## ***Annex***

## *Theme 1: The political economy of integration revisited*

- **Global economic integration: Have we passed the peak already?**
  One of the consequences of the great recession in the European Union has been a loss in the decades old pre-crisis integration momentum. Centrifugal forces have become visible both on product and financial markets, with drops in cross-border trade volume, a reversal of pre-crisis capital flows from the core to the periphery and a sharp cross-border divergence in risk premia. These centrifugal forces have not been restricted to the EU, however, and the great recession has also brought a large fall in trade and financial flows throughout the world. As economic theory generally posits a strong relation between integration and prosperity, these trends need to be better understood. Possible questions include:

  - What are the recent global trends in economic integration and how can they best be measured? How can these trends be interpreted in a historical perspective (e.g. how do they compare to post Great Depression developments)? )? How can centrifugal forces in product and financial markets coexist with surging cross-border flows in information and data?

  - What are the drivers of the recent emergence of centrifugal forces? To what extent are these forces temporary or permanent? Driven by markets or by policies? How should policies best respond?

  - To what extent are recent EU (dis)integration trends specific or a reflection of more global forces?

  - How does the post-crisis surge in migration flows relate to other global trends in economic integration?

- **Globalisation and inequality reconsidered**
  While globalisation has contributed to increasing the average level of income both in developed and developing countries, there is a widespread perception that globalisation has also been associated with higher income inequality. Cross country income inequality has decreased over the last decades, mainly due to the convergence of large developing economies like China, but within-country income inequality has risen in the majority of advanced economies, as well as in China and the Middle East. Higher income inequality is a concern for welfare reasons but also because it may affect growth. It is therefore important to better understand the globalisation inequality nexus. Possible questions include:

  - To what extent is globalisation causing an increase in inequality? How can the role of globalisation be disentangled from other possible sources of inequality (e.g. technical progress)? Is the EU different from other advanced economies in this respect?

  - What elements in the globalisation process (financial integration, trade integration, migration) affect income distribution?

  - How can potential negative effects of globalisation be mitigated? Can we design policies (i.e. tax and benefits, labour and product market policies) that reverse the increase in income inequality?

- **Glues of integration and forces of disintegration in the current political environment at the global, national and sub-national level**.

  While integration and globalisation have always triggered opposition from some quarters, in the pre-crisis years the mainstream remained generally supportive. More economic integration including in the EU was seen as an essential determinant of sustained economic growth and stability. Views have changed in the post-crisis world and centrifugal forces are becoming stronger. Discussions about a possible break-up of the euro area are being held in the public domain alongside discussions on how to complete the Economic and Monetary Union. Possible questions include:

  - Has the crisis led to a temporary reassessment of integration or has it amplified an underlying trend?
  - Was the reassessment particularly strong in the EU?
  - What are the policies that could strengthen the forces of integration in the EU?

## *Theme 2: Challenges to integrated markets for goods and services*

- **Global value chains and EU competitiveness: do global value chains support convergence?**

  The ongoing internationalization of production has altered the economic landscape. Technological development has facilitated the geographical fragmentation of production processes, resulting in the emergence of global value chains. Different parts of a firm's production processes can now be located in different parts of the world, according to the comparative advantages of the locations. This 'slicing up of the value chains' has given rise to increased trade with the use of imported intermediate goods in manufacturing industries having been increased globally, thereby involving more industries and countries in the value chains. Thanks to the rapid development of ICT, it has also turned traditionally non-tradable activities into tradable ones. However, recent trends following the great recession give a mixed picture and need to be better understood. Possible questions include:

  - What are the main recent developments in specialization patterns, technology intensities, regional and international integration, and offshoring strategies as drivers of productivity and economic growth?

  - What is the role of GVCs in the explanation of the differing growth trajectories and structural developments within Europe?

  - What are the main challenges of making GVCs more "inclusive" by overcoming participation constraints for Small and Medium Enterprises and facilitating access for less well integrated countries?

- **Divergences in TFP trends? Facts, prospects and policies**

  Over the medium- to longer term, trends in total factor productivity growth will determine the growth and convergence trajectories of the EU economies. However, already before the crisis, Europe has suffered from disappointing productivity growth, and developments since then have only reinforced this dismal trend. Moreover, persistent productivity growth divergences among EU, and in particular euro area countries, raise concerns of rising income differentials and long-term cohesion across countries. Possible questions include:

  - What are the major trends and drivers of total factor productivity growth in the EU? What are the major explanatory factors for trend divergences across countries?

- How to assess the legacy of the crisis? What are the major obstacles to a trend reversal of total factor productivity growth?

- What policies to reduce the growth gap of laggard countries and to re-ignite a sustainable convergence process?

- **The interaction of trade integration and monetary integration in the Single Market**
  Europe's single market and its founding freedoms are under strong pressure at a time when there is a great need for Europe to deepen and expand its single market. Its contribution to economic growth and political cooperation in Europe is uncontested, but the European economy has changed profoundly since the birth of the single market and many new areas of growth are only partially part of the single market. New reforms also put the light on the single market's contribution to jobs and economic opportunities, not least because the social effects of the crisis remain dire in many countries. Possible questions are:

  - What should be the vision for the single market? How to preserve the integrity of the single market among the Ins and Outs of EMU?

  - What can be done to challenge the rise of economic and political populism – and use single market reforms to improve economic opportunities across the EU?

  - What economic reforms are needed to underpin an expanded single market?

- **What do we actually know about the importance of services trade in the EU?**

  The cross-border provision of services can be organised in many different ways, for example through the secondment of headquarter employees, the temporary or permanent recruitment of local employees, the sub-contracting of local service providers, or the opening up of a sub-division in another country. Depending on the model chosen, these transactions will be recorded in very different ways in the balance of payment (BoP) statistics, but not necessarily as services trade even though they are very similar. At the same time, the increasingly digital nature of many services makes it possible to have a higher degree of centralisation of service provision, for example in the form of 'shared services' provided within a firm from a location with lower labour costs. Possible questions include:

  - How much can BoP statistics tell us about the cross-border provision of services?

  - What can be learnt from firm-specific data and case studies about trade in services?

  - Is there an unwarranted manufacturing bias in economic policies aiming to attract investment?

## *Theme 3: Challenges to integrated financial and capital markets*

- **International capital flows, volatility, capital controls: The legacy of the crisis**

International capital flows are typically thought to bring some important benefits to countries' economies, basically via improvements in allocative efficiency and in risk sharing. However, these effects are hard to find in macroeconomic data: the benefits of capital flows are surprisingly elusive. At the same time, having gone through a number of crises in emerging markets and in advanced economies, awareness of the potential costs to international financial integration and capital flows has risen. Possible questions include:

- How to reassess the cost and benefits of international financial integration and capital flows?

- What kind of circuit breakers and/or precautionary instruments may be needed to avoid harmful feedback loops?

- How to design effective regulatory frameworks to moderate capital flows that could otherwise exacerbate pro-cyclical behaviour and generate risks frameworks? How to encourage capital flows in forms that are less vulnerable to sudden reversal such as equity and long-term debt?

- **Financial market integration in the EU: Fragmented markets and a reversal of flow directions?**

  During much of the past two decades, Europe experienced rapid financial market integration. It was also a notable exception to the infamous Lucas paradox with capital flowing massively from more- to less-advanced Member States, The global and euro area crises has brought an abrupt end to this integration phase and led to re-fragmentation on European financial markets. It has also highlighted the possible negative side-effects of rapid financial integration, notably in the form of capital misallocation and insufficient risk sharing. Some Member States even experienced sudden stops in private foreign capital inflows and funding problems in their banking system, challenges that were previously thought to be the preserve of emerging markets. Both price and quantitative measures of financial integration suggest that fragmentation forces have weakened in the past couple of years. However, levels of cross-border integration are still below their pre-crisis peaks and capital flows from more- to less-advanced economies remain subdued. Possible questions include:

  - To what extent is the fragmentation of European financial markets a temporary by-product of the global and euro area crises or the result of more permanent changes in policies and investors' behaviours?

  - Is Europe or the euro area different from other advanced economies in the extent of fragmentation? What is the role of the regulatory framework in this respect, notably in terms of insolvency systems and NPL?

  - To what extent has the Banking Union helped contain fragmentation forces and make financial integration more conducive to risk sharing and financial stability? What are the most critical measures of the Capital Market Union in this respect?

- **Monetary and fiscal transmission channels at the zero lower bound**

  Under normal economic conditions with well anchored inflation expectations, monetary policy is regarded as the most important tool for stabilising the economy. Economic developments since 2009 and in Japan since the 90s have, however, shown that monetary policy can reach limits given by the ZLB for nominal rates. Standard macro models suggest that fiscal policy is especially powerful in such a situation. However a number of questions remain:

  - How much is the spillover of fiscal policy affected under the ZLB?

  - Which is the appropriate instrument for fiscal consolidation under a ZLB?

  - Do current macro models over-predict the inflationary consequence of fiscal expansions in an economy with spare capacity?

  - By how much is the demand stimulus of a fiscal expansion mitigated by the sovereign risk channel, i. e. what is the role of fiscal space?

  There is a strand of the literature which asks what happens if the economy is caught in a long lasting liquidity trap, with inflation expectations not anchored any longer. Some results suggest that the fiscal multiplier could be smaller in this case. While fiscal policy results under the ZLB are usually derived under the assumption that monetary policy is powerless, this is of course not generally the case. Central Banks can still affect term and risk premia across assets via QE measures and can influence expected future short term rates via forward guidance. In this area important questions are

- How strong are the portfolio effects on real economic aggregates?

- How strongly is forward guidance hampered by tome consistency problems?

- How much fiscal space is created by QE measures?

- **Consequences for fiscal policy coordination when financial markets are fragmented.**

  After the financial crisis the risk assessment of financial markets has changed fundamentally and there is rising awareness of sovereign risk and the interconnectedness between sovereigns and the domestic banking system. In this context the so called "sovereign risk channel" was introduced in the fiscal policy discussion, suggesting that rising risk perceptions in financial markets can strongly dampen the effects of fiscal expansion of individual member states in EMU. The flip side of fragmentation is that the search for safe assets has intensified among investors and some governments can borrow at extremely low (even zero) interest rates. This raises a number of questions

  - Is fragmentation still a problem in the EA after all the measures that have been taken to overcome it, or has this become a less relevant issue?

  - What is the appropriate conduct of fiscal policy for countries with limited fiscal space and how is fiscal space affected by QE?

  - How can the financial windfall for countries with fiscal space be used in an intertemporal optimal manner (frontloading of public investment)?

  - Does fragmentation call for a more centralised fiscal policy?

## *Theme 4: Challenges to integrated labour markets*

- **Wages and nominal and real unit labour cost differentials in EMU**

  Widely accepted conventional wisdom has it that in many countries wage growth has fallen massively behind productivity growth over the past couple of decades. However, the exact meaning of the "decoupling of wages and productivity" remains often unclear, and the driving forces poorly explained. At the same time, divergent nominal wage and unit labour cost trajectories in euro zone countries have contributed to the build-up of large imbalances within the currency area. Against that background, a fresh look at the nexus between wage growth and productivity growth appears warranted; and for EMU countries, in particular, the issue of how to ensure sustainable wage and unit labour cost developments needs to be re-examined. Possible questions include:

  - How to measure "decoupling" and to disentangle the driving factors? Are there common trends and/or country-specific episodes to be identified?

  - How to think about sustainable wage and unit labour cost developments in EMU beyond the "keep wages in line with productivity" paradigm?

  - Is there a need for co-ordinating mechanisms at the national and/or supra-national level and, if yes, how could such mechanisms look like?

**Migration: Global trends, the European picture and its implications for potential growth**

Recently, Europe has been facing a surge in the influx of asylum seekers coming on top of the net migration inflows of the past years. While far from the levels seen in other parts of world, these flows have put considerable strain on several Member States' administrations and societies. Thus, managing immigration and integration has become a top challenge for European policy makers and a critical re-assessment of migration trends and its implications is high on the agenda: Possible questions include:

- What are the likely trends in migratory flows in and out of Europe, in terms of size, composition and skill structure?

- Do we need to rethink the economic impact of immigration given a changing character of inflows? What are the likely short-term, medium-term and long-term implications?

- In particular, are there specific consequences for social models in the EU and, if yes, what is the likely direction of change?

- **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?

## *Theme 5: Deepening EMU*

- **Structural convergence in EMU: does the right macro policy mix help?** Fiscal and monetary policies are traditional instruments of economic stabilisation. They are used to smooth out temporary fluctuations of aggregate demand. In normal times, they are generally not expected to foster structural convergence across Member States. The euro area has been recovering very gradually from the post-2007 crisis exhibiting a persisting shortfall of aggregate demand since 2009. Investment expenditure has remained weak especially in countries characterised by structural weaknesses. The latitude to support investment and more generally aggregate demand with macroeconomic policies is limited as centralised monetary policy is effectively constrained by the zero lower bound, and most Member States run out of fiscal space within the commonly agreed set of fiscal rules. Possible questions include:

  - Could the right policy mix mitigate potential risks to economic convergence?

  - Does the current EU economic governance framework sufficiently take into account the possible risks to economic convergence ensuing from a persistent shortfall of aggregate demand including in particular in structurally weak Member States?

  - Is there scope for reviewing the EU governance framework with a view to better address the current policy predicament in the euro area?

- **What are the minimum structural convergence requirements to ensure a proper functioning of EMU?**

  The euro area crisis has led to an unprecedented surge in cyclical divergence within the euro area. It has also affected medium-term growth prospects unevenly across Member States. These differences in growth performance reflect both differences in exposure to the global and euro area crises and in the capacity to adjust to shocks. Large and persistent growth differences are a serious concern for the euro area as they make the single monetary policy less effective and undermine citizens' trust in the euro. This, ultimately, jeopardises the stability and sustainability of EMU. The Five Presidents' Report has therefore proposed a set of measures aimed at strengthening Member State convergence toward more resilient economic structures. In particular, it has called for the convergence process to be based on a set of commonly agreed standards with a legal character. Significant progress towards the latter would be regularly monitored and would be a condition for members to benefit from further instruments, such as a shock absorption mechanism. Designing such common standards raises a number of questions:

  - What features of a Member State's economic structure are instrumental in determining whether it is likely to prosper in EMU?

  - In which areas should can (and should) common standards be defined (e.g. labour markets, product markets, business environment, efficiency of public administrations)? Should the standards include elements of fiscal policies (e.g., certain aspects of tax policies)?

  - How should such standards be specified in practice?

  - How binding should the standards be and how should Member State's compliance be monitored and enforced?

- **How to strengthen economic governance in the euro area? Do we know what is needed but don't know how to deliver it?**

  The post-2007 financial and economic crisis has revealed evident gaps in the EU's economic governance framework. Some of the gaps had been known from the very beginning, others emerged with hindsight. The combination of centralised monetary policy making and decentralised fiscal policy was a clear political compromise imposed by the political realities at the time of inception. By contrast, the importance of financial markets for overall macroeconomic stability was a painful lesson of the crisis. While very important steps have been taken in the past few years to fill some of the governance gaps, fundamental features of the original architecture remain unchanged: (i) fiscal policy remains a national prerogative without the possibility to effectively bring into play euro-area considerations at the central level; (ii) peer pressure remains the only instrument at EU level to encourage structural reforms, which, albeit essential for a proper functioning of the monetary union, are being implemented at a slow pace. Possible questions include:

  - What does the ideal economic governance in the EMU look like?

  - Are there economic trade-offs standing in the way of a further pooling of economic decision making in the euro area? Or is it simply politics, stupid?

  - Can appropriate design and/or sequencing help surmount existing obstacles?