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Eidgenössisches Departement für
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Direktion für Wirtschaftspolitik

Strukturberichterstattung Nr. 57/3

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Significance of autonomous tariff dismantling for future negotiations of free trade agreements

Schwerpunktthema:
Potenzial und volkswirtschaftliche
Auswirkungen von unilateralen
Importerleichterungen der Schweiz

**Study on behalf of the State
Secretariat for Economic Affairs
SECO**



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List of Abbreviations

AAT	Average applied tariff (percent, destination market)
AD	Average (MFN) duty
AGR	Agriculture
AVG	Average
BND	Bound tariff
CCODE	Commodity code (HS4)
CETA	Comprehensive Economics and Trade Agreement ¹
CMD	Commodity
COMESA	Common Market for Eastern and Southern Africa ²
DESTA	Design of Trade Agreements
DFA	Duty-free imports
DT	Dyadic trade flows
EAC	East African Community
ECOWAS	Economic Community of West African States
EEA	European Economic Area
EFTA	European Free Trade Association ³
EU	European Union
EX	Exports
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GP	Government Procurement
GSP	Generalised System of Preferences
GSP+	Generalised System of Preferences +
HS	Harmonised System
IM	Imports
IND	Industry
IPR	Intellectual Property Rights
ISIC	International Standard Industrial Classification
ITC	International Trade Centre
LDC	Least Developed Countries
MAD	Market Access Database

¹ Free Trade Agreement between the EU and Canada

² COMESA members (2017) are Burundi, the Comoros, the Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Swaziland, Seychelles, Uganda, Zambia and Zimbabwe.

³ EFTA members (2017) are Iceland, Liechtenstein, Norway, and Switzerland.

MAN	Manufacturing
MAX	Maximum
MERCOSUR	Mercado Común del Sur
MFN	Most Favoured Nation
MRA	Mutual Recognition Agreement
n.e.s.	not elsewhere specified
NTB	Non-tariff Barrier
NTM	Non-tariff Measure
POP	Population
PREF	Preferential trade regime
RoO	Rules of Origin
SACU	Southern African Customs Union ⁴
SADC	Southern African Development Community ⁵
SECO	State Secretariat for Economic Affairs of Switzerland
SRV	Services
STRI	Services Trade Restrictiveness Index
TFEU	Treaties of the Functioning of the European Union
TPP	Trans-Pacific Partnership
TRD	Trade
TRDVL	Trade value (USD)
TTIP	Transatlantic Trade and Investment Partnership
UK	United Kingdom
UNCTAD	United Nations Centre for Trade and Development
US	United States of America
UTD	Unilateral Tariff Dismantling
WITS	World Integrated Trade Solution
WTI	World Trade Institute
WTO	World Trade Organisation
WTO TAO	WTO Tariff Analysis Online
XSHR	Share in total export (percent)

⁴ Members of SACU are Botswana, Namibia, Lesotho, South Africa, and Swaziland.

⁵ Members of SADC are Angola, Botswana, Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.

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Executive Summary

Study

This study on the “Significance of autonomous tariff dismantling for industrial products for future negotiations of free trade agreements” is part of the framework topic “Studies on the potentials and economic impact of the unilateral easing of import restrictions for Switzerland”, and is carried out by the World Trade Institute (WTI) for SECO, the Swiss State Secretariat for Economic Affairs.

Goal of the study

Unilateral tariff dismantling has been practiced by various countries in the world, like Norway, Singapore, Canada, New Zealand and Iceland. Switzerland has not done so, but SECO has set out a range of studies under the framework topic to get a better understanding of the issues related to unilateral tariff dismantling. This specific project focuses on the relationship between unilateral tariff cuts and bargaining leverage in future Free Trade Agreements (FTAs). It is important to get more insight into how important this issue is as part of the overall Swiss trade policy and what the different (potential) effects and related bargaining aspects could be in order to draw conclusions about the viability of such policy for Switzerland.

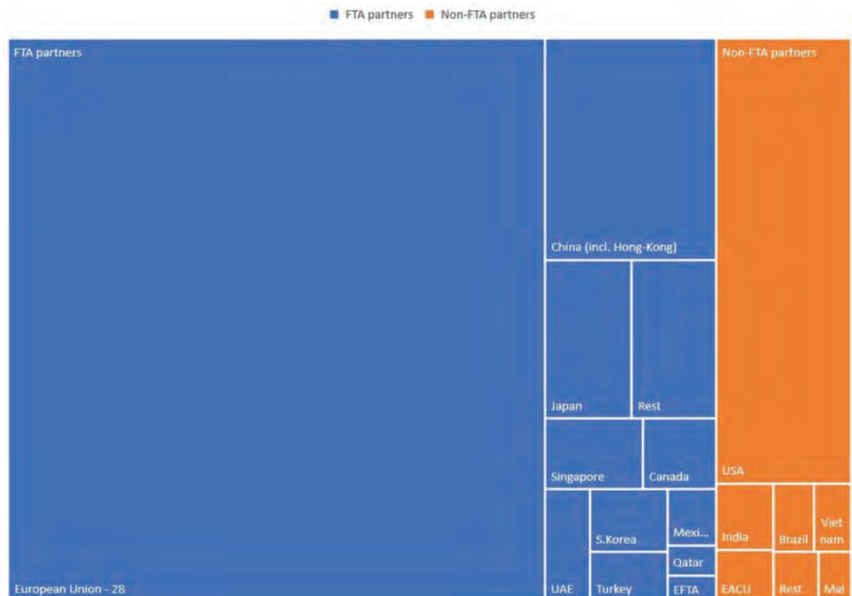
Methodological approach

In order to look at the importance of unilateral tariff dismantling in terms of the potential effects on the future Swiss bargaining position vis-à-vis prospective FTA partners, we use available data on trade agreements and their depths (from the DESTA database), existing tariff and non-tariff measure data, and we have carried out a wide range of in-depth interviews among Swiss, Norwegian, Icelandic, Hong-Kong, Singaporean and EU policy-makers and others involved in trade policy making (e.g. business associations) – with a focus on unilateral tariff dismantling. These information sources are brought together into four Chapters (apart from the Introduction and Conclusions) in which we follow a step-by-step approach to highlight each important aspect with respect to the significance of autonomous tariff dismantling on industrial products for future negotiations of free trade agreements for Switzerland.

Before looking at the issue of unilateral tariff dismantling, we first study Swiss manufacturing trade (imports and exports) data and split them into a trade share already covered by free trade agreements with trade partners and a trade share that is not covered yet. This is important, because the issue how unilateral tariff dismantling for industrial goods would affect the Swiss bargaining position is only relevant for negotiations that still have to take place (i.e. vis-à-vis *prospective* FTA partners), not for negotiations that are already concluded. We find, as shown in Figure 1, that already 84 percent of Swiss total trade (exports plus

imports) are currently covered by FTAs (blue area). This means that the focus of our study is on the remaining 16 percent of Swiss trade that is not yet covered (orange area).

Figure 1 Swiss manufacturing trade (exports and imports) covered and not covered by existing FTAs (2016)

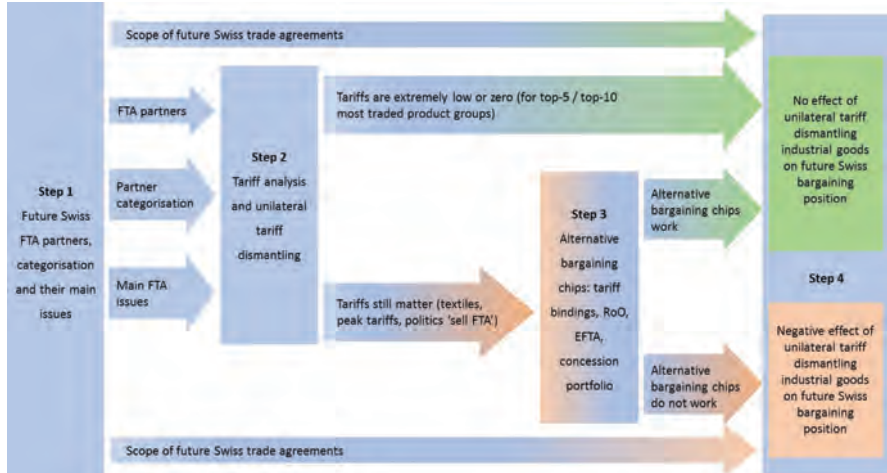


Source: Own calculations based on EZV (2016)

Focusing on those countries with who Switzerland does not yet have an FTA, the first step of our methodology – presented conceptually in Figure 2 – is to categorise the group of prospective trade partners into those with which Switzerland (directly or via EFTA) has already launched negotiations, those with who Switzerland has a declaration of cooperation, and other partners. We study the economic structures of the partner economies, sizes of the partner markets, trade policy characteristics of these partners (e.g. levels of protection), and their FTA activism, both in terms of number of existing FTAs and the levels of ambition with respect to commitments they have offered in previous negotiations. In Step 2, we carry out a tariff analysis for most important traded sectors as well as for peak tariffs in order to see for what prospective trade partners unilateral tariff dismantling would matter. For some countries, unilateral tariff dismantling matters (a lot), for others not (so much or not at all). For the subset of countries for which unilateral tariff dismantling matters, we study whether the future negotiation position of Switzerland would be undermined. In Step 3, we then turn to analysing four potential alternative bargaining chips that Switzerland could use to offset

the loss of tariffs for industrial goods as a bargaining chip in negotiations. We look at tariff bindings (1), rules of origin (2), EFTA (3) and the concession portfolio (4) as the four potential offsetting strategies. For each of them we check how powerful they could be as alternative bargaining chips and whether they would be potentially useful for Switzerland in future negotiations. In Step 4 we summarise the findings and draw overall conclusions.

Figure 2 Conceptual approach to the study



Source: Own compilation

10 Key Takeaways from this study

The 10 most important findings and key takeaways from this study are presented here. They summarise the main lessons from each Step and the overall conclusions.

Key Takeaway 1: The literature on unilateral tariff dismantling is inconclusive

From the academic literature, no uniform picture emerges as to whether unilateral tariff dismantling has a detrimental future effect on bargaining leverage. Keohane (1986), Davis (2004) and Limão (2007) come across concrete evidence that tariff reductions have been used actively to trade for other concessions from negotiating partners. This points to leverage that may be lost in the case of unilateral tariff dismantling. A more recent study, however, of Ciuriak & Xiao (2014) puts question marks at the potential detrimental effect of unilateral tariff dismantling (for Canada), because they argue that FTA partners still benefit from certainty that Canadian tariffs are fixed at zero (a benefit not extended to the wider WTO membership) and that after removal of industrial tariffs, Canada can still pursue defensive interests in agriculture and deeper trade issues to obtain favourable concessions.

Key Takeaway 2: Swiss trade is only for 16% not covered by FTAs today

Already 84 percent of Swiss total trade (exports and imports) is covered by FTAs today (see the blue area in Figure 1), while 16 percent is not (yet). Because unilateral tariff dismantling does not matter for existing FTAs (because negotiations are completed and industrial tariffs are already essentially zero), the focus of our study is on the 16 percent of Swiss trade that is not yet covered (orange area in Figure 1).

Key Takeaway 3: Prospective FTA partner characteristics show large variations

We find a large variation in economic and trade characteristics of prospective FTA partners of Switzerland:

- With regard to structure of the economy, partners range from agriculture-dominated societies like Pakistan and Myanmar to manufacturing-driven economies like Algeria and Thailand and a service economy like the US;
- With regard to the sizes of partner markets, partners range from small economies like Mauritius and Sri Lanka to large economies like Brazil (MERCOSUR) and the US;
- With regard to trade relations, the variation is very large from Swiss exports of medicaments to most prospective partner countries and specific products to individual partners (e.g turbo-jets to Indonesia) to imports of petroleum from EACU and imports of textiles from Indonesia, Vietnam, Malaysia, Pakistan, MERCOSUR, and Ecuador;
- With regard to tariff levels of protection, Algeria (18.8 percent MFN duty) and ECOWAS (16.7 percent MFN duty) are the most protectionist prospective trade partners, while Mauritius (1 percent MFN duty) and the US (3.5 percent MFN duty) are relatively most open;
- With regard to non-tariff measures, the US (5770) and MERCOSUR (2771) have the largest numbers of NTMs according to the UNCTAD TRAINS database, while Sri Lanka (124) and Pakistan (136) have least. This does not necessarily mean the US and MERCOSUR are more protective, but they do have more requirements in their regulatory systems that could lead to administrative burdens;
- With regards to FTA activism, MERCOSUR is most active, followed by Malaysia and the US. Mongolia, Iran and Sri Lanka have least pursued FTAs;
- With regard to commitments made in previous negotiations, the picture that emerges from prospective trade partners is complex and dispersed (based on the DESTA database). When looking at partners overall, we see that the US, but also Mongolia, Vietnam, and Malaysia have committed most to deeper levels of commitments in areas like services, investment, IPR, public procurement, standards and competition policy. Iran, Sri Lanka, EACU (Russia), Algeria and Ecuador have committed only very little in these areas. Mongolia, Vietnam and Malaysia in particular have committed on standards, while the US, Vietnam, Malaysia and also Myanmar have made significant commitments in services. Regarding competition policy, commitments have generally been very shallow for all prospective trade partners.

Key Takeaway 4: Swiss import tariffs for most industrial products are already low or zero

Overall, Swiss tariffs on industrial goods for prospective trade partners are very low or even zero (at HS4 level), which implies that at first sight, unilateral tariff dismantling will not have a major impact on the future Swiss negotiating position vis-à-vis its prospective trade partners.

Key Takeaway 5: The textile sector is an exception and peak tariffs still exist

The sector exception to Key Takeaway 4 is the textile and clothing sector, where Swiss import duties still exist for non-LDC countries and which is a sector that is of offensive interest for various prospective FTA partners (e.g. Pakistan, Iran and Moldova). For this sector, unilateral tariff dismantling could lead to a loss in bargaining power for Switzerland. In addition to the textile and clothing sector, we also find evidence of peak industrial tariffs. These peak tariffs are sometimes very high (e.g. up to 63 percent for Switzerland), but only apply to niche products. Nonetheless, they could be relevant for trade negotiations as bargaining chips because for a small number of prospective partner exporting firms they may be the key impediment to market access.

Key Takeaway 6: For ‘selling’ the FTA even very low or very niche peak tariffs matter

From a negotiating perspective, when FTA partners ‘sell’ the FTA (or the start of negotiations of an FTA) at home, they usually rely on providing evidence where the other side has lowered (or will be asked to lower) tariffs as a result of the negotiations. This would allow FTA partners to garner support from exporting industries to offset resistance from import-competing industries that will face increased (Swiss) competition. So even very low tariffs or niche peak tariffs would matter politically to garner support – possibly beyond their economic significance.

Key Takeaway 7: Rules of Origin and EFTA are not considered relevant bargaining chips

Recent academic research shows that rules of origin constitute significant barriers to trade in a tariff context. Upon unilateral tariff dismantling, however, the regulatory burden of rules of origin for companies will be significantly reduced. They are only relevant when accumulation of origin matters after unilateral tariff dismantling or in case of avoiding (indirect) imports from countries against which Switzerland has put trade defence measures (i.e. safeguards) in place. In addition, from our in-depth interviews we understand that it is mainly Switzerland that advocates the more liberal rules of origin provisions (as opposed to its FTA partners). This means that we do not consider rules of origin to be a viable alternative bargaining chip for Switzerland.

Another alternative bargaining chip we investigated is whether the usefulness of the EFTA platform for Switzerland to negotiate FTAs with prospective trade partners would increase following unilateral tariff dismantling. Though we clearly see the benefits of EFTA as a

negotiating platform for Switzerland, the usefulness of EFTA does not change because of unilateral elimination of tariffs on industrial goods. In case we would have found evidence of cross-concessions between EFTA members in negotiations, the EFTA platform, in conjunction with a concession portfolio could prove more useful after unilateral tariff dismantling than before. We did not find this evidence, however. Therefore, we do not consider EFTA to be a viable alternative bargaining chip for Switzerland in the context of unilateral tariff dismantling.

Key Takeaway 8: Tariff bindings and the concession portfolio are relevant bargaining chips

If applied rates (actual tariffs imposed) are lower than bound rates (maximum tariff rates committed to in the WTO), in which case we say ‘there is water in the bindings’, a country can raise applied rates up to the committed bound rates without violating WTO commitments. The level of water in the bindings is very small at the moment for Switzerland (as is the case in most developed countries). However, after unilateral tariff dismantling for those sectors where tariffs are still applied (e.g. textiles) and for peak tariffs, the water increases a lot (assuming the bound rates at the WTO do not change). That means, though Switzerland applies zero tariffs, it could raise them if it wanted to up to the level of the bound rates. Only via FTA commitments could prospective trade partners be sure Switzerland would not do that. Hence ‘water in the bindings’ becomes a relevant alternative bargaining chip for Switzerland in prospective FTA negotiations, especially after unilateral tariff dismantling.

A second potent bargaining chip is the concession portfolio. Looking at concessions on tariffs in agriculture (that remain) in exchange for lower industrial tariffs or looking at concessions regarding regulatory cooperation, TBT, SPS, investment, services, standards⁶ or competition policy as part of a package that also includes reducing partner country’s industrial tariffs (if Switzerland has already unilaterally dismantled them). This concession portfolio is a useful bargaining chip because NTMs are high for products still and can be exchanged against NTMs in other sectors, and because when unilateral tariff dismantling leads to reductions in tariffs market access can still be difficult (or *de facto* impossible) due to non-compliance with specific standards. So NTMs are another tool that can be used to obtain (give away) market access. This makes the concession portfolio a relevant bargaining chip for Switzerland after unilateral tariff dismantling.

Key Takeaway 9: Overall summary table for prospective FTA partners

Table 1 below summarises our assessment of each of the prospective FTA partners and the degree to which unilateral tariff dismantling (in relation to each of them) could lead to an adverse effect on the Swiss negotiating position. They are judged on ‘export reliance on textiles & clothing’, ‘misalignment with Swiss offensive interests’, and ‘export reliance on agricultural products’. We find that for some economies the potential risk of loss of bargaining

⁶ Standards refer to environmental and labour standards, not technical standards (covered in TBT) or sanitary and phytosanitary standards (covered in SPS).

power because of tariff dismantling is low (for the UK, US, Mauritius, and Thailand). For two countries, the potential risk that Switzerland loses bargaining power is high (for Iran and Moldova). For all other countries, we assess the risk level that Switzerland loses bargaining leverage is medium. In the next Key Takeaway, we will elaborate upon the economic significance of this low-medium-high categorisation in terms of trade flows.

Table 1 Assessment of prospective FTA partners

Prospective Partner	Timeline for Negotiations	Export Reliance on Textiles & Clothing	Misalignment with Swiss Offensive Interests	Export Reliance on Agricultural Products	Overall Adverse Effect
Algeria	Negotiations launched	Low	High	High	Medium
Ecuador	Negotiations launched	Low	High	High	Medium
EACU	Negotiations launched	Low	High	Medium	Medium
India*	Negotiations launched	Medium	High	Medium	Medium
Indonesia	Negotiations launched	Medium	Medium	Medium	Medium
Malaysia	Negotiations launched	Low	Medium	High	Medium
Thailand	Negotiations launched	Low	Medium	Low	Low
Vietnam	Negotiations launched	Medium	Medium	Medium	Medium
Mauritius	Cooperation agreement	Low	Medium	Low	Low
MERCOSUR	Cooperation agreement	Low	High	High	Medium
Mongolia	Cooperation agreement	Medium	Low	High	Medium
Myanmar	Cooperation agreement	Low	Medium	High	Medium
Pakistan	Cooperation agreement	High	High	Low	Medium
EAC	Other partner	Low	High	High	Medium
ECOWAS	Other partner	Low	High	High	Medium
Iran	Other partner	High	High	High	High
Moldova	Other partner	High	Medium	High	High
Sri Lanka	Other partner	Low	High	Low	Medium
UK	Other partner	Low	Low	Low	Low
USA	Other partner	Low	Low	Low	Low

Note 1: The way the three factors have been aggregated is explained in Chapter 6; Note 2: We use blue for prospective partners with whom negotiations are launched; yellow for partners with a joint declaration on cooperation, and green for other partners.

Key Takeaway 10: How relevant is unilateral tariff dismantling for Switzerland's future in terms of affected trade flows?

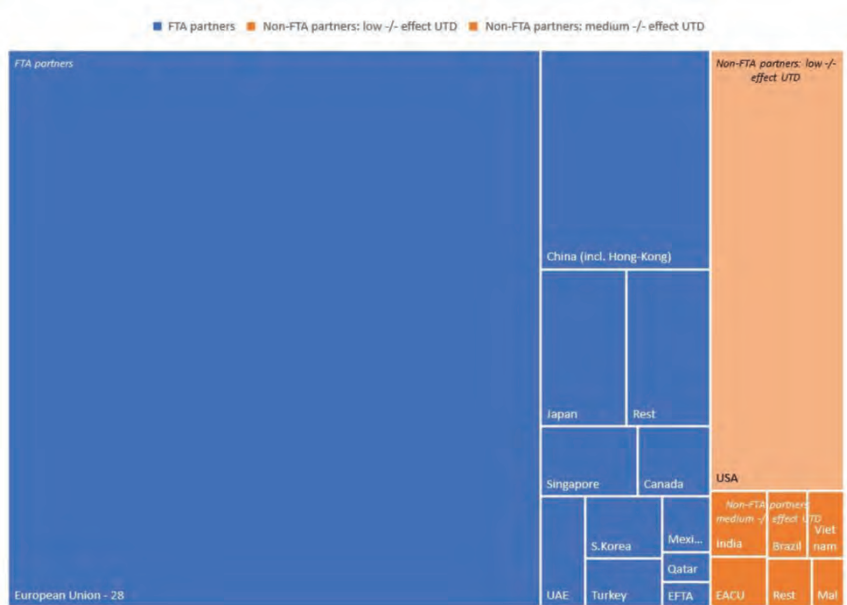
From Key Takeaways 2 and 4 – 9, our study concludes that unilateral tariff dismantling effects are expected to be modest, because – with the exception of textiles and peak tariffs - Swiss industrial tariffs are already very low. We also find that unilateral tariff dismantling matters for Switzerland's negotiation position vis-à-vis some of Switzerland's prospective trade partners (to medium and high degrees) and that Switzerland has two alternative bargaining chips in its toolkit it could use to offset loss of bargaining power due to unilateral tariff dismantling.

In order to gauge the economic relevance of the loss in future bargaining power for Switzerland due to unilateral tariff dismantling, we can look at for what share of current Swiss trade (exports and imports) would unilateral tariff dismantling be potentially negative.

- First, we know that for 84 percent of Swiss manufacturing trade flows, FTAs are currently in place (blue part in Figure 3). This leaves 16 percent of Swiss manufacturing trade 'uncovered' and open for possible FTA negotiations (light and dark orange in Figure 3);
- Second, we classify the loss of Swiss bargaining power vis-à-vis each possible trade partner as low, medium or high (see Key Takeaway 9, Chapter 6) and find that:
 - For 13 percent of current Swiss manufacturing trade flows the risk is considered low (light orange part in Figure 3);
 - For 3 percent of current trade flows the risk is considered medium (dark orange part in Figure 3);
 - For 0.1 percent of current trade flows the risk is considered high (not shown as the share is too small to show graphically in Figure 3).
- So if we add up all medium- and high-risks in terms of loss of bargaining power, we find that 3.1 percent of Swiss trade flows could possibly be negatively affected by unilateral tariff dismantling;
- Three effects should still be taken into account:
 - First, this figure could be an underestimate because from interviews with negotiators we understand that in order to mobilise the pro-FTA forces in a country any (even very small) tariff gains on the other side matter;
 - Second, this figure could be a worst-case scenario, because even for partners where loss of bargaining power is a high risk, it could only mean a slightly less favourable FTA for Switzerland, not a 'no-deal' (which is what is assumed here), which would mean that the 3.1 percent is too high;
 - Another third reason, this figure could be a worst-case scenario, is because Switzerland can still employ two alternative bargaining chips to industrial tariffs (water in the bindings and the concession portfolio) to offset the loss in bargaining position. If successful, there is no negative effect of unilateral tariff dismantling and the 3.1 percent is too high.

- Although we do believe that the political economy argument carries considerable weight in 'selling' trade agreements, we also believe that both alternative bargaining chips are potent and can be used for political economy purposes also. Moreover, with tariffs being ever lower, and the bulk of current barriers to trade coming from NTMs, the concession portfolio argument will increase in importance over time, with or without unilateral tariff dismantling.

Figure 3 Swiss manufacturing trade (exports and imports) covered and not covered (split into low and medium risk) by existing FTAs (2016)



Source: Own calculations based on EZV (2016)

1. Introduction

This study on the “Significance of autonomous tariff dismantling for industrial products for future negotiations of free trade agreements”, which is part of the framework topic “for studies on the potentials and economic impact of the unilateral easing of import restrictions for Switzerland”, is carried out by the World Trade Institute (WTI) for SECO, the Swiss State Secretariat for Economic Affairs. Unilateral tariff dismantling has been practiced by various countries in the world, like Norway, Singapore, Canada, New Zealand and Iceland. Switzerland has not done so, but SECO has set-out a range of studies under the framework topic to get a better understanding of the issues related to unilateral tariff dismantling. This specific project focuses on the relationship between unilateral tariff cuts and bargaining leverage in future Free Trade Agreements (FTAs). In case such a policy were to be pursued by the Swiss government, it would be important to get more insights into the different (potential) effects and related bargaining aspects that matter in order to draw conclusions about the viability of such policy for Switzerland. What also matters is how important this issue would be in terms of Swiss trade potentially affected (since a large share of Swiss trade is already covered by existing trade agreements – see section 2.2 – and would thus not be impacted).

The questions we are asked to investigate as part of this study, are:

- **Question 1:** What is the likely effect on Switzerland’s negotiating position for subsequent free trade agreements? Are there alternative ‘bargaining chips’ that are just as attractive or might be made so?
- **Question 2:** To what extent could autonomous tariff dismantling for industrial goods increase the pressure on agricultural products and foods in negotiations?
- **Question 3:** How great is the potential of future free trade agreements, particularly regarding tariffs?
- **Question 4:** How can the interests of future trade agreements be balanced against autonomous tariff dismantling?

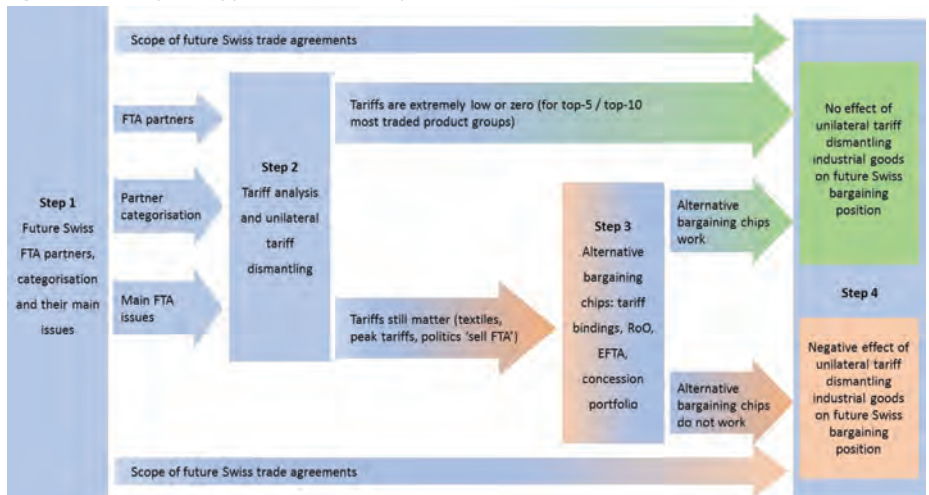
We are looking at these questions by working through four clear methodological steps:

1. **Step 1:** Where we identify prospective Swiss agreement partners and key agenda items for these partners. This helps us to examine the potential effects of unilateral tariff cuts on the negotiation position for subsequent FTAs (not for existing ones).
2. **Step 2:** Based on the country categorization resulting from Step 1, we make an initial assessment of if and how priorities would change, should Switzerland autonomously dismantle its tariffs on industrial products (Question 1): for what trade partners do tariffs still matter for negotiations and for which ones they do not. For those countries where tariffs still matter, it may be important to look at alternative bargaining chips to tariffs – which we do in Step 3.

3. **Step 3:** Building on the analysis of Step 2, we look at alternative bargaining chips Swiss trade negotiators could offer after autonomous tariff dismantling, including their viability. We also report experiences from Norway, Hong Kong and Singapore who have gone down this road before, as well as Iceland who has unilaterally dismantled industrial tariffs recently, and of the EU to depict how Switzerland’s main trading partner looks at unilateral tariff dismantling.⁷ This assessment allows us to infer under which settings autonomous tariff cuts on industrial products would need alternative bargaining chips or would increase the pressure on agricultural products and foods (Question 2).
4. **Step 4:** The results from the analysis in the previous steps will be used to make more informed predictions about the scope for future trade agreements in terms of number and depth (Question 3 and Question 4).

The steps are conceptually unconnected as presented in Figure 1.1 below.

Figure 1.1 Conceptual approach to the study



Source: Own compilation

This report is structured as follows:

⁷ Hong Kong, Singapore, Norway and Iceland have most consistently and across sectors engaged in unilateral tariff dismantling for industrial goods. That is the reason these countries were selected for interviews and gathering evidence. We opted not to look at Canada in this study, because Canada – though having done down the unilateral tariff dismantling road in part in 2010, did not do so consistently and still has (low) tariffs on industrial goods (as well as significant tariff on some agricultural products) as shown by Ciuriak and Xiao (2014). We also did not include New Zealand for a similar reason as shown by NZIER (2010): New Zealand has unilaterally reduced tariffs, but has since 2010 adopted the policy that further reductions would only happen as part of multilateral or bilateral trade negotiations.

- In Chapter 2, we present shortly the background and context of unilateral tariff dismantling and some views regarding this policy;
- In Chapter 3, we look at the results of Step 1: the identification of potential Swiss FTA partners and their main issues;
- In Chapter 4, we look at the results of Step 2: unilateral tariff cuts on industrial products (for most important sectors to highlight tariffs that would have most impact, for peak tariffs to look at niche products where tariffs still matter, and for non-tariff issues) and negotiating dynamics that could result (setting the stage for whether alternative bargaining chips (Chapter 5) are needed or not);
- In Chapter 5, we look at the results of Step 3, focusing on alternative bargaining chips, including *inter alia* country-experiences from countries that have already pursued unilateral tariff dismantling strategies before. We look at the water in between applied and bound rates, the EFTA premium, rules of origin and non-tariff measures (i.e. deeper trade issues) as the four possible alternative bargaining chips and assess their potency for Switzerland;
- In Chapter 6, we present Step 4 of our approach: the conclusions regarding how unilateral tariff dismantling may affect prospective Swiss FTA negotiations.

WTI research team

Bern, 29 August 2017

2. Context and background

2.1 Tariffs and bargaining position

The nexus between governments' unilateral trade policies and their leverage at the international bargaining table has been a recurring theme in the economic diplomacy and international political economy literature. In an analysis of the 19th and early 20th century trade policies of Western European and North American countries, Keohane (1986) argues that varying forms of free-riding concerns constituted a major impediment to unilateral tariff cuts by the major powers. Empirically, the author finds that especially the United States and France preferred specific reciprocal bargains over unilateral tariff liberalization in order to ensure that trading partners matched their free trade commitments.

The use of tariff cuts as "coins" in specific reciprocal bargains has also been documented for more recent time periods. Looking at trade negotiations conducted by the United States, the European Communities and Japan in different fora from the 1970s to the late 1990s, Davis (2004) finds that the individual countries strategically traded off tariff cuts on industrial products for tariff cuts on agricultural products. In this regard, issue linkage involving tariff liberalisation is presented as a powerful means to secure favourable bargaining outcomes (Sebenius, 1983). Similar reciprocal bargains, albeit involving different agenda items, have been observed for FTAs involving industrialised and developing countries: For instance, the United States has strategically used the margins between multilateral and preferential tariffs to obtain concessions from agreement partners on non-classical trade issues (e.g. intellectual property rights; see Limão, 2007). Similarly, after its shift to FTAs under the Global Europe strategy, the European Union has leveraged preferential margins as a tool to obtain wide-ranging concessions from developing country partner states. In light of this empirical evidence, some observers have argued that from a bargaining power perspective the idea of "unilateral free trade is a dangerous fantasy" (Wolf, 2016).

However, not all studies converge on this same conclusion. Most notably, in their analysis of the specific case of Canadian tariff cuts on industrial products, Ciuriak and Xiao (2014) express scepticism about the allegedly detrimental effect of this policy choice on Canada's bargaining leverage. Two reasons motivate their scepticism: First, the authors contend that Canada's FTA partners still benefit from the certainty that Canadian tariffs are fixed at zero, a benefit which is not accorded to the wider WTO membership. Second, they posit that after the removal of industrial tariffs, Canada can still capitalise on its defensive interests in agriculture to obtain favourable concessions in free trade negotiations.

In this study, we have interviewed a wide range of experts in Switzerland, Norway, Iceland, Hong Kong and Singapore to get more insights into the issue of unilateral tariff dismantling on industrial goods and its effect on the bargaining position in future trade agreements. We find that for Iceland and Norway, the economies benefited from unilateral tariff elimination on industrial goods. In the example of Norway, the economic impact of unilateral tariff elimination has been described as follows:⁸

The result of the tariff elimination was as intended, it reduced costs for business and for the government administration, and it led to an increase in imports from developing countries.⁹ The unilateral dismantling of tariffs has resulted in a less discriminatory regime. "Preference erosion should be promoted rather than feared."

2.2 FTA context for Switzerland and Swiss trade

From the previous section, it has become clear that among researchers there is no one opinion regarding the link between unilateral tariff dismantling and bargaining power in trade negotiations. This is exactly the purpose of this study: to delve deeper into the potential effects of unilateral tariff dismantling in industrial goods for the future bargaining position of Switzerland if Switzerland were to carry out this policy. The evaluation of this aspect is central for Switzerland, because its economy is characterised by a small internal market with a heavy reliance on international trade.

Before turning to unilateral tariff dismantling, it is important, however, to look at the bigger FTA picture for Switzerland first. Unilateral tariff dismantling may or may not have a negative effect on Swiss bargaining power for *future* trade agreements. Switzerland is, however, a country that is deeply embedded in a dense network of existing trade agreements already, both at the multilateral and regional levels, which have paved the way for trade liberalization in different issue areas. This embeddedness leads to two important points. First, the conservation of a strong negotiation position that Switzerland has successfully used in past negotiations is a prerequisite for the country to obtain concessions in future trade negotiations and get beneficial trade deals (so a good analysis of the impact of unilateral tariff dismantling matters). Second, if Switzerland is already heavily embedded in existing FTAs, how important are any future FTAs that could still be pursued for Switzerland? We can shed light on this question by looking at the share of Swiss trade already covered by trade agreements

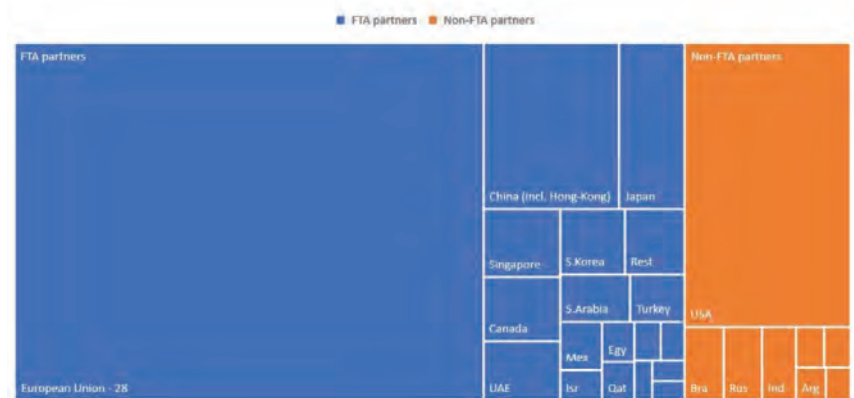
⁸ See Annex C.

⁹ For more details see e.g. Norwegian Ministry of Foreign Affairs (2012) Rapport; Import from developing Countries, available at: https://www.regjeringen.no/globalassets/upload/UD/Vedlegg/Handelspolitikk/121029_Import_from_developing_countries_WEB_v2.pdf (accessed 12 July 2017).

and the share that is not.¹⁰ Only with regard to the part of trade not yet covered by trade agreements the bargaining loss would be an issue (because for the parts that are covered any unilateral tariff dismantling would no longer matter as negotiations are already concluded). Figure 2.1a depicts the share of Swiss manufacturing exports covered by FTAs¹¹ (blue part) and the share of Swiss manufacturing exports *not* covered by FTAs (orange part). Figure 2.1b does the same for manufacturing imports. The data are reported in value terms for 2016, based on statistics of the Swiss Customs Office (Eidgenössische Zollverwaltung EZV, 2016).

From Figure 2.1a it becomes clear that for manufacturing exports 80 percent (blue part) is already covered by existing trade agreements for Switzerland.¹² Of the 20 percent (orange part) not covered, the bulk goes to the US (15.7 percent), followed by Indonesia & Malaysia & Vietnam (1.5 percent), MERCOSUR (1 percent), Russia (1 percent), and India (0.8 percent). All other countries with which Switzerland does not have an FTA constitute the final 0.7 percent of exports.

Figure 2.1a Swiss manufacturing exports covered and not covered by existing FTAs (2016)



Source: own calculations based on EZV (2016)

From Figure 2.1b, a similar picture emerges. 89 percent (blue part) of all Swiss manufacturing imports come from countries with which Switzerland already has a trade agreement. Of the

¹⁰ For the sake of this concise overall context, we only show trade figures only and not also investments for two reasons. II First, because investments – unlike trade that is covered broadly by the scope of Swiss trade agreements (with the exception of agriculture) – are sometimes not, sometimes marginally and sometimes ambitiously included. Second, because a good overview of investments covered by FTAs also requires us to look in detail at each of the signed agreements to gauge the degree to which investments are covered and that is not possible.

¹¹ Meaning that Switzerland has concluded an FTA with the destination country. It does not necessarily mean that all the exports going to this country are exported duty free, since some goods might be excluded by the FTA or in some cases FTAs are not always used.

¹² Though for some, like the Sino-Swiss FTA long adjustment periods have been agreed to so the level of impact of existing trade agreements may still increase over time.

11 percent of imports not covered by trade agreements (orange part), 9 percent relates to imports from the US, 1.1 percent from Indonesia & Malaysia & Vietnam and 0.7 percent from India. All other countries combined are responsible for the final 0.5 percent of uncovered imports.

Figure 2.1b Swiss manufacturing imports covered and not covered by existing FTAs (2016)



Source: own calculations based on EZV (2016)

Summarising the specific trade situation for Switzerland, we can conclude that for 20 percent of Swiss manufacturing exports, the issue of unilateral tariff dismantling in future trade negotiations could be relevant. Of this 20 percent one potential trading partner is responsible for the bulk of the effects: the US. For imports, we conclude that 11 percent of Swiss manufacturing imports are not covered already by trade agreements thus making the unilateral tariff dismantling for this share of imports potentially relevant. For imports too, the US constitutes the bulk of the potential effects.

3. Step 1: Swiss Free Trade Agreement Partners

Keeping in mind that the majority of Swiss trade is already covered by existing FTAs, in this Chapter, we will identify the Swiss priorities for negotiating further FTAs. These priorities relate both to prospective agreement partners (categorised into three groups) and the envisaged content of the corresponding treaties.

To approximate the Swiss government's FTA strategy, we consulted the official documentation by the Swiss Confederation and complemented the information contained therein with interviews conducted with SECO representatives. In the following paragraphs, we will build on the main findings from the different sources to propose a categorisation scheme of Switzerland's preferred future FTA partners. Moreover, we will use the results to map the treaty clauses Switzerland seeks to enshrine in prospective trade agreements. Below, we will explain our methodological approach for the identification of Swiss priorities regarding future FTA negotiations, followed by the categorisation of prospective agreement partners and the description of the Swiss template treaty provisions.

3.1 Methodological Approach

To identify the Swiss FTA priorities, we first consulted the official documentation by the Swiss Confederation. SECO (2017a) provides information on the existing network of Swiss FTAs, as well as on-going negotiations and Declarations on Cooperation signed with prospective partner states. In addition to this documentation, SECO (2017b) outlines the main tenets of the Swiss foreign economic policy strategy, including the criteria for the selection of FTA partners. The 2016 Foreign Economic Policy Report by the Federal Council provides further guidance on the most recent Swiss FTAs, as well as the Confederation's priorities partner- and content-wise in moving forward.

The official documentation offers mainly insights with respect to the status quo of Swiss foreign trade policy and the perspectives of on-going negotiation processes and Declarations on Cooperation. As a result, the documentation does not allow us to map the full universe of *potential* FTA partners and ideal treaty provisions, nor does it provide us with exact indications on the prioritisation among prospective partners. In order to obtain a better understanding of these points, we conducted complementary interviews with five SECO representatives. The experts were selected as a function of their corresponding fields of duty. In this context, we ascertained to cover the systemic features of the Swiss FTA strategy, as well as the intricacies of market access negotiations as the main focal point of this study.¹³

¹³ Since we have been asked to preserve anonymity on behalf of the interviewees, we will refrain from providing additional information on specific task areas and expertise in negotiating individual FTAs.

To grant the trade policy experts sufficient time for reflection, they received a copy of the questionnaire in advance of the scheduled interview date. The questionnaire prompted the interviewees to identify FTA partner states as well as ideal treaty provisions not mentioned in the official documentation by the Swiss Confederation.

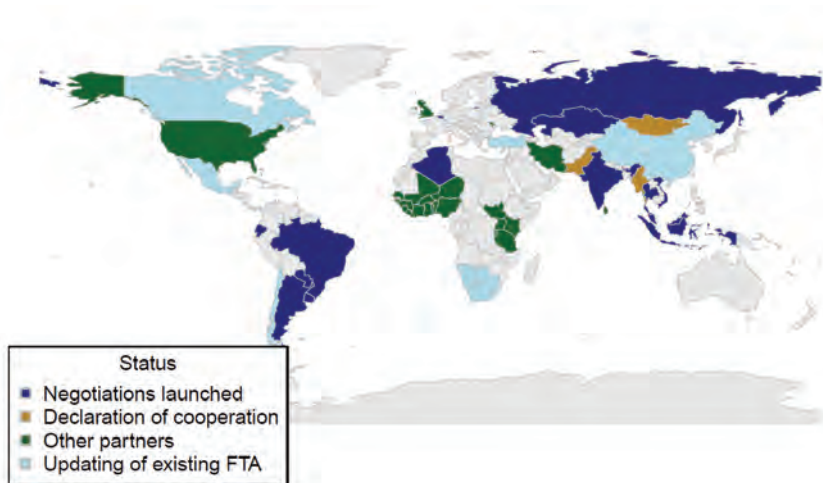
Below, we will summarise the main findings from this analytical exercise. The discussion of results is divided into the analysis of prospective Swiss FTA partners (Section 3.2) and ideal FTA provisions for Switzerland (Section 3.3).

3.2 Future FTA Partners

3.2.1 Country List

Figure 3.1 illustrates the prospective Swiss FTA partners. The countries are grouped into four categories: negotiations launched, joint declaration on cooperation, other partners, and updating of existing FTA.

Figure 3.1 Swiss priorities with respect to future FTA partners (authors' illustration)



Source: SECO (2017a), own illustration

The countries and trading blocs in the four different categories are the following (alphabetical order):

1. Negotiations launched:

- Algeria
- Ecuador
- Customs Union Russia-Belarus-Kazakhstan
- India
- Indonesia
- Malaysia
- Mercado Común del Sur (MERCOSUR)
- Thailand
- Vietnam

2. Joint Declaration on cooperation:

- Mauritius
- Mongolia
- Myanmar
- Pakistan

3. Other partners:

- East African Community (EAC)
- Economic Community of West African States (ECOWAS)
- Iran
- Moldova
- Sri Lanka
- United Kingdom
- United States of America

4. Up-dating of existing FTA:

- Mexico (updating already in progress)
- Turkey (updating already in progress)
- Canada
- Chile
- China
- Southern African Customs Union (SACU)

The official documentation reveals that Switzerland is currently in negotiations with nine partner states or trading blocs. Moreover, the country has signed joint declarations on cooperation with four partners. Six existing FTAs are to be further updated or already in the process of modernisation. In addition, the SECO interviewees indicated seven prospective partner states or trading blocs currently not mentioned in the official documentation.

Regarding the prioritisation of countries and trading blocs within the different categories, the interviewees consistently referred to the foreign economic policy strategy of the Swiss Federal Council as a benchmark. In the 2004 Foreign Economic Policy Report, the Federal Council detailed four principal criteria for the selection of FTA partners:

1. The economic importance of a prospective partner;
2. The risk of trade diversion resulting from trade initiatives linking the prospective partner to direct competitors;
3. The existence of a window of opportunity for negotiations, as well as
4. The political feasibility of trade negotiations.

In this context, particularly the first two criteria offered guidance to the SECO representatives when discussing the set of prospective FTA partners: Among the partner states with which Switzerland is currently involved in trade negotiations, all the countries were deemed important either due to their growth potential and economic weight in the world trading system (notably the partner states in Asia but also MERCOSUR) or because of their participation in trade initiatives with the European Union as a direct competitor for Swiss exports of goods, services, and capital (Ecuador as a recent case in point).

The interviewees were more selective with respect to the priorities in the group of countries with which a cooperation agreement exists. Pakistan was consistently named as the most important future FTA partner in this context. Regarding the category of other partners, economic considerations were also the prime determinant of which countries were named. Time horizons differed in this context: FTAs with ECOWAS, Sri Lanka and Moldova constitute a short-term goal, i.e. these prospective partners could be approached in the near future for starting a formal negotiation process, similar to the case of the recent on-set of negotiations with MERCOSUR. According to the SECO experts, in light of the triggering of Art. 50 of the Treaty on European Union, the United Kingdom could be approached in the medium term for FTA negotiations.¹⁴ A similar time horizon was deemed to apply to the United States: In this regard, the Swiss strategy was judged to be contingent on the fate of the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union. Iran was named as a partner which could be approached in the very long term after the country becomes more integrated in the international economic system.

The fourth and final category relates to the updating of already existing FTAs: Switzerland can capitalise on dynamic clauses enshrined in its trade agreements to deepen and/or widen commitments in new rounds of negotiations. Updating is currently in progress or envisaged by the Swiss government for six FTAs.

¹⁴ However, for the time being and in anticipation of the United Kingdom's withdrawal from the European Union, Switzerland seeks to ensure that the existing mutual rights and obligations in its relationship with the United Kingdom will continue to apply after the country leaves the European Union, and to develop these rights and obligations where necessary («Mind the gap» Strategy).

For the classification of the prospective FTA partners and the subsequent analysis of negotiation dynamics in this study, we will select all the countries from the first three categories. Three reasons motivate this selection: First, abstracting from the precise mechanisms underpinning FTA negotiations, in the context of the updating of existing treaties, Switzerland would theoretically not be able to leverage tariff cuts on industrial products as a bargaining chip since the country has already undergone tariff elimination after the entry into force of the corresponding agreements. This scenario is plausible, as several SECO experts indicated that Switzerland enters into FTA negotiations by offering partner states unrestricted market access for industrial products from the day of entry into force of the corresponding treaty. Second, in the context of the third analytical step, several interviewees from countries which have already implemented unilateral tariff cuts (cf. also third analytical step) emphasised that none of their existing FTA partners had objected to this trade policy measure. Third and finally, scholars in international relations and law have argued that countries can more easily adapt existing agreements compared to forming new agreement ties, due to the trust, mutual understanding and joint experience built throughout dyadic cooperation processes (Abbott & Snidal 2004). Following from these three points, a discussion of the countries in category four would not add substantively to the research project.

In contrast to category four, countries from the other three categories will all be analysed to capture the effects of unilateral tariff elimination on bargaining dynamics as broadly as possible. Since we do not know *ex ante* the timeline of the potential policy measure, we will cover both countries where negotiations are likely to be concluded in the near future, as well those partner states where an FTA constitutes a mid- to long-term project and is further contingent on external developments.

3.2.2 Country Categorisation

After having identified the Swiss preferences with respect to prospective FTA partners, we now propose a categorisation of these partners. The categorisation will serve the purpose of providing a detailed account of the economic fundamentals and trade regime of a given partner state or trading bloc. The information from the categorisation scheme will inform our analysis under the second analytical step, where we examine for which future FTA partners potential unilateral tariff cuts on industrial goods by Switzerland might exert a detrimental effect on the bargaining process.

We have categorised the partners based on four main criteria:

- **Trade relations with Switzerland:** Dyadic trade flows, offensive and defensive interests, application of the Generalised System of Preferences (GSP) regime;
- **Economic structure:** Composition of economic production;
- **Market size:** GDP, export orientation and population size;

- **Trade regime:** Degrees of tariff and non-tariff liberalization, as well as the design of existing FTAs.

The main findings, including the data sources to produce the descriptive statistics, are detailed in Tables 3.1-3.4.

The first category relates to the trade relations between Switzerland and the individual partner states or trading blocs. The corresponding information is presented in Table 3.1. The data on dyadic trade flows between Switzerland and the FTA partners reveal substantial variation, which matches the negotiation priorities indicated by the SECO experts: based on economic considerations, the United States, the United Kingdom, India, and MERCOSUR stand out as the most important trading partners, with levels of dyadic trade flows well above the median in the sample (USD 821 mln). Thailand, the Customs Union Russia-Belarus-Kazakhstan, Malaysia, Indonesia and Iran reveal medium but still above-median levels of trade flows with Switzerland. Trade flows are minimal with several prospective partners from Asia (Pakistan, Mongolia, Sri Lanka, and Myanmar) and Africa (ECOWAS, Algeria, EAC, and Mauritius). The same holds true for Ecuador and Moldova.

Table 3.1 further provides an insight into offensive and defensive interests in the trading relationship between Switzerland and the corresponding potential partner state(s): for each prospective FTA dyad (for example: Switzerland-India), the top five HS4 product categories traded between the partner states are indicated (for example top five Swiss exports to India and *vice versa*), with the shares in the total directed trade flows detailed in parentheses. Following Swiss practice, we do not include precious metals, jewellery, diamonds and antiques (including paintings) even when they feature prominently because in part they relate more to monetary policy (e.g. shipments of gold) and in part – though they represent high value - they do not relate to underlying economic production in the Swiss economy. Regarding top Swiss export products and hence offensive interests for the Swiss government, pharmaceuticals, machinery, jewellery and orthopaedic appliances appear recurrently in Table 3.1. The main import categories vary between textiles and agricultural products for developing partner states to machinery and pharmaceuticals for industrialised partners. Annex A provides additional information in this regard, including the average level of import duties levied on the product categories in question.

Concerning tariff protection, the Swiss Confederation is granting a GSP regime to developing countries with preferential treatment in duties for industrial and agricultural products. In a similar vein, imports from least-developed countries enter on a duty-free and quota-free basis. As illustrated in the last column of Table 3.1, many prospective FTA partners currently benefit from GSP treatment.¹⁵ As illustrated in Annex A, Sri Lanka, Moldova and Malaysia do

¹⁵ For further information see the Ordinance 632.911 of the Swiss Federal Council on preferences.

not levy import duties on the top Swiss export products, while the United States, Vietnam and the EAC levy relatively small average duties of under 2 percent. India, Indonesia, Algeria, Pakistan and ECOWAS, on the other hand all levy tariffs higher than 10 percent, with Indonesia (average import tariffs of 16.7 percent) topping the chart.¹⁶

Table 3.1 Trade relations between Switzerland and the prospective FTA partners¹⁷

Prospective partner	Dyadic trade flows (mln. USD)	Top 5 export products CH to partner state (% in total exports to partner state)	Top 5 export products partner state to CH (% in total exports to CH)	Preferential regime with CH ¹⁸
India	3'383	Medicaments (8.2) Other aircraft (7.4) Unspecified (7.3) Wrist watches (5.2) Human blood (4.7)	Ketones and quinones (5.3) Oxygen-function amino-compounds (5.1) Heterocyclic compounds (3.9) Coffee (3.5) Women's blouses (2.3)	GSP
Indonesia	911	Turbo-jets etc. (12.1) Human blood (9.8) Medicaments (6.6) Unspecified 5.2 Mixtures of odorous substances (4.5)	Footwear (8.6) Footwear, uppers of textile (6.9) Monitors and projectors (6.5) Essential oils (5.1) Coffee (2.9)	GSP
Malaysia	1'346	Medicaments (15.7) Turbo-jets etc. (13.6) Wrist-watches etc. (9.7) Human blood etc. (7.0) Unspecified (3.2)	Telephone sets etc. (17.3) Vacuum cleaners (7.3) Electronic integrated circuits (7) Apparel of vulcanised rubber (5.5) Turbo jets, etc. (4.4)	GSP
Vietnam	1'541	Medicaments (29.7) Human blood etc. (2.8) Unspecified (2.0) Turbo-jets etc. (1.7) Microphones etc. (1.1)	Telephone sets etc. (25) Footwear, uppers of leather (7.2) Footwear, uppers of textile materials (6.8) Automatic data processing machines (5.2) Crustaceans (4)	GSP
Thailand	2'100	Medicaments (14.4) Wrist-watches etc. (13.6) Human blood etc. (7) Turbo-jets etc. (6.8) Watch parts (5.9)	Other clock or watch parts (12.7) Watch straps etc. (4.8) Automatic data processing machines (4) Trunks and suitcases (3.5) Watch cases (3.4)	GSP
Customs Union Russia-Belarus-Kazakhstan	2.885	Medicaments (26.6) Human blood etc. (11.1) Wrist-watches etc. (5.6) Wrist-watches etc. (3.1) Malt extract, etc (3.1)	Petroleum oils etc. (34) Unwrought aluminium (8.8) Nuclear reactors and fuel (8) Oilcake (7.7) New pneumatic tyres (4.3)	None
Ecuador	199	Medicaments (40.9) Oxygen-function amino-compounds (8.9) Human blood etc. (8.4) Mixtures of odorous substances (5.2) Orthopaedic appliances etc. (3.5)	Cocoa Beans (41.6) Bananas (17.7) Cut flowers (15.7) Human blood etc. (8.7) Crustaceans, etc (3.2)	GSP
Algeria	382	Human blood etc. (35) Medicaments (15.8) Electrical apparatus etc. (7.7) Turbo-jets etc. (7.2) Medicaments (3)	Hydrogen etc. (57) Medicaments (13.1) Other lifting machinery (5.8) Dates etc. (3.7) Cane of beet sugar etc. (3.4)	GSP

¹⁶ The average tariff is so large due to Indonesia's 56% import tariff on odorous substances. The other tariffs are all below 5%. Odorous substances are organic products with pleasant odours (for example perfumes and soaps). They constitute less than 5% of the Swiss exports to Indonesia.

¹⁷ For regional trading blocs (e.g. ECOWAS), dyadic trade flows were summed across regional partners.

¹⁸ In the case of organisations, note that GSP is granted to the individual states but not to the organisation as such (e.g. to Brazil, Argentina, Uruguay and Paraguay, as MERCOSUR members, not to MERCOSUR as an organisation).

Prospective partner	Dyadic trade flows (mln. USD)	Top 5 export products CH to partner state (% in total exports to partner state)	Top 5 export products partner state to CH (% in total exports to CH)	Preferential regime with CH ¹⁸
Mauritius	61	Medicaments etc. (23) Human blood (9) Wrist-watches etc. (8) Nuclear reactors etc. (6) Air or vacuum pumps etc. (4)	Other clock or watch parts (22.4) Watch straps etc. (18.7) Cane or beet sugar, etc. (11.8) Wrist watches (6.7) Men's suits (5.2)	GSP
MERCOSUR	4'253	Medicaments (22) Human blood etc. (19.5) Organic derivatives of hydrazine or of hydroxylamine (9.1) Heterocyclic compounds (3.4) Unspecified (3)	Coffee (20) Unwrought aluminium (10.7) Oil-cake and other solid residues (9.7) Poultry (6.9) Petroleum (5.2)	GSP
Pakistan	436	Medicaments (33.9) Unspecified (6.2) Human blood; animal blood (4.9) Wrist-watches etc. (4.5) Military weapons (4.1)	Men's or boys' suits etc. (19) Bed linen etc. (14.3) Articles of apparel etc. (9.2) Undenatured ethyl alcohol etc. (6.9) Women's or girls' suits etc. (6.1)	GSP
Mongolia	11	Medicaments (53.6) Unspecified (7.9) Wrist-watches etc. (7.5) Parts of motor vehicles (6) Motor cars etc. (1.8)	Guts, bladders and stomachs of animals (64.2) Wrist-watches etc. (14.2) Jerseys etc. (8.4) Wrist-watches etc. (3.8) Shawls (2.1)	GSP
Myanmar	34	Human blood etc. (42.8) Medicaments (23.9) Wrist-watches etc. (5.1) Air or vacuum pumps etc. (4.4) Electrical transformers etc. (3.1)	Women's or girls' overcoats (12.2) Men's or boys' suits etc. (10.2) Palm oil and its fractions (9.1) Men's shirt (8.9) Jerseys (8.7)	GSP
United States	41'016	Medicaments (28.2) Human blood etc. (13.4) Wrist-watches etc. (5.1) Orthopaedic appliances etc. (4.5) Water (incl. mineral) (3.2)	Human blood etc. (24.3) Medicaments (8.3) Orthopaedics appliances (6.8) Motor cars (6.3) Medical instruments (5)	None
United Kingdom	16'976	Medicaments (35.2) Human blood etc. (8.9) Wrist watches etc. (5.6) Wrist watches etc. (4.6) Orthopaedic appliances (1.6)	Heterocyclic compounds (18.1) Motor cars (13.3) Helicopters, aeroplanes, spacecraft (4.9) Medicaments (4.5) Turbo jets, etc. (2.8)	None
EAC	195	Medicaments (43.7) Mixtures of odoriferous substances (4.3) Unused postage etc. (3.9) Unspecified (3.4) Insecticides (3.1)	Cut flowers etc. (38.7) Coffee (26.1) Sunflower-seed (13.6) Unmanufactured tobacco (7.8) Leguminous vegetables (3.8)	GSP
ECOWAS	1'004	Medicaments (24.6) Motor cars etc. (12.4) Unspecified (5.1) Turbo-jets etc. (5) Electric generators (5)	Petroleum oils etc. (78) Cocoa beans (15.6) Dates etc. (2.1) Ground-nut oil (1) Coconut (0.5)	GSP
Sri Lanka	206	Medicaments (15.8) Unspecified (13.4) Human blood etc. (11.9) Electronic integrated circuits (8.1) Wrist-watches (4)	Electricity distribution boards (20.1) Electrical machinery parts (4.5) Dish washing machine etc. (4.3) Fish fillet (4.3) Men's suits (4.1)	GSP
Moldova	39	Medicaments (7.3) Insecticides etc. (20.7) Wine presses etc. (11.9) Human blood etc. (6) Wrist-watches etc. (4)	Nuts (34.1) Women's or girls' overcoats etc. (8.5) Orthopaedic appliances etc. (6.7) Footwear (6.2) Women's or girls' suits etc. (5.9)	GSP
Iran	486	Medicaments (27) Human blood (20.4) Wrist-watches etc. (7.3) Turbo-jets, turbo-propellers and other gas turbines (4.7) Mixtures of odoriferous substances (4.6)	Carpets etc. (48) Ginger etc. (10.9) Nuts (10) Lac, natural gums, resins (3.8) Carpets and other textile floor coverings (3.6)	GSP

Note 1: Dyadic trade flows and top five export products; Total 2015; UN COMTRADE; Note 2: Preferential trade regime in trading relationship with Switzerland: 2017; SECO; Note 3: GSP is granted to individual states not to organisations they are members of.

The second category concerns the economic structure of the prospective FTA partner states. Economic structure is operationalised through the GDP shares of agriculture, manufacturing and services in Table 3.2 (where in red we highlight the largest and smallest values). Countries like the US and UK have very low levels of agricultural value added to GDP ratios, while for Pakistan, Myanmar and EAC members this share is over 25 percent. Algeria and Thailand have high manufacturing value added to GDP ratios (47 percent and 27 percent respectively), while this is much lower for the US (12 percent), UK (10 percent), EAC (9 percent) and Nigeria (9 percent). The UK and US clearly are service-driven economies (with services value added to GDP ratios of 78 and 79 percent respectively) while this is much less the case for Indonesia, Vietnam and Algeria. The data collected thus reveals substantial variations among the possible FTA partners as a function of different levels of economic development and the corollary specialisation in agriculture, manufacturing, and services.

Table 3.2 Economic structure of the prospective FTA partners¹⁹

Prospective partner	Agriculture value added to GDP (%)	Manufacturing value added to GDP (%)	Services value added to GDP (%)
India	18	17	51
Indonesia	13	21	43
Malaysia	10	23	53
Vietnam	18	13	38
Thailand	11	27	52
Customs Union Russia-Belarus-Kazakhstan	6	18	57
Ecuador	10	14	52
Algeria	11	47	42
Mauritius	4	15	73
MERCOSUR	13	21	58
Pakistan	25	14	54
Mongolia	14	9	52
Myanmar	29	20	38
United States	1	12	78
United Kingdom	1	10	79
EAC	33	9	48
Nigeria (ECOWAS)	21	9	53
Sri Lanka	9	20	60
Moldova	15	14	69
Iran	8	12	50

Note: for all indicators: average 2011 – 2015; World Bank Economic Indicators (WEI)

The third category relates to the market size of the future partner states: production capacity is operationalised as absolute GDP levels, export capacity as the export share of GDP, and

¹⁹ For regional trading blocs the value added figures were averaged across regional partners.

internal market size by the total domestic population. In the corresponding Table 3.3 (where in red we highlight the largest and smallest values), the United States, the MERCOSUR countries, the United Kingdom, India and the Customs Union Russia-Belarus-Kazakhstan stand out as the most significant partners.

Table 3.3 Market size of the prospective FTA partners²⁰

Prospective partner	GDP (USD mln)	Trade share of GDP (%)	Export share of GDP (%)	Import share of GDP (%)	POP (mln)
India	1'930'604	51	23	28	1'311
Indonesia	895'157	48	24	24	258
Malaysia	314'005	144	77	67	30
Vietnam	168'477	167	84	83	92
Thailand	397'455	134	69	65	68
Customs Union Russia-Belarus-Kazakhstan	2'234'828	84	45	38	171
Ecuador	92'960	58	28	30	16
Algeria	199'824	65	35	30	40
Mauritius	11'960	114	51	63	1
MERCOSUR	2'977'207	50	25	25	295
Pakistan	236'920	32	12	19	189
Mongolia	11'851	107	47	61	3
Myanmar	61'603	30	14	16	54
United States	16'758'890	30	13	17	321
United Kingdom	2'766'269	60	29	31	65
EAC	144'457	51	17	34	174
Nigeria (ECOWAS)	487'446	36	22	14	182
Sri Lanka	74'077	51	20	30	21
Moldova	7'367	124	43	81	4
Iran	529'049	44	25	19	79

Note: GDP: Average 2011-2015; WEI; Trade, export and import shares of GDP: Average 2011-2015; WEI; Population: Total 2015; WEI

Given the focus of this study on FTA negotiations, the existing trade regime of the respective partner(s) was operationalised based on several variables. First, to approximate the tariff protection of a country, we calculated the average of country's MFN applied duties. In this context, the second column in Table 3.4 (where in red we highlight the largest and smallest values) shows that Algeria, India and Pakistan have the highest tariff levels, with 19, 13 and 12 percent, respectively. The same countries, as well as Myanmar, Mongolia and Nigeria, also have very few product lines covered by duty-free imports. Second, to gauge levels of protection based on non-tariff measures, we use a count by UNCTAD of all measures in force per country or trading bloc. In this context, the United States, MERCOSUR and Thailand rank

²⁰ For regional trading bloc, GDP and population values were summed across regional partners, while trade, export and import shares of GDP were averaged.

highest.²¹ Third, regarding restrictiveness in the services sector, the World Bank Services Trade Restrictions Index (STRI) indicates low levels of permeability for foreign services providers notably on the Asian market.

Table 3.4 Trade protection by prospective FTA partners²²

Prospective partner	MFN duty (%)	Tariff lines covered by duty-free imports (%)	NTMs in force (sum)	Services trade restrictiveness index
India	13.4	2.9	272	65.7
Indonesia	6.9	12.7	590	50
Malaysia	6.1	65.6	689	46.1
Vietnam	9.5	35.4	330	41.5
Thailand	11	35.3	1572	48
Customs Union Russia-Belarus-Kazakhstan	7.8	14.2	596 ²³	35.1
Ecuador	11.9	42	999	6.2
Algeria	18.8	1.7	NA	38.3
Mauritius	1	93	NA	16.9
MERCOSUR	11.9	5.3	2771	28.4
Pakistan	12.3	0	136	28.3
Mongolia	5.0	1	NA	13.7
Myanmar	5.6	3.9	172	NA
United States	3.5	45.9	5770	17.7
United Kingdom ²⁴	5.1	31.7	545	14.3
EAC	12.8	37	NA	28
ECOWAS	16.7	5.3	1232	27.1
Sri Lanka	9.3	14.9	124	38.2
Moldova	11.5	41.7	NA	NA
Iran	NA ²⁵	NA	NA	63.3

Notes: MFN duty: Average 2016; WTO World Tariff Profiles; Duty-Free Imports: Average 2016; WTO World Tariff Profiles; NTMs: Total in force 2017; UNCTAD TRAINS NTM; Services Trade Restrictiveness: STR Index 2014; Borchert et al. (2014; World Bank)

Overall, the data presented in Tables 3.1 to 3.4 lead to the conclusion that the Swiss government seeks FTAs with a diverse set of partner states, which differ substantially in their existing trading relationships with Switzerland, their economic structure, and market size. This

²¹ The information on NTMs is to be interpreted carefully: Since each country exhibits its own legal system, the sum of NTMs is only an imperfect measure for comparison.

²² For regional trading blocs, all values in this table were averaged across regional partners. In the case of the number of NTMs in force, the average was rounded to the closest integer value.

²³ Data only available for Russia.

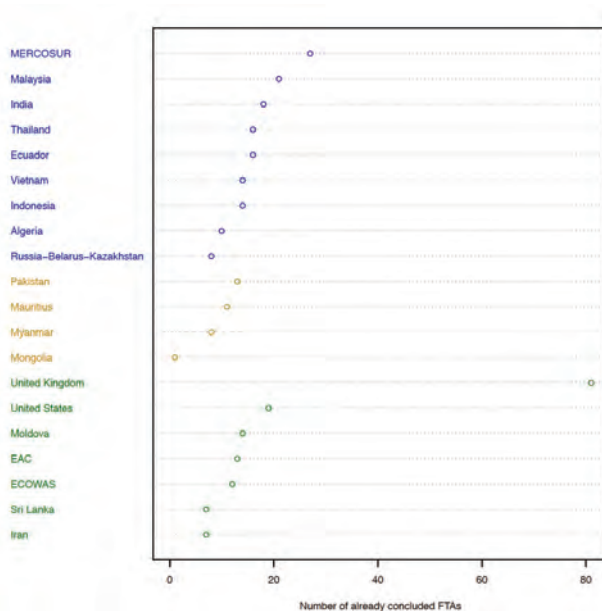
²⁴ Where applicable, the relevant indicators for the European Union were selected.

²⁵ Iran is not a member of the World Trade Organisation.

variation will subsequently be used to explain the differential effect of a potential unilateral tariff dismantling exercise on the Swiss bargaining position.

In addition to the information presented in Table 3.4, we also shed light on the existing FTA regime of the prospective partner states. To characterise a partner state’s participation in the global system of trade regulation, we revert to the Design of Trade Agreements (DESTA) database²⁶. DESTA provides granular information on the design of trade agreements in six different issue areas: services, investment, intellectual property rights, public procurement, standards, and competition policy. Regarding coverage, the database runs from 1947 to the present and features all trade agreements concluded outside the realm of the WTO for which the researchers could retrieve an official agreement text (approximately 800 FTAs). The design of each agreement was double-coded manually based on a scheme with over 150 variables referring to the abovementioned issue areas. For the purposes of this project, we leveraged the data contained in DESTA to create indices for the FTA activism and potential agreement templates of the prospective Swiss agreement partners.

Figure 3.2 FTA activism of prospective FTA partners



Source: DESTA database

²⁶ DESTA. The database was created jointly by researchers at the World Trade Institute, the University of Salzburg, as well as McGill University.

The DESTA data reveals that the potential partners differ starkly with respect to their participation in global trade regulation. For the three different status categories identified, Figure 3.2 details the number of FTAs concluded by a prospective partner state and differentiated according to the three categories set out above (countries with which negotiations launched in blue, joint declaration on cooperation countries in yellow, and other partners in green). There is substantial variation in this context between countries such as the United States, which has already signed 19 trade agreements with different partners around the globe, and Mongolia, which has only just recently joined the FTA bandwagon by inking its first trade agreement with Japan.²⁷ The UK is a special case: because it is currently still a member of the EU it has shown a high level of trade activism, defined as the number of FTAs concluded. This statistic is expected to change drastically after Brexit, dropping significantly and then rising potentially depending on the success of the UK to sign its own trade agreements in the years to come.

There is also notable variation in the provisions found in the partners' existing FTAs: Given the information in DESTA, for each trade agreement we calculated a depth index based on 48 depth-related indicators in the issue areas covered in the dataset (for a list of the variables see Annex B). The index was then divided by 48 to allow for a straightforward comparison on a [0, 1] scale.

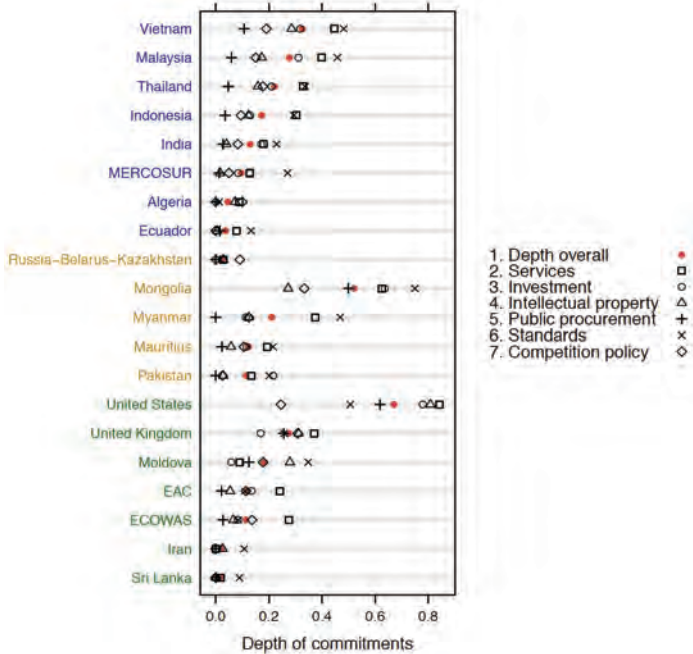
The corresponding indicator has been labelled "Depth overall". The same procedure was repeated for the depth-related indicators in the individual issue areas. In a subsequent step, we aggregated the information across prospective FTA partners by taking the mean across the indicators for the corresponding trade agreements.²⁸ The main findings from this analysis are displayed in Figure 3.3.

Even though each individual country exhibits its own specific mix of commitment levels, a few general patterns can be observed in Figure 3.3. While nearly all the countries have opted for services provisions in their FTAs, and most on standards, fewer if any commitments have been made in the areas of intellectual property rights and public procurement. These patterns become relevant when discussing the treaty provisions Switzerland seeks to enshrine in future FTAs, which will be performed in the next section. We also observe that the variation of commitments is higher among the countries with which joint declarations on cooperation have been issued and other countries, that among the countries with which negotiations have commenced.

²⁷ The scenario will change for the United Kingdom in the post-Brexit phase: The country's exit from the European Union will decrease the number of British FTAs substantially.

²⁸ Similar results are obtained when using a different rule for aggregation (for example maximum values).

Figure 3.3 Commitment levels per issue area by prospective FTA partner(s)



Source: DESTA database

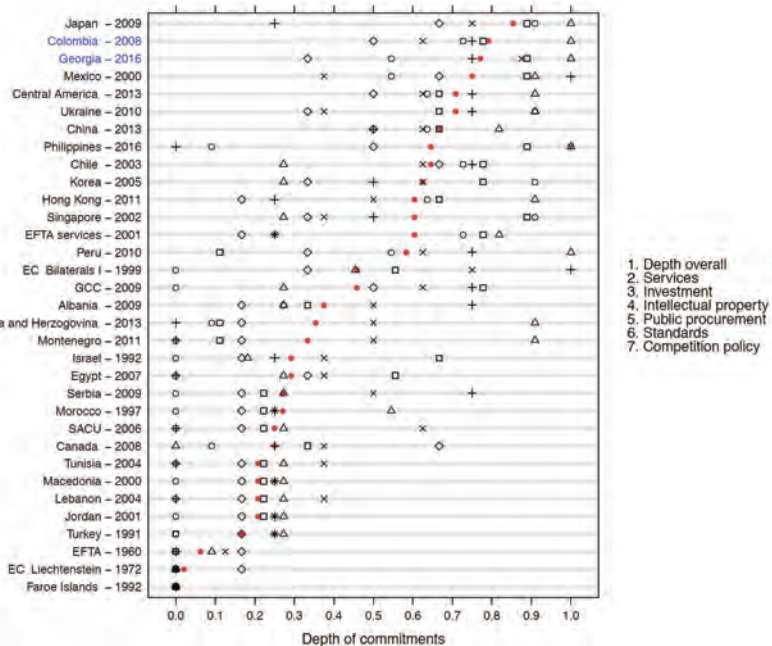
3.2.3 Ideal FTA Provisions

When addressing the Swiss ideal treaty clauses, the SECO interviewees mentioned the existence of model treaty provisions at the level of the European Free Trade Association (EFTA) as ‘best practice’ for EFTA and Switzerland, which are differentiated according to individual trade and trade-related issue areas. These model provisions are followed by the Swiss government when negotiating both under the umbrella of EFTA and on the bilateral track. According to one interviewee, the model treaty provisions are up-to-date with the notable exception of services and investment, where EFTA is relying on an outdated framework for its trade negotiations based on a GATS mode-three differentiation between investments in services and goods.

A useful proxy approach to look at the degree to which the actual Swiss trade agreements approach the ideal treaty provisions (i.e. the deep commitments on services, investment, IPR, public procurement, standards and competition policy that Switzerland pursues) consists of assessing the depth of existing Swiss FTAs. The deeper the agreement, the closer it comes the Swiss ex ante negotiating template goals. Figure 3.4 displays the levels of commitments found

in Swiss FTAs which are in force or have been signed recently, ranked from highest to lowest on the overall depth index (as per the abovementioned DESTA approach).

Figure 3.4 Commitment levels per issue area in Swiss FTAs



Source: DESTA database

Figure 3.4 indicates the FTAs with Japan (2009), Colombia (2008) and Georgia (2016) as the agreements with the highest level of aggregate depth. Upon closer examination, one can see that the corresponding treaties exhibit relatively high commitment levels on services, investment, intellectual property, public procurement, and standards, and low levels only for competition policy. By means of illustration, the recently concluded FTA with Georgia contains public procurement provisions extending commitments beyond the central level to comprise sub-central and local public procuring entities as well as public enterprises in some utilities sectors. On intellectual property, the agreement features tangible provisions on patentability as well as enforcement. Regarding services, the EFTA-Georgia agreement contains liberalisation provisions on the movement of natural persons in the provision on services.

The pattern in Figure 3.4 matches the information retrieved from our different sources. In the 2016 Foreign Economic Policy Report (pp. 836-886), the Swiss Federal Council places emphasis on offensive interests particularly in the issue areas of investment, services, public

procurement, intellectual property rights, and standards. This finding is confirmed in a recent study on EFTA’s PTA strategy commissioned by the EU Directorate-General Policy Department (2016, pp. 22-31).

When elaborating on the negotiating template used by EFTA, the SECO interviewees equally pointed to several FTAs with a high depth value in Figure 3.4. More specifically, three out of five trade policy experts affirmed that the recently concluded FTA with Georgia (highlighted in blue) exhibits a high degree of overlap with the model treaty design. The willingness of Georgia to make commitments towards Switzerland and its fellow EFTA members was primarily attributed to the existence of an ambitious FTA between Georgia and the European Union, as well as Georgia’s determination to signal its liberal-mindedness to the Western European audience (see also 2016 Foreign Economic Policy Report, p. 860). One interviewee further mentioned the FTAs with Colombia, Peru and Hong Kong as being relatively close to the ideal negotiating template. Our analysis based on the DESTA data indicates that while the FTA with Colombia (highlighted in blue) might indeed serve as a template in future negotiations, the treaties with Peru and Hong Kong feature shallow commitments in several issue areas with offensive Swiss interests, notably services in the case of Peru and public procurement in the case of Hong Kong.

The design of existing Swiss FTAs (Figure 3.4) further allows for a comparison with the level of ambition enshrined in the prospective partner states’ existing trade agreements (Figure 3.3). As affirmed above, on average, the potential partners exhibit low levels of commitments especially on public procurement and intellectual property rights. This implies that if Switzerland seeks to conclude FTAs in line with the EFTA template, the partner states will have to be incited to make ambitious reciprocal commitments especially in these two issue areas during the bargaining process.

In addition to the clauses found in existing treaties, the SECO interviewees detailed several issue areas where Switzerland seeks to move beyond existing preferential commitment levels in breadth and depth. In this context, new or more ambitious provisions would mainly build on the existing WTO framework (WTO+ provisions), but can potentially also relate to issue areas currently not regulated at the multilateral level (WTOx). Moreover, several already concluded agreements, both with and without Swiss participation, could serve as a reference for more ambitious or novel treaty clauses. Table 3.5 provides a summary of these provisions as indicated by the interviewees.

Table 3.5 Additional FTA provisions pursued by Switzerland

Issue area	Nature of commitment	Description	Reference agreement(s)
Investment	WTO+	National treatment commitments, notably with	Comprehensive Economic and Trade Agreement (CETA)

Issue area	Nature of commitment	Description	Reference agreement(s)
		respect to pre- and post-establishment	
Public procurement	WTO+	Coverage of procuring entities extending to the sub-central level	Existing Swiss FTAs and WTO Government Procurement Agreement
Technical barriers to trade	WTO+	Mutual Recognition Agreements (MRAs) on good manufacturing practices	EC-South Korea
Sanitary and phytosanitary measures	WTO+	MRAs	TTIP ²⁹
Digital security	WTOx	Regulatory framework in FTA	Transpacific Partnership Agreement (TPP)
Rules of Origin	WTO+	Design of more liberal rules of origin	NA
Trade remedies	WTO+	Ban of the use of anti-dumping duties and countervailing measures	Existing Swiss FTAs with prohibition clauses
Trade facilitation	WTO+	Further advances in expediting trade flows	WTO Trade Facilitation Agreement
Sustainable development	WTOx	Confirmation of provisions in found in recent FTAs	Existing Swiss FTAs with sustainable development chapters

Source: The information in this table is based upon desk research of existing information on the issue areas and expert interviews.

²⁹ Since the TTIP negotiations are still on-going, it is difficult to determine the scope of the SPS provisions enshrined in a potential final agreement. However, the proposals initially tabled by the negotiation parties indicate their willingness to achieve clauses on equivalence and mutual recognition regarding SPS (see for example Art. 8 of the European Commission's proposal for the SPS chapter as published on January 7, 2015).

4. Step 2: Unilateral tariff dismantling and negotiating position

In this Chapter, Step 2, we build on the future FTA partner categorisation developed in Step 1. Again, recalling that most Swiss trade is already covered by FTAs, we look at trade negotiation priorities with possible FTA partner states (with which Switzerland does not yet have preferential trade agreements) by looking at currently existing tariffs for these countries on the Swiss side (i.e. those that could be unilaterally removed).

- *We do this first by looking at the most important sectors that are traded and check whether for these sectors tariffs still remain (if so, these tariffs have a high significance). If we find tariffs, we look at what unilateral tariff dismantling in industrial goods could mean.*
- *After checking tariffs on important trade flows, we look at whether peak tariffs still exist for niche sectors and products. Though not as economically significant as tariffs on the large trade flows, in trade negotiations they could still matter. Again, if we find tariffs, we look at what unilateral tariff dismantling industrial goods could mean.*
- *We finally look at non-tariff measures as barriers between Switzerland and its (future or ongoing) trade negotiation partners.*

This Chapter (Step 2) will thus tell us – for the selected (possible or ongoing) trade negotiation partners – whether and where tariffs and non-tariff measures still matter – and thus where the initiative of unilateral tariff dismantling in industrial goods could alter the negotiating landscape.

In order – in this Step 2 – to look at existing tariffs between Switzerland and (current and possible) trade negotiation partners, and to identify how priorities would change if Switzerland were to autonomously dismantle its tariffs on industrial products, we look at two possible scenarios:

1. Swiss industrial tariffs matter little if at all for the prospective FTA partner. Reductions in these tariffs cannot be used in an exchange for concessions on agenda items with offensive Swiss interests. As a result, unilateral tariff cuts on industrial products by Switzerland are not expected to affect the bargaining process.
2. Swiss industrial tariffs matter for the prospective FTA partner. In exchange for them Switzerland can obtain concessions on other agenda items of offensive Swiss interests. As a result, unilateral tariff cuts on industrial products by Switzerland potentially hamper the Swiss bargaining position.

Therefore, in Section 4.1, we first look at the existing Swiss tariffs for top-5 traded industrial product groups. We do this, because typically the top-5 most traded product groups account for over 70 percent of industrial goods trade.³⁰ If we find no tariff lines for this top-5, the bulk

³⁰ Increasing the number of top-5 most trade product groups to the top-10, increases the share of trade measured only marginally. We do carry out this analysis, however, in the section below for the top-10 most traded product groups.

of exports from partners to Switzerland are tariff-free, and Scenario 1 above (i.e. industrial tariffs matter little if at all for the prospective FTA partner) is most likely. If we do find tariffs in the top-5, this is an indication – no matter whether the tariff is high or low – that a significant share of industrial goods trade is still affected by Swiss import tariffs. In that case, Swiss industrial tariffs would matter for a prospective FTA partner and unilaterally dismantling them could potentially weaken the Swiss bargaining position, especially if – as looked at in Step 1 – there is a gap between ‘standard’ provisions found in the FTA partners FTAs compared to Swiss FTA interests.

In addition to looking at the top-5 most traded industrial product groups, we acknowledge the fact that though tariffs may be low overall and on average, for some niche products – that could be of interest for both Switzerland and potential prospective FTA partners – there could still be peak tariffs.³¹ That is why in Section 4.2 we also look at Swiss peak tariffs. In a similar vein to Section 4.1 – albeit to a much less significant extent – if we find no peak tariffs, Scenario 1 is likely to apply (i.e. industrial tariffs matter little or not at all and therefore unilateral dismantling does not affect the Swiss bargaining position). If we do find peak tariffs, to some degree elements of Scenario 2 could apply, especially if peak industrial tariffs are found on (politically) sensitive products.

Traded volumes are an important factor when it comes to assessing whether tariffs have a significant impact or not and thus how important possible remaining industrial tariffs really are for prospective FTA partners for Switzerland. Hence, we first analyse the top-5 (as well as top-10) most traded industrial product groups and only afterwards the issue of peak tariffs; i.e. we analyse them in order of likely economic significance.

4.1 Existing Swiss tariff rates for top-5 traded industrial product groups

4.1.1 Overall findings

When we study Swiss import tariffs for each country listed and prioritised in Step 1 (Chapter 3)³², we find that Switzerland does not levy import tariffs on any of the top-5 industrial goods sectors³³ coming from these countries, except for consumer-ready textiles and a handful of luxury goods.³⁴ The detailed data are provided in Annex A for all prospective FTA partners of

³¹ Because these peak tariffs would apply to niche products, if we would use a more aggregated sector definition (much more aggregated than individual products), this tariff would almost disappear as it is averaged away against much larger product categories that face no or very low tariffs.

³² Except for platinum from two countries of the Eurasian Economic Union – Russia and Belarus. The economic effects of these tariffs regarding platinum are economically not significant and the Swiss customs even report export composition excluding precious metals.

³³ Top five export goods at HS-4 level in terms of percentage share in the overall exports.

³⁴ Luxury goods are defined as goods for which demand increases more than proportionately with income.

categories 1 – 3 (as explained in Chapter 3). This implies that in general key industrial imports are not affected by tariffs as applied rates are already zero.

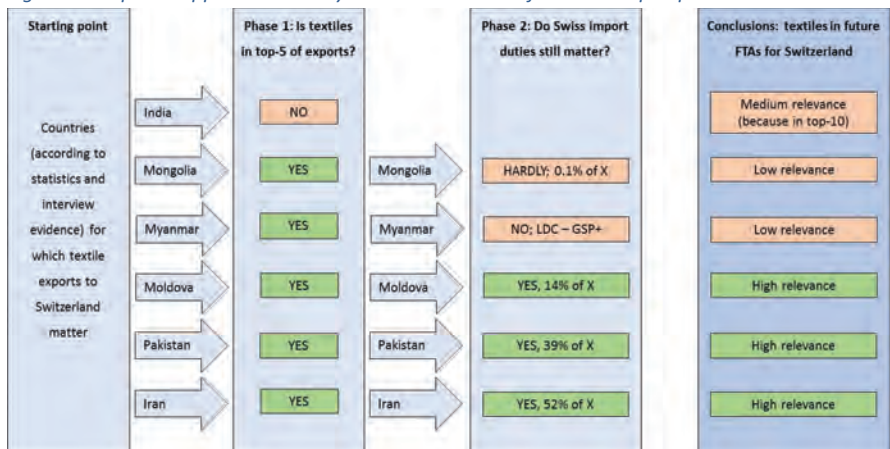
To check whether this main conclusion also holds when we enlarge the group to the top-10 most traded industrial product groups, we also carried out this analysis. Our conclusions when looking at the top-10 most traded industrial product groups does not change: the top-10 key industrial sector imports for Switzerland are not affected by tariffs – except for the already mentioned sectors of textiles and some luxury goods.

From our top-5 and top-10 sector analysis, constituting the very large majority of industrial goods traded, Swiss tariffs do not matter and thus unilateral tariff dismantling would not hurt Switzerland's future bargaining position.³⁵

4.1.2 Textiles

Both statistical tariff data and interview evidence have singled out tariffs on textiles that can be used strategically in negotiations. Interview partners stated that unilateral tariff dismantling in industrial goods could weaken the Swiss position in negotiating with countries interested in textile exports to Switzerland, in particular India and Pakistan. We therefore look at textiles in more detail, working our way through two phases as shown in Figure 4.1.

Figure 4.1 2-phase approach to analyse the textile sector from a UTD perspective



Source: Own compilation

³⁵ Under the assumption that exiting trade flows are a good proxy for the ‘potential of trade’ focusing here on intensive margins. This line of analysis does leave out the possibility for cross-concession possibilities (i.e. agricultural concessions being linked to industrial tariff concessions) because if tariffs for industrial goods are already low, the tariff-concession argument becomes weaker. We also leave out the possibility of changes in exports/imports driven by tariff changes elsewhere in the economy – the size effect which is very hard to measure.

The first phase is identifying the FTA partners for Switzerland where textile exports are in the top-5 most important exports. The second phase is identifying for those countries selected in Phase 1, what currently Swiss import duties are and whether they apply to significant export portions.

If we look at the importance of textiles in the export patterns to Switzerland of potential Swiss FTA partners, we find that for Pakistan, Myanmar, Mongolia, Iran, and Moldova, textile exports matter. That means, for each of these countries, textiles feature in the top-5 export product groups to Switzerland. India also exports textiles to Switzerland, but the value of textiles does not feature in the top-5 of most important Indian exports. Hence, we will not further analyse India.³⁶

As a second step, we look at these countries for which textile exports to Switzerland matter, and investigate what levels of tariffs Switzerland applies and on what products. A diverse picture emerges. Myanmar enjoys preferential duty-free market access under LDC benefits, while Mongolian jerseys face duties, but they account for a mere 0.1 percent of Mongolia's exports to Switzerland. Thus, for these two countries, tariffs are either non-existent or are expected to have virtually no effect. Thus, for Myanmar and Mongolia, based on the statistical data available, we do not expect unilateral tariff dismantling to undermine Switzerland's future negotiating position in FTA negotiations with these potential FTA partners.

It is, however, important from a negotiating perspective to note that when FTA partners 'sell' the FTA (or the start of negotiations towards an FTA) at home, they usually rely on providing evidence where the other side has lowered (or will be asked to lower) tariffs because of the negotiations. Such concessions might not economically be very relevant (e.g. as in the case for Mongolia) but even when absolute numbers are small, to get the support of the export sector and to counterbalance the lobbying from import-competing groups, highlighting small (market access) gains may be politically important, especially when pertaining to a domestic sector that is important. Hence, the psychological effect of textile tariff elimination could be a perception-altering tool to increase partner's interest in negotiations.

For Pakistan, Iran and Moldova, the situation is different than for India (for which textiles do not feature in the top-5 of most important export sectors), and Myanmar and Mongolia (for which textiles exports do matter, but Swiss tariffs are zero or virtually zero). First – as said above – textiles feature in their top-5 list of most important exports to Switzerland (in value terms). They range from 14 percent (Women's coats and suits from Moldova) to 39 percent (Bed linen and suits from Pakistan) and 52 percent (Carpets and Other floor covering from Iran). On top of that, as shown in Table 4.1, Swiss average duties for textiles from these countries matter. This implies that for these countries, for the textiles sectors, unilateral tariff

³⁶ The listed top five products constitute 87% of Indian exports to Switzerland.

dismantling would remove a bargaining chip for Switzerland in future FTA negotiations, potentially negatively affecting the Swiss bargaining position.³⁷

Table 4.1 Average duties paid by textile exporters (for who textiles are top-5 exports)

Country	Item	HS Code	Percent share of total export	Range of duty paid
Mongolia	Jerseys etc.	6110	0.1	CHF 60-282/100kg
Myanmar	Women's or girls' overcoats	6202	2.7	0
	Men's or boys' suits, etc.	6203	2.2	0
Pakistan	Men's or boys' suits etc.	6203	19.0	CHF 91-330/100kg
	Bed linen etc.	6302	14.3	CHF 62-221/100kg
	Women's or girls' suits etc.	6204	6.1	CHF 111-507/100kg
Moldova	Women's or girls' overcoats etc	6202	8.5	CHF117-287/100kg
	Women's or girls' suits, etc.	6204	5.9	CHF151-714/100kg
Iran	Carpets, etc.	5701	48.0	CHF68.5/100KG
	Carpets and other textile floor coverings	5702	3.6	CHF25-47/100KG

Source: COMTRADE, WTO TAO, own calculations; Exports to Switzerland from the respective countries.

4.1.3 Unilateral tariff dismantling for main trade product groups

When studying Swiss import tariffs for each possible FTA country, we find that Switzerland does not levy import tariffs on any of the top-5 most important industrial goods coming from these countries. The exceptions are consumer-ready textiles and certain luxury goods. When we enlarge the number of product groups from top-5 to top-10, this conclusion remains. This means, that key industrial imports are not affected by tariffs as applied rates are already zero, and thus that the erosion of the Swiss bargaining position because of unilateral tariff dismantling would be weak to non-existent.

There are two important qualifications that need to be mentioned, however. First, for the textile sector we find that for potential FTA partners, Pakistan, Moldova and Iran, both the relevance of exports from these countries to Switzerland and existing Swiss tariffs matter. This implies that unilateral tariff dismantling would remove an important reason for these three countries to enter an FTA with Switzerland, thus potentially weakening the Swiss bargaining position vis-à-vis these countries. For India, this is also the case, but to a much lesser extent, because textiles exports do not feature in India's top-5 exports to Switzerland (though they do feature in the top-10). Second, if we look at the political economy of 'selling' an FTA at home, it is important to keep in mind that, though not always statistically or economically significant, small market access improvements (i.e. tariff eliminations or reductions) are used

³⁷ It is important to note, however, that the overall tariff findings lead to a different conclusion. This conclusion is partner-specific for textiles-trading partners only.

to promote and get buy-in from domestic sectors/industries that benefit from a FTA. Unilateral tariff dismantling may diminish this ‘pitch possibility’.

Evidence from our interviews with those countries where unilateral tariff dismantling has already taken place, also points to this: while economic benefits for both countries seem to have materialised, both Iceland and Norway report increasing challenges during preferential trade negotiations following unilateral tariff elimination on industrial goods with partners for who tariffs mattered. Given that negotiators can no longer ‘sell’ zero-tariff market access for industrial products at home, a push to extract other concessions (e.g. in agriculture, services and investment) was observed.³⁸

4.2 Existing Swiss peak tariffs

Table 4.2 below reports the simple average and the range of tariffs in Switzerland across product groups for the year 2012. While average applied tariffs are much lower for industrial products (e.g. chemicals) than for agricultural products, there is still some heterogeneity within industrial products. The average applied duties³⁹ are more than two percent on average in the wood and paper product group as well as the textiles and clothing sector (as explained above in Section 4.1.2), and lower than two percent in the remaining reported industrial sectors.

Table 4.2 Swiss tariffs by product groups (2012)⁴⁰

Product Groups	MFN applied duties		
	in %, simple average	Duty-free in %	Maximum duty in %
Animal products	112,9	31,1	>1000
Dairy products	122,5	0	273
Fruit, vegetables, plants	18,5	35	>1000
Coffee, tea	4,3	36,1	157
Cereals & preparations	13,1	31,7	294
Oilseeds, fats and oils	19,7	46,9	152
Sugars and confectionery	11,9	32,3	201
Beverages & tobacco	35,5	16,8	440
Cotton	0	100	0
Other agricultural products	8,5	68,1	816

³⁸ Annexes C and D.

³⁹ Switzerland applies specific duties on imports, not ad valorem. Therefore, the reported applied duties are calculated averages and not official rates.

⁴⁰ This Table comes from WTO-ITC-UNCTAD (2013). Though we do not focus on agricultural tariffs, we do not want to report only part of Tables, hence agricultural tariffs are mentioned also.

Product Groups	MFN applied duties		
	in %, simple average	Duty-free in %	Maximum duty in %
Fish & fish products	0,1	92,9	15
Minerals & metals	1,4	15,1	28
<i>Petroleum</i>	0	100	0
<i>Chemicals</i>	1	35,8	17
<i>Wood, paper, etc.</i>	2,9	18,4	27
<i>Textiles</i>	5,9	2,1	58
<i>Clothing</i>	5,2	0	29
<i>Leather, footwear, etc.</i>	1,8	3,8	10
<i>Non-electrical machinery</i>	0,5	21,6	8
<i>Electrical machinery</i>	0,7	21	7
<i>Transport equipment</i>	1,3	8,4	12
<i>Manufactures, n.e.s.</i>	1,3	18	32

Source: WTO-ITC-UNCTAD (2013)

A more recent picture of Swiss simple (unweighted as opposed to trade-weighted) average tariffs and range of tariffs across product groups for the year 2016 is available from the WTO's 2017 Trade Policy Review for Switzerland (see Table 4.3). This corroborates the overall assessment made above that on average tariffs on industrial goods are low to non-existent, but that some tariff peaks exist. The Trade Policy Review finds that while Swiss average tariffs are higher in wood, pulp, paper, and furniture, as well as in the textiles and clothing sector (as explained in Section 4.1.2) within industrial products, there is also evidence of tariff peaks in other manufacturing sectors including chemicals, leather, and transport equipment. For example, Table 4.3 shows that in chemicals, peak tariffs of up to 40.5 percent still exist. Non-electrical machinery imports face peak tariffs of up to 15.1 percent and transport equipment of up to 20.9 percent.

The trade-weight of the tariff peaks in industrial goods is, however, low. That is to say: the trade share of – for example – the chemicals tariff of 40.5 percent is only 0.02 percent. This implies that though peak tariffs matter and can even be very high (for Switzerland up to 63 percent for certain industrial products), their trade-weighted relevance is very limited. That in turn implies that the Swiss bargaining position is not heavily affected by these peak tariffs – although their removal could be used by (prospective) negotiating partners to 'sell' the FTA at home for political and support-facilitating reasons as mentioned before.

Table 4.3 Swiss tariffs by product groups (2016)⁴¹

	No of lines	Simple average (%)	Tariff range (%) ^(a)	Standard deviation	Share of tariff quota lines (%)	Share of duty free lines (%)
Total	8299	9.0	0 – 1850.6	42.4	3.8	19.7
HS 01 – 24	2310	28.0	0 – 1850.6	79.9	13.4	24.7
HS 25 – 97	5989	2.5	0 – 382.5	6.4	0.1	17.7
WTO Agricultural products	2134	30.8	0 – 1850.6	83.5	14.7	20.0
Animals and products thereof	173	103.0	0 – 1850.6	227.1	67.6	9.8
Dairy products	58	100.2	2 – 402	108.8	24.1	0
Fruits, vegetables and plants	617	29.9	0 – 569.6	63.4	20.7	15.1
Coffee, tea, and cocoa	62	10.7	0 – 87	15.8	0	16.1
Cereals and preparations	426	22.1	0 – 128	26.2	5.4	10.6
Oilseeds, fats, oils	394	22.2	0 – 196.6	37.4	0	26.6
Sugars and confectionary	58	7.2	0 – 47.2	8.5	0	25.9
Beverages, spirits and tobacco	124	24.2	0 – 264.3	39.0	21.0	8.9
Cotton	6	0	0	0	0	100.0
Other agricultural products, n.e.s.	216	5.9	0 – 382.5	29.4	2.8	57.4
WTO Non-Agricultural products	6165	2.3	0 – 63.1	3.9	0	19.6
Fish and fishery products	254	0.5	0 – 33.7	2.5	0	75.2
Minerals and metals	1286	1.9	0 – 27.9	2.7	0	12.2
Chemicals, photographic supplies	1083	1.2	0 – 40.5	2.7	0	38.2
Wood, pulp, paper and furniture	344	5.0	0 – 35.1	6.1	0	21.2
Textiles	766	6.0	0 – 63.1	6.1	0	7.2
Clothing	332	5.3	0.6 – 31.6	4.0	0	0
Leather, rubber, footwear, travel	178	2.1	0 – 44.1	3.7	0	3.4
Non-electric machinery	855	0.8	0 – 15.1	1.3	0	15.9
Electric machinery	382	1.0	0 – 9.3	1.3	0	16.2
Transport equipment	183	1.9	0 – 20.9	2.8	0	9.8
Non-agricultural products, n.e.s	481	1.4	0 – 20.8	2.1	0	15.2
Petroleum	21	0	0	0	0	100.0
By ISIC sector (b)						
ISIC 1 – Agri, hunting, fishing	881	22.3	0 – 569.6	55.3	17.1	26.7
ISIC 2 – Mining and quarrying	105	0.6	0 – 14.9	2.0	0	62.9
ISIC 3 – Manufacturing	7312	7.8	0 – 1850.6	40.9	2.2	18.2
By stage of processing						
First stage of processing	1402	14.5	0 – 569.6	44.8	11.1	34.5
Semi-processed products	2459	3.4	0 – 102.4	7.4	0.0	20.1
Fully processed products	4438	10.6	0 – 1850.6	51.7	3.6	14.7

(a) The highest tariff peak is 1850.6 percent (HS 02062290), followed by 1.582.2 percent (HS 02062990); (b) International Standard Industrial Classification (Rev.2). Electricity gas and water are excluded (1 tariff line). Note: Calculations for averages are based on the national tariff line level (8-digit), excluding in-quota rates. Tariff schedule is based on HS2012.

Source: WTO Secretariat calculations, based on data provided by the authorities.

⁴¹ This Table comes from the WTO Secretariat (2016). Though we do not focus on or report agricultural tariffs, we do not want to report only part of Tables, hence agricultural tariffs are mentioned also.

Based on the peak tariff data presented in this Section, we conclude that even though tariffs on industrial products are overall low or zero, peak tariffs are still present for some niche industrial products. The trade-share of these peak-tariff affected industrial products is, however, very low. Nonetheless, they could function as ‘bargaining chips’ or as means to ‘sell the FTA at home’ for FTA partners (possibly magnifying their importance politically) if they were not unilaterally dismantled by Switzerland beforehand.

4.3 Case studies for potential Swiss FTA partners in Asia

Having looked at top-5 most important traded sectors and at peak tariffs, in this section, we present three short case studies for Indonesia, India and Vietnam. During the interviews, in particular Vietnam, Indonesia and India were mentioned repeatedly as examples of countries where unilateral tariff dismantling of industrial tariffs could hurt Swiss future bargaining power and reduce the three countries’ appetite for concluding the ongoing FTA negotiations. For that reason, we focus on these countries separately in this Section. We find that for Indonesia agricultural products and garments are focus products for the FTA negotiations. For India, the range of export products is much more varied, with organic chemicals being important – as well as textiles and garments. For Vietnam, textiles matter, but also other products. For these three countries (India marginally less) unilateral tariff dismantling could affect the willingness of these countries to make commitments in negotiations with Switzerland (EFTA).

Box 4.1 Case studies for Vietnam, Indonesia and India

At first sight, we find that for each of the three countries’ five most important export product groups, Switzerland does not levy any duties. On top of that, Indonesia, India and Vietnam are all part of Switzerland’s GSP scheme. However, none of them is any longer classified as an LDC, which would entitle them to full duty-free market access. Under the GSP scheme, duties on textiles - an export interest for the three countries at hand - are lower than on an MFN-basis, but not zero overall. These arguments suggest that the interview findings are maybe not supported by further evidence. When analysing the countries’ export interests, however, some evidence that these three countries value tariff dismantling for industrial products as a valuable concession in the ongoing FTA negotiations appears.

When we look at Indonesia (where an FTA is currently under negotiation), textiles garments and footwear (as opposed to a textiles-only analysis above) constitute a relevant share of exports of Indonesia to Switzerland.⁴² For textiles, as explained in Section 4.1.2, tariffs still exist. For agricultural products (mentioned because of interest for Indonesia in FTA negotiations), Swiss import tariffs are significant, but only relevant for industrial goods tariff liberalisation if cross-concessions matter (a topic where both literature and interviewees are divided). For chemicals and related products, some

⁴² <https://www.eda.admin.ch/countries/indonesia/en/home/switzerland-and/export-promotion/trade-switzerland-indonesia.html>; downloaded 17 July 2017.

peak tariffs exist. It would require further research to see whether exactly for those chemicals products that Indonesia exports, peak tariffs still apply. These three arguments could explain the interview results with respect to Indonesia.

When we look at India (where an FTA is currently under negotiation), important Indian exports to Switzerland are organic chemicals, dyestuffs, machinery and parts, textiles and garments, leather products, shoes and shoe uppers, cotton, plastics, coffee, tea, and hand-knotted carpets (ArshaConsulting, 2015).⁴³ Referring back to the analysis of Section 4.1.2 on textiles, the main driver for the interview results regarding India becomes clear: with textiles, garments, leather, shoes, and hand-knotted carpets as important export products, on which (to varying degrees) Swiss import duties still apply, unilateral tariff dismantling would remove a reason for India to want to pursue the FTA with Switzerland. In addition, organic chemicals are subject to some peak tariffs, which is of interest for the Indian side.

Finally, when looking at Vietnam, there too, footwear and woven apparel of clothing accessories are important export products. The same goes for electrical machinery and mechanical appliances as well as fish and crustaceans. For the textiles related products, the same applies as for India and Indonesia. Regarding fish and crustaceans, agricultural tariff and non-tariff measures apply. Unilateral tariff dismantling could also for Vietnam lead to a diminished interest in pursuing an FTA with EFTA (where an FTA is currently under negotiation)

4.4 Non-tariff measures vis-à-vis future FTA partners

Though non-tariff measures (NTMs)⁴⁴ are not the focus of this study, we consider it important to provide some concise information on NTMs for three reasons. First, when looking at negotiating future FTAs, any trade deal between Switzerland and a third party is going to be a combination of tariff and non-tariff measure elements. In fact, the deeper elements in trade agreements that Switzerland pursues (e.g. TBT, SPS, services, public procurement, competition policy, investments) are all NTMs. Second, we have already discussed that there is a possibility (which we will explore further in Section 5.4) that cross-concessions between tariffs and non-tariff measures could be used in future negotiations (in a post unilateral tariff dismantling world as well). Third, with tariffs having dropped significantly and with ongoing globalisation leading to the emergence of value chains and production fragmentation, non-tariff issues have become more and more important. In fact, NTMs being regulatory differences between countries, FTAs are a potential tool to reduce them (i.e. the differences) without lowering levels of protection (Berden et al. 2009).

From Chapter 3, we recall the level of trade protection of prospective FTA partners reported in Table 3.4. The third column shows the NTMs in force (total sum) according to the UNCTAD TRAINS database. We observed that there is a great variation in NTMs among prospective

⁴³ <https://www.arshaconsulting.com/en/blog/posts/2015/october/india-switzerland-an-overview-on-bilateral-trade/>; downloaded 17 July 2017.

⁴⁴ We want to emphasise that Non-Tariff Measures and Non-Tariff Barriers are not the same. NTBs are a subset of NTMs and they are NTMs imposed with a deliberate protectionist intent that hurt trade disproportionately.

trade partners, ranging from only 136 for Pakistan up to 2771 for MERCOSUR and 5770 for the US. Note that more NTMs are not synonymous with protectionism because NTMs can be regulations that have a valid purpose, fall under the WTO's TBT or SPS regimes, pertain to health & safety, social or environmental regulations, yet that have the side-effect of affecting trade. The US has high levels of regulations for many sectors – much higher than Pakistan – and thus displays more NTMs. From a prospective FTA perspective, this is an indication that Swiss negotiations with third partners with higher levels of NTMs will also have a higher chance of having a regulatory character apart from discussions on tariff liberalisation.

During the interviews, questions were raised to what degree unilateral tariff dismantling would undermine Swiss offensive interests in IPR, public procurement, investment and services (i.e. NTMs). To assess this question, we need to understand two sub-questions:

1. Whether cross-concessions are more likely to happen after unilateral tariff dismantling than is currently the case – we do this in Chapter 5, section 5.4.
2. What are the current commitments of Swiss partners on IPR, public procurement and services?

The answer to the first question helps us to see whether there is a possible link between industrial tariffs and other concessions in different areas. We will look deeper into this sub-question in Chapter 5. The answer to the second question helps us to assess how far apart the FTA partner positions are from the Swiss position. The DESTA data revealed in Figure 3.3 show that some partners have engaged more ambitiously on non-trade issues like IPR, standards, investment, and competition policy than others (e.g. US, UK, and Moldova were rather ambitious while for example MERCOSUR, Pakistan, Myanmar, EAC and ECOWAS have shown much lower levels of commitments). This too is important information from an NTM perspective as these deeper elements of trade agreements *are* NTMs. Note that we did not only find significant variation on NTM commitments between prospective FTA partners, but also on different types of NTMs within offers of individual FTA partners (e.g. Mongolia's commitments on IPR and competition policy have been shallow, while commitments in standards and services have been rather deep).

5. Step 3: Alternative bargaining chips

For Step 3, we build on Step 1 (the future FTA partner categorisation) and Step 2 (the broad sector tariff analysis, peak tariff analysis and concise NTM description). From Step 2, we find that overall tariffs on industrial goods are already low, except for the textile sector, but that peak tariffs still exist (even if they apply to products that are only traded marginally). We also find that NTMs matter highly. Based on these findings, we expect that – looking at each of the prospective trade partners of Switzerland – for several unilateral tariff dismantling is not detrimental for the Swiss negotiating position, but that for some negotiations this might be the case.

Because for some future negotiations unilateral tariff dismantling could play a role, in this Chapter (Step 3) we look at what alternative bargaining chips Switzerland could bring to the negotiating table to offset the loss of tariffs for industrial goods as a bargaining chip in negotiations. We look at four bargaining chips: the difference between bound and applied rates (i.e. the ‘water’ between bound and applied rates), rules of origin, the EFTA premium, and the concession portfolio. For each of these bargaining chips, we analyse how they might work and whether we – in the end – consider them potent instruments or not.

Based on existing literature of the economics of tariff dismantling in general, the elimination of industrial duties is expected to lead to economic gains. First, because it allows for specialization in productive sectors, allowing the economy to become more productive overall, focusing on comparative advantages. Second, because it enables cheaper imports for consumers – which has positive trade, growth and job effects. The case of *unilateral* tariff dismantling⁴⁵ – the focus of this study – is a special one: not via multilateral or bilateral trade negotiations would Swiss tariffs come down, but unilaterally by Swiss decision. The main question of this study is, if in this special case the above mentioned economic benefits would materialise. When we focus on what such unilateral measure could imply for the future Swiss negotiating position, the interviews in Switzerland, but also talks with representatives of Iceland, Norway, Singapore and Hong Kong, demonstrate some concern among experts that loss of the bargaining chip ‘zero-tariff access for industrial goods’ is felt (whether economically relevant or not), and that this could pose an additional challenge for future FTA negotiations. See Annexes C, D, E, and F for details of the interviews with Norwegian, Icelandic, Hong Kong and Singaporean experts.

In Chapter 2 we show that 80 and 89 percent of Swiss exports and imports respectively, are already covered by FTAs. We are looking at the other 20 and 11 percent of exports and imports respectively. In Step 2 (Chapter 4) we conclude that – despite the concerns of experts –

⁴⁵ See for instance Raihan (2015) and Handley (2014).

unilateral tariff elimination on industrial goods is – at first sight – not expected to have a significant negative effect on the future bargaining position of Switzerland in prospective FTA negotiations. We specify three qualifications to this general conclusion: the textiles sector where unilateral tariff dismantling may be an issue for future bargaining power, for peak tariffs in some sectors that could be important for future FTA partners, and for the political element of ‘selling the FTA’ to garner domestic support or for creating domestic interest and support to start talking about an FTA in the first place. In case Swiss industrial tariffs matter for the prospective FTA partner (for the domestic textile sector of the FTA partner, for peak tariff reasons or for reasons to do with domestic support to ‘sell the FTA’), these tariffs could have been eliminated in exchange for concessions on other agenda items with offensive Swiss interests – an option that does no longer exist after unilateral tariff dismantling .is implemented This situation could potentially hamper the Swiss bargaining position, unless Switzerland can bring alternative bargaining chips to the negotiating table to substitute or even improve upon the loss of possible interest among FTA partners to pursue FTAs.

In this Chapter, we investigate four alternative bargaining chips that could be used by Switzerland to offset any negative bargaining position effect emerging from unilateral industrial tariff dismantling (i.e. for sectors where currently tariffs exist and removal could lead to loss of bargaining power):

- First, we discuss the extent to which Switzerland may use heterogeneity across industrial tariffs and the margin between tariff bindings at the WTO and applied tariffs strategically. In particular in textiles and for high peak tariffs, where applied tariffs on industrial goods do not yet tend towards zero already (see Chapter 4), decreasing uncertainty based on the gaps between bound and applied tariff lines (that increase significantly after unilateral tariff dismantling – as we will explain later) may become both economically and legally relevant.
- Second, we look in more detail at how ‘rules of origin’ constitute *de facto* (hidden) barriers to trade, to what extent they remain after unilateral tariff dismantling, and then whether they could be used as an alternative bargaining chip.
- Third, we investigate to what extent Switzerland may benefit more from negotiations under the umbrella of EFTA in comparison with negotiating FTAs on its own after unilateral tariff dismantling.
- Fourth, we conclude the assessment by looking at potential changes in the concession portfolio of Switzerland. We focus here on the breadth and depth of the concession portfolio: on binding commitments in services, applied tariffs in agriculture, services, concessions in investment, and NTMs of products.

We do so by studying available evidence in the literature and by complementing this information with findings from semi-structured interviews with experts in countries that have already undergone autonomous tariff dismantling. The discussions in this context will provide

information on possible additional agenda items and the extent to which different alternative bargaining offers have been accepted by negotiation partners. The discussion of alternative bargaining chips will also be informative as to the extent to which the Swiss agricultural and food sectors can be expected to come under pressure after unilateral tariff reductions on industrial products. If the bindings-option, rules of origin-option, and EFTA-option as alternative bargaining chips do not prove to be reliable and potentially useable, the Swiss government may have to extend its concession portfolio to include agricultural and food products as an alternative bargaining chip.

5.1 Alternative bargaining chip 1: Swiss applied and bound tariff rates

The 'tariff bindings' option consists of increasing certainty among the exporters of the FTA partner states by binding industrial tariffs at zero in the corresponding trade agreements. The rationale underpinning this option goes as follows: at the WTO, countries exhibit a difference between their bound and MFN applied tariffs on many tariff lines.⁴⁶ Empirical research has shown that the so-called 'water' between bound and applied tariffs creates uncertainty among foreign exporters regarding the future trade policy choices of the reference country. This is the case, because with a zero tariff on an industrial product, but with a higher than zero bound rate, a country could legally increase tariffs up to the bound rate without being in violation of its WTO commitments. This uncertainty then becomes manifest in lower trade flows. By means of illustration, the trade-flow-reducing effect of a two-percentage-point increase in tariff flexibility has been documented to be equivalent to the decrease in trade flows resulting from a one-percentage-point increase in applied tariffs (Pelc, 2013, p. 99). It is for this reason that trade representatives have stated that one value-added of FTAs lies in the elimination of water in tariff lines (Pelc, 2016, p. 224). With respect to Switzerland, the viability of this option can be assessed in two ways. First, empirically, the Swiss MFN bound tariffs on industrial products can be examined to determine the different degrees of tariff flexibility before and after unilateral tariff dismantling. Based on this analysis, industrial products for which MFN bound rates are higher than zero can be examined to investigate the increase in water following unilateral tariff dismantling by Switzerland and thus the increase in potency of this instrument for Switzerland in prospective FTAs to increase certainty for partner exporters. Second, interviews can be conducted with trade representatives from the countries that have unilaterally dismantled tariffs already to infer to what extent the offer of increased certainty through preferential tariff bindings in FTA negotiations has mattered to partner negotiators and foreign exporters. The interviews with Norway, Iceland and Singapore have

⁴⁶ Bound rates are the commitments given off at the WTO by a WTO member regarding the maximum tariffs they agree to levy against other WTO members. So, a WTO member 'binds itself'. The applied tariffs are the actual tariffs levied on imports from WTO members. They can, by definition, not be higher than the bound rates (without repercussions in the WTO) but they can be lower – or even zero.

provided us with some interesting illustrations⁴⁷. As small open economies, these countries have reduced both bound and applied tariffs at the WTO to a substantial degree in the 21st century. Since these countries still exhibit water on many tariff lines, evidence from interviews will illustrate to what extent preferential tariff bindings can *de facto* still be used as bargaining chips after autonomous tariff cuts (United States Trade Representative, 2015, p. 291).

5.1.1 Difference between Swiss applied and bound tariff rates

Table 5.1 below reports the simple average, the range of tariffs, and the bound tariff rates in Switzerland across product groups for the year 2016. Table 5.1 is an adjusted (and partially enlarged) version of Table 4.2. We have added bound rate information and calculations regarding the ‘water’ between Swiss applied and bound tariff rates before and after unilateral tariff dismantling.⁴⁸ First, as said in Chapter 4, we witness some heterogeneity across tariffs on industrial products in Switzerland with wood and paper, textiles and clothing, and leather and footwear having the relatively higher tariffs (although still low in international comparison – see Table 3.4).

The literature suggests a correlation between reducing uncertainty regarding applied and bound tariffs and entry into market of foreign exporters, including FDI⁴⁹, Table 5.1 suggests that before unilateral tariff dismantling there is very little ‘water’ in Swiss tariffs for industrial products: the difference between average bound and applied tariffs is very low for industrial products (see Column (4)). In this regard, Switzerland is in line with other industrialised WTO members, which all - on average - tend to apply little to no differences between bound and applied MFN tariffs on industrial goods.⁵⁰

If, however, only Swiss applied tariffs on industrial goods were brought down to zero because of unilateral tariff dismantling, while bound duties remained at existing levels, then the ‘water’ between bound and applied rates would increase, strengthening the potency of this bargaining chip. In a prospective FTA negotiation, Switzerland could then offer to decrease the ‘water’ (i.e. committing to not raising tariffs above a percentage of the bound rates) to reduce uncertainty for FTA partner exporters (see Annex E). In Column (6) of Table 5.1, we show the ‘water’ in the bindings *after* unilateral tariff dismantling. It has increased significantly for sectors like textiles, clothing and wood (as expected) where there was already some ‘water’ in the bindings. It has, however, also increased for a sector like chemicals, where – before unilateral tariff dismantling – there was no ‘water’.

⁴⁷ Our discussions on Hong Kong did not bring out this point clearly.

⁴⁸ For the sake of focus, we have removed the information in the Table on the share of goods that were duty-free and the maximum duties applied (in %), to focus the argument on the increase in the level of the bindings following unilateral tariff dismantling.

⁴⁹ Handley, Kyle (2011) Exporting under Trade Policy Uncertainty: Theory and Evidence, Dissertation submitted to the Faculty of the Graduate School of the University of Maryland; Ciuriak, Dan and Xiao, Jingliang (2014) Should Canada unilaterally adopt global free trade? Canadian Council of Chief Executives.

⁵⁰ See e.g. Bagwell, Kyle, Bown, Chad P., and Staiger, Robert W. (2016) ‘Is the WTO Passé?’, *Journal of Economic Literature*, vol. 54, no. 4, pp. 1125-1231, p. 1131.

Table 5.1 – Swiss ‘water in the bindings’ by product groups (2012)

Product Groups	Final bound duties	MFN applied duties		MFN applied duties		
	% Simple average	% Simple average (before UTD)	‘Water’ (before UTD)	% Simple average (after UTD)	‘Water’ (after UTD)	Increase in ‘water’ (before vs. after UTD)*
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Animal products	149,8	112,9	36,9	112,9	36,9	0
Dairy products	107	122,5	-15,5	122,5	-15,5	0
Fruit, vegetables, plants	35,5	18,5	17,0	18,5	17,0	0
Coffee, tea	10,2	4,3	5,9	4,3	5,9	0
Cereals & preparations	49,1	13,1	36,0	13,1	36,0	0
Oilseeds, fats and oils	64,6	19,7	44,9	19,7	44,9	0
Sugars and confectionery	27,8	11,9	15,9	11,9	15,9	0
Beverages & tobacco	44,1	35,5	8,6	35,5	8,6	0
Cotton	0	0	00,0	0	0	0
Other agricultural products	17,4	8,5	8,9	8,5	8,9	0
Fish & fish products	1,3	0,1	1,2	0,1	1,2	0
Minerals & metals	1,4	1,4	0,0	1,4	0,0	0
<i>Petroleum</i>	2,1	0	2,1	0	2,1	0,0
<i>Chemicals</i>	1,0	1	0,0	0	1,0	1,0
<i>Wood, paper, etc.</i>	4,4	2,9	1,5	0	4,4	2,9
<i>Textiles</i>	6,4	5,9	0,5	0	6,4	5,9
<i>Clothing</i>	6,2	5,2	1,0	0	6,2	5,2
<i>Leather, footwear, etc.</i>	1,8	1,8	0,0	0	1,8	1,8
<i>Non-electrical machinery</i>	0,6	0,5	0,1	0	0,6	0,5
<i>Electrical machinery</i>	0,8	0,7	0,1	0	0,8	0,7
<i>Transport equipment</i>	1,9	1,3	0,6	0	1,9	1,3
<i>Manufactures, n.e.s.</i>	1,4	1,3	0,1	0	1,4	1,3

Source: WTO-ITC-UNCTAD (2013); * Percentage point increase.

In addition, this argument – though less economically significant for the Swiss or negotiation partner country economies overall – could be even more potent for peak tariffs in niche sectors or on niche products. For negotiating partner exporters facing a peak tariff, certainty could increase significantly if also commitments on bound rates were made (and this increase in certainty would be much higher than an economy-wide ‘water’ estimate would suggest on average). For example, the normal applied duty rate per 100 kg gross “*Silk yarn and yarn spun from silk waste, put up for retail sale; silk-worm gut*” imports to Switzerland currently is 251.00

CHF.⁵¹ Switzerland offered duty-free access for this item to many FTA partners, such as for example to China⁵²; given the potential cost-saving and increase in legal security in this and similar cases, binding of duty-free access for formerly high-peak tariff items and in textiles may be used as a potential bargaining chip.

5.1.2 Interview findings on use of difference between applied and bound tariff rates

From our interviews with government officials from Norway (Annex C) and Hong Kong (Annex E) we know that binding applied tariffs has been used as a concession in negotiations following unilateral tariff elimination on industrial goods. However, such binding of applied tariffs – in the experience of Norway – was not applied to the manufacturing sector, but to the agricultural sector and to binding of access commitments in the services sector.⁵³ Our findings from interviews with EU officials, point out, however, that bindings of applied tariff rates are no longer considered a concession in manufacturing, given that negotiators are of the opinion that the applied rate is in any case highly unlikely to be increased again (Annex F).

5.1.3 Conclusion: difference between applied and bound tariff rates

In conclusion, Table 5.1 suggests that increasing legal certainty by binding tariffs in an FTA is likely to generate interesting advantages for new partners of Switzerland in situations where Swiss bound rates higher than zero tariff existed in broader sectors (i.e. mainly in textiles, clothing, footwear and wood) and for peak tariffs. Unilateral tariff dismantling – without lowering bound rates at the same time – increase ‘water in the bindings’ significantly in those cases. Reducing the ‘water’ (i.e. reducing uncertainty for FTA partner exporters) could then be used by Swiss negotiators as a bargaining chip in FTA negotiations. For niche exporters from the partner country in a product or product group previously subject to peak tariffs, this argument is particularly potent. In contrast, in sectors where bound rates are already low, and where – therefore – unilateral tariff dismantling does not significantly increase the ‘water’ (e.g. electrical and non-electrical machinery) interview information suggests that addressing NTMs (i.e. differences between regulatory systems that could include TBT measures for electrical and non-electrical machinery) may be more relevant than binding of applied tariffs. If both bound and applied rates are unilaterally dismantled, there is no ‘water’ and this bargaining chip is rendered completely ineffective.

5.2 Alternative bargaining chip 2: Swiss Rules of Origin

The ‘rules of origin’ option is investigated as a second bargaining chip. In a tariff-world, for sectors with (high) applied MFN tariffs, utilization of preference margins by FTA partners is

⁵¹ See Guide to the Swiss customs tariff: www.tares.ch (accessed 10 July 2017).

⁵² See FTA with China (2014).

⁵³ See findings in Annex C.

dependent upon liberal rules of origin. Rules of origin are the criteria applied to determine the national source of a product. If rules of origin are strict, a product is quickly classified as not originating in the FTA partner – possibly increasing tariffs that apply, but certainly increasing uncertainty among FTA exporters about what national source applies. Indeed, one of the significant factors for non-utilization of tariff preferences by FTA partners has been found to be complex rules of origin requirements. For instance, Cadot et al. (2002)⁵⁴ estimated NAFTA's rules of origin related administrative costs to approximate two percent of the value of Mexican exports to the US. Cadot et al. (2006)⁵⁵ estimated ad valorem equivalents (AVE) of rules of origin compliance costs (admin and input) in EU and US FTAs of 3.5 percent for a change in chapter, and up to 15 percent for combinations of rules of origin involving technical requirements. Because of these estimates, rules of origin are seen by economists as 'hidden tariffs' that matter, and hence we investigate whether they could serve as alternative bargaining chip in case of eliminating of the real tariffs on industrial goods.

Though in a tariff-world, rules of origin matter and (see above) could constitute significant trade barriers, in the event of unilateral tariff dismantling by Switzerland, rules of origin are likely to lose most of their significance for industrial products, because the use of FTAs (with respect to industrial goods) and thus the need for a proof of origin would largely disappear. There are two caveats to this conclusion. First, if the origin of the imported content is used for accumulation of origin upon export to a FTA partner, proofs of origin are still relevant. Second, in the limited number of situations (now or in the future) where Switzerland would have preferential Rules of Origin and have trade defence measures in place against a country (e.g. countervailing duties in case of dumping), even in a world with otherwise full duty free access to the Swiss market for industrial goods, an exporter would still have to produce a certificate of origin to prove the country of origin benefitting from any preferential treatment under a Swiss FTA is not the country against which these trade defence measures are enacted.

Thus, though much less relevant after unilateral tariff dismantling, rules of origin would still matter to a very limited extent. And since rules of origin add to compliance costs of exporters (as the evidence above suggests), making rules of origin requirements less cumbersome anymore could be beneficial for possible Swiss FTA partners. .

In Chapter 4, we observed in Table 4.3 that for some sectors there still were peak tariffs (e.g. chemicals, textiles, and leather, footwear, etc.). Here too, when tariffs are unilaterally dismantled, the potency of the rules of origin argument as a bargaining chip is eroded, but here too, if the origin of the imported content is used for accumulation of origin upon export

⁵⁴ Cadot, Olivier, de Melo, Jaime, Estevadeordal, Antoni, Suwa-Eisenmann, Akiko and Tumurchudur, Bolormaa (2002) Assessing the Effect of NAFTA's Rules of origin, Research Paper, INRA-LEA, Paris, available at: http://web.worldbank.org/archive/web site/00894A/WEB/PDF/CADOT_RU.PDF (accessed 12 July 2017).

⁵⁵ Cadot, Olivier, Carrere, Celine, de Melo, Jaime and Tumurchudur, Bolormaa (2006), Product-specific rules of origin in EU and US preferential trading arrangements: an assessment, *World Trade Review*, vol. 5, no. 2, pp. 199-224.

to a FTA partner, proofs of origin are still relevant. So, also for niche products or product groups, the offer to further make rules of origin requirements less cumbersome or not mandatory anymore could be beneficial for possible Swiss FTA partners on top of unilateral tariff liberalisation because the latter would only streamline trade to a tariff-based extent. The combination of unilateral tariff dismantling, followed in FTAs by reducing requirements on rules of origin (where they still matter) could be useful because research suggests that rules of origin – at this moment – may be trade-restrictive in current Swiss FTAs and thus be restrictive for its FTA partners.⁵⁶ For example, with respect to Swiss rules of origin in the wood & paper, and textiles and clothing sectors, Estevadeordal & Suominen⁵⁷ (2003) show that rules of origin in pulp and paper products in the EFTA-Mexico FTA are more restrictive than Pan-euro rules of origin in those products.⁵⁸ Moreover, the EFTA-Mexico rules of origin in textiles and apparel are the most restrictive across products (see Table 5.2 below). This points to the potential scope for simplifying the rules of origin in these sectors as a bargaining chip where accumulation of origin would still matter after unilateral tariff dismantling. From our interview evidence we hear, that restrictive rules of origin provisions are mostly there because of demands of the Swiss/EFTA FTA partner, not because of Swiss demands (i.e. the restrictive EFTA-Mexico rules of origin could be there because Mexico pushed for them, not Switzerland or EFTA). This points to another important element regarding the use of rules of origin as a bargaining chip: if it is not Switzerland but the FTA partner asking for relatively more stringent rules of origin provisions, more facilitative rules of origin is not a potent bargaining chip for Switzerland because that is not what the FTA partner is seeking (and thus would not want to offer anything in exchange for).

Table 5.2 Sectoral Restrictiveness of Rules of Origin (1 – 7 scale, with 7 most restrictive)

HS Section	Pan-Euro	EFTA-Mex	NAFTA	US-Chile	Chile - CACM	JSEPA	Chile - Korea	SADC	Non-Pref. Avg.
1. Live animals	7.0	5.3	6.0	6.0	5.9	7.0	6.0	7.0	6.2
2. Vegetable products	6.6	4.0	6.0	6.0	5.6	7.0	6.1	6.6	6.6
3. Fats and oils	4.7	4.0	6.0	6.0	3.0	7.0	7.0	7.0	4.0
4. Food, beverages and tobacco	5.0	4.4	4.7	5.7	3.7	6.8	5.2	5.4	4.6
5. Mineral products	3.5	3.5	6.0	3.9	5.3	6.6	5.4	4.0	4.8
6. Chemicals	3.9	3.8	5.3	2.6	2.6	3.7	4.0	4.0	2.5
7. Plastics	4.9	4.9	4.8	3.7	3.2	4.0	4.1	4.7	4.0
8. Leather goods	3.3	3.5	5.6	5.0	3.7	4.0	4.9	3.8	3.4

⁵⁶ A note of caution is in place here: because rules of origin are finally agreed between FTA parties, the rules of origin regime is the combination of a Swiss view and a view of the FTA partner(s). From interviews and feedback, we understand that often the Swiss take on rules of origin provisions is the more liberal of the two.

⁵⁷ 'Rules of origin in the world trading system', paper prepared for the seminar on RTAs and the WTO, WTO, Geneva, 14 November 2003, available at https://www.wto.org/english/tratop_e/region_e/sem_nov03_e/estevadeordal_paper_e.pdf

⁵⁸ We need to note here, in order to do justice to the EFTA-Mexico FTA, that this is one of Switzerland's oldest FTAs and therefore, that at the time of concluding the FTA these provisions were not seen as so restrictive as they are today, when benchmarked against FTAs that were concluded much later.

HS Section	Pan-Euro	EFTA-Mex	NAFTA	US-Chile	Chile - CACM	JSEPA	Chile - Korea	SADC	Non-Prof. Avg.
9. Wood products	2.9	2.9	4.0	4.1	3.2	4.0	4.1	4.8	3.3
10. Pulp and paper	4.4	4.6	4.8	4.9	4.1	4.0	4.3	4.3	3.9
11. Textiles & apparel	6.1	6.1	6.9	5.9	4.5	6.0	5.5	6.1	3.4
12. Footwear	2.8	4.1	4.9	4.8	3.5	4.3	4.7	2.6	3.7
13. Stone and glass	3.7	3.7	4.9	4.4	4.2	4.0	5.0	3.7	3.5
14. Jewelry	3.7	3.7	5.3	5.2	4.0	4.0	5.4	3.7	3.4
15. Base metals	4.2	4.2	4.6	4.6	3.8	4.0	4.5	3.9	3.4
16. Machinery & electr. equipment	4.8	4.0	3.2	2.9	4.3	6.0	3.8	4.1	3.6
17. Transportation equipment	4.7	4.2	4.8	4.2	3.4	4.0	4.3	3.8	3.8
18. Optics	5.0	4.4	4.0	4.5	4.0	4.0	4.3	3.9	3.5
19. Arms and ammunition	4.0	4.0	4.7	5.5	4.0	4.0	4.8	3.1	4.0
20. Works of art, miscellaneous	4.1	4.1	5.1	5.3	3.6	4.6	4.7	4.0	3.3
Average	4.5	4.2	5.1	4.8	4.0	4.9	4.9	4.5	3.9

Source: Estevadeordal & Suominen (2003)

Table 5.2 provides a comparative analysis of the restrictiveness of rules of origin regimes across products and FTAs based on a categorical index first developed by Estevadeordal (2000)⁵⁹ to examine NAFTA rules of origin. The index ranges from 1 (least restrictive) to 7 (most restrictive), and can be conceptualised as an indicator of how demanding a given rule of origin is for an exporter.

The evidence at first sight is that rules of origin could point to a relevant alternative bargaining chip, because research finds that rules of origin constitute significant barriers to trade (e.g. in textiles and for example in the EFTA-Mexico agreement). These results, however, are found when there are also still significant tariffs in place (making the use of an FTA by means of rules of origin highly relevant). However, upon unilateral tariff dismantling – though not gone – the overall regulatory burden of rules of origin for companies will be significantly reduced because the number of cases where the burden materialises is reduced. They are only relevant when accumulation of origin matters after unilateral tariff dismantling or in case of avoiding (indirect) imports from countries against which Switzerland has put trade defence measures in place. If we add to these arguments the fact that in negotiations it is mainly Switzerland that advocates the more liberal rules of origin provisions (as opposed to its FTA partners), rules of origin cannot be viewed as a strong bargaining chip.

⁵⁹ Estevadeordal, Antoni. 2000. "Negotiating Preferential Market Access: The Case of the North American Free Trade Agreement." *Journal of World Trade* 34, 1 (February).

5.3 Alternative bargaining chip 3: the EFTA premium

A peculiar feature of Switzerland in the trade policy realm is that the country has concluded certain FTAs on a bilateral level, while other agreements have been negotiated through EFTA. Negotiating as part of the broader EFTA trading bloc may endow the country with more negotiating leverage given that i) the EFTA market size is bigger compared to only the Swiss one giving Switzerland as part of EFTA more leverage and ii) concession-making is – for more but not all⁶⁰ – a joint decision by four countries with distinct domestic political economy constraints. To gauge whether Switzerland benefits from an ‘EFTA premium’ in FTA negotiations, the existing Swiss FTAs as coded in DESTA are analysed. In this context, a focal point would be the agenda items which are of key importance for the Swiss government as identified under step 1: if Switzerland is more likely to obtain its preferred provisions when negotiating through EFTA as compared to negotiating bilaterally – following unilateral tariff dismantling, the former option may be more appealing for the post tariff cuts period. The ‘EFTA premium’ is further assessed in interviews with Norwegian and Icelandic stakeholders including the Ministry of Foreign Affairs, the Ministry of Trade, Industry and Fisheries, the Ministry of Finance, the Confederation of Norwegian Enterprise with its sectoral associations, and the Norwegian Confederation of Trade Unions.

Switzerland, as do the other EFTA members, generally conducts trade negotiations under the umbrella of the EFTA.⁶¹ More recently, Switzerland negotiated substantial trade agreements also on its own, namely the treaties with Japan (2009) and China (2013). We therefore investigate to what extent the loss of the Swiss bargaining chip ‘zero-duty access’ for industrial products could be compensated through concessions of EFTA members as a group. In particular, we look at variations in the concessions achieved in FTAs negotiated through EFTA, compared to the bilateral track. It should be noted, that the incentive to conduct trade negotiations with Switzerland alone or with EFTA members as a group is not only linked to achieving duty-free access for industrial products to the Swiss market, which unilateral tariff dismantling would facilitate (reducing the need for an FTA with EFTA), but also to other negotiating objectives. Rather, political and strategic considerations (such as achieving preferential market access, using EFTA to gain a foothold in Europe, entering the European market for the first time, but also for achieving domestic policy and political partnership goals) play a central role in the decision to negotiate a trade agreement with Switzerland. These considerations will remain valid, independent from a change in applied tariff rates in Switzerland.

⁶⁰ Some areas are negotiated bilaterally between EFTA members and prospective FTA partners. This pertains, for example, to market access in services, market access for agricultural goods, and investment.

⁶¹ See e.g. Art. 43:1(g) of the Convention establishing the European Free Trade Association (last amended on July 31 2013).

This finding is confirmed by the experience of Singapore (Annex E): Singapore has been successful in concluding several trade agreements despite substantial market access liberalisation on a unilateral basis. Political and strategic considerations proved important enough for Singapore to remain an attractive partner for FTAs and Singapore has been able to successfully negotiate agreements clearly benefitting its own economic and political interests.

5.3.1 DESTA analysis of the EFTA premium

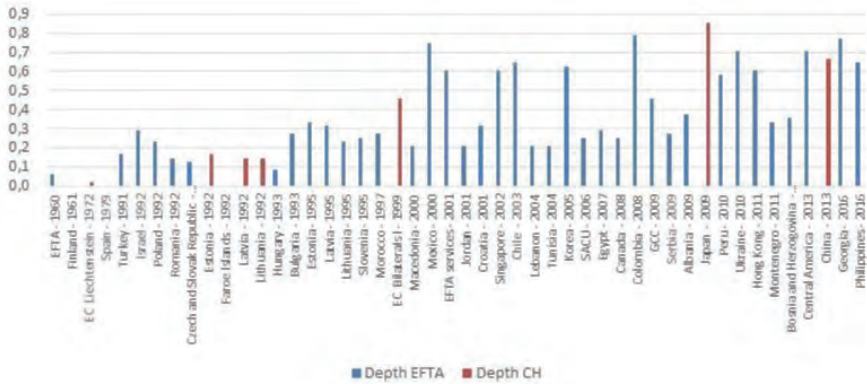
To see whether the results of negotiations through EFTA versus bilateral negotiations would make a difference, we turn again to the coded depth of the commitments in Swiss trade agreements (i.e. the DESTA database). As shown in Figure 5.1, checking the scopes of the different agreements, we do not find evidence of an ‘EFTA premium’. As can be seen in Figure 5.1, both the scope and the depth of the trade agreements of Switzerland increased over time independently from the forum within which they were negotiated.

Looking at the outcome of negotiations in more detail, we analysed the agenda items of key importance for Switzerland, as established in Step 1 of this study. According to this analysis, key importance is attributed to services, intellectual property, investment, and public procurement. Table 3.4 highlights that also at specific chapter-level a clear distinction between Swiss and EFTA types of agreements cannot be made. Furthermore, Table 3.2 exhibits the more ambitious negotiation targets in several chapters, varying from investment to technical barriers to trade to digital security and sustainable development. Figure 5.1 then shows that regarding the commitments undertaken in Swiss FTAs in key chapters, no clear pattern of different outcomes between the different negotiating fora is discernible. The two more recent FTAs with Japan and China which Switzerland negotiated outside of the EFTA framework, both feature high levels of commitments in key chapters⁶², while the more recent FTAs negotiated within the EFTA framework tend to slightly perform better regarding depth of commitments in these key chapters⁶³.

⁶² The FTA with Japan (2009) features of all Swiss FTAs the deepest commitments in services, investment, intellectual property, standards and competition policy, while it does not cover public procurement. Overall, the FTA with Japan ranks first with regard to overall depth of the agreement. The FTA with China (2013) features of all Swiss FTAs third deepest commitments in intellectual property, investment, services, standards and competition policy, and public procurement. Among all Swiss FTAs, it ranks 7th with regard to overall depth of the agreement.

⁶³ The FTA with Colombia (2008) features of all Swiss FTAs deepest commitments in intellectual property and second deepest commitments in services, public procurement, competition policy and investment, while it ranks third with regard to depth of commitments in standards. Overall, the FTA with Colombia ranks second with regard to overall depth of the agreement. The most recent FTA with Georgia (2016) on the other hand, ranks highest with regard to depth of commitments in services, intellectual property, and standards, second in public procurement and third in investment and competition policy. Overall, the FTA with Georgia ranks third with regard to overall depth of the agreement.

Figure 5.1 Depth of Swiss FTAs and EFTA FTAs



Source: DESTA, own calculations

However, since the outcome of trade negotiations depends considerably on the respective target of each individual negotiation and on the composition of trade interests between the individual partner countries, the achieved depth of commitments in key chapters in existing FTAs alone provides inconclusive data regarding the benefits of the negotiating forum for Switzerland. Moreover, EFTA partners Iceland and Norway have already unilaterally liberalised tariffs on industrial goods and therefore for these countries, the unilateral tariff dismantling effect is already reflected in the EFTA negotiating offer – something FTA negotiating partners know. In other words, we do not have evidence that suggests negotiating e.g. with China within the EFTA framework would have been more beneficial for Switzerland regarding depth of commitments in key chapters.⁶⁴ To establish whether Switzerland benefits from a so-called ‘EFTA premium’ in key chapters, the respective negotiating mandates would need to be compared with the final outcome of the negotiations.⁶⁵

Given that we currently do not find evidence confirming a distinct impact on the concessions of Switzerland undertaken when negotiating within EFTA as compared to negotiating bilaterally, we conclude that it is unlikely that the ‘EFTA premium’ plays an important role as alternative bargaining chip for Switzerland within the context of unilateral tariff dismantling: with regard to balancing the potential loss of the bargaining chip ‘duty-free access’ for industrial products to the Swiss market, cross-concessions within the group of EFTA members are unlikely.

⁶⁴ Apart from the political dimension that we do not cover here since it is not part of the study.

⁶⁵ Furthermore, it should not be forgotten that in comparison with the existing FTAs of the EU or of the US, and especially with regard to the most recent mega-regional agreements such as TPP or CETA, FTAs of EFTA members and of Switzerland on its own are considerably less comprehensive and substantial with regard to issues covered and the overall depth of commitments. See also Sieber-Gasser, Charlotte, 2015, Democratic Legitimation of Trade Policy Tomorrow: TTIP, Democracy and Market in the Swiss Constitution, Jusletter, 9. November 2015.

5.3.2 Interview findings from SECO and EFTA members Norway and Iceland

Via the interviews we aim to obtain additional information whether the use of the EFTA platform could be used as an alternative bargaining chip for Switzerland after unilateral tariff dismantling of industrial goods. The following two elements will be explained in more detail below:

- Cross-concessions across EFTA members;
- EU geographical and economic proximity.

Cross-concessions across EFTA members

One argument why EFTA could be attractive as bargaining chip could be related to the fact that prospective FTA partners may have a specific offensive interest vis-à-vis one EFTA member that another EFTA member could capitalise on. We obtained neither from Norway nor Iceland evidence suggesting that cross-concessions between individual EFTA members were taking place. This can most likely be attributed to the fact that while EFTA members negotiate their FTAs jointly, specific commitments in – for example – agriculture, services and investment are negotiated bilaterally. In fact, EFTA may currently benefit from the fact that Switzerland has not yet unilaterally liberalised all tariffs on industrial goods. While Norway and Iceland can no longer offer more preferential access for industrial goods in EFTA trade negotiations, Switzerland still can. As pointed out before, because Swiss tariffs on industrial goods are already very low (with the exceptions of some peak tariffs), while the potential cost savings for foreign exporters from unilateral tariff liberalization of Swiss tariffs on industrial goods may be limited, they may nevertheless have a (limited but positive) impact on the overall attractiveness of EFTA as a partner for a prospective FTA. This aspect is also reflected in the interviews with representatives of SECO in Step 1 of this study. Thus, while both Norway and Iceland could successfully negotiate FTAs even after unilateral tariff elimination on industrial goods, this may, to a limited extent, have been due to the attractiveness of the EFTA as a trading partner (including the opportunity of achieving tariff-free access for industrial goods to the Swiss market).

Economic and geographical proximity to the EU

The interviews also pointed out clearly that for FTA partners, EFTA could present a premium because EFTA and the EU are close geographically and closely integrated economically (agreements with EFTA and the EU would cover – in essence – the entire European market). So, EFTA negotiations could provide learning lessons in negotiating with the EU (or vice versa) and negotiating with EFTA as a block instead of with the individual members (Iceland, Liechtenstein, Switzerland and Norway), would be much more time consuming and expensive. Though we hold these arguments to be true, only if the block-approach via EFTA helps Switzerland to maintain leverage, even after unilaterally dismantling tariffs on industrial products, EFTA would have a direct extra value for Switzerland. The interview results with

Norway and Iceland clearly show that they fear the opposite could be the case (see previous point).

5.3.3 The future of the EFTA Premium

We cannot discern evidence suggesting that one or the other forum for trade negotiations is more beneficial for Switzerland. However, experiences of Norway (Annex C) and Iceland (Annex D) suggest that there is a small potential risk for EFTA to lose negotiating power in the process of Switzerland joining the other EFTA members in unilaterally eliminating tariffs on industrial goods. The interview results indicate that this may contribute to shifting the focus of potential future tariff negotiations under the EFTA umbrella to other sectors where tariffs are still present (e.g. food and agriculture). An effect may also be that converging on a common position among EFTA members will become more time-consuming (see interviews with SECO representatives in Step 1 of this study).

On the other hand, the focus of concessions in EFTA trade negotiations has already been shifting towards concessions in agriculture, services, IPR and investment, independent from a future scenario of unilateral tariff elimination on industrial goods by Switzerland.⁶⁶ This shift – though EFTA partners do not always fully eliminate industrial tariffs – has recently increased challenges faced by EFTA members during trade negotiations and is unlikely to cease in the near future, because countries continue to deepen their commitments in trade agreements in the abovementioned areas.⁶⁷ Keeping Swiss tariffs by not unilaterally eliminating industrial tariffs will, thus, not spare EFTA members (and Switzerland) from increased pressure to deepen concessions in non-industrial goods areas like agriculture, services, IPR and investment.

5.4 Alternative bargaining chip 4: the Concession Portfolio

A final option consists of modifying the concession portfolio for future FTA negotiations. As 21st century FTAs are multi-dimensional in their issue area coverage, Switzerland may offer preferential treatment on agenda items unrelated to industrial tariffs. To identify potential bargaining chips, the universe of more recent agreements can be screened for innovative approaches to concession making. Recent FTAs (like the recent EU-Japan and EU-China ones for Switzerland and EFTA ones with Georgia and Central-America) *inter alia* contain provisions on subsidies for renewable energy, individual tariffs for non-sensitive agricultural products

⁶⁶ See e.g. Gmür, Heidi, 2017, Aktive Schweizer Handelspolitik, NZZ, 18 January 2017 [Online], Available: <https://www.nzz.ch/wirtschaft/freihandel-aktive-schweizer-handelspolitik-ld.140635>.

⁶⁷ There are no indicators - with the exception maybe of trade policy under the current US government - that other (competing) industrialised economies will radically change their offensive trade policy. As an example, the EU is currently negotiating or about to ratify substantial trade agreements among others with Japan, Singapore, Malaysia, Vietnam, Mercosur, and Mexico. See EU Commission, 2017, Overview of FTA and other trade negotiations, last updated May 2017 [Online], Available: http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf

and emission-free transport. Based on the screening, a list of possible agenda items can be created and differentiated in relevance according to the different types of trading partners as identified under Step 1. Furthermore, a distinction can be made between two dimensions of concession making:

- Increase in the breadth of the portfolio of trade concessions possibly offered by Switzerland.
- Increase in the depth of trade concessions possibly offered by Switzerland.

As mentioned above, the need for alternative bargaining chips – in general – may not be pressing for Switzerland because tariffs on industrial goods are already very low. However, for some sectors and peak tariffs they are potentially important. We also pointed out that the overall attractiveness of a country may normally not suffer substantially from unilateral tariff elimination for industrial goods from the perspective of third countries (see Annex F). In addition, several large economies worldwide already engage in (partial) unilateral tariff elimination on industrial goods. Switzerland may therefore be able to count on the comprehension of third countries and would be in good company (Annex F), or even – as some research suggests – benefit from a positive ‘image’ of ambitious free trading country in a time of protectionist tendencies. Nevertheless, findings from our interviews do suggest that Switzerland may experience an increase in pressure to make concessions in sectors already under pressure today, namely in agriculture, investment and services (Annexes C-F).

A first important point to make is that for regional trade arrangements to fall within the remit of the WTO, they must adhere to Art. XXIV GATT or Art. V GATS. For goods, this implies that ‘substantially all trade’ needs to be liberalised and sector-specific arrangements only do not qualify. In line with the WTO framework, we have seen an increasing number of ever deeper trade agreements being signed or being under negotiation. In the next section, we first look at the concession portfolio from a ‘width’ perspective: i.e. cross-concessions across different sectors. The more sectors involved, the ‘broader’ the FTA. Then we look at the concession portfolio from a ‘depth’ perspective: i.e. deeper concessions versus shallower concessions. Tariffs constitute shallow concessions, while a wide range of NTMs constitute the deeper elements: TBT and SPS measures as well as public procurement, services barriers, regulatory cooperation (non-tariff measures), investment and competition policy.

5.4.1 Alternative Bargaining Chips: increasing the breadth of the Swiss offer

This study aims to shed light on possible effects of unilateral tariff dismantling for industrial products in case Switzerland would decide to pursue such a policy because unilateral tariff liberalization has not yet happened, it is not surprising that based on the interviews Switzerland has not experienced an increase in cross-concessions across sectors in its current FTA negotiations. While an increase in cross-concessions across sectors has obviously not been the experience of Switzerland in trade negotiations, experiences from Norway and

Iceland suggest that cross-concessions across sectors (e.g. services, investment, agriculture) are more likely to be requested after unilateral tariff liberalization than before.⁶⁸

We found there to be little ‘water’ in the bindings for Switzerland in industrial products before unilateral tariff dismantling (see section 5.1). However, these bindings increase significantly after unilateral tariff dismantling for those products where tariffs remained, especially for peak tariffs. Tying market access commitments in services to the binding of applied tariffs in agriculture have been used by Norway as alternative concessions in trade negotiations. Switzerland could increase its efforts in this regard as is also suggested by the OECD.⁶⁹ Furthermore, concessions in investment have been used by Norway to compensate for the loss of the bargaining chip ‘zero-duty access’ for industrial products. This may constitute another avenue for Switzerland to pursue in the future.

The interviews with Norway and Iceland point to the fact that demands for cross-concessions in agriculture have increased following unilateral tariff dismantling in industrial goods – as elements to gain from an FTA with these two countries. This was especially the case for FTA partners with offensive agricultural interests. It implies that after unilateral tariff dismantling for industrial products the Swiss concession portfolio could – to a larger extent than is currently the case – include agriculture as well. The degree to which this could be the case differs per possible negotiating partner.

Employing the breadth of the concession portfolio is also the answer to concerns raised in the interviews that prospective partners would be less willing to offer ambitious commitments on offensive Swiss issues, should Switzerland not be able any more to offer concessions on industrial tariffs (e.g. in IPR, public procurement, and services). The argument was that based on the phenomenon of protection-for-exporters, exporting industries would urge their governments to engage in trade negotiations to stay competitive vis-à-vis other countries’ industries.⁷⁰ Unilateral tariff dismantling might take away that advantage, unless market access gains for other sectors in the economy (e.g. service sectors) may be mobilised for this purpose instead. These sectors would then lobby their respective governments to conclude FTAs.

⁶⁸ Though rules of origin may provide some opportunities for alternative bargaining (see Section 5.2), the empirical evidence from Norway and Iceland suggest they are not often used.

⁶⁹ With regard to the binding of applied tariffs in agriculture see e.g. OECD (2006) *Agricultural Policy and Trade Reform: potential effects at global, national and household levels*, OECD Publishing, Paris; for implications of reducing water in services market access see e.g. Ciuriak, Dan and Lysenko, Dmitry (2016) *Quantifying Services-Trade Liberalisation: The Impact of Binding Commitments*, C.D. Howe Institute Technical Paper for: *Better in than Out? Canada and the Trans-Pacific Partnership*, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2730265 (accessed 12 July 2017).

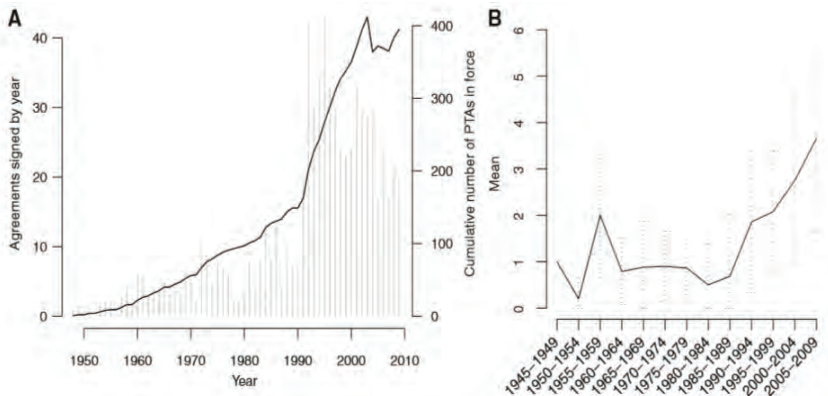
⁷⁰ Dur, Andreas (2010) *Protection for Exporters: Power and Discrimination in Transatlantic Trade Relations, 1930-2010*. Cornell University Press.

5.4.2 Alternative Bargaining Chips: deepening the Swiss offer

Even though cross-concessions seem to be asked for more frequently than looking at NTMs (as per our interviews), the trend in trade negotiations is to focus more and more on the latter. We recall that NTMs are regulatory differences regarding non-trade issues like TBT, SPS, regulatory systems for manufacturing, IPR, investment, and competition policy. Indeed – as evidenced by our DESTA database – trade agreements are getting increasingly deeper over time as shown in Figure 5.2. In the left panel (A) of Figure 5.2 we see that the number of regional FTAs has increased steadily from the 1950s to 1990 after which the number increased at a much faster rate only to level off after 2001. Regarding the depth of FTAs (panel B of Figure 5.2), we see a constant depth level (around 1) until 1990 and afterwards a steady increase in depth, up to an average depth of 3.5 on a 0 – 7 scale. The latter implies that FTAs have started to include deeper elements like competition policy, public procurement, and elements of regulatory cooperation to reduce NTMs.

As a result, looking at reducing NTMs on goods by aligning regulatory systems and requirements (at different levels, like conformity assessment procedures and results) is increasingly becoming a relevant alternative avenue of focus in trade agreements. With NTMs being relative more important trade barriers these days than are remaining tariff levels (except for agriculture), there is a lot of scope to look at a wide range of industrial products where NTMs are still high, even if tariffs are very low or even zero.

Figure 5.2 The number (A) and depth (B) of trade agreements (over time)



Source: Dür et al. (2014)

The focus on NTMs matters from an alternative bargaining chip point of view for two reasons. First, NTMs (i.e. regulatory divergence) can still be high for many products even if tariffs are zero. This would imply that for real market access the main issue to enter the Swiss market for an FTA partner would be to reduce regulatory divergence between the domestic FTA

partner and Swiss regulatory systems. For example: tariffs in chemicals are very low (except for a few peak tariffs). Chemical products from an FTA partner may still not be allowed to enter Switzerland, not because of tariffs but because the way the FTA partner produces chemicals does not comply with Swiss regulations. In that case, including in the FTA elements designed to reduce regulatory divergence (i.e. NTMs) could be a powerful bargaining chip. Indeed, research shows that between the EU and US markets NTMs could be as high as an equivalent of a 73 percent tariff (Berden et al., 2010; Berden and Francois, 2009). This would allow for cross-concessions: NTMs reductions in one product/sector for tariff reductions or other interests in exchange. Second, when unilateral tariff dismantling leads to reductions in tariffs for textiles (for example), NTMs in textiles (e.g. the way textile fabrics are coloured) could still prevent any de facto exports from a partner to Switzerland. Hence NTMs matter, even for the exact product to which unilateral tariff dismantling has been applied and mattered. As such reducing NTMs may help compensating the loss of the bargaining chip 'zero-duty access', since increased market access on a preferential basis may come from reducing regulatory divergence on top of zero-tariffs for a sector. Given that NTMs are generally regarded to be much more trade-distorting than current (nuisance) tariff levels for most industrial products⁷¹, this avenue could therefore provide ways to compensate for the loss of the bargaining chip of zero-tariff access to the Swiss market for industrial goods.

⁷¹ OECD (2005) Looking Beyond Tariffs: the role of non-tariff barriers in world trade, OECD Trade Policy Studies, Paris; Berden et al (2010); Berden and Francois (2009).

6. Step 4: Preferential trade agreement prospects

In this chapter, we will synthesise the different findings from the analysis carried out above. For this purpose, we will review the four main questions put forward in the Terms of Reference, and stated in Chapter 1:

- **Question 1:** What is the likely effect on Switzerland's negotiating position for subsequent free trade agreements? Are there alternative 'bargaining chips' that are just as attractive or might be made so?
- **Question 2:** To what extent could autonomous tariff dismantling for industrial goods increase the pressure on agricultural products and foods in negotiations?
- **Question 3:** How great is the potential of future free trade agreements, particularly regarding tariffs?
- **Question 4:** How can the interests of future trade agreements be balanced against autonomous tariff dismantling?

The discussion of these four questions will subsequently inform our final policy recommendations.

6.1 Main findings

Overall, our analysis indicates that the majority of Swiss exports and imports are already covered by trade agreements. Only 20 percent of exports and 11 percent of imports is not yet covered. It is this trade-subsection that prospective FTAs (especially a possible one with the US) are important for. It is for these prospective FTAs – and the Swiss negotiating power therein – that we need to look at what the effect of unilateral tariff dismantling would entail. We find that unilateral tariff dismantling on industrial goods would not exert a major negative effect on Switzerland's position with respect to future FTA negotiations. This is mainly because Swiss tariffs on industrial products are already relatively low. In addition, from a bargaining perspective, the interviews conducted for this study indicate that cross-concessions involving industrial tariffs only occur infrequently in FTA negotiations. In other words, they seem to occur less in practice than negotiation theory would predict. This implies that unilateral tariff dismantling on industrial goods would generally not affect Switzerland's pursuit of offensive interests in trade and trade-related issue areas in significant ways, nor that there is a significant increase in pressure for commitments regarding agricultural products. Some potentially negative effects for Switzerland's bargaining leverage must also be contrasted with the projected welfare-stimulating macroeconomic effects of unilateral tariff dismantling.

However, this general result should be qualified in two ways:

- First, the effects can vary considerably across prospective FTA partners. In this context, some negative effects can be expected with partner states which are heavily reliant on

exports of textiles and clothing to the Swiss market, and which have proven reluctant to liberalise in issue areas where Switzerland cultivates offensive interests.

- Second, in the scenarios with a relative loss in bargaining leverage, Switzerland will have to contemplate taking offsetting measures. Among these measures, two stand out as most relative alternative bargaining chips: a modified concession portfolio (involving commitments regarding non-tariff measures, services and investment), and using the ‘water’ in the bindings (i.e. room between applied and bound tariff rates).

Below, we will detail each of these points.

6.2 Variation across FTA partners

While the negative ramifications of unilateral tariff dismantling are on average not applicable to a high share of Swiss trade and not substantial, variation can be expected as a function of the characteristics of the prospective FTA partner. As the interviews with Norwegian and Icelandic trade officials revealed, the interest constellations within certain FTA dyads may lead to a lower appeal of the reference country as a potential FTA partner before engaging in negotiations. This could be less so once negotiations have started (especially since Switzerland/EFTA always put full tariff liberalisation for industrial products on the negotiating table at an early stage). Also, from the interviews we concluded that certain FTA partners (e.g. Vietnam) apply metrics of strict reciprocity in trade negotiations, which would force Switzerland to widen the scope of its concession portfolio or to make deeper commitments in existing issue areas.

In light of these points, in this study we have identified three relevant determinants of Swiss bargaining leverage: the intensity of the partner state’s export interests in textiles/clothing (loss of negotiating mass) and agriculture (becoming increasingly under pressure due to loss of negotiating mass if cross-concessions are relevant), as well as the partner’s track record of concession making in issue areas where Switzerland cultivates offensive interests, notably government procurement, intellectual property rights, and services.

According to the SECO representatives, Switzerland seeks to establish preferential ties with a diverse set of partners, which can be differentiated according to the status of the FTA project (negotiations launched, joint declaration on cooperation, other partner states). The corresponding countries and trading blocs are listed in Table 3.1. As detailed in the second analytical step, tariff liberalisation could prove particularly difficult for the Swiss government in negotiation settings where partners exhibit a combination of the following three characteristics:

- **Export dependence on textiles and clothing:** Even though Switzerland generally exhibits low tariffs for industrial goods, there are exceptions in a few sectors, notably textiles and clothing. Provided that partner states apply a strictly reciprocal metric in FTA negotiations, unilateral tariff dismantling on industrial goods would deprive the Swiss government of market access bargaining chips in these cases. As indicated in the third column in Table 6.1, among the prospective FTA partners, Iran, Pakistan and Moldova are heavily dependent on exports of textiles and clothing. India exhibits medium levels of export dependence (less because textiles do not feature in the top-5 of most important export sectors to Switzerland), and so do Indonesia and Vietnam. Myanmar and Mongolia exhibit low levels of export dependence.
- **Reluctance to liberalise issue areas with offensive Swiss interests:** Switzerland promotes preferential trade liberalisation in issue areas ranging well beyond the confines of market access for goods to cover *inter alia* government procurement, intellectual property rights, investment, and services. Even though cross-concessions do not occur frequently, several interviewees indicated that partner states' propensity to address these relatively new agenda items may be lower after unilateral tariff dismantling. This scenario is particularly plausible in instances where partner states have in the past proven reluctant to liberalise their markets in the different issue areas with offensive Swiss interests. Based on the DESTA data leveraged for this study, column four in Table 6.1 indicates the average degree of difference in ambition found in the existing FTAs of the prospective agreement partners. The Table shows that among the prospective FTA partners, only very few countries exhibit offensive interests comparable to Switzerland. The larger the difference, the larger the potential adverse effect.
- **Offensive interests in agriculture:** Switzerland can also expect a more adverse bargaining setting in negotiations where partner states exhibit offensive interests in Swiss defensive interest categories. If concessions on industrial goods are no longer possible due to unilateral tariff dismantling, partner states may in turn more strongly demand commitments in sensitive issue areas. In the case of Switzerland, agriculture stands out as the sector with the most import-competing interests. Based on the data presented for the first analytical step (cf. product categories in Annex A), the fifth column in Table 6.1 indicates the reliance of the prospective Swiss FTA partners on agricultural exports. In this context, most partner states exhibit offensive interests in agriculture, including Latin American, Southeast Asian and African countries, and - to a lower overall degree - the US. The higher the offensive interest in agriculture of the partner, the more detrimental unilateral tariff dismantling in industrial goods could be.

These three determinants of bargaining leverage interact to exert differential effects on negotiations. The effects of unilateral tariff dismantling in industrial goods could possibly prove challenging for Switzerland in negotiations with countries heavily relying on exports of textiles and clothing (e.g. Iran, Pakistan and Moldova), with different partner states that have

limited to no ambition in areas where Switzerland has offensive interests (e.g. Ecuador, Algeria, Sri Lanka) or that have offensive agricultural interests that are in opposition to Switzerland's defensive interests (e.g. MERCOSUR, India, EACU, Indonesia, Malaysia, Vietnam, Mongolia, Myanmar, and Sri Lanka). Minor to no adverse effects from unilateral tariff dismantling are projected for the potential negotiations with the United States, the United Kingdom, Mauritius, Thailand, and Malaysia.^{72,73}

Table 6.1 presents the overall adverse effect – as a combination of the three determinants mentioned above – that we see for the different possible trade partners with respect to unilateral tariff dismantling in industrial goods for Switzerland. We recall that total Swiss trade covered by these partners mentioned in Table 6.1 is 20 percent of Swiss exports and 11 percent of Swiss imports (since the rest of trade is already covered by existing FTAs – this is further illustrated in Figure 6.1). It is not possible to create this Table based on pure quantitative information, so it must be read as an estimate of the overall level of adverse effect we expect unilateral tariff dismantling to have for each of the partners for Switzerland in prospective FTA negotiations. This information is based on Annex A, interview results, our own analysis of statistical tariff data, and DESTA. For transparency reasons on how the different factors have been aggregated, please see the note under Table 6.1. The colour code in Table 6.1 matches the colours used in Chapter 3 for the three different categories of prospective FTA partners: countries with which negotiations launched in blue, joint declaration on cooperation countries in yellow, and other partners in green.

Table 6.1 Assessment of prospective FTA partners

Prospective Partner	Timeline for Negotiations	Export Reliance on Textiles & Clothing	Misalignment with Swiss Offensive Interests	Export Reliance on Agricultural Products	Overall Adverse Effect
Algeria	Negotiations launched	Low	High	High	Medium
Ecuador	Negotiations launched	Low	High	High	Medium
EACU	Negotiations launched	Low	High	Medium	Medium

⁷² In this context, a caveat is in order: For on-going FTA negotiations, it may be that unilateral tariff dismantlement is implemented after the conclusion of the corresponding bargaining processes, thereby exerting no effect on the Swiss position. To keep the empirical focus as broad as possible, in this study we have assumed a conservative position by accounting for the possibility that unilateral tariff liberalisation is enacted before the conclusion of the negotiations. In the policy recommendations, we will again address this assumption.

⁷³ A qualification is in order with respect to the United States: The country has a highly diversified economy and does not mainly rely on agricultural exports. However, the United States government has in the past sought to obtain liberalisation provisions on agriculture through FTAs. In this study, and based on the two other determinants of bargaining leverage, we argue that these pronounced offensive interests would still be present but not become more prominent after unilateral tariff dismantlement is enacted.

Prospective Partner	Timeline for Negotiations	Export Reliance on Textiles & Clothing	Misalignment with Swiss Offensive Interests	Export Reliance on Agricultural Products	Overall Adverse Effect
India*	Negotiations launched	Medium	High	Medium	Medium
Indonesia	Negotiations launched	Medium	Medium	Medium	Medium
Malaysia	Negotiations launched	Low	Medium	High	Medium
Thailand	Negotiations launched	Low	Medium	Low	Low
Vietnam	Negotiations launched	Medium	Medium	Medium	Medium
Mauritius	Cooperation agreement	Low	Medium	Low	Low
MERCOSUR	Cooperation agreement	Low	High	High	Medium
Mongolia	Cooperation agreement	Medium	Low	High	Medium
Myanmar	Cooperation agreement	Low	Medium	High	Medium
Pakistan	Cooperation agreement	High	High	Low	Medium
EAC	Other partner	Low	High	High	Medium
ECOWAS	Other partner	Low	High	High	Medium
Iran	Other partner	High	High	High	High
Moldova	Other partner	High	Medium	High	High
Sri Lanka	Other partner	Low	High	Low	Medium
UK	Other partner	Low	Low	Low	Low
USA	Other partner	Low	Low	Low	Low

Note: The way the three factors have been aggregated is as follows: 3x low = a low overall adverse effect; 2x low + 1x medium = a low overall adverse effect; 2x low + 1x high = a medium overall adverse effect; 3x medium = a medium adverse effect; 1x low + 1x medium + 1x high = a medium overall adverse effect; 2x medium + 1x high = a medium adverse effect; 1x low + 2x high = a medium overall adverse effect; 1x medium + 2x high = a high overall adverse effect; 3x high = a high overall adverse effect.

As mentioned in Chapter 2, a large part of Swiss trade is already covered by existing FTAs. 20 percent of Swiss exports and 11 percent of Swiss imports, however, are not (see Figure 2.1a and Figure 2.1b). Figure 6.1 only shows the shares of trade that are not yet covered by existing FTAs and categorises these trade flows according to the information on the classification of prospective FTA partners into the low-, medium-, and high-adverse effect categories following unilateral tariff dismantling of Switzerland (Table 6.1). In doing this Figure 6.1 shows how

relevant (from an overall total trade perspective)⁷⁴ these different categories are for Switzerland.

We can conclude that 84 percent of trade flows for which FTAs still need to be concluded are in the category where unilateral tariff dismantling is expected to have a ‘low-adverse effect’ (this is the US) as depicted in light orange.⁷⁵ 21 percent of trade flows are categorised as ‘medium-adverse effect’ of unilateral tariff dismantling (darker orange). The share of trade that is categorised as where unilateral tariff dismantling can have a potentially ‘high-adverse effect’ on the Swiss bargaining position is lower than 1 percent (constituting Iran and Moldova).

Figure 6.1 Share of trade with prospective Swiss FTA partners by overall adverse effect of unilateral tariff dismantling



Source: own calculations based on EZV (2016)

6.3 Alternative bargaining chips

Concerning future FTA negotiations, Switzerland should contemplate measures for potentially offsetting its potential decrease in bargaining leverage, especially for negotiations with

⁷⁴ Total trade means we have added up all exports and imports and look at total trade, combining Figures 2.1a and 2.1b into one new Figure with the three categories.

⁷⁵ Please note that we have not categorised the UK as ‘non-FTA partner in the statistics because the UK is at this moment still a member of the EU and as such covered vis-à-vis Switzerland via the EU-Swiss bilateral agreements. If in the future the UK leaves the EU it will fall (temporarily) under ‘non-FTA partners’ – which is why we did classify the UK. It would also be a ‘low adverse risk’ category member.

prospective FTA partners where unilateral tariff dismantling is expected to have medium- or high-level adverse effects on the Swiss bargaining position (see section 6.2). In this regard, we have examined four potential strategy adjustments: a stronger emphasis on tariff bindings in negotiations, strategic use of rules of origin, a heavier reliance on EFTA as a bargaining group, and a modified concession portfolio.

6.3.1 Alternative Bargaining Chips: Rules of Origin and EFTA

Out of the four options we investigated, rules of origin, and the EFTA premium prove not viable for the Swiss government. The rules of origin bargaining chip does not appear potent, because unilateral tariff dismantling would significantly reduce the importance of rules of origin (though not entirely eliminate them), and Switzerland seems to be the trade partner pushing already for the more liberal rules of origin regimes in negotiations.

Regarding the merits of negotiating under the umbrella of EFTA, there is no question that EFTA is valuable for Switzerland and that negotiating on an EFTA platform creates benefits also for Switzerland. However, our question is whether the EFTA platform could serve as a bargaining chip in the specific case of unilateral tariff dismantling. And for that, our quantitative analysis of the design of existing Swiss FTAs does give any evidence, neither does our qualitative analysis. Norway and Iceland have already unilaterally dismantled tariffs on industrial goods and are concerned that if Switzerland does the same also EFTA's negotiating power could be affected. We also did not find evidence of cross-EFTA partner concessions. Some arguments are raised in EFTA's favour (e.g. EFTA covers four countries with who separate agreements would take more time and be costlier, Europe is covered by EFTA+EU, and political sensitivities may be avoided by smart choice of either Switzerland or EFTA) but all these benefits of EFTA already apply today and are not affected by unilateral tariff dismantling.

6.3.2 Alternative Bargaining Chips: tariff bindings and concession portfolio

While rules of origin, and a heavier reliance on EFTA are no viable alternative bargaining chips, the country might benefit from more focus on tariff bindings and from broadening its concession portfolio along different axes.

Tariff bindings

Concerning tariff flexibility, Switzerland exhibits only very little water in between its bound and applied tariff rates at this moment and tariffs on industrial products are already very low in Switzerland. After unilateral tariff dismantling, and if Switzerland will not also reduce its bound tariff rates at the same time, the 'water' in between bound and applied tariff rates increases. This water will be largest for those sectors and peak tariff products where applied tariffs were highest (and are now dismantled), making the measure more attractive post-unilateral tariff dismantling, especially for those prospective partners that faced broader sectoral (e.g. textiles) and/or niche peak tariffs. This makes the alternative bargaining chip

‘tariff bindings’ a viable one to use, as is also suggested by the experiences of Norway post-unilateral tariff dismantling.

Concession portfolio

Non-tariff issues (i.e. the deeper trade issues like behind-the-border regulations) have received more and more attention recently, which trade agreements also covering elements of TBT, SPS, public procurement, investment, services barriers, and competition policy. This is in part a response to changes in how we trade today in a globalised world (i.e. through value chains), but also because tariffs have been successfully reduced over the past 40 years. According to several interviewees, the loss in bargaining power for Switzerland from unilateral tariff dismantling could be compensated by commitments regarding broadening the concession portfolio to include other sectors where tariffs or market access issues still exist (e.g. agriculture and services) or by including non-tariff measures in different or the same sectors, as well as selected concessions on investment, IPR, TBT, SPS, services and standards, and other deeper issues. The main findings from this assessment are summarised in Table 6.2.

Table 6.2 Assessment of offsetting measures

Offsetting Measure	Main Rationale	Assessment (Case of Switzerland)	Viability
Emphasis on tariff bindings	<ul style="list-style-type: none"> Applied tariffs at 0% with existing WTO bindings, means an FTA could still provide exporters from Swiss partner states with enhanced legal certainty and thereby a preferential margin. This mechanism becomes stronger after UTD and can be used in negotiations. 	<ul style="list-style-type: none"> Empirical analysis: Switzerland exhibits very little water before UTD but this increases after UTD. Interview findings: Concerns over tariff flexibility are not of paramount importance in negotiations with an industrialised country, but could be with other countries. 	High
Strategic use of Rules of Origin	<ul style="list-style-type: none"> Switzerland’s RoO are becoming decisively unimportant after UTD – so it cannot use this chip after UTD especially not if it is Switzerland pushing for the more liberal RoO regime. 	<ul style="list-style-type: none"> Empirical analysis: Swiss rules of origin are trade-restrictive at the moment for imports of pulp, paper, leather, textiles and footwear products, but post-tariff dismantling essentially irrelevant. Interview findings: Rules of origin are valued as concessions in FTA negotiations, especially by developing country partner states, but only if there are tariffs left and Switzerland is 	Low

Offsetting Measure	Main Rationale	Assessment (Case of Switzerland)	Viability
		usually the most liberal of the trading partners regarding rules of origin.	
Reliance on EFTA	<ul style="list-style-type: none"> A heavier reliance on EFTA could help Switzerland to balance out concessions across the membership of the four-country group and to benefit from a slightly bigger aggregate market size. 	<ul style="list-style-type: none"> Empirical analysis: The design of existing Swiss FTAs does not lend support for the EFTA premium hypothesis. Interview findings: Switzerland constitutes the biggest market among the EFTA members. Smaller partner states benefit from an EFTA premium. But Switzerland can use EFTA as a choice in difficult political situations. And EFTA gives Switzerland a bit more clout. 	Low
Modification of the concession portfolio	<ul style="list-style-type: none"> By offering concessions on alternative agenda items or focusing on those other agenda items, Switzerland could restore the initial bargaining equilibrium. 	<ul style="list-style-type: none"> Empirical analysis: Switzerland could offer greater concessions on non-tariff measures (in the goods sector) or focus more on the NTM side in FTA negotiations. Interview findings: Select commitments could be made on various NTMs (e.g. services, investment) 	High

Source: Own compilation based on interviews and Chapter findings

Overall, our analysis indicates that unilateral tariff dismantling on industrial goods could cause more attention to be directed towards tariffs or market access restrictions in other sectors (e.g. agriculture, services) as well as a greater focus on non-tariff measures as well as its existing commitments on investment and services. Even though the scope for cross-concessions is limited in FTA negotiations, our interviewees emphasised the validity of these measures as alternative bargaining chips.

Regarding the concession portfolio, an important practical qualification is warranted. From a political standpoint, addressing non-tariff measures may prove more challenging than tariff liberalisation, as more domestic regulatory authorities influence policy decisions in the former case. The political dynamic is challenging in both, but regulatory issues are much more domestic in nature and free trade agreements affecting these issues, that many people see as separate things, may prove challenging.

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Annex A Top Swiss product exports and imports

Abbreviations:

- CMD: Commodity
- CCODE: Commodity code (HS4)
- TRDVL: Trade value (USD)
- XSHR: Share in total export (per cent)
- AAT: Average applied tariff (per cent; destination market)
- BND: Bound Tariff

Unless otherwise noted, specific tariffs are per 100kg gross weight. When tariff lines contain an ad valorem tariff (AV), in addition to a specific tariff (S), they are marked so. Bound rates are reported as ranges between the smallest and highest amount levied.

Swiss Exports, min current USD 2016								Swiss Imports, min current USD 2015					
India	CMD	Gold	Silver	Medicaments	Other aircraft	Unspecified	All Commodities	Diamonds	Ketones and quinones	Oxygen-function amino-compounds.	Heterocyclic compounds	Coffee	All Commodities
	CCODE	7108	7106	3004	8802	9999	TOTAL	7102	2914	2922	2933	901	TOTAL
	TRDVL	19390.3	299.8	154.5	140.2	137.7	21579.9	123.1	79.0	76.6	57.8	51.7	1530.1
	XSHR	89.9	1.4	0.7	0.6	0.6	93.2	8.0	5.2	5.0	3.8	3.4	25.4
	AAT	10.0	10.0	10.0	na	na	10.0	0	0	0	0	0	0
	BND							CHF 80-800	AV - 0, S - CHF 1.5	AV - 0, S - CHF 1.2-12	0, S - CHF 1.3-40	AV - 0, 25-70	
Indonesia	CMD	Turbo-jets, etc.	Human blood etc.	Medicaments	Unspecified	Mixtures of odoriferous substances	All Commodities	Waste and scrap of precious metal	Gold	Articles of jewellery	Footwear	Footwear, uppers of textile	All Commodities
	CCODE	8411	3002	3004	9999	3302	TOTAL	7112	7108	7113	6403	6404	TOTAL

	TRDVL	70.2	57.0	38.5	30.0	25.9	580.2	590.7	407.2	42.1	28.6	22.8	1'371.1
	XSHR	12.1	9.8	6.6	5.2	4.5	38	43.1	29.7	3.1	2.1	1.7	80
	AAT	5.0	1.5	4.7	na	55.7	16.7	0	0	0	0	0	0.0
	BND							CHF 8	AV - 0, S - CHF 320	CHF 238-3999	CHF 214	108-CHF 148	100-
Malaysia	CMD	Gold	Medicaments	Turbo-jets etc.	Wrist-watches etc.	Human blood etc.	All Commodities	Gold	Telephone sets, etc.	Vacuum cleaners.	Electronic integrated circuits.	Apparel of vulcanised rubber	All Commodities
	CCODE	7108	3004	8411	9102	3002	TOTAL	7108	8517	8508	8542	4015	TOTAL
	TRDVL	944.4	127.3	109.9	78.9	56.4	1754.5	110.2	92.6	39.3	37.6	29.3	671.5
	XSHR	53.8	7.3	6.3	4.5	3.2	75	16.4	13.8	5.8	5.6	4.4	46
	AAT	0	0	0	0	0	0.0	0	0	0	0	0	0.0
	BND							AV - 0, S - CHF 320	0	unreported	0	CHF 16-	120
Vietnam	CMD	Medicaments	Human blood etc.	Unspecified	Turbo-jets etc.	Microphones etc.	All Commodities	Telephone sets etc.	Footwear uppers of leather	Footwear uppers of textile materials.	Automatic data processing machines	Crustaceans	All Commodities
	CCODE	3004	3002	9999	8411	8518	TOTAL	8517	6403	6404	8471	306	TOTAL
	TRDVL	153.9	50.0	34.6	29.8	18.8	519.0	255.8	73.9	69.8	53.5	40.5	1'022.2
	XSHR	29.7	2.8	2.0	1.7	1.1	37	25.0	7.2	6.8	5.2	4.0	48
	AAT	2.3	0		0	4.5	1.7	0	0	0	0	0	0.0
	BND							0	CHF 108-214	CHF 100-148	0	0	
Thailand	CMD	Gold	Medicaments	Wrist-watches etc.	Silver	Human blood, etc.	All Commodities	Gold	Other clock watch parts	Precious stones etc.	Watch straps etc.	Automatic data	All Commodities

												processing machines	
	CCODE	7108.0	3004	9102	7106	3002	TOTAL	7108	9114	7103	9113	8471	TOTAL
	TRDVL	1532.9	165.4	156.2	137.2	80.2	2840.6	1'561.7	121.4	50.3	46.1	38.5	2'602.3
	XSHR	54.0	5.8	5.5	4.8	2.8	73	60.0	4.7	1.9	1.8	1.5	70
	AAT	0	8	5	0	0.7	2.7	0	0	0	0	0	0.0
	BND							AV - 0, S - CHF 320	CHF 53-419	CHF 80-800	CHF 133-3863	0	
Customs Union Russia-Belarus-Kazakhstan	CMD	Medicaments	Human blood etc.	Wrist-watches etc.	Articles of jewellery	Wrist-watches, etc.	All Commodities	Gold etc.	Petroleum oils etc.	Colloidal precious metals etc.	Platinum etc.	Articles of jewellery etc.	All Commodities
	CCODE	3004	3002	9102	7113	9101	TOTAL	7108	2709	2843	7110	7113	TOTAL
	TRDVL	705.0	288.0	146.0	85.5	81.3	2840.0	1'640.0	108.0	108.0	108.0	86.6	2'320.0
	XSHR	24.8	10.1	5.1	3.0	2.9	46	70.7	4.7	4.7	4.7	3.7	88
	AAT	3.5	3.2	11.0	12.8	10.3	8.2	0	0	0	CHF80-1599/100kg for Russia/Belarus; 0 for Armenia/Kazakhstan/ Kyrgyzstan	CHF238-3999/100kg for Belarus/ Russia; 0 for Armenia/ Kazakhstan / Kyrgyzstan	0.0
	BND							AV - 0, S - CHF 320	Unbound	AV - 0, S - CHF 15	CHF 1599	80- CHF 238-3999	
Ecuador	CMD	Medicaments	Oxygen-function amino-compounds.	Human blood etc.	Mixtures of odorous substances	Orthopaedic appliances etc.	All Commodities	Cocoa beans	Gold	Bananas	Cut flowers	Human blood, etc.	All Commodities

	CCO DE	3004	2922	3002	3302	9021	TOTAL	1801	7108	803	603	3002	TOTAL
	TRDV L	44.3	9.7	9.2	5.7	3.8	108.4	38.1	28.1	16.2	14.4	7.9	119.7
	XSH R	40.9	8.9	8.4	5.2	3.5	67	31.9	23.5	13.5	12.0	6.6	87
	AAT	5.6	0	0.6	5.3	4.9	3.3	0	0	14 fr/100kg	0	0	0.0
	BND							0	AV - 0, S - CHF 320	CHF 14	AV - 0, S - CHF 6 - 4225	0	
Algeria	CMD	Human blood etc.	Medicaments	Electrical apparatus, etc.	Turbo-jets etc.	Medicaments	All Commodities	Hydrogen etc.	Medicaments	Other machinery, lifting etc.	Dates etc.	Cane beet or sugar etc.	All Commodities
	CCO DE	3002	3004	8535	8411	3003	TOTAL	2804	3004	8428	804	1701	TOTAL
	TRDV L	128.4	59.8	29.0	27.3	11.4	378.3	2.1	0.5	0.2	0.1	0.1	3.6
	XSH R	34.0	15.8	7.7	7.2	3.0	68	57.0	13.1	5.8	3.7	3.4	83
	AAT	3.8	6.6	30.0	5.0	5.0	10.1	0	0	0	0	0	0.0
	BND							CHF 1.5-5	0	0	AV - 0, S - CHF 1-4	CHF 61-85	
Mauritius	CMD	Medicaments, etc.	Human blood	Wrist-watches, etc.	Nuclear reactors, etc.	Air or vacuum pumps, etc.	All Commodities	Diamonds	Articles of pearls	Jewellery of precious metal	Other clock watch parts.	Watch straps, etc.	All Commodities
	CCO DE	3004	3002	9102	8448	8414	TOTAL	7102	7116	7113	9114	9113	TOTAL
	TRDV L	6.5	2.4	2.3	1.5	1.1	28.1	26.2	14.3	8.9	5.2	4.3	72.7
	XSH R	23	9	8	6	4	49	36	20	12	7	6	81
	AAT	0	0	0	0	0	0	0	0	0	0	0	0

	BND												
MERCOSUR	CMD	Medicaments	Human blood etc.	Organic derivatives of hydrazine or hydroxylamine.	Heterocyclic compounds	Unspecified	All Commodities	Gold	Coffee	Unwrought aluminium.	Oil-cake and other solid residues (soybean oil)	Poultry	All Commodities
	CCODE	3004	3002	2928	2933	9999	TOTAL	7108	901	7601	2304	207	TOTAL
	TRDVL	725.0	644.0	299.0	112.0	100.0	3300.0	1930.0	198.0	102.0	92.3	65.8	2880.0
	XSHR	22.0	19.5	9.1	3.4	3.0	57	67.0	6.9	3.5	3.2	2.3	83
	AAT	9.7	3.7	4.9	3.8		5.5	0	CHF63-70/100 kg for 090121/22/90	0	0	CHF32-1966/100kg	0.0
	BND							AV - 0, S - CHF 320	AV - 0, 25-70	AV - 0, 25-70	AV - 0, S - CHF39	CHF 32-4500	
Pakistan	CMD	Medicaments	Unspecified	Human blood; animal blood	Wrist-watches etc.	Military weapons	All Commodities	Men's or boys' suits etc.	Bed linen etc.	Articles of apparel etc.	Undenatured ethyl alcohol etc.	Women's or girls' suits etc.	All Commodities
	CCODE	3004	9999	3002	9102	9301	TOTAL	6203	6302	4203	2207	6204	TOTAL
	TRDVL	110.4	20.2	16.1	14.8	13.3	325.8	21.0	15.7	10.1	7.7	6.7	110.3
	XSHR	33.9	6.2	4.9	4.5	4.1	54	19.0	14.3	9.2	6.9	6.1	56
	AAT	13.6		6.9	5	15	10.1	CHF 91-330/100kg CHF 182-661	CHF 62-221/100kg CHF 87-460	0	0	CHF 111-507/100kg CHF 222-1428	0.0
	BND									CHF 160-328	CHF 0.7-35		

Mongolia	CMD	Medicaments	Unspecified	Wrist-watches etc.	Parts of motor vehicles	Motor cars, etc.	All Commodities	Gold	Guts, bladders and stomachs of animals	Wrist-watches etc.	Jerseys etc.	Wrist-watches etc.	All Commodities
	CCODE	3004	9999	9102	8708	8703	TOTAL	7108	504	9101	6110	9102	TOTAL
	TRDVL	3.5	0.5	0.5	0.4	0.1	6.5	400.1	2.6	0.6	0.3	0.2	404.2
	XSHR	53.6	7.9	7.5	6.0	1.8	77	99.0	0.7	0.1	0.1	0.0	100
	AAT	5		5	5	na	5.0	0	0	0	CHF 60-282/100kg	0	0.0
	BND							AV - 0, S - CHF 320	CHF 1.1/piece	CHF 120-565	CHF 0.17-0.27/piece		
Myanmar	CMD	Human blood etc.	Medicaments	Wrist-watches etc.	Air or vacuum pumps, etc.	Electric transformers, etc.	All Commodities	Precious stones (other than diamonds)	Diamonds	Women's or girls' overcoats	Men's or boys' suits, etc.	Palm oil and fractions	All Commodities
	CCODE	3002	3004	9102	8414	8504	TOTAL	7103	7102	6202	6203	1511	TOTAL
	TRDVL	10.0	5.6	1.2	1.0	0.7	23.3	36.6	1.5	1.3	1.1	1.0	49.0
	XSHR	42.8	23.9	5.1	4.4	3.1	79	74.7	3.1	2.7	2.2	2.1	85
	AAT	1.1	1.5	10	1	1	2.9	0	0	0	0	0	0.0
	BND							CHF 80-800	CHF 80-800	CHF 231-1315	CHF 661	182-CHF 200	
USA	CMD	Medicaments	Human blood etc.	Wrist-watches, etc.	Orthopaedic appliances, etc.	Jewellery of precious metal etc.	All Commodities	Gold	Human blood etc.	Articles of jewellery	Medicaments	Orthopaedic appliances,	All Commodities
	CCODE	3004	3002	9102	9021	7113	TOTAL	7108	3002	7113	3004	9021	TOTAL
	TRDVL	8390.0	3977.0	1507.0	1344.0	1067.0	30810.0	6742.0	2742.0	1012.0	940.0	761.7	20310.0
	XSHR	27.2	12.9	4.9	4.4	3.5	53	33.2	13.5	5.0	4.6	3.8	60

	AAT	0	0	0.1	0	5.8	1.2	0	0	CHF 238-3999/100kg	0	0	0.0
	BND							AV - 0, S - CHF 320	0	CHF 238-3999	0	0	
UK	CMD	Medicaments	Articles of jewellery	Human blood etc.	Gold	Wrist-watches, etc	All Commodities	Gold	Articles of jewellery	Heterocyclic compounds	Motor cars	Helicopters, aeroplanes; spacecraft	All Commodities
	CCODE	3004	7113	3002	7108	9102	TOTAL	7108	7113	2933	8703	8802	TOTAL
	TRDVL	3979.0	1454.0	999.7	948.1	629.2	13690.0	24'980.0	1'273.0	1'027.0	754.8	276.4	32'450.0
	XSHR	29.1	10.6	7.3	6.9	4.6	59	77.0	3.9	3.2	2.3	0.9	87
	AAT	NA	NA	NA	NA	NA	NA	0	0	0	0	0	0.0
	BND							AV - 0, S - CHF 320	CHF 3999	238-0, S - CHF 1.3-40	CHF 15-96	CHF 62-71	
EAC	CMD	Medicaments	Mixtures of odoriferous substances	Unused postage, etc.	Unspecified	Insecticides etc	All Commodities	Gold	Cut flowers etc.	Coffee	Sunflowerseed	Unmanufactured tobacco	All Commodities
	CCODE	3004	3302	4907	9999	3808	TOTAL	7108	603	901	1512	2401	TOTAL
	TRDVL	49.4	4.9	4.4	3.9	3.5	113.0	132.0	28.8	21.8	12.6	6.6	214.0
	XSHR	43.7	4.3	3.9	3.4	3.1	58	61.7	13.5	10.2	5.9	3.1	94
	AAT	0	0	5		2.12963	1.8	0	0	0	0 for LDCs; CHF134-156/100kg for GSPs in 151211/19/2129	0 for LDCs; CHF50/100kg for GSPs in 210110/20/30	0.0
	BND							AV - 0, S - CHF 320	AV - 0, S - CHF 6-4225	AV - 0, 25-70	CHF 74-200	CHF 50	

ECOWAS	CMD	Medicaments	Motor cars, etc.	Paintings, etc.	Unspecified	Turbos-jets, etc.	All Commodities	Gold	Petroleum oils, etc.	Cocoa beans	Dates etc.	Ground-nut oil	All Commodities
	CCO DE	3004	8703	9701	9999	8411	TOTAL	7108	2709	1801	804	1508	TOTAL
	TRDVL	97.2	49.2	29.6	20.3	20.0	425.0	3'680.0	479.0	94.9	13.1	6.0	4'290.0
	XSHR	22.9	11.6	7.0	4.8	4.7	51	85.8	11.2	2.2	0.3	0.1	100
	AAT	0.8	18.7	16.5		4.8	10.2	0	0	0	0	0	0 for LDCs, CHF 130-156/100kg for GSP in 190810/90
	BND							AV - 0, S - CHF 320	Unbound	0	AV - 0, S - CHF 1-4	CHF 79-200	
Sri Lanka	CMD	Gold	Medicaments	Unspecified	Human blood etc.	Precious stones (other than diamonds)	All Commodities	Precious stones (other than diamonds)	Electricity Boards etc	Diamonds	Electrical machinery parts	Dish washing machines etc	All Commodities
	CCO DE	7108	3004	9999	3002	7103	TOTAL	7103	8537	7102	8538	8422	TOTAL
	TRDVL	18.4	16.2	13.8	12.2	10.5	141.8	35.9	20.8	6.4	4.7	4.4	172.8
	XSHR	13.0	11.4	9.7	8.6	7.4	50	20.8	12.0	3.7	2.7	2.6	42
	AAT	0	0		0	0	0.0	0	0	0	0	0	0.0
	BND							CHF 80-800	CHF 29-53	CHF 80-800	CHF 31-91	CHF 7.7-23	
Moldova	CMD	Medicaments	Insecticides, etc	Wine presses, etc	Human blood etc.	Wrist-watches, etc	All Commodities	Nuts	Women's or girls' overcoats etc	Orthopaedic appliances, etc.	Footwear	Women's or girls' suits, etc.	All Commodities
	CCO DE	3004	3808	8435	3002	9102	TOTAL	802	6202	9021	6403	6204	TOTAL

	TRDVL	7.3	5.0	2.9	1.4	1.0	24.0	5.2	1.3	1.0	0.9	0.9	15.1
	XSHR	30.5	20.7	11.9	6.0	4.0	73	34.1	8.5	6.7	6.2	5.9	61
	AAT	0	0	0	0	0.2	0.0	0	CHF117-287/100kg	0	0	CHF151-714/100kg	0.0
	BND							AV - 0, S - CHF 2-42	CHF 231-1315	0	CHF 108-214	CHF 222-1428	
Iran	CMD	Gold	Medicaments	Human blood etc.	Wrist-watches, etc	Turbopumps, turbo-propellers and other gas turbines.	All Commodities	Carpets, etc.	Ginger, etc.	Nuts	Lac; natural gums, resins	Carpets and other textile floor coverings	All Commodities
	CCODE	7108	3004	3002	9102	8411	TOTAL	5701	910	802	1301	5702	TOTAL
	TRDVL	479.8	126.2	94.9	34.2	21.7	945.7	9.9	2.3	2.1	0.8	0.7	20.6
	XSHR	50.7	13.3	10.0	3.6	2.3	80	48.0	10.9	10.0	3.8	3.6	76
	AAT	NA	NA	NA	NA	NA	NA	CHF68.5/100KG	0	0	0	CHF25-47/100KG	0.0
	BND							CHF 137-139	CHF 3.75-68	AV - 0, S - CHF 2-42	0	CHF 29-95	
<p>Abbreviations: CMD: Commodity CCODE: Commodity code (HS4) TRDVL: Trade value (USD) XSHR: Share in total export (per cent) AAT: Average applied tariff (per cent; destination market) BND: - Unless otherwise noted, specific tariffs are per 100kg gross weight. When tariff lines contain an ad valorem tariff (AV), in addition to a specific tariff (S), they are marked so. Bound rates are reported as ranges between the smallest and highest amount levied.</p>													

Annex B FTA provisions coded in DESTA

Variable	Value
Services	
Does the agreement contain a reference to the liberalization of trade in services?	0/1
Does the agreement contain a reference to the General Agreement on Trade in Services (GATS)?	
Does the agreement contain an MFN clause for services?	0/1
Does the agreement foresee a negative list approach to services liberalization?	0/1
Does the agreement contain a national treatment clause for services?	0/1
Does the agreement grant the right of non-establishment for service provision (that is, does it allow the provision of services without local presence)?	0/1
Does the agreement allow the movement of natural persons in the provision of services?	0/1
Does the agreement contain a review provision for the services provisions?	0/1
Investment	
Does the agreement contain substantive investment provisions?	
Does the agreement contain provisions that grant compensation to investors in case of strife and/or expropriation?	0/1
Does the agreement contain a reference to the WTO agreement on trade-related investment measures?	0/1
Does the agreement contain non-discrimination provisions in relation to pre-establishment operations?	0/1
Does the agreement contain non-discrimination provisions in relation to establishment (e.g., greenfield investments)?	0/1
Does the agreement contain non-discrimination provisions in relation to post-establishment operation (e.g., the free movement of capital and resale)?	0/1
Does the agreement contain non-discrimination provisions in relation to mergers and acquisitions?	0/1
Does the agreement grant MFN treatment on investments?	
Does the agreement grant national treatment on investments?	0/1
Does the agreement mention specific restrictions regarding transfers and payments?	0/1
Does the agreement mention restrictions related to the temporary movement of business or natural persons?	0/1
Intellectual Property Rights	
Does the agreement contain a provision on intellectual property rights (IPRs)?	
Does the agreement contain an MFN provision for IPRs?	
Does the agreement include obligations for acceding to the Rome Convention?	0/1
Does the agreement contain obligations for acceding to the Paris Convention?	0/1
Does the treaty contain obligations for acceding to the Bern Convention?	0/1
Does the agreement mention the TRIPS Agreement?	0/1
Does the agreement contain obligations for acceding to the World Intellectual Property Organization (WIPO) Copyright Treaty?	0/1
Does the agreement contain obligations for acceding to the WIPO Phonograms treaty?	
Does the agreement contain specific provisions in relation to substantive standards of protection?	0/1
Does the agreement contain references to pharmaceuticals?	0/1
Does the agreement contain references to geographical indications?	0/1
Public Procurement	
Does the agreement contain substantive provisions on public procurement?	0/1
Does the agreement guarantee national treatment with respect to public procurement?	0/1
Does the chapter on public procurement include a transparency provision?	
Does the agreement contain a reference to the WTO/GATT procurement agreements?	0/1
	0/1

Variable	Value
Standards	0/1
Does the agreement contain a reference to the WTO Agreement on technical barriers to trade (TBTs) (the GATT standards code)?	0/1
Does the agreement call for cooperation and/or information exchange on TBTs?	
Does the agreement contain a requirement for standards to be least trade-distorting?	
Does the agreement encourage the use of international standards?	0/1
Does the agreement contain provisions calling for information exchange and technical cooperation on sanitary and phytosanitary (SPS) measures?	0/1
Does the agreement contain a reference to the WTO SPS agreement?	0/1
Does the agreement contain provisions that stipulate the harmonization of standards?	
Does the agreement contain provisions that stipulate the harmonization of SPS provisions?	0/1
	0/1
Competition	0/1
Does the agreement contain a competition chapter?	0/1
Does the agreement contain a provision stipulating the establishment of a national competition authority?	
Does the agreement contain a provision stipulating coordination among national authorities?	0/1
Does the agreement contain a provision stipulating the creation of a common authority/institution on competition?	0/1
Does the agreement contain a provision on monopolies and cartels?	0/1
Does the agreement contain a provision on mergers and acquisitions?	
	0/1
	0/1
	0/1
Total Range	0/48

Annex C Unilateral tariff dismantling industrial goods in Norway

In 2001 the Norwegian Government proposed⁷⁶ the goal of a gradual unilateral dismantling of tariffs on industrial goods (industrial goods include fish and fish products) imported into Norway. In annual propositions on tariffs and taxes specific proposals at dismantling have been made and approved. Consequently, more than 95 percent of industrial tariff lines in Norway became duty free on an MFN basis. With subsequent unilateral tariff eliminations, the average applied rate for non-agricultural goods is today 0.5 percent, one of the lowest rates in the world. The remaining merchandise duties which range between 5.6 percent – 10 percent are mainly collected on a few clothes and textile products. Around 80 percent of the duties collected on these items are collected on imports from developing countries, the remainder is mainly collected on imports from the US.⁷⁷

The expressed rationale for dismantling the barriers in 2001 were the following:

- Tariffs had a reduced importance for generating government revenue;
- The varying tariff rates at the time constituted a complex set of rules;
- The complexity of the tariff levels represented a cost for business and for the customs administration;
- The various remaining tariff rates were random – and resulted in unintended effects on business;
- The greater portion of the tariffs fell on imports from developing countries.⁷⁸ By reducing tariffs on an MFN basis developing countries would avoid the numerous administrative challenges tied to utilization of preferences under existing GSP schemes.

Prior to the decision nearly half of tariff lines on industrial goods (2000 lines) had been reduced to zero percent either unilaterally or because of tariff reduction negotiations in GATT and the WTO. So-called nuisance tariffs, i.e. tariffs under 3 percent were eliminated by a decision of Parliament on the 1st of January 1997.

Tariffs had also been eliminated on merchandise trade with the other EFTA countries (Switzerland, Iceland and Liechtenstein) as well as with the EU member states (except for fish and fish products). A large proportion of tariff lines were also duty free for imports from LDCs under the unilateral Norwegian GSP scheme (Generalised System of Preferences). All imports from the LLDCs were eligible for tariff and quota free imports. At the time of the proposal approximately 1500 tariff lines still specified duties; amounting to around 25 percent of the

⁷⁶ Langtidsprogrammet (2002-2005) (The Government's Long-Term Program).

⁷⁷ Norwegian tariff levels for agricultural products remain very high – averaging 51.3 percent.

⁷⁸ St. Prp. 1 2001-2002. Annual Government proposal to Parliament on Taxes, Tariffs and other charges.

tariff lines for industrial goods. 150 of the industrial tariff lines had tariffs of 15 percent or higher, with 17.7 percent being the highest. These higher tariffs were mainly in textiles.

The lack of utilization of preferences in trade by the LDCs is not a unique Norwegian experience. The cost of rules of origin is widely estimated to be between 1 and 7 percent. For tariffs below 5 percent the cost of compliance to attain preferential status is sufficient to compromise the value of the preference.

This experience also relates to non-LDC countries as Mexico's experience demonstrated. After the autonomous dismantling of tariffs in 2008 the share of MFN imports in Mexico grew substantially. As the study by Lopez Cordova shows, this increase is not solely a function of countries without FTAs increasing their exports, but also of FTA countries choosing to utilise MFN rates to avoid the administrative costs or hassles of the preferential rates.

In any case, it seems that the first year of Mexican unilateral tariff reduction has generated an incentive for some importers to avoid the administrative charge of requesting PROSEC and FTA preferences, consequently facilitating their import procedures and gaining competitiveness for their business operations.⁷⁹

The decision to propose autonomous elimination of tariffs on industrial goods in Norway was explicitly supported by the Confederation of Norwegian Business and Industry as the Confederation saw it as a means of reducing costs and administrative burdens for their business members. Subsequently the Confederation has argued for elimination of all industrial tariffs including for fish and fish products in the WTO.

Some examples of the unintentional arbitrary nature of the tariff rates:

- Buttons were subject to tariffs while zippers were not.
- Musical organs were subject to tariffs while pianos were not.
- Glasses (eyewear) were subject to tariffs while frames were not.
- Pencils were subject to tariffs while pens were not.

The 2001 decision introduced duty free access for around 500 tariff lines. Tariffs were eliminated on an additional 1750 tariff lines in 2009 and 2010.

The result of the tariff elimination was as intended, it reduced costs for business and for the government administration, and it led to an increase in imports from developing countries. As Arne Melchior, one of Norway's pre-eminent trade policy analysts has pointed out, the

⁷⁹ Mexican Unilateral Trade Liberalisation in the Middle of the Economic Crisis, Ernesto Lopez Cordova. Global Trade Alert Paper No. 2. (2010).

unilateral dismantling of tariffs has resulted in a less discriminatory regime. “Preference erosion should be promoted rather than feared.”⁸⁰

C1. Existing Free Trade Agreements

Norway is a founding member of the European Free Trade Area (EFTA) established in 1960. EFTA provides tariff free trade in manufactures and fish and fish products among its member states and provides for free movement of people since 2002.

Along with EFTA states Iceland and Liechtenstein Norway is a party to the European Economic Area Agreement (the EEA Agreement established in 1994) which includes the EU Member States. While Switzerland has a series of bilateral agreements with the EU, the EFTA member states nevertheless have agreed to coordinate negotiations on FTAs with third countries.

As of December 2016, Norway has 29 bilateral FTAs covering 40 countries. 27 of the agreements have been negotiated together with the other EFTA member states (Switzerland, Iceland and Liechtenstein). Notably only seven of these agreements were negotiated prior to the decision to unilaterally eliminate import duties on industrial goods.

The following countries are covered by EFTA FTAs (year of negotiations completed in parenthesis):

- Albania (2009)
- Bosnia (2013)
- Herzegovina (2013)
- Canada (2008)
- Central American States (Costa Rica, Panama (2013) and Guatemala (2014))
- Chile (2003)
- Colombia (2008)
- Egypt (2007)
- Georgia (2016)
- The GCC, Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates) (2009)
- Hong Kong (2012)
- Israel (1992)
- Jordan (2001)
- Republic of Korea (2005)
- Lebanon (2004)
- Macedonia (2000)

⁸⁰ The Most and the Least Favoured Nation. Norway’s Trade Policy in Perspective. Arne Melchior, NUI, The World Economy (2006)

- Mexico (2000)
- Montenegro (2011)
- Marocco (1997)
- Palestine (1998)
- Peru (2010)
- Phillipines (2016)
- Serbia (2009)
- Singapore (2002)
- SACU South African Customs Union(Botswana, Lesotho, Namibia, South Africa, Swaziland) (2013)
- Tunisia(2004)
- Turkey (1991)
- Ukraine (2010)

In addition, Norway has two bilateral agreements: one with the Faroe Islands and one with Greenland.

The EFTA Free Trade Agreements are negotiated jointly by the EFTA states after coordination of positions and with the assistance of the EFTA Secretariat. This coordinated approach allows the EFTA states to negotiate based on a bigger market and saves resources through pooling of information and assistance from the EFTA Secretariat. The FTAs establish free trade areas in reference to Article XXIV of the GATT. Each agreement is signed and approved/ratified by the individual EFTA member state. Agricultural concessions are negotiated bilaterally, yet form an integral part of the FTA. The EFTA member states do not have a shared external trade policy, but Switzerland and Liechtenstein have a customs union with common external tariffs. Because of EFTA member states' agreements with the EU and FTA partners, more than 80 percent of Norway's trade in goods takes place under preferential conditions.⁸¹

C2. Prospective Free Trade Agreements

Norway is currently involved in ongoing EFTA FTA negotiations with the following countries:

- · Algeria
- · Honduras
- · Ecuador
- · India
- · Indonesia
- · Malaysia
- · Russia; Belarus and Kazakhstan (currently on hold)
- · Thailand

⁸¹ EFTA's Free Trade Relations <http://www.efta.int/sites/default/files/publications/fact-sheets/General-EFTA-fact-sheets/EFTAs-Free-Trade-Relations-FAQs.pdf> n.d. Accessed 22 March 2017.

- · Vietnam

Bilateral negotiations have in addition been resumed with China after being put on hold by China in 2010.

Norway has been pushing for FTA negotiations with Japan for more than a decade without success, while Switzerland negotiated a bilateral FTA with Japan in 2009. Norwegian negotiators see Japan's unwillingness to enter into negotiations as a function of the already existing tariff free market access for industrial goods to Norway, and there is a perceived lack of will on the Japanese side to enter into concessions that will open up their market for tariff free access for fish and fish products.

The driving principle behind the FTA negotiations under the EFTA umbrella has been to maintain parallelism with the EU in its pursuit of Free Trade Agreements with third countries and to ensure comparable export possibilities to the EU. In addition, it has been an overriding goal for Norway (and EFTA as a negotiating group) to achieve free trade in fish and fish products, something the EU has not been willing to provide EFTA partners. In recent years the EFTA countries have increasingly focused on achieving FTAs with countries with the most economic value to the member states irrespective of whether the EU is engaged in negotiations with them or not.

Given the extensive coverage of the current FTAs it can be argued that the EFTA Member States have reached a saturation point for FTAs. Few remaining trading partners are not covered by existing agreements, and continued negotiations are expected to focus on updating and expanding current agreements. Yet among the non-FTA countries are some of the largest growing economies in the world and some important markets such as India, Thailand, Russia, Brazil and Nigeria which potentially can become increasingly important markets in particular for Norwegian fish and fish products. The US market is also not covered, and EFTA countries were following the TTIP negotiations closely.

C3. Implications of autonomous liberalization for future FTAs

As the sheer number of FTAs negotiated after the autonomous dismantling of industrial tariffs demonstrates, the tariff eliminations do not appear to have hampered Norway's ability to negotiate free trade agreements under the EFTA umbrella. Japan and China are probably the only countries that one can say have been unwilling to negotiate with the EFTA group, and instead have entered into bilateral FTAs with Switzerland. The implication is that other issue areas are also significant in motivating FTA negotiations with the EFTA countries. EFTA has concluded FTAs with some countries prior to them entering into agreements with the EU (for example South Korea and Singapore). Given the similarity in structure in EU and EFTA FTAs

the EFTA negotiations can perhaps be seen as a “trial run” for subsequent negotiations with the EU

While the autonomous elimination of industrial tariffs has not prevented the negotiation of FTAs, Norwegian FTA negotiators stress that the elimination has been a major challenge for Norway in the negotiations. Within a negotiating format where concessions are “traded” negotiators have to “sell” something that is already available for free. Given that a large share of the tariff eliminations is bound in the WTO, the potential concession of binding a 0-tariff within an FTA is also limited. In negotiations with countries with a large degree of openness in the form of low or zero tariffs the autonomous elimination of industrial tariffs has posed less or no problem.

FTA negotiators also stress that existing tariff free trade has resulted in a push from FTA negotiating partners for concessions in other areas, particularly in trade in agriculture, but also in services and regarding investment. Given Norway’s open regime also on trade in services the binding of access with the FTA has been an element that has been traded. “Binding” of agricultural tariffs to applied vs scheduled tariff rates has also been used. Norway has not entered into extensive commitments in investment, nor accepted linkages to development cooperation in the FTA negotiations.

Not all FTA partners have pushed for market access in agriculture, notable South Korea, which maintains defensive interests in agriculture trade. Where concessions in the agricultural sector have been made, they have mainly been in trade in processed agricultural products in line with market access provided to the EU. Negotiators avoid providing access beyond what has been provided to the EU as it will result in pressure from the EU to allow them the same access.

An example of issue areas pursued with trading partners with low tariffs, but also with others, is commitments to restrict the use of trade restricting measures. In the negotiations with Hong Kong, Chile and the Ukraine agreement was reached on the elimination of trade restrictive measures such as anti-dumping duties. Similarly, limitations on use of such measures were negotiated in the FTAs with Costa Rica, Panama and Guatemala.

The existing FTAs have provided varied levels of benefits to Norway. In the negotiations with South Korea, the primary goal from the Norwegian side was to achieve liberalization in the South Korean import regime for fish and fish products. This was achieved and Norwegian exports have since flourished. The main benefits to the South Korean side were achieved in the marine sector.

Issue areas that have been pursued by Norway in the FTAs in addition to liberalizing trade in fish and fish products have been liberalization of trade in services, promotion of investment and government procurement.

Revenue from tariffs has consistently been reduced over time. In 1900 revenue from tariffs amounted to 70 percent of revenue from taxes and charges. In 2002 tariffs provided NOK 1650 billion around 0.4 percent of government revenue from taxes and other charges. The share has subsequently been reduced to 0.3 percent.

C4. Conclusions

In Norway the elimination of tariffs on industrial goods, including fish and fish products, has not been seen as a negative development by stakeholders or changing governments. In the most recent overview of Norwegian trade policy presented to and discussed in Parliament, the White Paper on Globalization and Trade. Possibilities and challenges for Norway in Trade Policy from May 2015, this is stated explicitly. “For the Norwegian economy and business, openness for imports is at least as important as market access for Norwegian exports.” An open Norwegian merchandise market is essential for providing continuous improvements in competitiveness and the import of new ideas and technologies.⁸²

Norway’s near elimination of all industrial tariffs has not prevented negotiation of FTAs under the EFTA umbrella, but the negotiations themselves have been challenging and contributed to the expansion of issue areas covered in the agreements.

⁸² Meld.St. 29 (2014-2015) Globalisation and Trade.

Annex D Unilateral tariff dismantling industrial goods in Iceland

D1. Reasons for unilateral tariff dismantling + main debate

There were multiple reasons cited by the government at the time the decision was made. The unilateral abolition of industrial tariffs formed part of a wider reorganization of the tax system, aimed inter alia at its simplification. General excise duties were abolished as of 1 January 2015 (with a much greater impact on government revenue than the abolition of industrial tariffs) and various amendments have also been made to the VAT system and applicable rates. Other than general simplification and enhancement of the efficiency of the tax system, the aim of the unilateral abolition was stated to be the improvement of living standards in Iceland. The abolition was expected to lower the consumer price index by as much as 0.5% in 2016 and up to 1% in 2017. This would increase the disposable income of households and improve the competitive position of retail trade in Iceland. It should also be mentioned that the government committed to partial abolition of industrial tariffs – notably on clothing and footwear – as part of collective wage negotiations in 2015.

The government's plan for the unilateral abolition of industrial tariffs was well received by employers' and retail associations, trade unions and consumer associations. There was virtually no negative discourse pursuant to the decision; it was near universally a popular decision. Since implementation, there has been some debate (primarily between the trade unions and retail/employer associations) on the extent to which the abolition of tariffs has affected retail prices and benefited consumers. The picture is complicated by various economic factors, including an ongoing economic boom, rising domestic costs and the rapid strengthening of the Icelandic krona (around 20% over the last 12 months). Little focus has effectively been of late on the abolition of industrial tariffs and there are other factors that have, over the last couple of years, had a far greater effect on consumers and domestic retail prices.

D2. Is unilateral tariff dismantling 'weakening the negotiating position'?

The report of the working group on review of the Customs Tariff, on which the decision on the unilateral abolition of industrial tariffs was based, addressed this issue, albeit quite superficially. On the one hand, it was considered that the unilateral abolition of industrial tariffs would not have a significant impact on free trade negotiations in the EFTA context, as the Icelandic market was small in the overall scheme of such negotiations. On the other hand, it was recognised that Iceland might encounter difficulty in luring its trading partners to the negotiating table in a bilateral setting, as those trading partners might not see much value in a bilateral free trade agreement with Iceland. In general, it may be said in this context that the potential effect of the unilateral abolition has yet to manifest itself. Both The Ministry of

Industries and Innovation acknowledges that abolition of industrial tariffs may result in increased pressure on the heavily protected agricultural sector in free trade negotiations and the Farmers Association has been critical of this aspect.

D3. Role of industrial tariffs in concession portfolio – cross-concessions?

The impact on government revenue of the abolition of industrial tariffs was estimated at ISK 5 billion. That includes ISK 4 billion in tariff revenue foregone and an additional ISK 1 billion knock-on effect on VAT revenue. The vast majority of Iceland's trade was already governed by free trade agreements (EEA and FTAs, EFTA and bilateral) at the time of the abolition. Although the decision to abolish industrial tariffs had multiple objectives, it appears clear that the government saw them more as a nuisance than a source of revenue.

D4. Is/was there an EFTA premium for Iceland?

It's clear from the perspective of the experts that Iceland has benefitted tremendously from negotiating FTAs through EFTA. The fact that the Icelandic government does not see its unilateral abolition of industrial tariffs as having any significant impact on EFTA FTAs owing to the relative insignificance of the Icelandic market speaks to the extent to which Iceland has historically enjoyed an "EFTA premium" through those negotiations. Only time will tell if this will continue to be the case, as well as whether Iceland's sensitive agriculture sector will come under increasing pressure in such negotiations.

D5. Other issues

Owing to a range of factors, primarily an ongoing economic boom and substantial strengthening of the Icelandic krona (around 20% in the last 12 months), there has been minimal focus so far on the effects of the unilateral abolition of industrial tariffs that occurred at the start of 2017. Much more was made of the abolition of tariffs on clothing and footwear at the start of 2016, although the extent to which the planned benefits of this action was reaped by Icelandic consumers still remains a bone of contention between trade unions and employers' organizations. Most certainly, the Farmers' Union fears that the unilateral tariff dismantling exposes the sensitive and still heavily tariff-protected agriculture/food sector, as Iceland will effectively have nothing else to trade with in future negotiations with e.g. free trade partners. As support for the government's agricultural trade restrictions has effectively never been widespread or the subject of any type of "national consensus", the internal debate on tariff protection/tariff reductions (propelled by employers, trade unions and consumer associations alike, ostensibly to benefit consumers) can and will henceforth exclusively focus on food and agriculture.

It's perhaps too early to draw any definitive conclusions and – owing to the factors cited above – there are other developments at play that presently muddy the waters. Iceland is unsure of the effects of its unilateral tariff dismantling on future FTAs; this remains to be determined.

As such, the prevailing sentiment is that market access to Iceland may in the overall scheme of things be of minor concern to EFTA's trading partners, meaning concessions on the part of Iceland will neither be what makes or breaks a free trade deal. To this extent, Iceland may harbour an anticipation of "free-riding" in the EFTA context; an anticipation which may or may not prove realistic. In any event, it was recognised at the time of the decision to unilaterally abolish industrial tariffs that the decision might lead to difficulties in luring prospective free trade partners to the negotiating table as they might have a hard time seeing any tangible benefit in such a deal.

Annex E Unilateral tariff dismantling industrial goods in Hong Kong and Singapore

E1. Introduction and context: Hong Kong

In a way, free trade was the birthmark of Hong Kong. Since the 18th century, the British has been trying to expand trade with China but China imposed many restrictions, including the requirement that trade can only be conducted at designated ports with designated trading firms. This did not change until the Treaty of Nanking was signed in 1842, which allowed the British merchants to trade with anyone without going through the designated trading firms. Hong Kong was also ceded to Great Britain, which quickly declared it as a free port.

Thus, from the beginning, it has been the destiny of Hong Kong to be an entrepôt for the Far East, especially China. As a key link in the Empire's trading system, it did not make sense for the British to impose trade restrictions in Hong Kong and they continued the free trade policy for the next one hundred years, until Hong Kong was seized by Japan in the World War II. The entrepôt business revived after the war, but came to a halt again when the United Nations imposed a trade embargo against China when the Korean War broke out. Nonetheless, Hong Kong was able to quickly industrialise its economy by combining the capital, equipment and know-how brought by the capitalists who fled China, as well as the cheap labour provided by the refugees from Mainland China. As most of its neighbours were still recovering and did not develop as fast as Hong Kong, there was no need to erect trade restrictions either.

By early 1960s, textiles and clothing has become the leading export industry of Hong Kong, which was the biggest exporter of textiles and clothing worldwide. As a matter of fact, Hong Kong was so competitive that many developed countries, including the UK, imposed quota restrictions on textile and clothing exports from Hong Kong. Nonetheless, because raising tariffs would put additional burdens on its manufacturers, Hong Kong continued its free trade policy and did not introduce trade restrictions against imports.

When China started its economic reform in the late 1970s, Hong Kong quickly seized the opportunity and became China's window to the world. In addition to the traditional entrepôt business, foreign investors and service providers also used Hong Kong as a base to channel their investment into China, as Hong Kong provided familiar legal environments based on the Common Law system and able employees who communicate well in both English and Chinese. As China liberalised its trade regime in anticipation of its WTO accession, more and more trade was shifted to China and Hong Kong started to lose its significance as an entrepôt. In 2005, Hong Kong lost its place as the busiest port in the world, and Mainland Chinese ports such as Shanghai and Shenzhen started to catch up. To solve the problem, the Hong Kong government signed the Closer Economic Partnership Arrangement (CEPA) with Mainland China. The CEPA

granted unparalleled market access for both manufacturers and service providers from Hong Kong, and helped to boost the Hong Kong economy.

E2. Effects of unilateral tariff dismantling on bargaining process: Hong Kong

Hong Kong has been a Member of the GATT since 1986 and a long-time champion of the multilateral trading system. In recent years, however, as more and more of its neighbours started to sign free trade agreements, Hong Kong also jumped on the FTA bandwagon for fear of being squeezed out of foreign markets by its competitors. It signed its first FTA with New Zealand in 2010, and has since then signed two more FTAs with EFTA and Chile. It is currently negotiating FTAs with ASEAN, Macao, Georgia, Maldives and Australia.

The unilateral tariff dismantling does make it difficult for Hong Kong to negotiate with its potential FTA partners. However, one bargaining chip Hong Kong could use is that only 45.6% of its tariff lines are bound in the WTO even though it does not charge any tariff in practice. The bound rates are set at zero and cover all of the agricultural products and 36.7% of non-agricultural products. Thus, Hong Kong argues that an FTA with binding tariff commitments at zero reduces the uncertainty for its FTA partners, and many of its FTA partners find this argument persuasive and consider it a major benefit of signing an FTA with Hong Kong.

E3. Possible compensation mechanisms and political sensitivities: Hong Kong

To compensate the negotiating disadvantage created by its zero-tariff regime, Hong Kong also points to the following potential benefits for its FTA partners:

The first is the access to the services market in Hong Kong. While Hong Kong has been a model citizen for free trade in goods, the same is not true for trade in services. In many services sectors, it was hard for foreign service suppliers to break in. Thus, services commitments become a key benefit for its FTA partners. For example, in its FTA with New Zealand, Hong Kong made commitments on private education, business services, environmental services and logistics. Similarly, its FTA with EFTA provides commitments on financial services, telecom services and logistics services. The FTA with Chile addresses Chile's priority interests in architectural services, engineering services, audio-visual services, and construction services.

The second benefit is access to the Chinese market through its CEPA with China. As noted by Nicholas Kwan, Director of Research of Hong Kong Trade Development Council, CEPA can be used "as a conduit" for foreign firms to enter Chinese market. Because CEPA also carries the political task of ensuring Hong Kong's property and stability, it provides one-of-a-kind deal to Hong Kong. For example, for services trade, CEPA provides either commitments ahead of China's WTO schedule, lower qualification requirements, or opportunities reserved for Hong Kong service providers only. Overall, CEPA provides full or partial liberalisation to 153 services sectors, which accounts for 95.6% of the 160 sectors as defined under the Services Sectoral

Classification List of the WTO. Initially, the benefits were reserved for Hong Kong service suppliers (HKSS), which are defined as businesses with “substantive business operations” in Hong Kong. In 2011, however, Supplement VIII to the CEPA amended relaxed the requirements for “substantive business operations” to allow a Hong Kong service supplier to apply for CEPA preferences in sectors beyond its scope of business operations in Hong Kong. Moreover, CEPA only requires the service supplier to be a legal person duly established in Hong Kong and does not require it to be locally owned. These features made it attractive for foreign firms to establish operations in Hong Kong. As noted by the Hong Kong government, almost half of the HKSS certificates were issued to companies with majority foreign ownership, including many service providers from Hong Kong’s FTA partners.

Third, because Hong Kong does not have an agricultural sector, it is easier to negotiate with Hong Kong than other countries with agricultural interests. Not only that, as a market of 7.3 million people with substantial purchasing power, Hong Kong also provides good market opportunities for countries with significant agricultural export interests.

E4. Rules of Origin: Hong Kong

Nowadays, Hong Kong has largely outsourced its manufacturing activity to China, and its economy is heavily dominated by services, which account for 93% of the economy. Thus, rule of origin is not a big issue in Hong Kong’s FTAs, as most goods are trans-shipment rather than manufactured in Hong Kong. However, as mentioned earlier, origin of services used to be a major issue, but has now become less of a problem.

E5. Introduction and Context: Singapore

With its strategic location, Singapore has been an important link in the trade between the East and the West since Sir Thomas Stamford Raffles founded the colony in 1819. On the one hand, Singapore imported rubber, coffee and tin from the neighbouring countries in southeast Asia, and exported them as industrial materials to the West after further processing. On the other hand, Singapore also imported industrial equipment and other manufactured products from Europe and North America, and re-distributed them to other countries in Asia.

After the World War II, Singapore sought independence from the British and was granted full internal self-government in 1959. While Singapore remained an important entrepot, the government recognised the need to diversify the economy and decided to embark on industrialisation to provide the jobs needed by its 2 million population. In 1963, Singapore joined the Malaysian Federation as an independent state. The merger with Malaysia provided a big internal market, thus the Singaporean government tried to encourage industrial development through import substitution. At that time, almost all industrial sectors were protected, as the government hoped Singapore to become the industrial hub of Malaysia.

For several reasons, the union with Malaysia became short-lived. In 1965, Singapore was expelled from the union and became an independent country. This means that the import substitution strategy was no longer feasible as the domestic market is too small in Singapore. Instead, the government adopted an export-oriented strategy and introduced many initiatives to attract foreign investors to develop the manufacturing and service sectors in Singapore. As many of these firms engaged in export processing work, the government also removed tariffs on almost all products as it no longer made sense to protect the domestic market, which was very small.

Since then, Singapore has embarked on a path of rapid growth and is now one of the richest countries in the world. Looking back, the export-orientation strategy coupled with autonomous tariff dismantling has worked.

E6. Effects of unilateral tariff dismantling on bargaining process: Singapore

While Singapore has been a freeport for a long time and almost all imports enter the country duty free, it did not bind its low tariffs until recent decades in order to preserve bargaining flexibility. Before the Uruguay Round (UR), only less than 0.5% of its tariff lines were bound. In the UR negotiations, Singapore agreed to increase its tariff binding to 69.6% of all tariff lines. The binding on industrial products was raised from zero to 65%, with the average bound rate reduced from 12.4% to 5.1%. Singapore also bound 100% of all agricultural products with a ceiling rate of 10% for all except tobacco and liquor products. Moreover, the bound rate was also reduced to zero for agriculture equipment, construction equipment steel, pharmaceuticals, furniture and medical equipment.

The unilateral tariff dismantling does create some difficulty for Singapore in FTA negotiations. The most famous exchange on this took place during its FTA negotiations with Japan, where the Japanese MITI Vice Minister put bluntly to Singapore's Ambassador to Japan Chew Tai Soo, "You are already naked, what else have you got to show?".

Nonetheless, as the Singapore market is too small to matter and the effective tariff rate has always been zero, industrial tariffs never became a major issue in Singapore's FTA negotiations. The only exception was in its FTA negotiation with the US, where the US insisted on the lifting of the ban on chewing gum, which Singapore agreed as a limited exception in the end.

E7. Possible compensation mechanisms and political sensitivities: Singapore

The unilateral tariff dismantling removes the layers of protection available for Singapore's domestic sectors, and could have made it more difficult for Singapore to attract other countries in FTA negotiations according to conventional thinking. However, over the years,

Singapore has artfully turned such disadvantage into an advantage, by emphasising the following benefits of entering into FTAs with Singapore:

First, Singapore could provide a testing case for countries hesitant to enter into FTAs. If we look at Singapore's FTAs, we can see that many FTAs are either the first or second bilateral FTAs. For example, the ones with Japan and India are their first ever FTA, while the one with Australia is the first after Australia's FTA with New Zealand 20 years ago. Ng Bee Kim, Singapore's chief negotiator in the TPP, explained the rationale as follows:

"Singapore's very openness and smallness could paradoxically make it an attractive FTA partner, especially for countries that are just starting out on the path of bilateral trade agreements. Unlike a larger country with substantial capabilities in manufacturing at low costs, Singapore offered little threat to domestic producers of being driven out of business by a flood of cheaper imports. Our openness and good trade relations with other nations meant too that Singapore would not have too many defensive areas in the negotiations or frictions to deal with. Singapore's week-known pragmatic approach in dealing with issues may have given some confidence as well to partners that we would not make unreasonable demands, and that we would work with them to find solutions to thorny issues."

Second is the signalling effect. As a country with high-standards in technical standards, services and investment, Singapore has a reputation of insisting on high-quality commitments in FTAs negotiations. Thus, as explained by Ng:

"a deal with Singapore showed that they were able to conclude good-quality trade agreements. It was a statement of the seriousness of intent of the country to pursue trade and investment liberalisation and facilitation. An ambitious FTA represented the openness of the economy to foreign trade and investment, and its confidence that it would be able to honour the obligations undertaken. It signalled that the economy was open for business, and gave the assurance that there were rules to keep markets open and protect investors. Further, having a high quality agreement under their belts would allow these countries to start from higher ground for subsequent FTAs. Their subsequent FTA partners would tend to look at previously concluded agreements to gauge the level of commitments and quality the country was capable of."

Third is to help push for necessary domestic reforms. Again this is explained by Ng:

"The government could argue that certain regulatory changes or new legislation were necessary because of the FTA. The changes could thus be attributed to external causes, and perhaps easier to implement in some cases. Although this might be truer in the case of negotiating with more powerful partners, the fact that Singapore would seek high standards may have been sufficient to help some countries achieve this aim in some instances despite Singapore's relative size."

A good example in this regard is Japan.

Fourth is to provide a template for future FTAs. Due to its small size, Singapore is usually on the receiving end of FTAs templates, especially when it negotiates with big FTA partners. This gives its negotiating partners more leverage in dictating the terms of the agreement and makes the resulting FTA a perfect template for future FTAs. This is especially the case for

services and investment issues. One good example is the US-Singapore FTA, which was used as a template for later FTAs that the US signed. As observed by Ng:

“The USSFTA was concluded about ten years after NAFTA. The intervening years presented the US with an opportunity to learn from its experience of implementing NAFTA, and from the experience of its other partners. When the US started negotiating with Singapore, it was then able to use the knowledge gained to craft improved disciplines. It was also able to work with Singapore to use the USSFTA as a canvas to update the content of its trade agreements to reflect the changes that had taken place and to anticipate future developments. For instance, the USSFTA declared a permanent moratorium on the imposition of customs duties on “digital products”, a term that was coined to encompass products ranging from computer software to CDs.”

Fifth is the stepping stone effect. There are two levels of such effect here. At the first level, one reason that many countries such as China, Japan, Korea, India and Australia all choose to sign an FTA with Singapore is because Singapore is part of ASEAN, which makes it a great entry point to other countries in the region. By establishing themselves in Singapore, firms from these countries can gain a foothold in the region and sometimes even be able to invest as Singaporean firms if they satisfy the necessary conditions. At the second level, Singapore has been consciously using its bilateral FTAs as the seed for broader region-wide FTAs. The best known example is the TPP, which grew out of the P4 Agreement that Singapore signed with 3 other countries. In a way, Singapore’s bilateral deals with China, Japan, Korea, India, Australia and New Zealand also provided the impetus for the Regional Comprehensive Economic Partnership (RCEP) negotiations.

E8. Rules of Origin: Singapore

As Singapore’s tariff dismantling covers almost all products from all countries, the unilateral tariff dismantling doesn’t have much effect on the imports into Singapore. However, things are more complicated on Singapore’s exports, as the Rules of Origin (ROO) rules have to be followed before Singapore’s exports fulfil the relevant criteria. This is especially a problem for Singapore, where about a third of the exports are transshipment. Singapore also has products sent for outward processing, wherein the lower value added manufacturing activities are outsourced to the immediate neighbours. This issue came up, for example, in the negotiations with the US. To address these issues, the US Singapore FTA included special ROO rules, including yarn forwarding rule for textiles (requiring that the yarn production and all operations forward occur in either Singapore or the United States, but the fiber may be from anywhere), integrated sourcing initiative for IT products and medical equipments (where the requirement that these products meet specific ROO rules when shipped between the United States and Singapore is eliminated), as well as a special origin criteria exclusively for recovered and remanufactured goods (treating them as originating in the country where they are recovered or remanufactured).

Annex F Other perspectives on unilateral tariff dismantling

F1. Overall attitude Toward “Domestic” Unilateral Tariff Elimination

Neither the EU nor the US has or would seriously consider unilateral tariff elimination; Canada has done, and Turkey effectively is forced to provide it, courtesy of its customs union with the EU in conjunction with EU FTAs.

EU: As a large attractive economy, which itself is relatively open but faces significant barriers elsewhere, the EU has not and unlikely ever would consider unilateral tariff reduction, even for goods in which it is competitive. Offensively, tariffs are thus seen as providing leverage, both in multilateral and bilateral negotiations. Defensively, the EU still has a significant light industrial sector that competes directly with developing countries. Many member states do see tariffs as a legitimate means to protect these and other industries although some bemoan the generally low levels of protection EU tariffs afford, and that the EU does not have the capacity to raise tariffs to high enough levels to counter unfair subsidies. The chemical industry (as well as industry associations in Sweden and Denmark) have at times talked about getting rid of low “nuisance” tariffs, this has never gone anywhere in large part as high-volume/high-value trade produces significant revenues for the EU even at low rates, and member states would not want to make this up out of their contributions to the EU’s “Own Resources.”

US: General tariff elimination would never be seriously considered by either the Executive branch or Congress, although some think tanks (notably Cato) advocate the idea. One difficulty is US governance: under the Constitution, the House has authority over tariffs. Any tariff change requires legislation that must start with the House and can be easily halted by any one Senator, so defensive interests play a significant political role. But as with the EU, remaining US tariffs, which include significant peaks, are seen (in USTR) as useful leverage in trade negotiations.

Note: That said, the US does have a process to address adverse consequences of tariffs on production inputs through the “Miscellaneous Tariff Bill” (MTB) process, which eliminates certain tariffs (mainly on chemicals, but also minerals and various other industrial components) when there is no domestic production. (The US collects about \$45 billion in tariff revenues; of this, just over \$25 billion is on intermediate products. The last MTB “saved” importers \$745 million in duties.) This process was always extremely tedious (petitions for inclusion of a product in MTBs went through individual Congressmen) and indeed MTBs were blocked between 2010 and 2016. In part as a reaction to that, the U.S. in May 2016 adopted the [American Manufacturing Competitiveness Act](#) (AMCA), which creates a new process whereby the US International Trade Commission (USITC) in October 2016 and 2019 will open a call for proposals for tariff reductions/eliminations, analyse these and then recommend to Congress tariffs on specific products that can be eliminated because the products meet the criteria of (a) no domestic production; (b) at least ten domestic beneficiaries from tariff-free import; and (c) no revenue loss of more than \$500,000. Congress is meant to consider an MTB within 90 days of receiving the report; it can take

individual items off the USITC list, but may not add any. The USITC started the process in October 2016; it will be interesting to see in August (when the USITC will submit its final recommendation) how Congress reacts.

Canada: Canada unilaterally eliminated “nuisance” tariffs (below 2%) on about 1700 industrial input products in 2010 and 2011, essentially as the revenue gains were considered less important than the economic benefit of the imports. This has generally been seen as beneficial, in particular in attracting investment into Canada and improving utilization of preferential tariffs under NAFTA, and in 2014 the Canadian Council of Chief Executives called for Canada to do so more broadly.⁸³ Our expert interviews confirm that this has not gone anywhere recently and they remain doubtful for any action under the Trudeau administration.

Turkey: Interestingly, both the EU and Turkey reportedly considered the option of Turkey leaving the EU customs union and concluding a full-FTA with the EU as part of the scoping exercise related to the “modernization” of their trading relationship, but three separate studies indicated that the administrative costs of instituting rules of origin requirements and certifications would be unduly high. But by remaining in, Turkey is frustrated it cannot independently conclude trade agreements with third countries, and even more so when EU trade agreements essentially require it to give duty-free treatment to others without getting anything in return (as third countries rarely feel a need to grant concessions to a Turkey that has essentially given unilateral tariff elimination to them through agreements they have concluded with the EU). The EU-Turkey FTA will thus “add on” elements other than those covered in the EU-Turkey customs union accord; Turkey will use this as a new FTA template in trying to negotiate FTAs with those third countries.

2.2. Attitude toward Others “Unilaterally Disarming”

The potential “costs” in terms of negotiating leverage of unilaterally eliminating tariffs on industrial products depends to a large extent on the size of the economy, its importance as a trading partner, its existing bound and applied tariffs (and the “water” between them), the weight of other “non-tariff measures” affecting industrial products, the importance of access to other sectors of the economy as well as the perceived need for other “rules” with the country (e.g. on IPR), and other such considerations. In the absence of specific knowledge about the economy concerned, it was difficult for interlocutors to give concrete answers.

The absence of tariffs, however, need not disadvantage a country in negotiations: in the case of Singapore, its effective entrepôt status neither prevented it from being an important priority of the EU (which had strategic as well as economic interests in concluding an FTA) nor weakened its ability to pursue its offensive interests (see Annex E for results on Hong Kong

⁸³ Dan Ciuriak and Jingliang Xiao, “[Should Canada Unilaterally Adopt Global Free Trade?](#),” Canadian Council of Chief Executives, May 2014; Mike Moffat, “[Making It Simple](#),” Mowat Centre, March 2016.

and Singapore). Canada's previous unilateral tariff-elimination exercise (albeit very partial) had no adverse consequences in the CETA talks.

One issue, raised even by those who sympathise with the idea, was that having industrial tariffs to "trade off" is useful to the process. Even when tariffs are generally low, being able to "give" them adds a sense of reciprocity to the other partner in market access talks. When Indonesia, for instance, came into FTA negotiations with the EU offering in the initial round immediate tariff elimination on 90% of industrial products, it discomfited the EU, which has a more extensive list of sensitive products. Brussels wanted a longer give and take discussion to justify its own "concessions", even though both sides know the FTA will likely eliminate over 95% of industrial tariffs in the end. The "additional access" of negotiated elimination is also a useful talking point at home when negotiations are unable to really remove the more important non-tariff measures which can be the real obstacles to trade (the Japan example in the EU-Japan negotiations). Elimination of tariff peaks can be particularly important here. Finally, being able to point to some give, even in generally low tariffs, is a useful rationale for the other country's concessions in such areas as agriculture.

Contrary to the academic findings in the literature, there is little perceived value in having the FTA bind the unilaterally-eliminated tariffs. Too many trade negotiators "know" that it is politically and economically difficult to resurrect tariffs that have been eliminated once an economy is accustomed to having them at zero percent.

The administrative headache of complying with rules of origin to benefit from an FTA – especially SMEs complain about these in Brussels - is seen as a necessary evil to limit the extension of preferential agreements to third countries (especially China). While EU and US exporters would not have to deal with this in an FTA with a country that had unilaterally eliminated tariffs, neither would they benefit from the preference margin, which can be significant even at low levels for high-value goods. The unilaterally-eliminating country's exporters would still have to deal with the headache, of course, which in some instances is a not-so-unintentional way of limiting the access the other country is meant to gain through the FTA.

F3. Third Country Effects

While interlocutors acknowledged the trade diversion consequences of preferential trade agreements, they also pointed out that unilateral elimination could affect third countries as well, mainly in the sense of eroding tariff preferences. This concept normally applies to least developed countries benefiting from GSP schemes, but the EU and US seem conscious that they would be adversely affected should a country with which they have an FTA subsequently unilaterally eliminate tariffs on an MFN basis. There was some sense of annoyance about the idea that those two large economies may have had to "pay" for something they could have

gotten for “free” had they waited, but also an acceptance that countries would have the right to do this.

F4. Comment

The perceptions recorded above are skewed to the extent that they reflect the views of those close to the negotiating “game” - for those in that circle, the process of negotiating tariff elimination is to an extent as important as the substantive outcome. These negotiators are less concerned about being able to claim they won additional access for their exporters; the dead-weight administrative and distributional costs (primarily on smaller firms) of complying with preferential rules of origin do not bother them.

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