understood financial stability risks. Possible questions are:

  - What are the risks form an extended period of monetary policy stimulus? Do those risks outweigh the benefits of the stimulus?

  - What are the important strategic interactions at the present juncture between monetary policy and other policy areas relevant for macroeconomic developments (macro prudential, micro prudential, fiscal, and structural)? How can we ensure they are jointly accountable?

  - Is there scope to develop forward guidance strategies also in other policy areas? What would be relevant parameters?

- **The risk-free asset and the safe interest rate: price formation on financial markets and the transmission of monetary policy**. While the risk free interest rate is an important concept in economic theory, recent history has challenged the standard of using AAA sovereign bonds as universal benchmark. The extraordinary amount of safe haven flows encountered during the financial crisis increased the value of safe assets and deflated their yields, therewith distorting the yardstick for the risk-free interest rate. Possible questions are:

  - What is the demand for safe assets by market participants, their motivations (for example to dispose of collateral or as store of value), and their degree of substitution with money across various financial actors and estimates of quantities involved.

  - Review different measures of risk-free returns (triple A government bonds, swap rates, etc.) and how the prices of the underlying assets are determined on financial markets.
- **Strategies to erode the mountains of public and private debt: a critical reassessment**. Proposals to reduce the levels of "excessive" debt are going to be crucial in providing the conditions for an enduring return to growth. Yet the proposals are often politically contentious, often constraining their use. And they tend to focus on selected sectors, when

there are strategic interactions with efforts to contain debt elsewhere in the economy. Other policy efforts, for example to revive growth or anchor financial stability, may conflict or compliment with proposals to reduce debts. Possible questions for this work stream are:

- How should deleveraging efforts be efficiently phased across sectors? What are the important strategic interactions with other policy efforts to revive the economy and what do they mean for the operation of policies to deal with excessive debts?

- In light of the answers above, what are the specific and feasible options for reducing excessive debts in order to support growth prospects at the present juncture?

- **Banking union and beyond: improving the mechanisms for private risk sharing and allocation of capital in EMU.** Risk sharing helps to smooth through asymmetric shocks and successful currency unions generate the bulk of their internal risk sharing through private financial markets. The EA scores less highly on this front generally, and during the financial crisis a rapid reversal of primarily debt based cross border holdings contributed to the scale of the downturn. While the establishment of the single supervisor and other elements of banking union will improve the degree of risk sharing to some degree, there remains a strong case for policy initiatives that help to cultivate private sector risk sharing within the single market. This project could:

  - consider policy initiatives for Europe that could help improve the degree of private sector risk sharing, borrowing from the experience of other nations where appropriate

  - investigate where there are mechanisms (e.g. through tax policies) that could encourage capital flows and the development of proper risk premia within the single market, but make them less "flighty" during times of market stress.

- **Finance for investment and growth.** While it is consensual that economic activity in the EU would benefit from a wider use of alternatives to bank lending as source of external funding, the question of how best to do that remains underexplored. The losses the financial industry incurred in 2008/09 impaired the political (and public opinion) acceptance of more sophisticated forms of financial activity. This project is not intended to particularly add to the established microeconomic literature on the benefits of financial intermediation in a wider sense, or elaborate on the statistical measurement of the value added from various forms financial services can take, but it could cover:

  - How can selected financial services, for example market making, derivative trading and security tranching contribute directly – or indirectly – to higher or more efficient investment, innovation and eventually economic growth.

  - To what extent can more intensive use of market financing by large corporations act as a stepping stone for medium sized firms in using market financing or crowd in bank lending to small enterprises? Which financial market segments would be particularly "valuable" in this respect?

Theme III: European convergence and integration mechanisms

The financial and sovereign crises have exposed the limits of the EU's governance framework and slowed pre-crisis integration trends in a number of areas (e.g. financial markets, trade, etc…). They have also shown that, notwithstanding hopes of structural convergence harboured at the launch of the euro, Member States still tend to respond very differently to common shocks. The large country differences in growth performance triggered by the crises have been accompanied by rising income and wealth inequality as well as a drop in popular support for European integration. The ongoing reforms in the EU/euro area governance framework should help contain these divergence forces so as to set the EU/euro area on a more sustainable path. This raises the question of how to best design policies that foster convergence, integration and social cohesion.

Issues to be addressed under this theme could include

- **Centralisation versus re-nationalisation of economic policies in the EU: where did we go too far and where not far enough?** Macroeconomic policy making in the EU is characterised by a mix of centralisation and decentralisation. The financial and sovereign crises have led to an overhaul of economic policies in the EU that has involved a clear shift of policy making from the national to the EU/euro area level. The adoption, inter alia, of the Six- and Two-Packs, of the European Semester of policy coordination and the launch of the Banking Union bear witness to this centralisation trend. Some commentators argue that the emerging framework falls short of the genuine European economic government that is needed for a sustainable EMU. Others, however, contend that the EU suffers from too much centralisation and that a renationalisation of some policies is in order. Possible questions to address include:

  - What are the arguments in favour or against centralisation? How do these arguments vary across policy areas (fiscal, financial, macro-prudential and structural)?

  - What is the optimal mix of centralisation and decentralisation in the EU and in EMU? Should the mix be tilted towards more centralisation in some policy areas and less centralisation in others?

  - Member States that have adopted the euro do not have the same needs in terms of optimal mix than other EU Member States. How can these differences be reconciled?

- **United in diversity? How much and what kind of structural convergence is needed in the Euro Area?** The overall record of the euro area in terms of convergence has been mixed, and an increasing cross-country heterogeneity both in terms of business cycle and medium-term trends can be observed in the aftermath of the financial crisis. The tendency for persistent divergences partly reflects the need to correct the large external and internal imbalances that had built-up in some countries before the crisis. But it also marks a more long-term pattern of diverging TFP performance and slow income catching-up. Structural reforms have been less ambitious than generally expected at the launch of the euro, and as a result, a number of economies in the euro area now face painful adjustment processes and mediocre short- to medium-term growth prospects. Possible questions to address include:

  - What kind of structural convergence is needed in the euro area to ensure smooth adjustment processes to asymmetric shocks and convergence in medium-term growth prospects?

  - During the pre-crisis period, the large cross-border capital flows were not conducive to durable income convergence, being partly wasted in non-productive uses. Is there a link between this capital misallocation and the productivity performance of recipient countries?

  - Why have some income convergence processes partly failed in the euro area? Selected case studies could help to shed some light on EMU's convergence challenges

- **Fulfilling the minimum requirements for a functioning of EMU? The fiscal compact, fiscal integration and financial market discipline.** The establishment of the banking union and the implementation of the latest fiscal governance reforms represent the most comprehensive set of governance reforms at the EU level since the introduction of the EMU. Key reform elements are the so-called six-pack, two-pack and – as part of the Treaty on Stability, Coordination and Governance in EMU (TSCG) – the fiscal compact. Possible questions to address include:

  - Well-designed fiscal frameworks are generally associated with better fiscal outcomes in terms of deficit and debt developments. Does the reformed fiscal governance framework fulfil the criteria of a well-designed fiscal framework?

  - While the discussion has focused mostly on the short-term effects of fiscal consolidation, how will the strengthened fiscal framework impact economic growth over the medium- to long-term? What could be its implications in terms of inter-generational equity?

  - An important element of the fiscal compact is the introduction of a balanced budget rule. What are the key requirements for an effective fiscal correction mechanism? Does the current set-up fulfil these requirements? Should fiscal rules be complemented by some form of fiscal coordination at the EU/euro area level?

  - How can the conflict between fiscal rules and the need for discretionary fiscal policy in a monetary union be resolved? What would be the implications for fiscal policy of secular stagnation?

  - What role can financial market discipline play in support of sovereign debt sustainability? How can signals sent to/by markets be improved?

- **Structural convergence versus systems competition: the case of taxation, social policies and factor mobility in EMU.** Representing local preferences and capabilities, taxation regimes, public services provisions, transfer and benefit systems, and other social protection instruments differ significantly across EU Member States. However, the existing configuration relying largely on systems competition and soft coordination mechanisms faces growing tensions, raising fears of a race-to-the bottom and/or calls for restriction of factor mobility, in particular labour, or other forms of "protectionism". Against that background, possible questions to be addressed include:

  - In what areas can an inconsistent trinity of local decision-making, unfettered integration of product and factor markets and the "exclusive" provision of public services and welfare benefits be identified?

  - What are possible/likely/desirable mechanisms to overcome such inconsistency trilemma?

- **Of rich and poor: macro-implications of the trends in income and wealth distribution.** The impact of the financial and sovereign crises on households' income and wealth, and thereby on their welfare, has been large. It also appears to have been heterogeneous across household categories and across Member States. The EU faces the challenge to support a sustainable recovery that heals the negative social consequences of the crises. Possible questions to address include:

  - What are the developments in income and wealth inequality in Europe since the crises and what are their main causes? What explains the heterogeneity across countries? Does EMU make a difference?

  - What are the implications of income and wealth inequality for growth?

- How can we ensure that the recovery is not accompanied by rising inequality? Which role should public policies, such as tax and benefit policies, and labour and product market policies play?

- **Political economy of EMU: rebuilding trust and popular support for economic integration.** Surveys suggest that the financial and sovereign crises have led to a deterioration of confidence in the European institutions and diminished support for European economic integration. There is also evidence that trust between Member States has weakened in recent years and policy discussions have tended to be articulated around well-publicised broad divides between, for instance, debtor and creditor countries. However, mutual trust is an essential ingredient for the smooth adoption and implementation of the policies necessary to underpin the recovery, to enhance medium-term growth prospects and ensure a sustainable EMU. And obviously, well-functioning mechanisms for ensuring democratic legitimacy and accountability need to be in place both at the EU (i.e. European Parliament) and at the national level (i.e. national parliaments). Possible questions to address include:

  - What are the recent trends in confidence in the EU and trust across Member States? How can these trends best be measured? What is the role of the financial and sovereign crises in explaining recent developments in confidence? To what extent are these developments of a cyclical nature and likely to be progressively reversed with the recovery?

  -Which steps can be taken to improve support for European economic integration? How can Member States' ownership of the policies necessary to support the recovery be strengthened?

  - How could potential deficiencies in terms of democratic legitimacy and accountability be remedied, both in a scenario without and a scenario with Treaty change?