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## Conclusions

This report has identified both benefits and obstacles to a Swiss-US free trade agreement (FTA). Our central message is that an FTA can be highly worthwhile for both parties, but requires a strong commitment to surmount entrenched interests. The size of potential benefits is directly related to the capacity of each government to liberalize trade and investment more than either has done before. Policy officials need to not only make path-breaking concessions at the negotiating table, but also build persuasive coalitions for liberalization at home.<sup>1</sup>

The US trade promotion authority (TPA) expires in June 2007. Without that authority, it will be almost impossible for the United States to negotiate and ratify a free trade pact with Switzerland. For the United States, as for Switzerland and most other countries, the major trade event over the next 18 months is completing the World Trade Organization (WTO) Doha Development Round. In practical terms, that means the Swiss-US FTA must be agreed by late 2006, so that it can be brought to Congress either shortly before, or as a companion to, the Doha Round package. The contentious debate over ratification of the Central American–Dominican Republic Free Trade Agreement (CAFTA-DR) will not be repeated with Switzerland, as none of the labor or environmental issues that featured so prominently will be present, but some congressmen and senators may oppose it because of difficult commercial issues.

On the Swiss side, two aspects will attract considerable political notice and very likely spark a referendum. One of those is the liberalization of

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1. We use the term “concession” in the time-honored sense of mercantilism. In this sense, nearly all trade and investment concessions benefit the country that makes them.

agriculture, even if phased in over the working life of today's farmers. The other is the precedent of a stand-alone agreement with the United States, outside of the framework of the European Free Trade Association (EFTA), and as a counterpart to Switzerland's strong economic ties to the European Union. Swiss leaders will need to persuade the population that the benefits of an FTA with the United States, especially the spur to investment and growth, justify a departure from traditional ways of managing a prosperous but lethargic economy.

## **Strong Links, Similar Values, Large Benefits**

The United States is Switzerland's most important economic partner after the European Union. On a number of political economy criteria (summarized in chapter 1), Switzerland ranks at or near the top of partners that the United States is considering for new FTA pacts. To be sure, on national security grounds, Switzerland ranks low in the US queue, like most non-Muslim countries. However, as the US-Chile and US-Singapore FTAs as well as CAFTA-DR attest, national security is not the only touchstone for launching or concluding US FTAs. Commercial relations between Switzerland and the United States rest firmly on large investment holdings, substantial two-way flows of business services, and significant bilateral merchandise trade.<sup>2</sup> As leading advocates of market capitalism, Switzerland and the United States are well situated to conclude an FTA that breaks new ground in dismantling barriers.

Calculations based on gravity and computable general equilibrium (CGE) models, reported in chapter 8, suggest that a Swiss-US FTA could augment bilateral merchandise trade flows by between 20 percent (CGE model) and 100 percent (gravity model). The CGE model calculates a very modest increase in two-way services trade of about 12 percent, but this figure probably reflects limitations in modeling services trade and estimating the height of barriers. Gravity models of foreign direct investment (FDI), surveyed in chapter 7, suggest that a free trade area might increase the stock of FDI in Switzerland by some 40 percent, giving a strong push to Swiss technology and trade in services and manufactured goods.

Although the CGE calculates that the projected increase in two-way trade would lead to negligible changes in US and Swiss GDP levels, we are skeptical of this result for Switzerland. The modeling framework does not reflect the benefits of adopting improved technology in the wake of more intense competition, the exit of less-efficient firms, and greater scale and network economies. Based on alternative methodologies, also summarized in chapter 8, the annual GDP gains to each partner from expanded trade could

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2. Two-way FDI and portfolio investment levels, as well as two-way merchandise trade flows, are well above the norm predicted by gravity models of trade and investment.

be on the order of \$1.1 billion. For Switzerland, this amounts to a permanent gain of about 0.5 percent of GDP. The abovementioned expansion of inward FDI stock, perhaps by 40 percent, would add significantly to this figure.

Other benefits, hard to model but no less important, could flow from a forward-looking Swiss-US FTA. The pact might push agricultural reform both in the European Union and the United States. And it might influence, in a positive way, the multilateral agenda for liberalizing trade in services, government procurement, and other areas.

## Answering the Skeptics

If launched, undertaking an FTA will require reasoned responses to skeptics. In chapters 1 and 9, we addressed three systemic concerns, first, that a bilateral FTA might impede progress on the WTO Doha Round. In our view, this argument invokes a false dichotomy. Swiss-US FTA negotiations should not drain the resources of the US trade representative's office. A Swiss-US FTA should fully comply with Article 24 of the General Agreement on Tariffs and Trade (GATT), which requires that states eliminate barriers on substantially all the merchandise trade between the partners. To be sure, we have recommended 20-year phaseouts for barriers on sensitive agricultural products, twice as long as the agreed norm in the WTO's 1994 Understanding on the Interpretation of Article 24. In light of the practice already established in multiple FTAs, we believe a fair review would conclude that the standards of Article 24 are met if these long phaseouts are accompanied by our WTO-plus recommendations in other areas.

Nonetheless, we recommend that Switzerland and the United States invite the director general of the WTO to appoint an independent group of experts to critique the agreement for its consistency with the text and spirit of Article 24. This independent review would be additional to the customary Article 24 reviews by government representatives, which in virtually all cases—including past FTAs entered into by the United States and EFTA—have led to inconclusive findings.<sup>3</sup> The independent review should not only critique the new FTA, but also suggest appropriate remedies, or even compensation to other WTO members, to the extent that the agreement falls short.

In some areas, the Swiss-US FTA could set a benchmark for WTO agreements in the Doha Round and subsequent multilateral agreements, and go beyond the minimal requirements of Article 24. Topics for pathbreaking provisions include eliminating barriers to services trade, including movement of skilled personnel; new rules on geographical indications (GIs) and government procurement; and very liberal rules of origin.

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3. See Sutherland et al. (2004) for an acid critique of the banal nature of past Article 24 reviews.

A second systemic concern is that a Swiss-US FTA would simply add to the “spaghetti bowl” of preferential trade agreements, numbering some 300 concluded and proposed (Sutherland et al. 2004), that critics claim are eroding the multilateral trading system. If the GATT/WTO system could have achieved liberalization equivalent to that of the “strong” bilateral and regional agreements, the FTA process would be rightly deplored. But the postwar history of trade negotiations does not suggest that equivalent liberalization was remotely possible. A worthwhile Swiss-US FTA will go far beyond the achievements of the Doha Round, and could in fact set a model for diminishing the “spaghetti bowl” problem through liberal rules of origin. Moreover, most of the trade diversion resulting from a Swiss-US FTA can be categorized as preference dilution, since the new agreement would create a more level playing field between existing partners (EU and NAFTA members) and the new partner (the United States or Switzerland).<sup>4</sup>

A third systemic concern, which seems to be fading from the public debate anyway, concerns the formation of “hub-and-spoke” systems and supraregional trading blocs with political as well as economic dimensions. Obviously a Swiss-US FTA would do nothing to consolidate supraregional blocs in Europe or the Western Hemisphere; quite the opposite. By the same token, however, as spelled out in chapter 9, a Swiss-US FTA has the character of a “reverse-hub-and-spoke” agreement, alleviating the commercial disadvantages that confront a small “spoke” country (in this case, Switzerland).

## Managing Agriculture

Agriculture is by far the toughest area, both from the standpoint of negotiations and adjustment. Chapters 2 and 3 showed that difficult issues spring not only from the extremely high tariffs and strict tariff-rate quotas (TRQs), but also from certain sanitary and phytosanitary (SPS) measures as well as different ideas about the protection of GIs. The combined result of various barriers is that agricultural trade between the United States and Switzerland remains well below potential.

The gravity and CGE models suggest that completely eliminating agricultural barriers would more than double two-way trade, increasing each partner’s exports by more than a billion dollars annually. In previous negotiations, through EFTA or on its own, Switzerland has liberalized agricultural trade to a very limited extent, using a “positive list” approach. This

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4. A more general observation can be made: Since many FTAs are already in existence, each new FTA that has a major country as one partner is likely to level the playing field in a way that adds to global economic efficiency. As a major country’s network of FTAs expands, the list of “outsiders” grows shorter and shorter, as does the prospect of harmful trade diversion when an additional country is added to the FTA roster.

would not be an acceptable *modus operandi* for a Swiss-US FTA. However, as chapter 2 points out, prior US FTAs have always allowed for long phaseouts, a very limited number of exceptions through TRQs, and special safeguards on the path to eventually eliminating agricultural barriers. The US-Morocco FTA has small TRQs and no phaseout periods for at least four product categories. The same is true for CAFTA-DR for sugar imports by the United States.

SPS standards are closely related to agricultural trade. While ostensibly designed to ensure animal and human health, at times, SPS measures can amount to nontariff barriers. Some issues are best left to the WTO, but others can be addressed in the Swiss-US FTA. Chapter 3 recommends that the United States and Switzerland incorporate the best elements of their respective SPS agreements with Australia and the European Union into the Swiss-US FTA. They should also create a standing group of senior government officials to promote the convergence of SPS standards and, where possible, resolve current and future disagreements.

Chapter 3 also examines how the United States and Switzerland use GIs to protect certain sectors through “branding.” Like the United States, Switzerland applies a strong regime of intellectual property protection, but Swiss authorities believe that the current US system does not adequately protect holders of GI rights. A forward-looking agreement should endorse “state of the art protection”—to borrow Ambassador Zoellick’s expression—or all forms of intellectual property, including GIs. The United States should certify appropriate Swiss agricultural goods as “distinctive products,” and support Switzerland’s position in WTO talks.

Finally, and critically important to enlist domestic support, the Swiss-US FTA should contain special safeguard provisions for agriculture, accompanied by meaningful adjustment programs for adversely affected workers, firms, and communities. Robust assistance will be necessary to manage the transition from extreme protection to freer trade, especially in beef, pork, dairy products, cereals, oilseeds, and sugar.

## **Expanding Trade in Manufactures**

More than 95 percent of merchandise trade between the United States and Switzerland involves manufactured products. While the vast majority of manufactures trade enters free or pays only nuisance tariffs, the remaining high tariffs catalogued in chapter 4 still restrict trade in a number of products. Moreover, eliminating even nuisance tariffs can spark commerce, as industrial firms can then rationalize production and invest in new facilities with no fear of trade barriers.

The gravity model reported in chapter 8 suggests that a Swiss-US FTA could more than double two-way manufactures trade, while the CGE model suggests an expansion of about 20 percent. Market access negotiations for

manufactured products should be smooth, and most tariffs should be eliminated immediately. Longer phaseouts will be necessary for the most sensitive products. The Swiss-US FTA could further contribute to seamless global production by adopting liberal rules of origin (especially with respect to cumulation and certification) by giving greater scope for mutual recognition of standards and permitting more self-assessment.

## Services: The Future of International Trade

Both the United States and Switzerland recognize the crucial role of services as a source of sustained competitiveness and export expansion. Barriers remain, but both countries have affirmed their intention to further liberalize their service sectors. Chapter 5 documents the barriers that affect financial services, network industries, the audiovisual sector, and professional personnel. In its FTAs with Singapore and Australia, the United States negotiated WTO-plus provisions that the Swiss-US FTA could readily adopt. But the Swiss agreement should go further and set a higher standard: In particular, it should extend unconditional most favored nation (MFN) rights with respect to services, advance the process of mutual recognition of educational and professional credentials, and extend national treatment to responsible insurance firms based in each country.

## Government Procurement

Opening government procurement in Switzerland and the United States would make public spending more efficient and set a useful precedent for WTO negotiations. The WTO Government Procurement Agreement (GPA), signed by both countries, does not cover all federal procurement in either nation. Moreover, Switzerland reserved its application of the GPA to US firms in important sectors, arguing that the United States had not given equivalent access to Swiss firms. The Swiss-US FTA is a new opportunity for reciprocal extension of GPA benefits to firms in both countries. Both countries should extend their federal procurement coverage, offering the best terms negotiated in prior FTAs and enhancing access for research and development as well as transportation and utility services.

Further, the FTA should include initiatives to open more US states to procurement from Swiss firms to the same extent that Swiss cantons are already open to US firms, as explained in chapter 6. The United States should seek to cover two or three “holdout” states, in addition to states that have previously agreed to GPA or FTA procurement provisions.<sup>5</sup>

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5. As an aside, the CGE model reported in chapter 8 does not attempt to reflect barriers on government procurement. Meaningful liberalization of these highly protected purchases could make a significant addition to the calculated trade and welfare gains.

## Investment

Investment is the bedrock of Swiss-US commercial relations, and the synergy between direct investment and trade is now widely recognized. Most of the literature endorses the idea that addressing the remaining frictions in investment relations could foster Swiss-US two-way trade.

On every investment question of global importance, Swiss and US policies are closely aligned. Still, a Swiss-US FTA would improve the investment environment. Both governments need to further liberalize sectors dominated by public monopolies, relax impediments to foreign ownership in selected sectors, allow easier access to temporary employees, and review conditions for licensing professional personnel. The FTA should proclaim the rights of private investors with respect to national treatment, and ensure appropriate compensation in the event of public taking of private property. It should also establish arbitration procedures for resolving disputes between private investors and host states, including an appellate body to ensure the consistent application of legal principles.

## Swiss-EU Relations

Our penultimate chapter explored the implications of a Swiss-US FTA on Swiss-EU economic relations. Brussels will surely take notice of a US agreement with Switzerland—the first US FTA with a European country—but there are reasons to believe that the pact would not damage relations between Bern and Brussels. From a purely commercial point of view, apart from agriculture, EU producers have already obtained almost unfettered access to the Swiss market. Brussels has historically respected the Swiss tradition of operating on a different and somewhat independent commercial track. Very likely, as chapter 9 suggests, the European Union will come to view the Swiss-US FTA in the same benign light that the United States views the EU-Mexico FTA.

## Wrapping Up

Our bottom line is that a Swiss-US FTA makes very good sense, if negotiated as an agreement that pushes the frontier of liberalization. The agreement can point both the United States and Europe in a different, less distorting direction for agriculture, preserving the scenic and cultural values of rural life without burdening consumers with high prices and world markets with subsidized output. The agreement can quickly reach the goal of tariff-free trade in manufactured goods, coupled with liberal rules of origin and significant progress on aligning technical standards and conformity assessment systems. The WTO General Agreement on Trade in Services (GATS)

is practically an empty vessel: While the principles are strong and solid, they apply to very little trade. By contrast, the Swiss-US FTA can extend the principles quite widely, going as far as strict national treatment for foreign investors, and mutual recognition of professional degrees and certificates.

The economic payoff from these and other terms will be significant: a sharp expansion of bilateral trade, more choice and lower prices for household consumers and industrial users, and an influx of direct investment, especially in Switzerland. If the Swiss-US FTA becomes a touchstone for future trade and investment agreements, the political and economic payoff will be even larger, not only as a trade agreement between two countries, but as a model for others to follow.