7

Direct and Portfolio Investment

The United States and Switzerland both figure prominently in foreign direct investment (FDI). They are known worldwide for their brand-name multinational enterprises (MNEs) and outward FDI stocks, which represented 112 percent of GDP for Switzerland in 2003 and 19 percent for the United States (UNCTAD 2004b). In performance index rankings for outward FDI between 2001 and 2003, Switzerland was ninth, and the United States thirtieth, among listed nations.[1] Both countries have also become important hosts to foreign MNEs and inward direct investment. Inward FDI stocks as a share of Swiss GDP increased from 8 percent in 1980 to 50 percent in 2003; for the United States, from 3 to 14 percent.[2]

For both countries, portfolio investment faces low barriers. Outward portfolio investment is particularly weighty for Switzerland, while inward portfolio investment is a major feature of the US economy. Portfolio investment exchanges between the two countries are substantial, with equity holdings as the dominant asset. The size of Swiss-US portfolio income flows is quite considerable, especially when benchmarked against flows to and from the European Union.

1. Based on data reported in UNCTAD (2004b).

2. From 2001 to 2003, Swiss and US inward "FDI performance," as measured by a three-year moving average of several indexes, ranked 49th and 112th respectively. According to a recent OECD report, Switzerland's gross fixed capital formation will rise by 3.6 percent in 2006, driven partly by inward FDI. This estimate is supported by UNCTAD, which argues that the short- and medium-term outlook for the Swiss economy seems brighter than it has in the past four years. See OECD (2005) and UNCTAD (2004b).

In most bilateral relationships, US outward direct investment outpaces the partner country's investment in the United States. The opposite is true, however, in the Swiss-US relationship: Swiss direct investment in the United States has historically exceeded US FDI in Switzerland. In 2003, the stock of Swiss FDI in the United States, based on US data, reached $113 billion, while the stock of US FDI in Switzerland was $86 billion (tables 7.1 and 7.2). In fact, the United States is the chief destination for Swiss direct investments abroad, making Switzerland the sixth-largest foreign direct investor in the United States, surpassing Canada. Conversely, Switzerland is the fourth most important destination for US direct investments, and US-based MNEs are the most important foreign investors in Switzerland. US companies prefer to have their European headquarters in Switzerland, because of its central location, good air access, and skilled multilingual personnel. A key Swiss objective in its free trade agreement (FTA) with the United States is to reinforce these advantages.

A recent OECD (2005) cross-country analysis examines the treatment of direct investment in international agreements, arguing that superior benefits result from addressing investment issues in multilateral and bilateral trade agreements rather than classic bilateral investment treaties (BITs), because of the former's broader scope. A Swiss-US FTA that addresses the small number of Swiss and US investment frictions should augment an already robust relationship.

Negotiating issues that might arise within the context of a Swiss-US FTA can be anticipated by analyzing each country's position. We first evaluate bilateral FDI within a larger transatlantic context, and sketch the industry and geographic breakdown of bilateral FDI stocks. The next two sections identify leading companies in the Swiss-US relation, the share of FDI in capital formation, and its relation to GDP. We address a handful of barriers facing FDI and then turn to portfolio investment. Portfolio investment channeled by Swiss financial institutions to the United States is huge and encounters very few obstacles. The chapter concludes with recommendations, mainly for FDI.

Foreign Direct Investment in Perspective

By year-end 2003, the global stock of outward US direct investment totaled $1.789 trillion (historical cost). Stock in the EU-15 totaled approximately $845 billion, and over $86 billion was placed in Switzerland (table 7.1). In US FDI, Switzerland thus hosts approximately 10 percent of the EU-15 level. Recent increases in US direct investment in Europe mainly reflect activity in the United Kingdom, Switzerland, the Netherlands, and Germany. Since 1999, US FDI stock in each of these countries has increased by at least $30 billion.

Table 7.1 US foreign direct investment stock abroad by industry, 2003[a]

	Switzerland		EU-15		World	
Industry	**Billions of dollars**	**Percent of total FDI**	**Billions of dollars**	**Percent of total FDI**	**Billions of dollars**	**Percent of total FDI**
Depository institutions (banks)	7.1	8	27.8	3	63.7	4
Information	–2.7	–3	32.2	4	47.5	3
Finance (except banks) and insurance	3.3	4	110.8	13	299.8	17
Manufacturing						
Chemicals	3.0	3	48.3	6	90.3	5
Computers and electronic products	0.6	1	23.5	3	57.6	3
Electrical equipment, appliances, and components	(D)	(D)	4.3	1	9.7	1
Food	0.2	0	10.1	1	22.7	1
Machinery	0.5	1	10.2	1	21.4	1
Primary and fabricated metals	(D)	(D)	8.8	1	23.0	1
Transportation equipment	(D)	(D)	15.0	2	45.4	3
Subtotal	8.7	10	160.3	19	378.0	21
Mining	0.0	0	12.1	1	98.7	6
Professional, scientific, and technical services	0.5	1	19.8	2	40.6	2
Real estate, rental, and leasing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Retail trade	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Utilities	0.0	0	7.9	1	26.9	2
Wholesale trade	11.9	14	75.9	9	140.6	8
Other industries[b]	57.6	67	397.8	47	693.1	39
Total	86.4	100	844.7	100	1,788.9	100

(D) = deleted to maintain data confidentiality
n.a. = not available

a. Historical cost basis, year-end 2003.
b. Holding companies (except banks) comprised 84 percent of the "other industries" share to the world.

Source: US BEA (2004a).

Table 7.2 Foreign direct investment stock in the United States by industry, 2003[a]

Industry	Switzerland		EU-15		World	
	Billions of dollars	Percent of total FDI	Billions of dollars	Percent of total FDI	Billions of dollars	Percent of total FDI
Depository institutions (banks)	(D)	(D)	60.4	7	87.5	6
Information	11.7	10	76.8	9	120.1	9
Finance (except banks) and insurance	23.0	20	108.8	13	185.7	13
Manufacturing						
Chemicals	26.2	23	83.1	10	123.2	9
Computers and electronic products	0.6	1	26.1	3	45.9	3
Electrical equipment, appliances, and components	(D)	(D)	7.2	1	42.3	3
Food	5.3	5	10.3	1	19.1	1
Machinery	2.6	2	27.0	3	37.7	3
Primary and fabricated metals	1.3	1	11.7	1	19.4	1
Transportation equipment	(D)	(D)	36.3	4	63.7	5
Subtotal	72.3	64	291.8	34	475.5	35
Mining	(D)	(D)	(D)	(D)	(D)	(D)
Professional, scientific, and technical services	0.5	0	22.8	3	28.4	2
Real estate, rental, and leasing	0.6	1	18.7	2	47.0	3
Retail trade	0.3	0	17.6	2	24.2	2
Utilities	(D)	(D)	(D)	(D)	(D)	(D)
Wholesale trade	4.0	4	101.3	12	182.2	13
Other industries	(D)	(D)	157.4	18	227.5	17
Total	112.9	100	855.7	100	1,378.0	100

(D) = deleted to maintain data confidentiality

a. Historical cost basis, year-end 2003.

Source: US BEA (2004b).

By year-end 2003, the inward stock of FDI in the United States from all countries was valued at $1.378 trillion (historic cost). Of this total, $856 billion originated from the EU-15 and $113 billion from Switzerland (table 7.2). By country of origin, the United Kingdom holds first place, followed by Japan, Germany, the Netherlands, France, Switzerland, and Canada. For comparison, UK FDI is 16.7 percent of the US total inward stock, while Swiss FDI is 8.2 percent. Over the past five years, affiliates with parents in the United Kingdom, Germany, Luxembourg, the Netherlands, and Switzerland accounted for the largest dollar increases of inward investment positions in the United States.

Swiss-US FDI

The total stock of inward foreign direct investment in Switzerland reached 200 billion Swiss francs in 2003, or approximately $154 billion at end-2003 exchange rates (chapter appendix table 7A.1). This represents an 18-fold increase of inward FDI in Switzerland since 1980, and an almost fivefold increase since 1990.[3] In 2003, the United States was the largest single source of FDI in Switzerland, accounting for 40 percent of the country's total, up from 28 percent in 1998. EU member states taken together held 56 percent, with the Netherlands, Germany, and France constituting the largest EU sources of FDI in Switzerland. The recent growth in US FDI primarily reflects activity in the financial and management sector. Within this sector, holding companies play the most significant role by far (table 7.1). Investment in Swiss finance and holding companies, reaching nearly 50 percent in 2003, likewise accounts for the predominant share of global FDI in Switzerland (chapter appendix table 7A.1).

Total Swiss FDI in the United States reached almost $113 billion in 2003, which represents about 13 percent of the total EU-15 FDI stock in the United States (table 7.2). The stock of Swiss FDI in the European Union is about twice as large as Swiss FDI in the United States (chapter appendix table 7A.2). Switzerland's FDI in the United States is concentrated in the manufacturing sector, where pharmaceuticals and food are prominent. The US financial sector receives a fifth of total Swiss FDI (table 7.2). On a global level, Swiss firms allocate almost twice as much FDI to services as they do to manufacturing (chapter appendix table 7A.2).

As already mentioned, FDI in Switzerland is highly concentrated in finance and kindred activities. In 2003, out of a total inward FDI stock of 200 billion Swiss francs, 53 percent was attributed to financial and holding companies,[4] 15 percent to banks and insurance, and 10 percent to commerce

---

3. The stock of total FDI in Switzerland increased from $9 billion in 1980, to $34 billion in 1990, to $154 billion in 2003. See UNCTAD (2004b).

4. In 1998, the comparable figure was 44 percent.

(chapter appendix table 7A.1). The remainder is essentially divided between transport, chemicals and plastic, machinery and metalworking, electronics, energy, optics, and watches.[5]

The stock of Swiss FDI in the United States reflects major investments in pharmaceuticals, chemicals, food, equipment, finance, and banking (UNCTAD 2004b). As table 7.2 illustrates, Swiss FDI in the US manufacturing sector ($72 billion) accounted for about 64 percent of total Swiss FDI stock in the United States ($113 billion).

FDI Income Flows

FDI income flows—dividends, interest, and royalties—between the United States and Switzerland are significant in both directions. Flows from the United States to Switzerland are about $13 billion annually; from Switzerland to the United States, approximately $7 billion (table 7.3). By comparison, FDI income flows from the EU-15 to the United States are about $10 billion annually.

The Connection Between FTAs, FDI, and Exports

Appendix D summarizes several academic articles on the connection between FTAs and FDI. Most studies use variants of the gravity model. While different studies reach different numerical results, on the whole, FTAs are found to encourage inward FDI. Each country extends its own economic market to include the partner. Firms located in one FTA partner gain reliable access to markets in and inputs from the other partner. The FTA assures that firms can acquire industrial inputs from the partner country, free of tariffs and other barriers, and that goods and services can be readily sold to purchasers in the partner country.

The empirical studies suggest that, for Switzerland, the FDI-augmenting effect of an FTA could be substantial. Linked to the United States, Switzerland would extend its "economic market" by 4,700 percent, since US GDP is almost 47 times the size of Swiss GDP. Even applying an elasticity coefficient of 0.01—about the size of the smallest positive elasticity reported in appendix D—the increase in the inward Swiss FDI stock (from all sources) might eventually exceed 40 percent. Applied to US investment in Switzerland, a 40 percent increase suggests that the US FDI stock in Switzerland might eventually rise by $34 billion on account of the FTA, or to about $120 billion from its 2003 level of $86 billion.

5. Figures provided by the Swiss National Bank (2004).

Table 7.3 US income flows from FDI and portfolio investment, 2004 (billions of dollars)

	Switzerland		EU-15		World	
	To United States[a]	From United States[b]	To United States[a]	From United States[b]	To United States[a]	From United States[b]
FDI income[c]	6.8	13.0	9.9	n.a.	92.8	209.3
Portfolio income	9.3	38.2	61.9	75.2	143.4	235.1

n.a. = not available

a. US income from investments in Switzerland, EU-15, and world.

b. Payments to foreign owners (Swiss, EU-15, and world) from investments in the United States.

c. FDI income flows include dividends, interest, and royalties.

Source: US BEA (2004b).

Empirical analysis by Graham and Wada (2000) suggests that a 40 percent increase in the US FDI stock in Switzerland might boost US manufactured exports by 24 percent.[6] Assuming a 24 percent increase, US exports of manufactures might rise by $2.2 billion annually (from $9.2 billion to $11.4 billion) on account of the pull from a larger US FDI stock in Switzerland. While all these estimates are highly speculative and exceedingly rough, it seems likely that a Swiss-US FTA would sharply boost both direct investment in Switzerland and US exports to Switzerland. To a very much smaller extent, the FTA would inspire parallel effects in the other direction, as adding Switzerland to the US economic market represents an increase of only about 2 percent in US market size.

Chapter appendix table 7A.3 illustrates the complementary relationship between exports and outward direct investment. Over 1994–2004, positive correlations between FDI stocks and exports can be observed in both directions, as between Switzerland and the United States. For example, US FDI stock in Swiss manufacturing industries increased by 6.8 times, while US manufactured exports increased 1.7 times. Simple correlations such as these do not, of course, demonstrate causality, but they do suggest that Swiss-US experience supports the causal relationships found by Graham and Wada (2000) using sophisticated econometric techniques.

6. Graham's estimated coefficient is an increase of 6 percent in US manufactured exports for every 10 percent increase in the US stock of FDI. Hejazi and Safarian (1999), however, estimate a much smaller coefficient for the "pull" on Canadian exports. The higher US coefficient estimated by Graham may reflect the fact that the United States can supply a very wide array of manufactured goods.

Leading Companies in the Bilateral Relationship

Of the world's 100 largest nonfinancial MNEs, five are Swiss (Nestlé, ABB, Novartis, Roche Group, and Holcim), and 25 are American. The top Swiss firms, together with many others, are present in the United States (table 7.4). In 2004, Swiss-owned companies operating in the United States employed 500,000 people and paid an average compensation per employee of about $64,000 (US BLS 2005). Average US compensation per employee is approximately $53,000.[7] In 2002, Swiss firms spent over $4.3 billion on US research and development activities and imported $6.2 billion of goods from the United States. Nestlé appears to be the largest Swiss firm operating in the United States, employing almost 47,000 people in the food sector (table 7.4).

Swiss direct investment is largest in New Jersey ($5.5 billion), California ($4.9 billion), New York ($2.9 billion), Texas ($2.4 billion), and Illinois ($1.5 billion) (see UNCTAD 2004b). Illinois has the largest number of Swiss companies (147), followed by New York (96), Missouri (130), Pennsylvania (98), and Florida (68).

In 2004, US-owned companies in Switzerland employed 58,000 people. Of the 650 American companies in Switzerland, the largest employers are McDonald's, IBM, and Altria. Following suit, the principal sectors are food, technology, and consumer goods. Over the past two decades, US parent companies have increasingly used holding companies—essentially, management vehicles—to supervise their worldwide activities, and many of these companies are based in Switzerland.[8] The US parent companies of Swiss firms are mostly headquartered in New York, Nevada, California, Utah, and New Jersey.[9]

FDI Related to Capital Formation and GDP

Swiss inward and outward FDI flows are a substantial proportion of annual gross fixed capital formation. On average, between 1998 and 2003, they amounted to 22 and 44 percent respectively (table 7.5). The current

7. Based on the hourly compensation rate of $25.57 for the fourth quarter of 2004, as reported by the US BLS (2005).

8. In technical terms, a holding company is a company whose primary activity is holding the securities or financial assets of other companies. See US BEA (2004a, 2004b).

9. New York firms invest most heavily in miscellaneous manufactures, used merchandise, and chemical manufactures. Nevada comes next, with a focus on primary metals, particularly gold and silver. Following them are California (chemical manufactures, computer and electronic products, transportation equipment, including aircraft parts), Utah (primary metal manufactures essentially), and New Jersey (chemical manufactures, primary metal manufactures, computer and electronic products). For more information, see the Embassy of Switzerland (2005) in Washington, DC.

Table 7.4 Top 15 companies in the bilateral relationship, 2004

Rank	Name	Number of employees
Swiss companies in the United States		
1	Nestlé	46,600
2	UBS AG	25,000
3	Zürich Financial Services	21,100
4	Novartis	20,000
5	Crédit Suisse	18,500
6	Hoffmann-La Roche	17,000
7	ABB	11,000
8	Gate Gourmet	10,000
9	Schindler	6,500
10	Adecco	6,500
11	Scintilla	3,000
12	SGS	3,800
13	Syngenta	3,000
14	Holcim	2,300
15	Clariant	2,800
	Total employment	197,100
US companies in Switzerland		
1	McDonald's	7,200
2	IBM	3,400
3	Altria Group, Inc.	3,000
4	Johnson & Johnson	2,100
5	Hewlett-Packard	1,800
6	Synthes-Stratec	1,700
7	Texas Pacific	1,600
8	Procter & Gamble	1,500
9	Cablecom	1,450
10	Mettler-Toledo	1,250
11	General Electric	970
12	EDS	965
13	HCA Healthcare	900
14	Johnson Controls	900
15	Dow	830
	Total employment	29,565

Source: Swiss-American Chamber of Commerce (2005).

Table 7.5 FDI flows as share of gross fixed capital formation (percent)

Annual average during period	Inward FDI flows		Outward FDI flows	
	United States	Switzerland	United States	Switzerland
1992–97	5.4	4.7	7.1	21.3
1998–2003	9.1	22.0	7.7	43.9

Source: UNCTAD (2004b).

level of FDI flow into Switzerland reflects an almost fivefold increase since the early 1990s.[10] The current level for Swiss outward FDI represents a twofold increase over the same period, and constitutes a substantial share of Swiss gross fixed capital formation.

While Swiss inward and outward flows have reached a two-digit relationship to gross fixed capital formation, in the United States, both inward and outward flows remain at a one-digit relationship. US inward FDI as a percentage of gross fixed capital formation rose from about 5 percent in the early 1990s to about 9 percent in the late 1990s (table 7.5). Outward FDI has increased less, remaining in the range of 7 to 8 percent of gross fixed capital formation.

For both the United States and Switzerland, the size of the FDI stock has grown significantly relative to GDP. As portrayed in table 7.6, Swiss inward FDI rose from 8 percent of GDP in 1980 to nearly 50 percent in 2003. Swiss outward FDI escalated nearly sixfold relative to GDP since 1980, from 20 percent to 112 percent. Likewise, US inward FDI rose from 3 percent of GDP in 1980 to 14 percent in 2003. Relative to GDP, outward US FDI grew from 8 percent in 1980 to almost 19 percent in 2003.

In market value, FDI in the United States reached $2.435 trillion in 2003, reflecting both financial inflows and a substantial appreciation in share values. By comparison, historical-cost FDI in the United States was $1.378 trillion for 2003, less than two-thirds of the market value.

Impediments to FDI in Switzerland

Investment barriers are very low in Switzerland, and the country has a reputation for welcoming FDI. The freedom of trade and industry guaranteed by the Swiss Constitution allows anyone, including foreign nationals, to

10. Based on the indicated average of 4.7 percent for inward FDI as a share of gross fixed capital formation between 1992 and 1997.

Table 7.6 FDI stock as share of GDP[a] (percent)

	Inward FDI stock		Outward FDI stock	
Year	**United States**	**Switzerland**	**United States**	**Switzerland**
1980	3.0	7.9	7.8	20.0
1990	6.9	15.0	7.5	28.9
2000	12.4	36.1	13.2	97.1
2003	14.1	49.7	18.8	112.0

a. Historical cost basis, year-end.

Source: UNCTAD (2004b).

operate a business in Switzerland, establish a company, or acquire a company. With few exceptions, establishing a business requires no approval from the government, chambers of commerce, or professional associations. Switzerland does not have a screening mechanism for foreign investments, nor does it have preferences or restrictions in sector or geography. Since 1997, permission has not been required to buy commercial or industrial real estate, or principal residences. Exchange control restrictions on capital flows are unknown.

However, there are Swiss investment restrictions in sectors dominated by public monopolies, including rail transport, postal services, certain insurance services, aspects of trade in alcoholic beverages, and salt (WTO 2004b). Special licensing provisions apply to banks, insurance companies, and investment brokers. They also affect hotels and restaurants in certain cantons. Physicians, dentists, pharmacists, and attorneys are licensed professions, as are certain mercantile and service businesses, such as wine merchants, private employment agencies, and temporary employment services.

Temporary Skilled Worker Visas

MNEs usually require foreign nationals, both permanent and temporary, to carry out key operations. If visas and work permits are difficult to obtain, the country becomes a less desirable location, especially for headquarters activity. Foreign nationals may perform skilled activities in Switzerland on a temporary basis, if they have the required permits (WTO 2004b). For some cases, visa approval requires demonstration of need. This situation will evolve, as residence qualifications for EU nationals will be completely liberalized by 2014 under the bilateral agreement with the European Union on free movement of persons.[11]

11. Similar terms apply to nationals of the European Economic Area (EEA).

In the nonfinancial sector, all corporate directors must be individuals (not other companies), and the majority of the board of directors of a stock corporation must be Swiss citizens, residing in Switzerland.[12] However, this latter requirement does not apply to holding companies. At least one managing director of a limited liability company must reside in Switzerland, and to establish a branch of a foreign company in Switzerland, an individual residing in Switzerland must be nominated as representative.[13] The Swiss parliament is considering repealing the nationality requirement, in line with Switzerland's initial offer in 2003 in the General Agreement on Trade in Services (GATS) negotiations. Draft legislation was originally published in the *Federal Journal* in July 2001, and the legislation is expected to enter into force by 2007.

Companies or their manufacturing facilities must be registered at cantonal or district levels. In certain regions, such as remote zones, the confederation and canton may provide investment incentives. Examples include tax exemptions for up to ten years, or a financial guarantee of up to one-third of the total cost of a project for eight years.

Impediments to FDI in the United States

As a general rule, foreign investors, like domestic firms, are not obligated to register with or seek approval from the federal government (EIU 2005b). Foreign firms are not subjected to local content requirements, ownership restrictions, or current transfer requirements, nor do they face controls on foreign exchange access or repatriation of profits. However, an important impediment that faces nearly all foreign firms is the difficulty and expense of obtaining work visas (e.g., H1-B visas) for temporary personnel.

Other barriers remain for foreign firms entering banking, mining, defense contracting, fishing, shipping, communications, aviation, and certain energy industries. The federal government also screens foreign

12. According to the WTO (2004b, 38), "Switzerland's revised Law on Stock Corporations, adopted in 1991, forms the basis of its investment legislation. Corporate governance (except in the banking sector) is generally based on a unitary system in which the board of directors has supreme strategic responsibility for the conduct of a company's affairs. Related powers may not be delegated, nor may they be withdrawn by the shareholders."

13. The WTO elaborates on Swiss establishment procedures in greater detail. For instance, it explains that "a permanent residence permit of the associate(s) is required under cantonal laws for the establishment of a commercial presence in the form of an enterprise without legal personality under Swiss law (i.e., in a form other than stock corporation, limited liability company or cooperative society), and for the establishment of a commercial presence by natural persons. (. . .) The minimum capital requirement ranges from Sfr 20,000 to Sfr 100,000 depending on the form of business; a maximum of Sfr 2 million is set for limited liability companies. (. . .) Establishment of a limited liability company does not normally take more than 10 days, substantially under the European average" (WTO 2004b, 39).

acquisitions that might threaten national security under the terms of the Exon-Florio amendment.[14] As a general rule, foreign nationals or firms are allowed to purchase US real estate, but some states restrict the purchase of land.[15] Foreign nationals or firms must report to the US Department of Agriculture when they purchase agricultural land (EIU 2005b).

A European Commission (2004a) report singled out three FDI limitations in the United States. The first involves the Exon-Florio amendment; the second deals with foreign ownership restrictions in areas such as defense, communications, and aviation; and the third concerns tax discrimination.

The Exon-Florio Amendment

To monitor the influence of foreign investment in the United States, a Committee on Foreign Investment in the United States (CFIUS)[16] was established in 1975. From its inception, the committee received notification of foreign acquisition of US companies, then determined whether such acquisitions raised national security concerns. The committee's authority was bolstered, in 1988, by passage of the Exon-Florio amendment,[17] which authorizes investigations into the national security dimensions of foreign acquisitions. This considerably expanded federal authority to obstruct foreign investment. While a threat to national security is the statutory justification for impeding FDI, "national security" is an elastic term that can be interpreted expansively, if the president wishes;[18] under Exon-Florio, CFIUS reports and advises the president, who makes a final determination.

---

14. In addition, restrictions exist on financial transactions with Cuba and Cuban nationals, Burma, Iran, Iraq, Sudan, the Taliban, specified terrorist groups, and specified drug traffickers. Those restrictions are strictly enforced (EIU 2005).

15. State restrictions are easily circumvented by establishing a US corporate presence.

16. The CFIUS is an interagency committee that is chaired by the Secretary of the Treasury and contains representation by the departments of state, defense, commerce, and justice; and the offices of management and budget, the US trade representative, and the Council of Economic Advisers. See Graham and Krugman (1995).

17. The Exon-Florio Amendment to the Defense Production Act (section 5021 of the 1988 Trade Act) encourages the president to investigate the potential national security impact of any merger, acquisition, or takeover leading to foreign ownership of legal persons engaged in interstate commerce. The president can block any foreign transaction on national security grounds.

18. According to Graham and Krugman (1995, 132), the role of the CFIUS "remains to be fully defined [and it is feared] that the direction of policy is toward ever broader definitions of national security concerns, [which would lead] the Exon-Florio amendment [to create] a de facto screening agency for FDI."

Apart from blocking a handful of transactions, the Exon-Florio amendment and CFIUS process can inflict delays and legal costs on foreign firms.[19] The United States has taken a reservation for Exon-Florio under the OECD Code of Liberalization of Capital Movements and the National Treatment Instruments, and after the terrorist attacks of September 11, 2001, the European Commission asserts that potential acquisitions in the telecommunications sector were deterred by the Exon-Florio amendment (European Commission 2004a).[20]

Foreign Ownership Restrictions

According to the OECD, the United States scores slightly below the OECD mean on an aggregate indicator of FDI restrictions (OECD 2004c). Foreign ownership restrictions usually involve limiting the share of foreign equity capital in selected sectors. In 2000, such equity restrictions were comparatively more stringent in the United States than they were in the European Union.

Equity restrictions are based on a mix of sovereignty and national security concerns. Most pertinent for Switzerland, the United States maintains restrictions on the share of foreign ownership in a few services sectors in the communications market, including broadcasting, common carrier radio licenses, and mobile phones. For example, a foreign investor can only own 20 percent of a US firm that holds common carrier radio licenses.

Tax Discrimination

Foreign investment in the US market may face discriminatory tax practices (European Commission 2004a). Tax discrimination arguably originates from burdensome reporting requirements, "earnings-stripping" provisions, and state "worldwide" unitary tax systems.[21] We merely note these issues

---

19. Over the past 18 years since the Exon-Florio amendment, the CFIUS has reviewed approximately 10 percent of all foreign acquisitions proposed in that period. These 1,560 reviews led to 25 investigations, of which 11 were approved. Of the remaining transactions, 13 investigations were cancelled by the parties, and only one was halted by the president (Bruce Stokes, "Tighter Control of Foreign Investment?" *National Journal,* July 23, 2005, 2389).

20. US agencies have allegedly used the Exon-Florio legislation to impose stringent corporate governance requirements "on companies seeking FCC approval of the foreign takeover of a US communications firm in the form of Network Security Arrangements going further than before" (European Commission 2004a).

21. US reporting rules obligate foreign controlled firms to keep books and records on related parties transactions, and to store the required documents in a location that the US tax authority specifies. Internal Revenue Code provisions on "earnings stripping" limit the extent of

without commenting on them. Historically, tax issues are addressed in tax treaties, not in FTAs, and the Swiss-US FTA is very unlikely to depart from historic practice. Moreover, US and Swiss withholding tax rates on direct investment income flows to parent companies based in the other country are very low because of the bilateral income tax treaty of 1996.[22] The statutory rate of Swiss withholding tax is 35 percent, while the statutory US rate is 30 percent. However, the bilateral Swiss-US withholding tax rates on FDI flows are only 5 percent for dividends, 5 percent for interest, and zero percent for royalties. Withholding taxes paid to the foreign jurisdiction can be credited against the parent firm's home country tax liability, which mitigates their force as an investment deterrent.

International Disputes

Investment disputes between the United States and Switzerland are rare.[23] No disputes involving both of them are listed among the cases addressed by the International Center for Settlement of Investment Disputes (ICSID). The United States is, however, involved in numerous cases, more often resulting from foreign demands for equal treatment in the United States than the other way around. For example, based on the 1978 US International Banking Act, all foreign-owned bank operations in the United States face constraints on interstate banking. Although domestic banks in the United States are subject to substantially similar restrictions, these controls remain more severe than parallel restrictions against US banks in Europe.[24]

The North American Free Trade Agreement (NAFTA) contained a major innovation in establishing a trilateral mechanism for handling investment disputes. Mexico had long been a champion of the Calvo doctrine, which called for strict regulation of foreign investment and required that disputes be adjudicated only in local courts. The NAFTA accord codified a major change in Mexican policy: It liberalized investment rules and created, in Chapter 11, a trilateral dispute resolution framework.[25] Mexico thus signaled to investors that it was committed to a new regime,

---

interest payments that can be made to a related party and still be deducted against US corporate income. State "worldwide" unitary tax systems can subject the foreign earnings of a Swiss MNE (for example) to taxation by a state (e.g., California).

22. This Swiss-US treaty became effective as of 1998. For complete details, see US IRS (1998).

23. This section draws on Hufbauer and Schott (2005).

24. Under pressure from the United States, the commission decided, in the spring of 1989, that it would apply a national treatment rather than a reciprocity standard for US banks operating in Europe. For more information, see ICSID (2005).

25. NAFTA's Chapter 11 refers to its dispute settlement mechanism.

and correspondingly opened many sectors to foreign investment (Vega-Cánovas and Winham 2002).[26]

Chapter 11 of NAFTA is unique among NAFTA provisions in allowing private investors to enforce government obligations.[27] For purposes of the NAFTA dispute settlement process, the definition of investment is broadened to include minority interests, portfolio investment, and real property. NAFTA's substantive rules include investment liberalization rights for foreign investors (Article 1101) and guarantees to protect existing investments established under conditions more favorable than those scheduled in the national reservations of individual NAFTA members (Article 1108).[28] However, the investor provisions that have sparked the most disputes filed under Chapter 11 are national treatment rights (Article 1102), most favored nation (MFN) rights (Article 1103), minimum international standards of treatment (Article 1105), performance requirements (Article 1106), and especially provisions for compensation in the event of expropriation (Article 1110). Article 1110 is the most criticized because it attempts to balance investor rights with government measures to protect public welfare.

In a joint statement, NAFTA member governments somewhat narrowed the scope of foreign investment protections under Chapter 11, and concurrently, the US government adopted more restrictive investor protection language in its FTAs with Chile, Singapore, and Central American countries (NAFTA Free Trade Commission 2005). The new language in the Chile and Singapore FTAs indicates that environmental or health regulations would rarely constitute indirect expropriation eligible for compensation.

Hufbauer and Schott (2005) recommend that NAFTA's Chapter 11 should add an appellate body for investor state disputes. A similar proce-

26. According to Vega-Cánovas and Winham (2002), industries opened to FDI included railroads, telecommunications, satellite transmission, banking, and some petrochemicals. However, the NAFTA accord did not mean North America was wide open to foreign investors. In fact, each country maintained investment thresholds or screening mechanisms. There are three types of reservations under NAFTA's Chapter 11: sectoral, reciprocal ("tit for tat"), and investment review reservations. Among the three NAFTA partners, the United States retained the longest list of "tit-for-tat" reservations.

27. Several principles embodied in NAFTA Chapter 11 are also found in the WTO Agreement on Trade Related Investment Measures (TRIMs). However, unlike NAFTA, the WTO TRIMs agreement does not grant private foreign investors the right to launch dispute settlement proceedings.

28. Under Article 1108 (4), no party may "require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective." Other rights and obligations covered under Chapter 11 are prohibitions on senior management nationality requirements (Article 1107), and an environmental protection provision, under which members are not allowed to reduce environmental standards to attract investment (Article 1114) (Hufbauer and Schott 2005).

dure might be adopted in the Swiss-US FTA. An appellate body could help establish clear and uniform jurisprudence for arbitration panels.

Portfolio Investment

Table 7.7 gives an overview of portfolio securities holdings between the United States and Switzerland, the European Union (EU-15), and the world.[29] While the stock of total US inward portfolio investment was about $6 trillion in 2004, total outward portfolio investment was about $3.2 trillion. Similarly, in 2003, the stock of Swiss portfolio investment abroad totaled $650 billion, while the stock of inward portfolio investment in Switzerland amounted to about $450 billion (table 7.8).

The largest share of US inward portfolio investment is in long-term debt securities (59 percent), while equity investment constitutes the most important component of US portfolio investment abroad (66 percent). For Switzerland, equities are the largest share of inward portfolio investment (89 percent in 2003), while debt securities, specifically bonds, are the largest component of outward portfolio investment (55 percent) (table 7.8). Swiss holdings of US portfolio securities totaled approximately $200 billion in 2004, while US holdings of Swiss portfolio securities totaled $120 billion in 2003. Swiss portfolio investment in the United States represents 3 percent of total US inward portfolio investment.

Likewise, US holdings of Swiss portfolio securities represent 4 percent of the share of total US holdings of foreign portfolio securities. US holdings of Swiss securities are about 7 percent of US holdings of EU-15 securities. By contrast, Swiss portfolio investment in the United States is about 10 percent of EU-15 portfolio investment in the United States.

Equity Investment

Equity investment constitutes 98 percent of US portfolio investment in Switzerland and 60 percent of Swiss portfolio investment in the United States. By comparison, equities represent only 40 percent of EU portfolio investment in the United States, and 53 percent of US portfolio investment in the EU-15.

In 2003, Swiss holdings of US equities amounted to $120 billion, or 6 percent of total foreign equity investment in the United States (table 7.7).

29. Data on foreign holdings of US portfolio securities and US holdings of portfolio securities, by type and country, are available at US Department of the Treasury (2005). Data on Swiss portfolio investment abroad on a global basis can be found on the Swiss National Bank (2005b). However, Swiss data do not provide for a detailed picture of the Swiss position in the United States or Europe.

Table 7.7 US holdings of portfolio securities by partner and type, 2003–04 (billions of dollars)

	Switzerland		EU-15		World	
	To the United States, 2004	From the United States, 2003	To the United States, 2004	From the United States, 2003	To the United States, 2004	From the United States, 2003
Equity securities	120	118	843	977	1,904	2,079
Long-term debt securities	69	1	1,106	412	3,515	874
Treasury debt	33	n.a.	n.a.	n.a.	1,462	n.a.
Other long-term debt	36	1	n.a.	n.a.	2,052	n.a.
US agency debt	12	n.a.	n.a.	n.a.	623	n.a.
Corporate debt	24	n.a.	n.a.	n.a.	1,429	n.a.
Short-term debt securities	11	1	137.0	153	588	199
Total debt	80	2	1,243.0	442	4,103	874
Total equity and debt	199	120	2,086	1,832	6,007	3,152

n.a. = not available

Source: US Department of the Treasury (2005).

Table 7.8 Swiss holdings of portfolio securities (world totals), 2003[a]
(billions of Swiss francs and dollars)

	To Switzerland		From Switzerland	
	Dollars	**Swiss francs**	**Dollars**	**Swiss francs**
Equity securities	398.4	498.0	290.6	363.2
Shares	345.4	431.8	179.8	224.8
Investment fund certificates	53.0	66.2	138.4	173.0
Debt securities	58.8	73.5	360.1	450.1
Bonds	46.2	57.7	331.9	414.9
Money market paper	0.9	1.1	28.2	35.2
Total equity and debt	445.6	557.0	650.4	813.0

a. End = 2003, Sfr 1.00 = US$ 0.80, according to the IMF's *International Financial Statistics* database.

Source: Swiss National Bank (2005b).

US holdings of Swiss equities amounted to $118 billion, accounting for 6 percent of total US equity investment abroad. US inward and outward equity investments with Switzerland are thus about the same. This relationship also holds for equity investment between the United States and the European Union.[30]

Debt Securities

Long-term debt securities accounted for 35 percent of total Swiss portfolio securities in the United States but represented only 1 percent of US portfolio investment in Switzerland (table 7.7). In other words, investment in debt securities between Switzerland and the United States is heavily one-sided. Swiss holdings of US debt securities total approximately $80 billion, while US holdings of comparable Swiss securities amount to only $2 billion. This pattern is not unique to Switzerland, however. The United States has invested much more heavily in the EU debt market, with long-term debt securities representing 23 percent of overall US portfolio investment in the European Union. Nevertheless, EU outward debt investment in the United States ($1.106 trillion) is almost three times higher than EU inward investment from the United States ($412 billion) (table 7.7).

30. US holdings of EU equities amounted to $977 billion in 2003, while EU holdings of US equities amounted to $843 billion in 2004 (table 7.8).

In large part, the Swiss-US relationship is lopsided because Swiss banks act on behalf of investors around the world, many of whom want to acquire US debt securities. Meanwhile, most US investors who want to hold European debt securities prefer the larger and more liquid markets of Germany, France, and Italy.

Portfolio Income Flows

In 2004, US portfolio income receipts from Switzerland were around $9 billion, about 15 percent of US portfolio income receipt inflows from the EU-15. In the same year, Swiss portfolio income receipts from investments in the United States (US payments in table 7.3), reached $38 billion. This figure corresponds to half of the amount of EU-15 portfolio income receipts from investments in the United States, and underscores Switzerland's role as a financial center.

Portfolio Investment Issues

Barriers to portfolio investment in the United States and Switzerland are insignificant. They persisted in US real estate investment trusts (REITs) until President George W. Bush signed into law the American Jobs Creation Act of 2004, which gives foreign portfolio investors in listed US REITs the same favorable tax treatment that US corporations have (AFIRE 2004).

The rate of withholding taxes for Swiss-US portfolio investment is about half of the statutory rate. For both countries, the withholding tax rate is 15 percent of portfolio investment income flows (PWC 1999). However, these tax payments can be credited against the home country tax liability. This credit is important for portfolio investors that pay home country taxes, but it does not alleviate the tax burden for nonprofit investors and pension funds that pay no domestic taxes.

Swiss banks have raised concerns over the question of information exchange. However, the US Treasury appears to have no intention of raising exchange of information or money laundering issues in a Swiss-US FTA.[31]

31. A recent case involving Nigeria provides evidence that the Swiss government and banks are committed to fighting corrupt money laundering by national leaders. In September 2005, Switzerland started a process for returning $458 million that was stolen by General Sani Abacha (a former president of Nigeria) and deposited in Swiss banks. Speaking at the Institute for International Economics on September 27, 2005, Swiss Secretary of State for Economic Affairs Daniel Gerber pointed out that this agreement makes Switzerland "the first and so far the only country where a court of law ordered the transfer of Abacha funds back to Nigeria" (World Bank 2005a).

Recommendations for Investment

The very good Swiss-US commercial relationship can be improved, first and foremost, by eliminating barriers to merchandise and services trade, but secondly by addressing the modest frictions in investment relations described above. If liberalization proceeds, two-way commerce can flourish, and two-way investment expand beyond its already robust level. We offer recommendations for the investment frictions that could be fruitfully addressed in the Swiss-US FTA.

- Swiss investment restrictions in sectors dominated by public monopolies should be phased out within the broader framework of welcoming private investment by Swiss and foreign firms. Rail transport, postal services, certain insurance services, and alcoholic beverages all deserve attention.
- Swiss conditions for licensing selected professions and business activities deserve scrutiny. Some of the restrictions inhibit the operations of foreign MNEs—notably, licensing terms that affect banks, insurance companies, investment brokers, employment agencies, wine merchants, hotels, and restaurants. Restrictions on certain professionals, such as attorneys and accountants, may also have an inhibiting effect, and should be reviewed. Technically speaking, this recommendation can also be classified under services, as a Mode 3 recommendation in the parlance of GATS. We point it out here because of its importance for FDI, and Switzerland's attractiveness as a headquarters location.
- Easier access to temporary employee visas is particularly important for US-based MNEs with operations in Switzerland, and for Swiss-based MNEs with operations in the United States. Swiss legislation is expected to relax visa barriers by 2007, but the FTA should supplement the process. Spouses of accredited temporary employees should be allowed to work in Switzerland. The United States should apply similar principles to Swiss nationals working on a temporary basis in the United States (usually under H1-B visas).
- Impediments to FDI in the United States primarily involve foreign ownership restrictions in selected sectors, though they potentially include the CFIUS review process. The United States should liberalize its foreign ownership restrictions that inhibit bona fide Swiss investments in the communications sector, particularly in broadcasting services, common carrier radio licenses, and mobile phone services.
- As for the CFIUS process, the United States should agree that the sole ground for blocking a bona fide Swiss transaction would be national security. Further, the United States should commit to expeditious CFIUS reviews, including advisory opinions when requested.

- As an example to the world, the Swiss-US FTA should proclaim the rights of private investors with respect to national treatment, performance requirements, standards for the public taking of private property, and appropriate compensation in the event of expropriation. For obligations, the language in the US-Chile and US-Singapore FTAs is more relevant than that of NAFTA.
- As in NAFTA, the Central American–Dominican Republic Free Trade Agreement (CAFTA-DR), and the US-Chile, US-Australia, and US-Singapore FTAs, the Swiss-US FTA should contain procedures for resolving disputes between private investors and host states through arbitration, preferably under the auspices of the ICSID. The Swiss-US FTA should also provide for an appellate body to ensure that arbitration panels are faithful and consistent in applying legal principles.
- The main friction point for portfolio investment appears to be the withholding tax rate of 15 percent. While this tax is credited against the investor's home tax liability, some important investors—such as pension funds and charitable foundations—have no home country tax liability to absorb the credit. The FTA is not the place to negotiate withholding tax rates or other tax issues, but it can be an opportunity for the parties to indicate whether the time is ripe to revisit the 1996 bilateral income tax treaty.

It is no exaggeration to say that investment is the bedrock of Swiss-US commercial relations. On every investment question of global importance, Swiss and US policies are closely aligned. Both nations agree that direct and portfolio investment should be unfettered to the maximum extent; both respect property rights; both adhere to the principles of national treatment and MFN treatment; both are skeptical of state corporations; and both take a critical but not altogether hostile view of public subsidies for infant and senescent industries.

The synergy between direct investment and trade—a matter of common observation at least since the work of Reddaway (1967) and Hufbauer and Adler (1968)—has been established by econometric research (e.g., Graham and Wada 2000). US and Swiss two-way stocks of FDI exceed $200 billion. These powerful investment links foster $20 billion of two-way trade in manufactured goods annually, $16 billion in services, and another $20 billion in FDI income flows. This relatively free flow of two-way trade in goods, services, and income cycles back to promote further investment between the two countries. To facilitate this possible feedback loop, the Swiss-US FTA should liberalize across the board, as has been discussed in this and previous chapters. But what might be the economic returns from such a move? The next chapter, which simulates liberalization according to gravity and computable general equilibrium models, offers some encouraging estimates.

Appendix 7A

Table 7A.1 Foreign direct investment stock in Switzerland, 2003[a]

Industry	United States		European Union		World	
	Billions of Swiss francs	Percent of total FDI	Billions of Swiss francs	Percent of total FDI	Billions of Swiss francs	Percent of total FDI
Manufacturing						
Chemicals and plastics	n.a.	n.a.	n.a.	n.a.	11.7	5.8
Electronics, energy, optical, and watchmaking industries	n.a.	n.a.	n.a.	n.a.	9.8	4.9
Metals and machinery	n.a.	n.a.	n.a.	n.a.	4.8	2.4
Other manufacturing and construction	n.a.	n.a.	n.a.	n.a.	6.8	3.4
Textiles and clothing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Subtotal	n.a.	n.a.	n.a.	n.a.	33.0	16.5
Services						
Banks	n.a.	n.a.	n.a.	n.a.	26.1	13.1
Finance and holding companies	n.a.	n.a.	n.a.	n.a.	105.7	52.8
Insurance	n.a.	n.a.	n.a.	n.a.	4.0	2.0
Other services	n.a.	n.a.	n.a.	n.a.	4.3	2.1
Trade	n.a.	n.a.	n.a.	n.a.	20.6	10.3
Transportation and communications	n.a.	n.a.	n.a.	n.a.	6.4	3.2
Subtotal	n.a.	n.a.	n.a.	n.a.	167.2	83.5
Total	79.2	40	112.0	56	200.2	100

n.a. = not available

a. End = 2003, Sfr 1.00 = US$ 0.80, according to IFS database.

Source: Swiss National Bank (2004).

Table 7A.2 Swiss foreign direct investment stock abroad, 2003[a]

Industry	United States		European Union		World	
	Billions of Swiss francs	Percent of total FDI	Billions of Swiss francs	Percent of total FDI	Billions of Swiss francs	Percent of total FDI
Manufacturing						
Chemicals and plastics	n.a.	n.a.	n.a.	n.a.	62.2	14.7
Electronics, energy, optical, watchmaking industries	n.a.	n.a.	n.a.	n.a.	12.4	2.9
Metals and machinery	n.a.	n.a.	n.a.	n.a.	20.1	4.8
Other manufacturing and construction	n.a.	n.a.	n.a.	n.a.	38.6	9.1
Textiles and clothing	n.a.	n.a.	n.a.	n.a.	9.4	2.2
Subtotal	n.a.	n.a.	n.a.	n.a.	142.8	33.7
Services						
Banks	n.a.	n.a.	n.a.	n.a.	59.4	14.0
Finance and holding companies	n.a.	n.a.	n.a.	n.a.	116.2	27.4
Insurance	n.a.	n.a.	n.a.	n.a.	81.1	19.1
Other services	n.a.	n.a.	n.a.	n.a.	9.6	2.3
Trade	n.a.	n.a.	n.a.	n.a.	10.8	2.6
Transportation and communications	n.a.	n.a.	n.a.	n.a.	3.8	0.9
Subtotal	n.a.	n.a.	n.a.	n.a.	280.9	66.3
Total	81.6	19	181.6	43	423.7	100

n.a. = not available

a. End = 2003, Sfr 1.00 = US$ 0.80, according to IFS database.

Source: Swiss National Bank (2004).

Table 7A.3 FDI stock and exports, selected sectors, 1994–2004

	1994	1996	1998	2000	2002	2004
Part A (billions of dollars)						
US direct investment position in Switzerland						
Total FDI stock	27.9	30.7	38.2	55.4	74.2	100.7
All manufacturing	1.6	3.7	4.5	3.4	5.4	10.8
Chemicals	0.3	1.8	2.7	1.5	2.3	4.8
Swiss direct investment position in the United States						
Total FDI stock	24.9	30.4	48.3	64.7	123.9	122.9
All manufacturing	13.2	16.2	23.2	30.1	82.4	77.3
Chemicals	6.8	8.8	14.2	18.4	25.1	30.0
US exports to Switzerland						
Total manufacturing[a]	5.5	8.2	7.1	9.8	7.7	9.2
Chemicals[b]	0.8	0.6	0.9	1.4	1.4	1.8
Swiss exports to the United States						
Total manufacturing[a]	6.2	7.6	8.4	9.9	9.1	11.2
Chemicals[b]	1.5	2.0	2.0	2.2	2.5	2.8
Part B (index values, 1994 = 100)						
US direct investment position in Switzerland						
Total FDI stock	100	110	137	198	266	361
All manufacturing	100	234	288	218	342	687
Chemicals	100	540	811	462	685	1,437
Swiss direct investment position in the United States						
Total FDI stock	100	122	194	260	497	493
All manufacturing	100	123	176	228	624	585
Chemicals	100	129	209	271	369	441
US exports to Switzerland						
Total manufacturing[a]	100	150	130	179	140	167
Chemicals[b]	100	83	114	183	179	240
Swiss exports to the United States						
Total manufacturing[a]	100	123	136	160	147	182
Chemicals[b]	100	132	132	147	166	188

a. Manufacturing is defined as all trade in HTS chapters 24 through 98.
b. Chemicals are defined as all trade in HTS chapters 28 through 38.

Sources: US BEA (2005a) and USITC (2005d).