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KOF Swiss Economic Institute

EDITORIAL

Contributing to the Future of Europe

From a Swiss perspective, European issues are often perceived with astounding indifference or are simply ignored. This is particularly true when it comes to the institutional development of the European Union. Economists at Swiss universities usually hold back on any suggestions for the further development of Europe. It was one of the aims of the 'Future of Europe' conference organised by KOF at ETH Zurich in March to change this state of affairs. The conference was attended by numerous high-profile economic researchers from Switzerland and abroad. At the heart of the debate was the question what the European institutions responsible for economic issues (practically all of them) should look like to prevent further crunches such as the euro crisis and to make Europe futureproof. The current Bulletin also introduces the ebook that has been produced on the basis of the conference. Aside from the subject of Europe's future, a second article shows that, contrary to general opinion, the status of vocational education and training remains positive. The Bulletin's third article examines the impact of the exchange rate on particular tourism regions in Switzerland.

David Iselin

ECONOMY AND RESEARCH

Bretton Woods, Brussels and Beyond: Redesigning the Institutions of Europe

Conventional wisdom is that a main constraint for reforming the European project is not the shortage of ideas or tools but the lack of priorities. To put it differently, economists have discussed what to do and how, but have been silent on who and when. Which institutions and rules are needed and when? The new eBook by Campos and Sturm (2018) makes the case that such institutional questions are of fundamental importance for the future of Europe.

One can no longer be sure whether Europe is just at a crossroads or on the brink. The multi-faceted economic crisis has deepened. It has also become a widespread political crisis. There is little disagreement that the European integration project needs to be reformed and that this needs to be done now, before the next economic downturn. The costs of doing nothing are large and rising, and we must think of innovative ways to make reform happen in a democratic, efficient, and sustainable manner.

Economists have debated what to do and how, but have been mostly silent on who and when. Which institutions and agencies are needed? Not asking the question, 'Which institutions should be redesigned or even created from scratch to carry out reform in Europe?', goes a long way towards explaining why reforms have not been implemented.

An eBook as a starting point for the discussion

In their new eBook, which collects reform ideas from 18 distinguished researchers, Campos and Sturm (2018) make the case that addressing such institutional questions is of fundamental importance for the future of European integration.

The individual chapters of this eBook distil the lessons from the Bretton Woods institutional framework and from the globalisation wave that followed it. The overarching questions that motivate the eBook are: Is a European Monetary Fund (EMF) sufficient? Are other institutions needed? How should these other institutions be designed and implemented? And how should they fit into the existing institutional framework?

The eBook is organised into five parts. The first examines the Bretton Woods system and European integration. The second looks at prominent European institutions (the European Parliament, the Structural Funds, and the ESM). The third focuses on financial institutions and on labour mobility. The fourth discusses key institutional aspects of monetary union. The fifth and final part highlights strategies for, and obstacles to, redesigning European institutions.

A serious omission in the future of Europe debate, in the view of Campos and Sturm (2018), is that the institutional question has not been raised. Compromises are necessary in terms of 'what' can be done 'when' and 'who' can solve the current difficulties. The eBook studies a few selected institutions. However, this list was not exhaustive and there are many that the eBook has not touched upon, such as labour market institutions (Blanchard 2018). An institutional map of Europe should be a priority for future research.

Reforms are needed now

How does the 'institutional approach' compare with others in the debate about the future of Europe? The main difficulty in answering this lies in the multitude of different proposals, suggestions and policies that have emerged in the last five years or so. Indeed, the European Parliament created a website that tracks such proposals and prepared a report comparing them (European Parliament 2018a, 2018b). Yet the most important proposal in the view of Campos and Sturm (2018) is that from the '7+7' French and German economists (Bénassy-Quéré et al. 2018), many of which contributed to the eBook. Their proposal encompasses reforms of the financial, fiscal and institutional architectures. In their opinion, the reform of the institutional architecture should receive greater priority and greater weight, and should have been fleshed out more ambitiously.

The European integration project needs reform and it needs it now. The next economic downturn may have severe political and economic consequences if it finds Europe unprepared. The costs of doing nothing are enormous. We must be creative, determined, and able to implement the needed reforms in a democratic, efficient, and sustainable manner.

This eBook cannot fully address the many issues surrounding the institutional question of how to design a new framework for the European integration project. The authors are convinced, however, that if it succeeds in raising and adding these issues to the current debate on the future of Europe, their task has been accomplished.

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www.kof.ethz.ch →

Save the Date

eBook Launch Event
Friday, 22 June 2018
KOF Swiss Economic Institute
Leonhardstrasse 21 8092 Zurich
www.kof.ethz.ch →

Social Status of Vocational Education and Training Has Not Declined

The public debate frequently conveys the impression that the social status of vocational education and training (VET) has declined. Can this impression be substantiated by empirical evidence? In a new study based on PISA data, KOF researchers show that the relative cognitive skills of prospective VET students and grammar school students have remained constant over time. This suggests that the social status of vocational education and training has not declined.

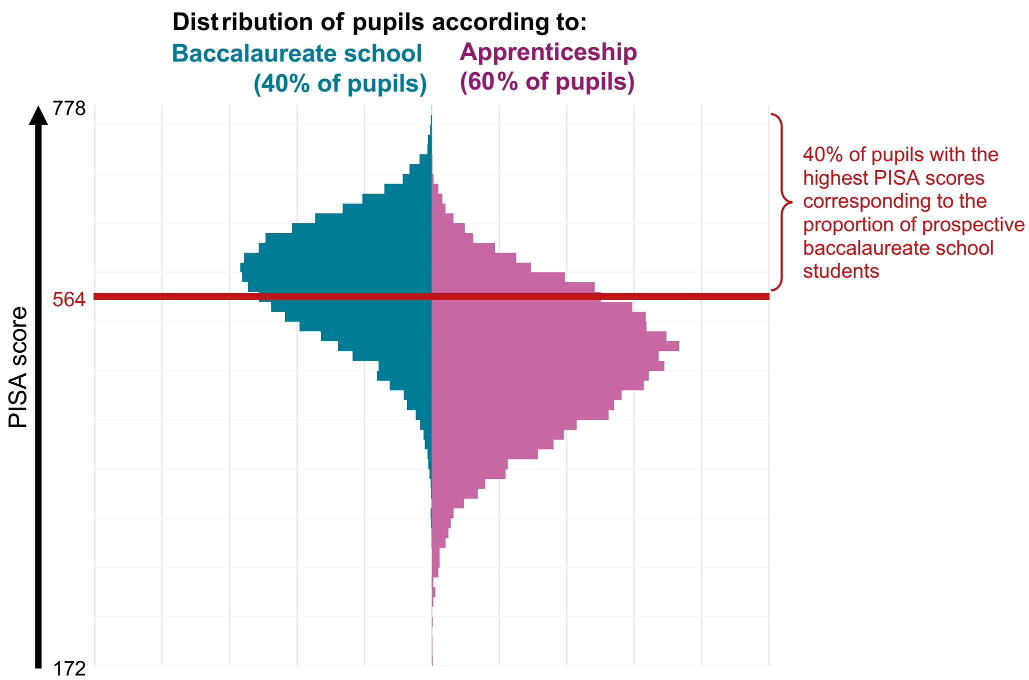
Measurements based on PISA skills

Thomas Bolli, Ladina Rageth and Ursula Renold base their analysis of students' cognitive skills on the data of the international PISA school performance studies of 2000, 2003, 2006, 2009 and 2012 (see http://www.oecd.org/pisa/). They utilise the data of around 50,000 students attending ninth-grade who have not yet reached the end of mandatory schooling. Aside from average test results in the areas of reading comprehension and mathematics, the authors used statements made by the adolescents regarding their plans once they have completed their mandatory schooling.

PISA skills pyramid

Similar to a population pyramid, graph G 1 shows the distribution of students' skills using the PISA skills on the vertical axis. The skills range from the lowest number of points (172) up to the highest number (778). The horizontal axis

G 1: Distribution of PISA Scores Between Prospective Baccalaureate School Students and Apprentices



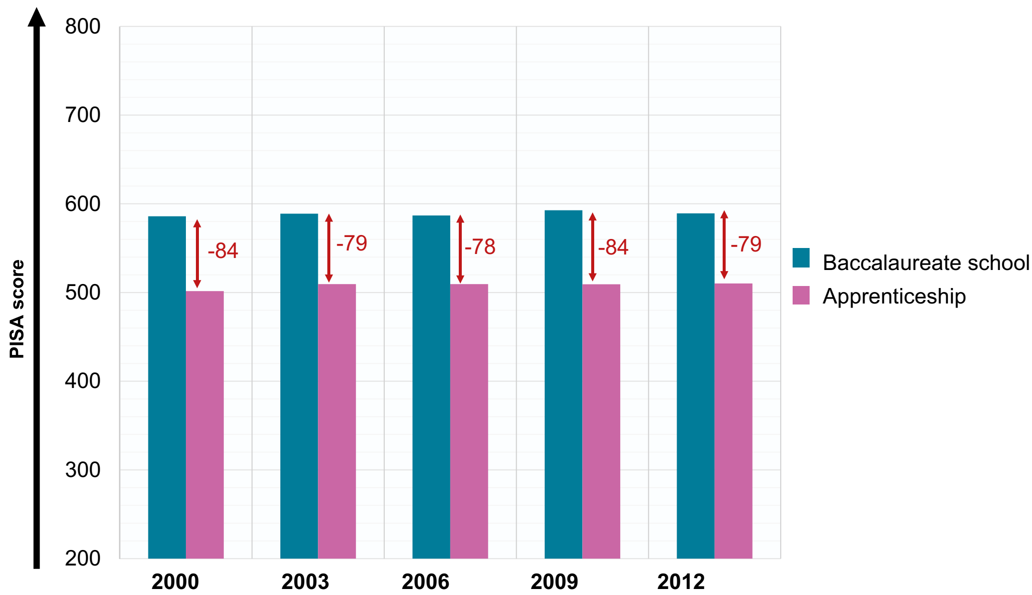
Source: Weighted PISA data for 2000, 2003, 2006, 2009, 2012 for the total of 47,631 ninth grade pupils represents the break-down of students into prospective VET and grammar school students. The blue area displays the distribution of the various PISA skills among prospective grammar school students, while the pink area shows the distribution of PISA skills among future VET students. The red horizontal line represents the percentage of prospective grammar school students of 40% at 564 PISA points.

Read from the top, graph G 1 shows that students with top PISA skills decide to attend grammar schools. However, the top students who decide in favour of VET also have very high PISA skills. This means that students with very high cognitive skills also choose to attend VET courses. Graph G 1 also demonstrates that the two distributions intersect to a large extent. Consequently, many prospective VET students have PISA skills above the red line. This would not be the case if the students with the highest cognitive skills uniformly decided to attend grammar schools.

In/decrease in skills differential between 2000 and 2012

As a next step, the researchers analysed the change in the relative skills of prospective grammar school and VET students between 2000 and 2012 (see Graph G 2). To simplify the interpretation of the data, the graph presents the mean of the average skills of the prospective grammar school students (blue) and VET students (pink) for each year. The red arrows show the differential in skills, which fluctuates between 78 and 84 PISA points. This confirms that, on average, prospective grammar school students have higher cognitive skills than prospective VET students, but also shows that the differential is surprisingly small. Graph G 2 furthermore suggests that the skills differential did not change between 2000 and 2012.

G 2: Stable Development of the Social Status of VET Relative to Baccalaureate School over Time



Source: Weighted PISA data for 2000, 2003, 2006, 2009, 2012 for the total of 51,191 ninth grade pupils

Skills differential as measurement of social status of VET

The result suggests that the social status of VET has not declined as is often claimed in the public debate. The authors' measurement of the social status of VET can also be used for other comparative analysis. In KOF Study No. 110, Bolli, Rageth and Renold analyse the social status of VET according to gender, town/country and language region as well as educational background and parents' origin. On top of this, KOF Working Paper No. 403 examines the change in social status of VET when adolescents born outside Switzerland remain in the country for an extended period.

Save the Date
KOF Wirtschaftsforum June 2018
Topic: Social Status of Vocational Education and Training in Switzerland
Tuesday, 12 June 2018
ETH Zürich, Zentrum, LEE E 101
www.kof.ethz.ch →

The KOF Study No. 110 'Der soziale Status der Berufsbildung in der Schweiz' by Dr. Thomas Bolli, Ladina Rageth and Dr. Ursula Renold can be found on our website:
www.kof.ethz.ch →

The KOF Working Paper No. 403 'Measuring the Social Status of Education Programmes: Applying a New Measurement to Dual Vocational Education and Training in Switzerland' by Dr. Thomas Bolli and Ladina Rageth can be found on our website:
www.kof-working-papers/403/ →

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Impact of the Exchange Rate on Swiss Tourism Regions

The exchange rate between the Swiss franc and other currencies plays a central role in terms of the development of Swiss tourism. However, a new study conducted by KOF shows that its impact varies significantly depending on the region.

Around 55% of overnight stays in Swiss hotels are booked by visitors from abroad. When the Swiss franc goes up, visits to Switzerland become more expensive for foreign travellers. Experience has shown that this has a negative effect on the number of overnight stays. However, the impact on hotel and catering businesses varies in the different tourism regions. Graph 3 compares the trend in overnight stays in the various regions with the (inverse) tourism-weighted exchange rate index since 2005. The graph shows substantial differences between urban destinations, the Alpine region and the remaining tourist regions. After the financial crisis broke out in 2008, for instance, overnight stays by foreign visitors in the Alpine region declined substantially, reacting with a time lag to the steady increase in the value of the Swiss franc. This decline did not stop before the introduction of the minimum exchange rate by the Swiss National Bank in September 2011. In addition, the graph already shows the recovery of overnight stays in line with the Swiss franc's slight devaluation since mid-2017.

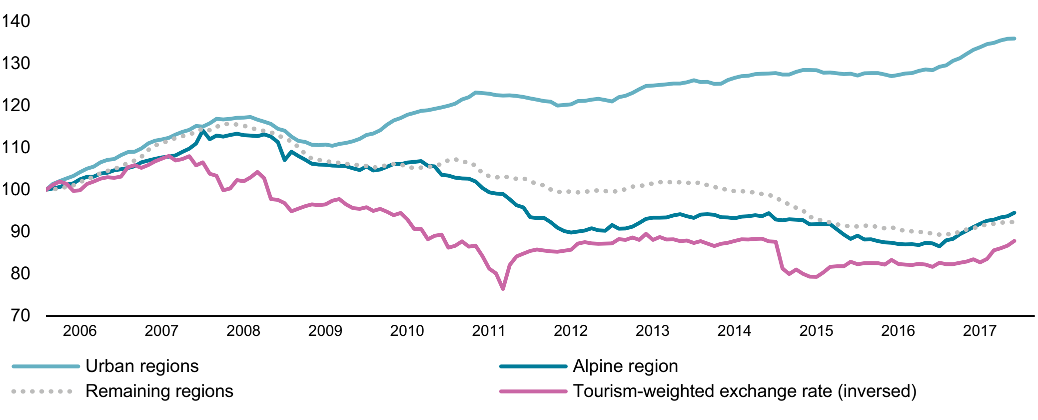
By contrast, urban destinations followed a very different trend. The number of overnight stays by foreign visitors has remained relatively unaffected by the exchange rate, although the recent devaluation of the Swiss franc appears to be having an accelerating effect on the relatively strong growth in urban regions. In the remaining regions, the number of overnight stays followed a similar trend to the development in the Alpine region. However, the impact of exchange rate fluctuations appears to be slightly less pronounced.

Estimate of region-specific impact of the exchange rate

Empirical analysis of the effect of the exchange rate on Swiss municipalities, which was published last year, confirms the impression conveyed by Graph 3. According to the study, the response to fluctuations in the exchange rate shown by rural municipalities and municipalities depending on tourism is much more pronounced than that shown by city destinations. Based on the model underlying the study, our analysis provides estimates of the impact of fluctuations of the exchange rate on overnight stays in Switzerland's 13 tourism regions. For our estimates, we utilise monthly data on overnight stays for the period January 2005 to February 2013, broken down according to tourism region as well as visitors' country of origin. This degree of detail allows us to examine which of the various parameters may also affect the number of overnight stays. The parameters consist of the income trend in the visitors' countries of origin as well general region- and time-specific effects, for instance hotels' price adjustments.

G 3: Overnight Stays by Foreign Visitors by Region and the Tourism-Weighted Exchange Rate

(Smoothed values; indexed: January 2006 = 100; Source: FSO, SECO, KOF)



[1] For the tourism-related exchange rate, see special analysis in KOF Forecasts for Swiss Tourism – October 2016.

[2] Stettler, C. (2017): How Do Overnight Stays React to Exchange Rate Changes? In: Schweizerische Zeitschrift für Volkswirtschaft und Statistik, 153(2), p. 123–165.

Substantial impact of the exchange rate on the Alpine region

Table 1 presents the estimated coefficients and standard errors of the empirical analysis. The coefficients for the respective regions show the intensity of the response of foreign visitors' overnight stays to a change in the value of the Swiss franc (so-called exchange rate elasticity). The highest coefficient of 2 was estimated for Grisons. This means that overnight stays by foreign visitors to Grisons decline by 2% when the Swiss franc gains 1% in value. Overnight stays also show a significant response to exchange rate fluctuations in Valais, Ticino and the Bern Region. In all three regions, a 1% appreciation of the Swiss franc results in an around 1.8% decline in overnight stays by foreign visitors. By contrast, urban regions such as Basel, Geneva and Zurich show either no response or a very weak response to fluctuations in the exchange rate. Interestingly, our estimates of the coefficients for the Fribourg and Jura & Three Lakes regions are also statistically insignificant.

T 1: Exchange Rate Elasticities by Tourism Region

Tourism region	Coefficient	Std. err.	Tourism region	Coefficient	Std. err.
Grisons	2.034	0.306	Vaud	0.94	0.166
Eastern Switzerland	0.987	0.383	Geneva	0.408	0.098
Zurich Region	0.337	0.22	Valais	1.85	0.343
Lucerne/Lake Lucerne	1.482	0.297	Ticino	1.827	0.544
Basel Region	-0.068	0.179	Fribourg Region	0.14	0.239
Bern Region	1.831	0.245	Aargau Region	0.958	0.295
Jura & Three Lakes Region	0.465	0.309			

Results are based on the regression model by Stettler (2017), study period: January 2005 to February 2018; respondent variable: logarithm of the monthly overnight stays by foreign visitors according to tourism region and visitors' country of origin; explanatory variables (time lag of 3 months): logarithm of real exchange rates between Switzerland and the countries of origin, logarithm of the real gross national product of the countries of origin; the model controls tourism region/country of origin-specific factors (including specific seasonal patterns) as well as region-specific trends using integrated dummy variables; the standard errors are cluster-robust at the tourism region/country of origin level.

Variation in length of visits and reasons for visits

One of the main explanations for the different impact of the exchange rate on rural areas and cities may be the varying reasons for the visits. Business travellers, who predominantly stay in cities, may be less sensitive to prices than holiday makers. On top of this, the average length of visits in urban areas is significantly shorter than that of visits to Alpine regions. It makes more sense for tourists who come for longer visits to compare Swiss prices with those of foreign destinations. Moreover, tourism regions differ in regard of the structure of the visitors' countries of origin. Tourists from long-distance markets, who often stay in urban destinations, tend to be less sensitive to the exchange rate than European guests, since expenditure in Switzerland accounts for a lower share of their total travel budget. In addition, Asian visitors frequently book their Swiss holiday in the context of a European trip and the Swiss franc exchange rate is unlikely to have much influence on their decision to book such a trip.

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The current KOF Forecasts for Swiss Tourism are available (in German) at:
www.kof.ethz.ch →

KOF INDICATORS

KOF Business Situation Indicator: Swiss Companies Report Significant Improvement of Their Business Situation

In May 2018, the KOF Business Situation Indicator for the Swiss private economy improved substantially, overcoming the two slight dampeners of March and April, and following up on the positive trend that prevailed until February (see G 4). The Swiss economy is enjoying a pronounced upswing.

In May, only the construction-related industries failed to record a rise in the Business Situation Indicator, while all other sectors of the economy reported a substantial gain (see T 2). Following a decline in the preceding month, the indicator for the manufacturing industry rose substantially in May. The financial and insurance service providers reported an improvement of their business situation. The upward trend was most pronounced in the retail trade, which managed to make up April's significant setback. Only the construction-related industries are clouding the positive picture: Although remaining predominantly positive, the business situation slowed down slightly in both the construction sector and the project engineering sector. Wholesalers, hotel and catering businesses and the other service providers were last surveyed in April. At the time, the business situation was improving in the hotel and catering industry and among the other service providers, while wholesalers reported little change.

G 4: KOF Business Situation Indicator
(Balance, seasonally adjusted)

T 2: KOF Business Situation for Switzerland (seasonally adjusted balances)

	May 17	Jun 17	Jul 17	Aug 17	Sep 17	Oct 17	Nov 17	Dec 17	Jan 18	Feb 18	Mar 18	Apr 18	May 18
Private sector (overall)	18.7	20.5	20.9	22.9	24.7	21.8	22.9	23.6	25.6	26.3	26.0	25.8	27.8
Manufacturing	1.7	7.3	6.3	11.7	16.5	15.3	18.5	17.9	18.3	20.5	19.9	18.3	23.8
Construction	27.6	29.3	30.4	29.7	29.9	30.0	29.7	28.5	30.4	30.4	28.0	30.3	29.5
Project engineering	48.0	47.6	47.0	47.1	47.6	48.6	49.5	49.8	46.0	49.0	50.4	48.4	46.9
Retail trade	-11.7	-0.7	-1.9	-1.4	2.7	1.5	0.6	3.8	1.4	7.3	4.9	0.8	6.6
Wholesale trade	-	-	16.0	-	-	20.3	-	-	28.4	-	-	28.4	-
Financial services	35.9	33.7	29.5	34.8	37.5	32.5	35.4	40.6	42.4	40.4	41.5	41.6	44.5
Hotel and catering	-	-	-2.0	-	-	0.5	-	-	4.8	-	-	6.6	-
Other services	-	-	32.9	-	-	24.4	-	-	26.3	-	-	27.2	-

Answers to the question: We assess our business situation as good/satisfactory/bad. The balance is the percentage of 'good' answers minus the percentage of 'bad' answers.

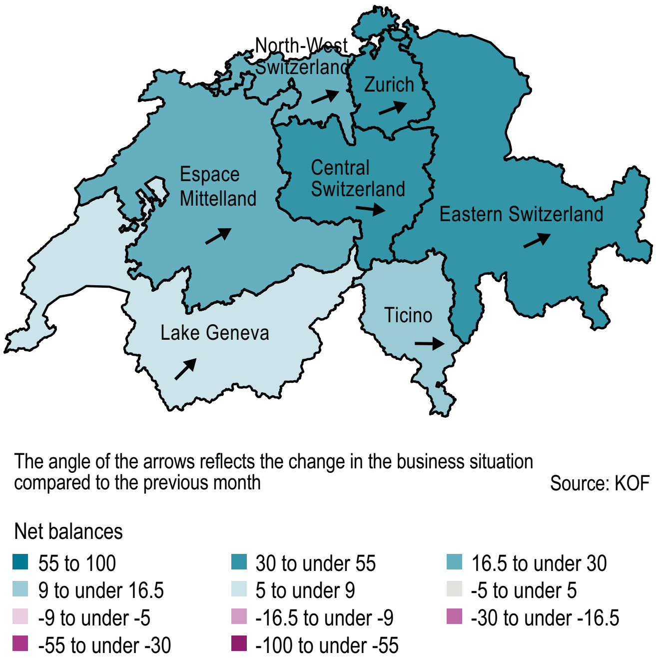
From a regional perspective, the business situation has improved in the almost all of the regions. The indicator went up in Espace Mittelland, Eastern Switzerland, North-West Switzerland and in the Zurich region. The Lake Geneva region also recorded a substantial improvement and reduced the gap to the other regions. In Ticino and Central Switzerland, the Business Situation Indicator remained more or less at the level of the previous month.

Explanation of graphs:
Graph G 4 presents the KOF business situation across all sectors covered by the survey. The business situation in sectors which are surveyed on a quarterly basis is kept constant during the intervening months.

Graph G 5 presents the business situation in the main regions according to the Federal Statistics Office (FSO). The regions are coloured according to business situation. The arrows in the regions indicate the change in the business situation compared to the previous month. An upward-pointing arrow, for instance, indicates that the situation has improved over the previous month.

The KOF business situation is based on over 4,500 reports by Swiss companies. Every month, businesses are surveyed in the following sectors: industry, retail trade, construction and project engineering as well as financial and insurance services. Businesses in the hotel and catering sector, wholesalers and the other service providers are surveyed in the first month of every quarter. Among other questions, the businesses are asked to assess their current business situation. They may rate their situation as 'good', 'satisfactory' or 'bad'. The balance of the current business situation is the percentage difference between the 'good' and 'bad' responses.

G 5: KOF Business Situation in the Private Sector



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You can find more information about the KOF Business Tendency Surveys on our website:
www.kof.ethz.ch/en/surveys/business-tendency-surveys →

KOF Economic Barometer Falls Back to its Long-term Average

The KOF Economic Barometer for May fell by 3.3 points to a new standing of exactly 100 points (see G 6). The last time the Barometer had a similar standing was in December 2015. The current value of 100 points indicates an average development of the Swiss economy in the coming months.

In May, the KOF Economic Barometer fell by 3.3 points to 100 points from revised 103.3 in April (first publication in April: 105.3). Within a few months' time, the Barometer has therefore reached its long-term average after over two years of above average values. At least for the time being, this indicates a normalization of economic development. The decrease by 3.3 points is mainly driven by the negative development of the indicators for manufacturing and the construction sector. Further negative contributions, albeit a little less pronounced, came from the indicators for consumption and the export sector. The hotel and catering service activities as well as the banking sector showed an increase in May.

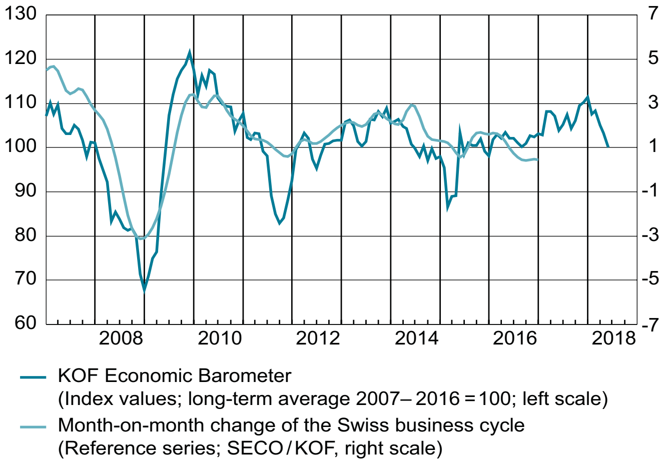
In the goods producing sector (manufacturing and construction), in particular the indicators of employment deteriorated. Further negative contributions came from the indicators for ordering and preliminary products.

Within the manufacturing sector, prospects deteriorated especially for the chemical and the wood processing industry. The indicators for the paper industry also contributed negatively. By contrast, the food processing industry developed positively. The decrease in the construction sector was based on a more pessimistic assessment of the situation by architectural as well as engineering offices.

KOF Economic Barometer and reference time series: annual update

In September 2017, the scheduled annual update of the KOF Economic Barometer took place. The annual update involves the following steps: redefinition of the pool of indicators that enter the selection procedure, update of the reference time series, and renewed execution of the variable selection procedure. The updated reference series is the smoothed continuous growth rate of the Swiss Gross Domestic Product (GDP) according to the new System of

G 6: Economic Barometer and Reference Series



National Accounts ESVG 2010, released in early September 2017, which takes into account the previous year's annual GDP data published by the Swiss Federal Statistical Office (FSO). As a result of the indicator variable selection procedure, the updated KOF Economic Barometer is now based on 273 indicators (instead of 272 as in the previous vintage), from a pool of almost 500 potential indicator series. They are combined using statistically determined weights.

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For detailed information on the KOF Economic Barometer, visit our website:
www.kof.ethz.ch →

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