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**Switzerland's new Free Trade Agreements (FTA): Opportunities in Asia,
Middle East and America for Swiss Exporters**

Ziltener, Patrick ; Blind, Georg D

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Ex Ante Evaluations of the Savings Potential

SWITZERLAND'S NEW FREE TRADE AGREEMENTS (FTA): OPPORTUNITIES IN ASIA, MIDDLE EAST AND AMERICA FOR SWISS EXPORTERS



OFFICIAL PROGRAMS



Preface

Dear Sir or Madam,

Helping Swiss and Liechtenstein SMEs to take advantage of free trade agreements (FTAs) is one of the core tasks of Switzerland Global Enterprise (S-GE). After all, FTAs facilitate more trade for our export-oriented economy, reduce barriers and are associated with tangible competitive advantages over other states. S-GE has therefore extended its FTA-related services as part of its «Service Public».

China is Switzerland's third largest trading partner after the EU and the USA, so the importance of the bilateral free trade agreement (FTA) with the People's Republic, which came into force on 1 July 2014, cannot be underestimated. A study of its potential commissioned by S-GE anticipates cumulative savings for exporting companies of more than 5.7 billion CHF over the next 14 years, based on a scenario with a utilization rate of 60% and annual export growth of 5%.

In addition, within the framework of the EFTA, two further FTAs have entered into force, namely the FTA with the Cooperation Council for the Arab States of the Gulf (GCC) and the FTA with the Central American countries (Panama and Costa Rica). Due to the increasing importance of the Gulf States to Switzerland, enormous savings in export can also be expected from this FTA.

Compared with last year's FTA report by S-GE, the focus in 2014 was therefore not on measuring the utilization rates of existing FTAs, but on estimating the potential of new agreements. To this end, S-GE was again able to call on the expertise of PD Dr. Patrick Ziltener of the University of Zurich. He is one of the leading experts on free trade agreements in Swiss academia and has been assisting S-GE with studies and analyses for years.

In 2014, S-GE was once again able to help many clients to take advantage of free trade agreements. With around 250 enquiries answered by ExportHelp's specialists, S-GE's services for SMEs are still enjoying increasing popularity. More than 100 SMEs attended the two FTA events in Berne and Neuchâtel again, where specific examples and workshops were used to explain to them how they could benefit from the advantages of free trade agreements. And more and more SMEs are also using S-GE's free online tools "Trade4Free" and "**MendelOnline**", the database containing information about the customs tariffs and import formalities of more than 100 countries. This service already has approximately 1,300 registered users one year after its launch.

With the numerous free trade agreements which are currently at various stages of negotiation with different states, the Swiss economy will definitely benefit from further optimized general conditions in international commerce in the coming years. We would like to ensure that the export sector recognizes these opportunities and actively uses them to succeed in export.

That is why we are calling on all exporting companies to make the most of the advantages of the free trade agreements – we will tell you how to do this in the best possible way. The savings will improve your export margins and will make your international business more profitable!

We hope that you enjoy reading the report. Please do not hesitate to contact us, if you have any suggestions or queries. Further information can be found at www.s-ge.com/exporthelp

Daniel Küng
CEO



Alfonso Orlando
ExportHelp Manager



SWITZERLAND'S NEW FREE TRADE AGREEMENTS (FTA): OPPORTUNITIES IN ASIA, MIDDLE EAST AND AMERICA FOR SWISS EXPORTERS

Ex Ante Evaluations of Savings Potential

Gulf Cooperation Council (GCC), Central American States (Costa Rica and Panama), Peoples Republic of China

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Authors:

PD Dr. Patrick Ziltener
Dr. oec. des. Georg D. Blind
University of Zurich

by order of Switzerland Global Enterprise.

Contact at Switzerland Global Enterprise:
Alfonso Orlando, Head of ExportHelp
aorlando@s-ge.com / Tel: 044 365 53 34

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1. Background

1.1. SWITZERLAND'S FTA POLICY

In addition to the EFTA Convention and the FTA with the European Union (EU) of 1972, Switzerland currently has a network of 28 FTAs with 38 partners outside the EU. Switzerland usually concludes its FTAs together with its EFTA partners Norway, Iceland and Liechtenstein, such as in the cases of the Gulf Cooperation Council (GCC) Countries and Panama and Cost Rica. Nevertheless, Switzerland has the possibility to enter into FTAs outside the EFTA framework as well, as in the case of China.

By entering into FTAs, Switzerland aims to provide its businesses with a level of access to international markets that is at least equivalent to the market access conditions enjoyed by its most important foreign competitors (SECO 2014). According to the foreign economic strategy of the Federal Council, the selection of prospective free trade partners is based on four main criteria:

- The current and potential economic importance of a partner;
- the extent of existing or potential discrimination that may result from the conclusion of FTAs between the prospective partner and important competitors of Switzerland;
- the willingness of the partner to enter into negotiations, and the corresponding prospects for success;
- other considerations such as the expected contribution of an FTA towards the economic stabilization and development of a partner or the compatibility with Swiss foreign policy objectives in general.

1.2. THREE NEW OVERSEAS FTA'S

In the course of 2014, three new FTAs entered into force.

1.2.1. FTA with the Gulf Cooperation Council (GCC) countries

On June 22, 2009 the EFTA States signed a comprehensive FTA in Hamar, Norway, with the member states of the Gulf Cooperation Council (GCC): Bahrain, Qatar, Kuwait, Oman, Saudi Arabia and the United Arab Emirates (UAE). It entered into force on July 1st, 2014. Given their function as a regional trade hub, the UAE rank first among the GCC States in terms of exports and imports in relation to Switzerland. In terms of trade volume, the GCC is Switzerland's fourth largest overseas free trade partner after the PR China, Hong Kong and Japan.

Customs duties on industrial products, as well as on fish and other marine products, were generally abolished at the entry into force of the agreement. While the GCC will eliminate customs duties for certain products after a transitional period of five years, a small number of particularly sensitive products are excluded from tariff dismantling.

Trade in basic agricultural products is defined in a bilateral agreement which Switzerland has concluded individually with the GCC. The GCC States grant duty-free access for a wide range of basic products (e.g. meats including dried meats, cheese, coffee, vegetables) starting with the entry into force of the FTA or after a five-year transitional period. Regarding processed agricultural products, the GCC states grant tariff-free imports for selected products (e.g. soups and sauces, beverages, yoghurt, cocoa powder) effective from the entry force of the FTA, or after a transitional period of five years. A revision clause provides for a periodic review of the scope of application and the possibility of extending the Agreement to further products.

With the entry into force of the agreement duties on exports of industrial products to the GCC were abolished for more than 90% of tariff lines. Customs duties on a further 6% of tariff lines will be abolished five years after the agreement's entry into force.

With regard to rules of origin, the FTA is based on the European model, incorporating EUR.1 movement certificates. It furthermore includes provisions on antidumping, state trading enterprises and subsidies, as well as sanitary and phytosanitary measures and technical regulations.

1.2.2. FTA with the Central American States (Costa Rica and Panama)

The EFTA States signed an FTA with Costa Rica and Panama in Trondheim, Norway, on June 24, 2013. It entered into force on August 29, 2014. The FTA foresees the possibility for other Central American States to join the Agreement.¹

With the entry into force of the FTA, the EFTA States abolished all customs duties on imports of industrial products, including fish and other marine products, originating in Central American States. The participating Central American States will gradually eliminate all customs duties on industrial products, including fish and other marine products, originating in an EFTA State (Annexes IV and V). All such goods will be duty free by 2029 at the latest. The Agreement provides for tariff concessions on both basic and agricultural products (Annexes IX to XVI).

The rules of origin are liberal, based on the European model. The rules open up for accumulation with all types of products (industrial and agricultural) among the Parties as well as for the possibility of self-declaration of origin in certain cases.

1.2.3. FTA with People's Republic of China

A bilateral FTA between Switzerland and the People's Republic of China was signed on July 6th, 2013 and entered into force on July 1st, 2014. With it the few remaining Swiss tariffs on Chinese industrial products were abolished, liberalizing some 99.7% of Chinese exports to Switzerland.

¹ EFTA's negotiations with Honduras are currently on hold. Negotiations with Guatemala have recently come to a conclusion (October 15, 2014) and the process of Guatemala's accession to the EFTA-Central America FTA has been initiated (EFTA 2014).

On the other side, only about 20% of Swiss exports to China were freed immediately from duties. The majority of Switzerland's industrial exports to China will enjoy full (or partial) tariff dismantling only over periods of 5, or 10 (and in a few cases over 12 or 15) years. According to SECO (2014), transitional periods and partial dismantling relate to products for which China has claimed to have a specific need for adjustment, for instance in cases with substantially higher level of tariffs (e.g. selected products in the watchmaking, machinery and chemical sectors). Exceptions from tariff dismantling relate to some particularly sensitive tariff lines (notably in the latter two sectors).

The FTA enables many Swiss agricultural products (including dairy products such as cheese, yoghurt, skimmed milk powder and butter, beef jerky, processed products such as chocolate, baby food, biscuits, jams, roasted coffee, confectionery, ice cream, non-alcoholic beverages, wine) to be exported to China tariff-free or at reduced tariffs.

With a view to further improvements of market access conditions, the Agreement includes a review clause providing for a biennial review of the tariff concessions.

For industrial products, in most cases a change in the four-digit tariff heading or domestic value added of 40% (in relation to the ex-factory price) confers origin status. As in previous Swiss FTAs, the rules of origin for basic agricultural products and processed agricultural products take into account the specific needs of the sector. Originating products of both Parties can be cumulated. Proof of origin is provided either by the standard movement certificate EUR.1² or by the declaration of origin on the invoice or shipping note ("self-declaration"). The declaration of origin allowing to provide proof of origin without any additional forms is reserved for authorized exporters. The declarations of origin must be numbered consecutively.

2 With additional indication of the HS tariff number at 6-digit level and of the applied origin criteria.

2. Methodology of Ex Ante FTA Evaluations

2.1. WHY EX ANTE EVALUATIONS?

It is certainly wise to conduct economic evaluation studies both before the negotiation of an FTA and after its implementation. As the Asian Development Bank (ADB) states, "a clear and accurate understanding of the potential effects of an FTA before its negotiation (ex-ante evaluation) is necessary in deciding the overall negotiation position of the country, based on overall cost–benefit analysis and the identification of what the country can and cannot provide to its FTA partners in the negotiations" (Plummer et al. 2010: 2).³ However, the realities of a negotiation process may produce a result which is sub-optimal from an economic point of view. Nonetheless an ex ante evaluation of the benefits of the negotiated agreement is useful, in order to avoid raising unrealistic or disproportionate expectations by policymakers, economic actors or the general public. If well publicized, ex ante evaluations of the potential of FTAs contribute to raising awareness among economic actors with regard to the things to come, they may prompt companies to undertake the necessary preparations and to develop their schedule. Therefore ex ante evaluations may lead to higher utilization rates from the moment of enforcement. "Big figures" may convince companies to consider the utilization of FTAs where they have not done so yet.

2.2. CONVENTIONAL METHODS AND THEIR LIMITATIONS

Cheong (2010) presents and discusses three ex ante evaluation methods: (i) trade indicators, (ii) SMART (Software for Market Analysis and Restrictions on Trade) in WITS (World Integrated Trade Solutions), and (iii) the GTAP (Global Trade Analysis Project) model. The main advantage of the first method is that "the data requirements for trade indicators are minimal", and therefore this method is supposed to be easy to implement. However, he argues, the main drawback of these trade indicators is that they do not provide precise numbers that quantify the effects of an FTA on trade, production, consumption, or welfare. (ii) is a partial equilibrium method, which is grounded in micro-economic theory, built to provide some quantification of the economic effects of an FTA to be expected in a specific market. The model and the simulation tools are part of the World Integrated Trade Solutions (WITS) trade database and software suite provided jointly by the World Bank and the United Nations Conference on Trade and Development (UNCTAD). This method produces estimations of how much will exports/imports increase or decrease, by partners and outsider countries. (iii) is considered to be the most sophisticated method of for the ex ante evaluation of a proposed FTA. It is based on a general equilibrium model that simulates a real-world scenario and introduces the FTA as a "policy shock". As exciting results from such studies often are for policymakers and the general public, there are fundamental problems with these models, such as the values for some behavioral parameters (mainly elasticities⁴).

Furthermore and most importantly, simulation-based studies usually assume a 100% utilization rate by importers and exporters in both countries. The reality of FTA utilization by companies⁵, as recent research has shown, is different. Some facts:

- only about one in two Swiss exporters to Japan were using the respective FTA more than one year after entry into force (Chiavacci et al. 2012)
- only 35% of Indonesian companies actually utilize (or plan to utilize) the FTA with the PR China (ADBI 2013)

³ The ADB sees pre-negotiation studies also as „helpful to exploit the potential exporting benefits of FTAs and to draw up necessary adjustment policies for sectors which may be negatively affected by FTAs. The results of pre-negotiation impact assessment studies should be reflected effectively in the FTA negotiations. Likewise, assessing the actual impacts of an FTA after its implementation (ex-post evaluation) to examine whether the impacts are within the expected range is also important to draw up further necessary adjustment policies for the affected sectors and to exploit the benefits that are yet to fully materialize. This kind of impact assessment is especially important when the negative effects of the FTA seem to be larger than the positive effects.“ (Plummer et al. 2010: 2)

⁴ Elasticities measure the sensitivity of producers and consumers to relative changes in price and income. Their values determine the outcome of a simulation. Some of these parameters are derived from empirical studies and incorporated, while parameters whose values remain unknown are „calibrated“, more or less arbitrarily by the researcher.

⁵ On the reasons of companies not to use FTAs cf. Schaub (2012).

- only 16.5% of Malaysian companies actually utilize (or plan to utilize) the FTA with Japan (ADBI 2013)
- only 18.6% of Japanese companies exporting to Switzerland (N=113) utilize the FTA Japan-Switzerland (JETRO 2013)
- 64.7% of Japanese companies complain about the "administrative workload to meet rules of origin" when using FTAs (JETRO 2013).

Only recently, economic research has begun to assume more realistic utilization rates in estimating the impacts of FTAs. Menon (2014) found that actual utilization rates significantly diminish the (estimated) benefits from preferential liberalization. However, also the most recent research fails to address the fundamental flaws in modeling mentioned above. Furthermore, the sometimes complex 'phasing out' modalities of FTAs (► Section 2.2.3 and 4.3 on the FTA with China) are not taken into account. As long as we cannot rely on models closer to economic realities, we are forced to restrict ourselves to the evaluation of saving *potentials* provided by FTAs, without being able to provide the policymakers and the interested public with estimations of the impact on future trade performance and economic growth rates.

2.3. THE APPROACH OF THIS STUDY

The elimination of tariffs is one of the main goals of FTAs, but not the only one.⁶ This study is focusing on the savings potential from trade in goods. It does not take into account benefits for companies resulting from other provisions in the FTAs concluded, such as pertaining to trade in services, to sanitary/phytosanitary and technical barriers to trade, to investment (improvements of the legal framework conditions for investors), to intellectual property rights, to government procurement, as well as to cooperation between authorities, to the promotion of exports, or to measures against anti-competitive business practices. Also, other important effects such as the increase of the level of legal security, or the improvement of the general conditions for cross-border economic activity and the locational qualities through an extended FTA network are not considered in this study.

What we are proposing is a new type of *ex ante evaluation* studies: In three steps we develop an approximation to changes in trade expected under a 'real life' FTA.

First, the *maximum savings potential* has to be calculated. The savings potential is defined as the duties currently being paid by any WTO exporter to that country, depending on the composition of his exports, less the duties that are not abolished through the FTA. We illustrate this with an abstract case - country 1 (C1) is trading with country 2 (C2):

<p>2013 exports of C1 to C2 x C2 WTO MFN applied rates = total duties 2013</p> <ul style="list-style-type: none"> - note that this may include a number of tariff lines with MFN=0
<p>2014 Jan 1st, a bilateral FTA C1-C2 enters into force</p> <p>2014 exports of C1 to C2 x C2 FTA rates (concessions year 1) = total duties 2014</p> <ul style="list-style-type: none"> - this includes a number of tariff lines >0 (not covered by FTA or only reduced tariff in the first year) - C2 removes duties in 10 equal annual stages
<p>2024 exports of C1 to C2 x C2 FTA rates (max. concessions year 10) = total duties 2024</p> <ul style="list-style-type: none"> - C1 maximum savings potential 2014: total duties 2013 - total duties 2014 - C1 maximum savings potential 2024: total duties 2013 - total duties 2024

6 Cf. „More than just tariff reductions” – free trade agreements explained by the chief negotiator“

Thus we can calculate the maximum FTA savings potential for any year starting with 2014 on the basis of information on country 1's exports 2013, country 2's MFN applied rates (incl. tariff lines that are MFN=0⁷), and country 2's FTA concessions schedule. *Caveat*: Future unilateral tariff reductions on an MFN basis are not taken into account, as well as progress of the WTO multilateral framework. Also, the volume and composition of bilateral trade might change over time.

Second, 'maximum savings' means that the estimation is made under the assumption that all these products are of Swiss origin (according to the rules of origin) and the utilization rate is 100%. This means: the FTA *can be and is effectively applied* to all these products. Obviously, these are unrealistic assumptions. To build ex ante scenarios close to the expected reality, we have to introduce an FTA utilization rate, ideally one derived from ex post analyses of comparable cases.

The FTA utilization rate measures the degree to which the FTA is successfully used to reach duty free exporting, i.e. utilization rate of 70% means that 70% of all exports (according to value) in that year were effectively making use of the FTA. For Swiss exports to Germany we found a utilization rate of 50%, another 40% being exported on duty free basis already, with the result that 90% of Swiss exports to Germany are effectively duty free. The utilization rate in Swiss exports to France is 37% (another 61% being duty free already), to Mexico 51%, to South Korea 60% (Ziltener/Blind 2014). Therefore, FTA utilization rates as assumed in the scenarios for the FTAs with the GCC (► 4.1.3) and the PR China (► 4.3.3) are realistic.

Third, to get even closer to the expected reality, we can introduce realistic projections of *export growth*. In the scenario ► section 4.3.3 for China we assume an annual export growth of 5%. Fact is:

- Swiss exports to the PR China have increased more than 12% annually on the average over the last seven years, including the years of the financial and economic crisis (SECO 2014).
- Swiss exports to the UAE have increased almost 11% annually on the average over the last seven years, including the years of the financial and economic crisis (SECO 2014).

Regrettably scenarios taking into account export growth have not been developed yet for the GCC and Central America. Thus the case of China remains the only 'proof of the pudding' – the proof that we can effectively develop a realistic scenario concerning the 'real life' benefits of an 'real life' FTA on an ex ante basis.

7 E.g. on the basis of the WTO Information Technology Agreement (ITA). ITA currently has 52 participants, representing 80 WTO members, which account for approximately 97% of world trade in IT products.

3. Results

3.1. SAVING POTENTIAL OF THE FTA WITH GCC

On the basis of the published Agreement (including Annexes⁸) and data for Swiss exports to GCC in 2012, an estimation of the maximum savings potential of this FTA can be made ► sections 4.1.1. 4.1.2. ► Under 4.1.3 we develop a scenario with reference to the utilization rates of the FTA with South Korea (in force since 2006). This enables a plausible estimation of the savings Swiss exporters are about to realize on the basis of this specific FTA.

3.1.1. Agriculture

Swiss annual exports of agricultural products amount to the value of 300 Mio USD to the GCC countries, 40% of which is tobacco (cigarettes). However, tobacco products as well as other important Swiss export items such as butter, chocolate and sugar confectionery, pastry and biscuits, instant coffee and wine are not covered by the Agreement. ► Table 1: This adds up to 58.7% of agricultural exports not being covered by this FTA. Consequently, there is no savings potential for more than half of Swiss exports in this area.

Of the remaining 41.3% some products are already duty free (e.g. coffee), but most are subject to a GCC tariff of 5%. Only 1% of Swiss food exports to the GCC are exempted from duties for the first time upon enforcement of this FTA (cocoa powder, yoghurt and certain food preparations). Therefore, in the first year, the savings potential of agricultural exports amounts to maximally 200'000 USD.

After five years, in 2019, another 27.7% of Swiss food exports will be freed from duties. The annual value of these goods is more than 84 Mio USD. The savings potential will then amount to 4.4 Mio USD annually.

The list of concessions in the agricultural sector shall be reviewed periodically and changes to the product coverage might be agreed upon (Annex III, Art. 5). There is the possibility that this leads to the liberalization of more agricultural goods. Especially with the inclusion of chocolate and sugar confectionery, butter, pastry and biscuits as well as milk powder, significant savings could be realized in the future, not to mention cigarettes.

3.1.2. Industrial Goods

In contrast to the world of agriculture, trade with industrial goods between Switzerland and the GCC comes close to the ideal of 'free trade' from the day of the enforcement of the FTA.

1. Almost no goods are exempted from tariff elimination. For Swiss exporters, only two exceptions are relevant:
 - odorous substances (29 Mio USD exported annually to GCC),
 - used tyres (exported annually in the amount of 90'000 USD to GCC).
2. Almost no goods (value of 7'200 USD) are subjected to later liberalization (five years of enforcement of the FTA).

This means that Swiss industrial exports amounting to 6.7 Bio USD are exempted from tariffs from July 1st, 2014 if they qualify as being of Swiss origin. A first crude estimation, based on the assumption '5% GCC import duty on all lines except agriculture', yields a savings potential of 334 Mio USD annually.

However, this does not mirror reality. Saudi Arabia does have a more differentiated customs duty policy, and there are several tariff lines that already are MFN zero (i.e. tariff free for all WTO members). For this study, all categories with tariffs higher/lower than 5%, including tariffs = 0, and those that will be exempted only in five years had to be filtered out.

8 LINK: <http://www.efta.int/free-trade/free-trade-agreements/gcc>

► Table 1: Maximum savings potential amounts to USD 245.7 million USD. The results show that the watch industry has the biggest savings potential with almost 82 Mio USD, followed by the engineering, electrical and metal industry (MEM) with more than 62 Mio USD and the jewelry sector with 56 Mio USD. Since pharmaceutical exports to the GCC are duty free already, the savings potential for the chemical/pharma industry is only 6.6 Mio USD. Exports of special oil/fuels could be freed from 4.6 Mio USD duties annually, exports of plastic/rubber products from 2.5 Mio USD, textiles from around 2 Mio USD, wood/paper products from 1.6 Mio USD. Furthermore, there is savings potential with leather products (666'000 USD) and with footwear/headgear (350'000 USD).

Compared with the first crude estimation, these results are much more precise: the maximum savings potential of this FTA in the industrial sector is 241 Mio USD annually – more than 90 Mio USD less. This is due to the fact that significant exports to the GCC are duty free already, and not because of lack of coverage by the Agreement.

3.1.3. Realistic Scenario

On the basis of our research on the effectiveness of Switzerland's FTAs (Ziltener/Blind 2014) we can now estimate how much of this savings potential might be realized effectively. The FTA utilization rate measures the degree to which the FTA is successfully used to reach duty free exporting, i.e. utilization rate of 70% means that 70% of all exports (according to value) in that year were effectively freed from customs duties.

- The maximum savings potential in the exports of agricultural goods to the GCC countries is 4.4 Mio USD annually. A good deal of this potential might be realized since our ex post FTA evaluation studies show that Swiss origin is generally given and the FTA utilization rate among food exporters is rather high. Therefore a utilization rate of 70% is not unrealistic: 3 Mio of 4.4 Mio USD savings might be realized annually, but only after 5 years after the enforcement of this FTA (► 4.1.1).
- The maximum savings potential in the exports of industrial goods to the GCC countries is 241 Mio USD annually. In the case of the watch industry a utilization rate higher 70% (as with exports to South Korea) is not unrealistic. This would result in annual savings as high as 57 Mio USD. The MEM industry will be similarly successful (again, as with exports to South Korea). Savings of 44 Mio USD (out of the potential of 62 Mio USD) are likely. Given the lower incentives in the chemical/pharma industry, the utilization rate is expected to be significantly lower. The opposite is the case with the plastic, rubber, leather and wood products, where a good deal of savings should be expected.
- The rules of origin do make it sometimes difficult for the Swiss textile industry to use FTAs, but the professional handling of exports can partly compensate for this. However, it is unrealistic that the 2 Mio USD possible will be realized. The jewelry industry is a similar case, with a utilization rate of under 20% in the case of exports to South Korea.
- Assuming an overall FTA utilization of 50% we can expect Swiss exporters to realize around 120 Mio USD in the first year (2014-15). If the rate could be increased to 70%, then annual savings of 170 Mio USD would be possible. Over 10 years (2014-2024), savings would accumulate to 1.2 - 1.7 Bio USD – without taking account a (very likely) increase of Swiss exports to the GCC countries.

3.1.4. Table Swiss Exporters to the GCC-Countries: FTA savings potential

Sector	Exports total (Mio USD)	MFN tariff free		Not covered by FTA		FTA tariff free immediately		FTA tariff free after 5 years		Max. Savings Potential (Mio USD)
		Mio USD	%	USD	%	Mio USD	%	USD	%	
Agriculture (HS01-24)	304.2	35.3	11.6	178.5	58.7	3	1	84.3	27.7	4.4
Mineral Products (HS25-27)	91.5	-	-	-	-	91.5	100	-	-	4.6
Chem./Pharmaceutical (HS28-38)	1310	1150	87.8	29	2.2	131	10	0	0	6.6
Plastic/Rubber (HS39-40)	49.2	-	-	0.09	0.2	49.1	99.8	-	-	2.5
Leather Products (HS41-43)	13.3	-	-	-	-	13.3	100	-	-	0.7
Wood Products (HS44-49)	30.7	-	-	-	-	30.7	100	-	-	1.6
Textiles (HS50-64)	38.4	-	-	-	-	38.4	100	-	-	2
Footwear/ Head-gear (HS65-67)	6.9	-	-	-	-	6.9	100	-	-	0.35
Stone/Glass (HS68-71)	1488	369	24.8	-	-	1119	75.2	-	-	56
Metals (HS72-83)	57.2	-	-	-	-	57.2	100	-	-	2.9
Machinery/Electrical (HS84-85)	1241	-	-	-	-	1241	100	-	-	60
Transportation (HS86-89)	455.7	275.5	60.5	-	-	180.2	39.5	-	-	9
Watches/Instruments (HS90-97)	1635	40	2.5	-	-	1595	97.5	-	-	95
total	6721	1869.8	27.8	207.6	3.1	4556.3	67.8	84.3	1.3	245.7

Notes: does not always add up to 100% since a small amount of exports cannot be classified. Data source: UNCOMTRADE (trade data USD, 2012). Author's Calculations.

3.2. SAVINGS POTENTIAL OF THE FTA WITH CENTRAL AMERICA

As mentioned above, the FTA is designed for other Central American states to join later. In this section, 'Central America' refers only to the two countries having signed the Agreement up to date: Panama and Costa Rica. 'Panama' includes the free port 'Colón Free Trade Zone'.

On the basis of the published Agreement (including Annexes⁹) and data¹⁰ for Swiss exports to Central America in 2012-13, an estimation of the maximum savings potential of this FTA can be made. 'maximum' means that the estimation is made under the assumption that all these products are of Swiss origin (according to the rules of origin) and the utilization rate is 100%. Actual savings realized by Swiss companies will be lower: In other cases, 50 – 70% of possible savings are *de facto* realized (Ziltener/Blind 2014).

3.2.1. Agriculture

More than 100 tons of chocolate in the value of more than 1.2 Mio CHF annually are exported to Central America. The relatively high duties (15%, certain products 5-10%) will be eliminated within 5 years (Panama) respectively 15 years (Costa Rica).

Swiss sugar confectionery, *bonbons*, pastilles etc. (HS1704) are immediately freed from duties by Panama, while Costa Rica excludes this category of goods completely from the FTA. For these 46 tons of exports duties of 15% will still have to be paid for every shipment. As in all their other FTAs, the two Central American countries exclude coffee and coffee products through restrictive rules of origin.

2.5 tons of cheese are shipped annually to Costa Rica alone. Of these only the small amount of Schabziger (HS04062010) will be duty free. Panama grants Switzerland a duty free quota for cheese and preferential market access for certain meat products. Exporters of Bündnerfleisch and of typical Swiss cheese types such as Emmentaler and Gruyère will profit from that. Also dried vegetables (HS0712) from Switzerland are subject to a Panamanian preferential tariff (5/10% instead of 10/15%), while Costa Rica abolishes its tariffs over 10 years. Regarding food preparations (HS2106) there is a variety of rules, from immediate tariff elimination to a phasing out over 10 years. Exporters are advised to check their cases individually with the HS codes.

3.2.2. Industrial Goods

For most industrial goods (HS25-97), tariff elimination will take place over a period of 5 to 10 years, in a few cases even over 13 or 15 years (Panama: Annex V with 67 pages; Costa Rica: Annex IV with 59 pages¹¹). E.g. textiles: duties will be removed in 10 equal annual stages beginning on the date of entry into force of the FTA which means they will be completely freed on January 1st of 'year ten'. The process is complicated by the fact that the two countries have two partially different 'schedules': Panama e.g. abolished duties for chemical products within 5 years, Costa Rica within 10.

Pharmaceuticals in the value of more than 100 Mio CHF annually are exported to Central America, this is more than half (55%) of total Swiss exports to this region. Neither Panama nor Costa Rica do raise duties on this goods, the only exception being Costa Rica with duties on veterinary drugs (6% MFN tariff) which will be eliminated over 5-10 years.

In the **engineering, electrical and metal sector (MEM, HS72-85 and vehicles HS86-89)**, the share of rules differing between the two countries is rather high.

The imports of metal goods (HS72-83) from Switzerland, annually in the value of 7.5 Mio CHF, will be freed over ten years (with very few exceptions). The actual tariffs are 10-15% of value, Costa Rica having numerous lines with 5%.

Swiss machinery (HS84-85) is exported in the value of 16 Mio. CHF annually to Central America. These are mainly pumps, centrifuges, elevators as well as various machines and parts (HS8413-14, 8419, 8421-22, 8428, 8440, 8466, 8477-79 8481), electric generating sets and rotary converters, electrical switching apparatuses and electronic integrated circuits (HS8502-04, 8536, 8542), smart cards (HS8523) and in the case of Panama also

9 **LINK** <http://www.efta.int/free-trade/Free-Trade-Agreements/central-american-states>

10 Data source: <http://comtrade.un.org/data/>; MFN tariff information from the FTA Annexes IV/V and www.mendel-online.eu.

11 **LINK** <http://www.efta.int/free-trade/Free-Trade-Agreements/central-american-states>

bulldozers, mechanical shovels and excavators (HS842911, 842952). The applied tariffs of 10-15% on these goods will be dismantled by Panama over 5 years, by Costa Rica (6-15% tariff) over 10 years. There are some notable exceptions: Costa Rica e.g. frees the import of centrifuges (HS8421) and valves (HS8481) already after 5 years completely, selected machines and parts even upon enforcement of the FTA. Exporters are advised to check their cases individually with the HS codes.

Vehicles (HS 86-89) are exported in the value of 2.7 Mio CHF annually. These are mainly trucks (HS870423) for almost 2 Mio CHF exported to Panama (already without duties) and bicycles (HS8712) for more than half a Mio CHF to Costa Rica. Costa Rica raises duties (14%) on bicycles with a value of more than 1000 USD and will abolish this upon enforcement of the FTA.

Apart from selected machinery, the MEM industry will enjoy the full benefits of the FTA only after 10 years. Then a good deal of the MEM savings potential of 2-3 Mio. CHF annually will be realized.

Instruments (HS90) are exported from Switzerland to Costa Rica (10 Mio. CHF annually) and to Panama (3 Mio. CHF). These are mainly measuring apparatuses and medical instruments and appliances (HS9015,18-21). These imports are duty free in Costa Rica while Panama still raises those on selected categories. They all will be abolished with the enforcement of this FTA.

Swiss **watches** are exported to Central America in the value of 11 Mio. CHF annually, many of them probably to be re-exported from the Colón Free Trade Zone to third countries. In general Panama raises 10%, Costa Rica 14% duties on watches. Panama eliminates these duties over 10 years, Costa Rica immediately upon enforcement of this FTA. Since direct watch exports to Costa Rica only amount to one Million CHF, the savings potential in the first years will be only around 140'000 CHF. How much can and will be saved on duties in the process of re-export from the Colón Free Trade Zone cannot be known.

3.2.3. Conclusion

The maximum savings potential of this FTA can be estimated at 4-5 Mio CHF annually, after 10 years (2024). After that, the phasing out of few tariffs will increase this amount only slightly. For most exporters, the incentive to utilize this FTA will be significant only after some years. But, given the variety of rules in this Agreement, specific product category checks are advised.

3.3. SAVINGS POTENTIAL OF THE FTA WITH CHINA

On the basis of the published Agreement (including Annexes¹²) and the actual data for Swiss exports to China in 2013 (8.5 Bio CHF, according to Swiss Customs Data)¹³, an estimation of the maximum savings potential of this FTA can be made. As in the other cases presented here, 'maximum' means that this first estimate is made under the (unrealistic) assumption that all these products are of Swiss origin (according to the rules of origin) and that the utilization rate is 100%. ► In section 4.3.3 four scenarios with different FTA utilization rates and projected export growth are presented. This enables plausible estimates of the savings Swiss exporters are about to realize and how the savings will likely increase over time. The main challenge in this analysis were the complex phasing out modalities, from 0 to 12 or 15 years, as foreseen by the FTA.

12 LINK: <http://www.seco.admin.ch/themen/00513/00515/01330/05115/index.html?lang=en>.
13 3.3% of total Swiss exports could not be analyzed, for reasons of data availability („confidential transactions“).

3.3.1. Maximum savings potential according to Industrial Sectors, 2015 and 2028

Swiss Exports to PR China 2013 total 8'758'038'465 CHF
of which "confidential transactions" 291'728'999 CHF
object of analysis 96.7%

Sector	value*	average tariff*	Savings Potential	
			Year	
CHF			2015	2028
01-15 Agricultural Products	14'353'647	17%	506'233	2'378'957
16-24 Processed Agricultural Products	57'623'775	15%	2'488'880	7'199'007
28-38 Chemical, Pharmaceutical Products	2'261'226'740	5%	39'954'494	107'422'633
39-40 Plastic, Rubber	117'722'597	8%	3'341'090	9'661'257
44-49 Wood	30'522'537	5%	188'043	774'540
50-63 Textiles	83'321'007	14%	4'788'254	11'942'063
68-70 Stone/Glass	779'057'642	6%	9'030'157	47'103'327
72-85 Metall, Machinery	2'619'648'940	7%	50'036'782	151'908'455
86-89 Vehicles	84'474'583	7%	2'075'538	5'365'261
90-91 Watches, Instruments	2'264'348'819	9%	50'072'707	199'972'542
other	154'009'179	10%	3'831'318	14'726'041
Sum	8'466'309'466	7%	166'313'496	558'454'082

notes: savings potential in case of mixed tariffs (value, weight) only approximation; assumed FTA utilization

sources:

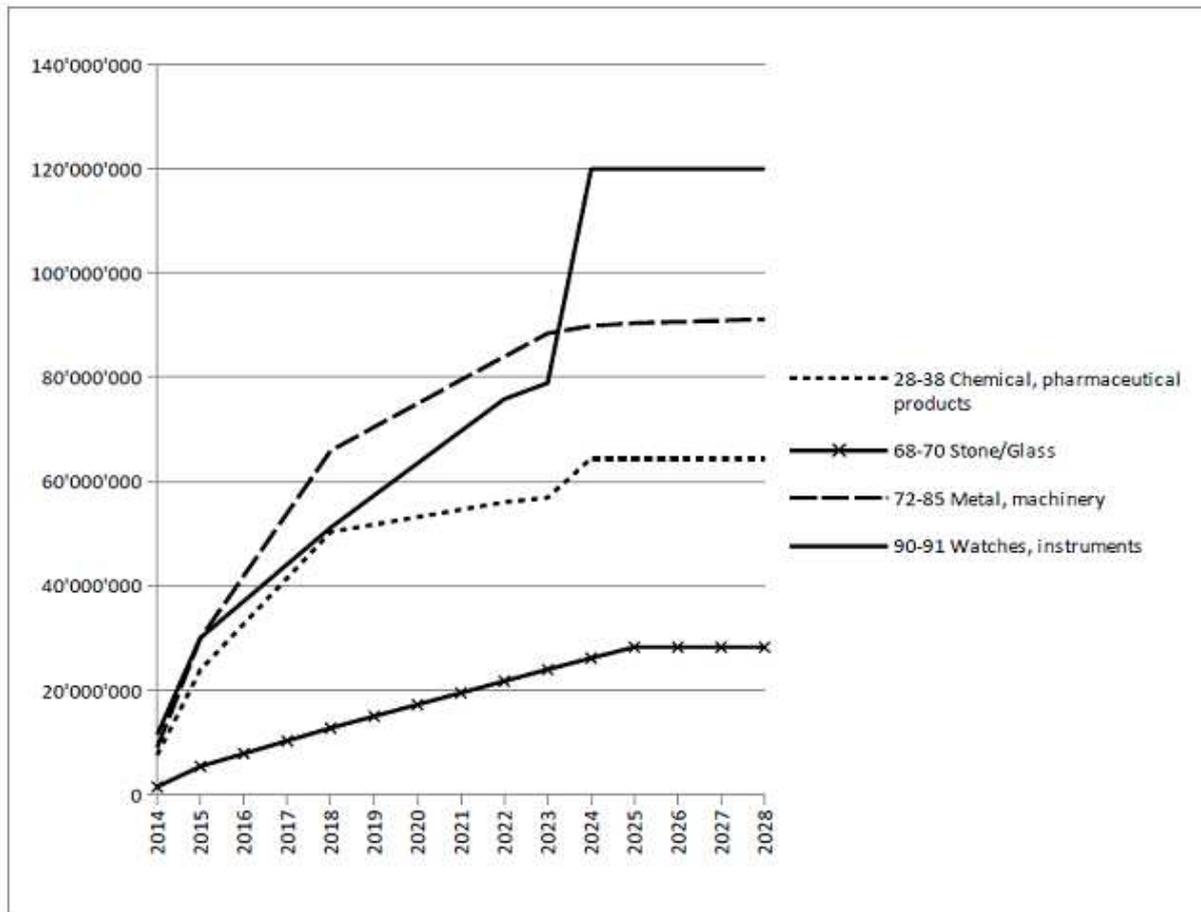
- trade data, tariffs: Swiss Customs Directorate

The sectors with the highest savings potential in 2015 are watches/instruments and the engineering, electrical and metal industry (MEM), followed by the chemical/pharmaceutical industry. Within these sectors, highest savings are to be expected for

- wrist watches (HS9101-2): a potential of more than 35 Mio CHF in 2015 already
- medicaments, antibiotica, antisera, vaccines etc. (HS2941, 3002-4): a potential of almost 30 Mio CHF in 2015 already
- in the MEM sector mainly gas turbines (HS8411), pumps (HS8414), machine tools (HS8462), electric motors and generators (HS8501), various machinery (HS8514-19, 8447): a potential of more than 17 Mio CHF in 2015 already
- jewelry (HS7113): a potential of more than 6 Mio CHF in 2015 already
- measurement, precision and medical instruments (HS9015-18, 9021, 9031): a potential of more than 5 Mio CHF in 2015 already
- and in the textile industry apparel (men's suits HS6203): a savings potential of more than 2 Mio CHF in 2015 already.

Given the complex phasing out modalities of this FTA it is not surprising that the maximum savings potential in the first complete calendar year after enforcement (2015) is very different from the maximum savings potential after the phasing out (completely and in some cases partially) of tariffs in 2028. Graphs 1 and 2 highlight the different phasing out modalities, according to industrial sector.

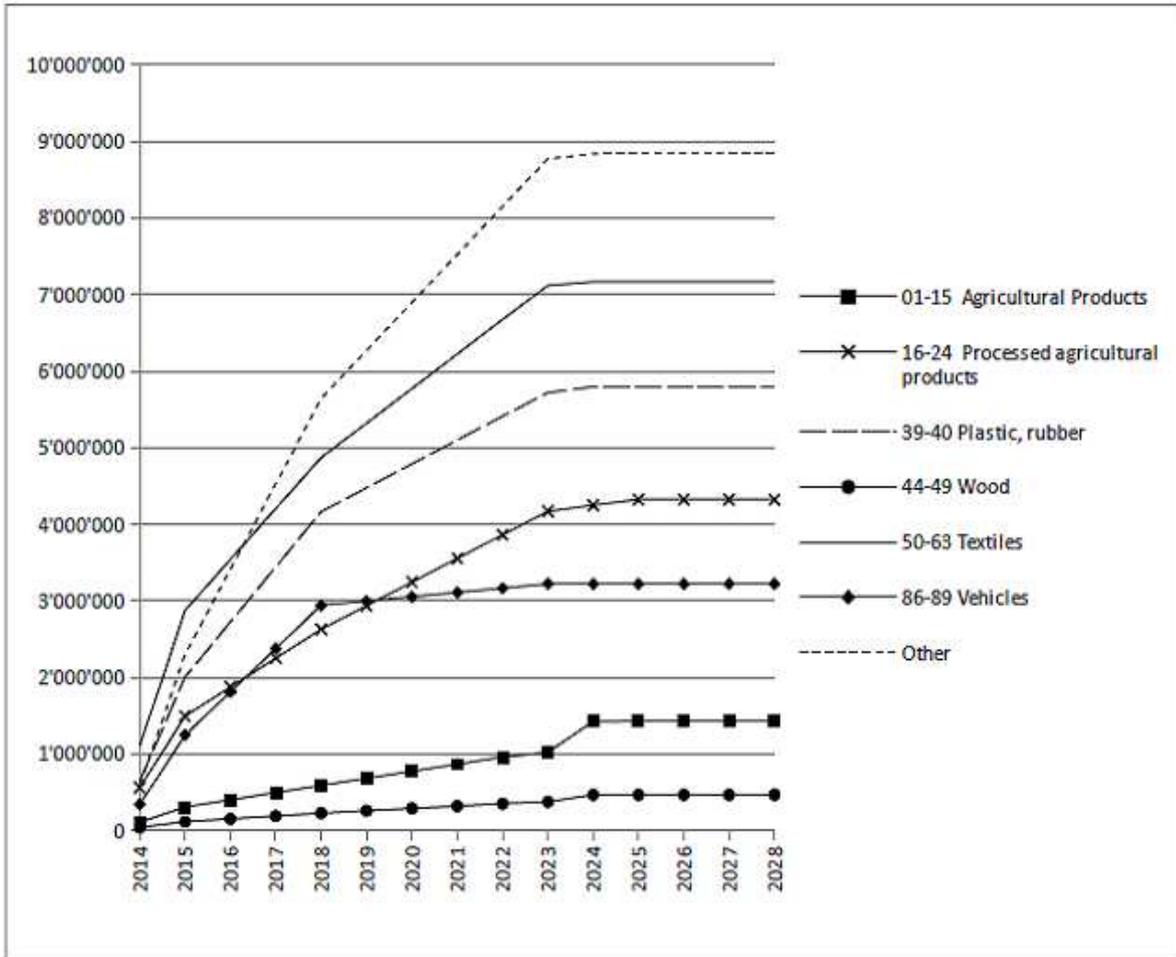
3.3.2. Maximum savings potential according to Industrial Sectors, 2014 and 2028 (Graph 1)



These are the three sectors with the highest potential savings:

- watches and instruments - while profiting from the first year on, it will experience a significant tariff dismantling in 10 years
- the MEM industry will have the opportunity to save up to 90 Mio CHF annually, while experiencing a rather constant increase of the potential in the first 10 years
- the chemical/pharma industry will reach a platform after 10 years, with a potential above 60 Mio CHF annually.

3.3.3. Maximum savings potential according to Industrial Sectors, 2014 and 2028 (Graph 2)



These are the other sectors with the development of the savings potential over time. Note the different scale (y axis): from 0 to 10 Mio CHF.

3.3.4. Realistic Scenarios

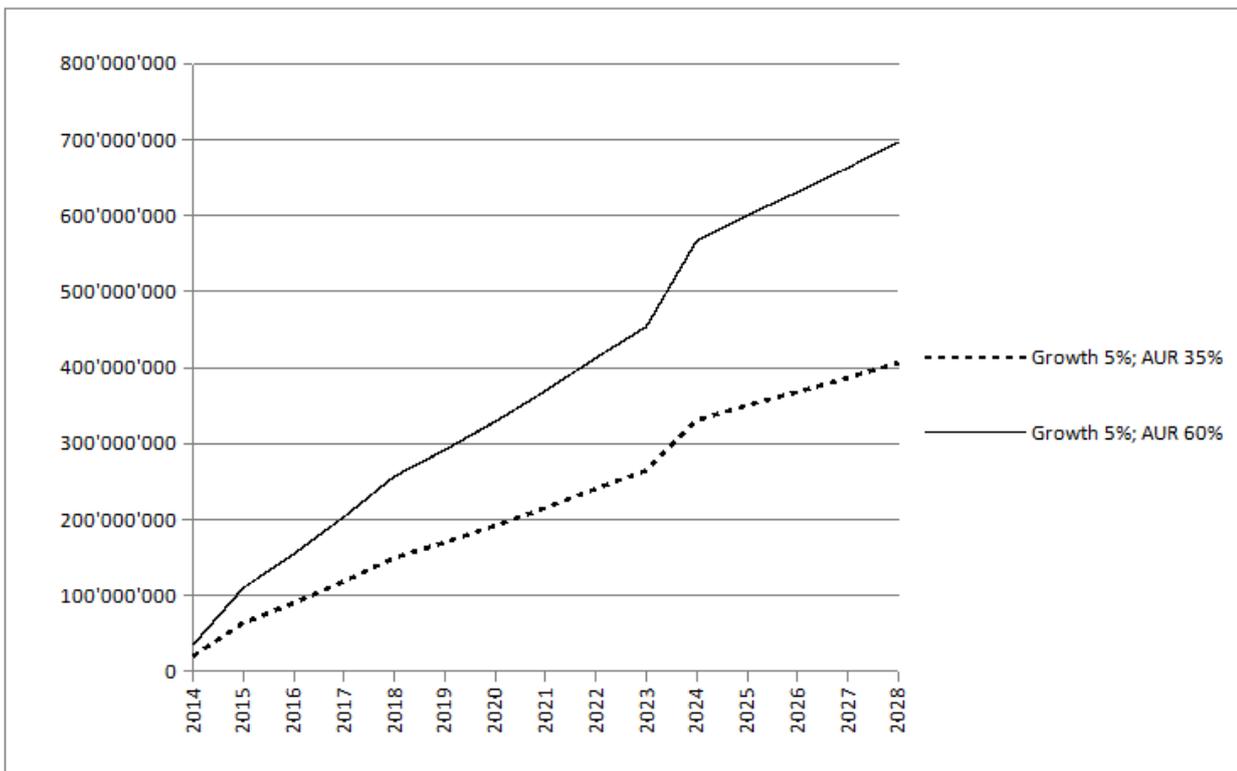
On the basis of our research on the effectiveness of Switzerland's FTAs (Ziltener/Blind 2014) we can estimate now how much of this savings potential will be realized effectively. As defined above, the FTA utilization rate measures the degree to which the FTA is successfully used to reach duty free exporting, i.e. a utilization rate of 35% means that 35% of all Swiss exports (according to value) in that year were effectively freed from customs duties. Scenario 1 assumes a utilization rate of 35%, Scenario 2 a utilization rate of 60%, Scenario 3 a utilization rate of 35% plus an export growth of 5% annually. Scenario 4 assumes also an export growth of 5% annually, but a higher utilization rate (60%).

1. Assuming a (hypothetically low) utilization rate of 35%, savings amounting to 58 Mio CHF might be realized in the first year. After 5 years this would allow 136 Mio CHF savings, then further increasing year by year to a value of 196 Mio CHF annually.
2. Could the utilization increased to 60% (as in the case of the FTA with South Korea), then savings of almost 100 Mio CHF are to be expected in the first year already, increasing to more than 200 Mio CHF after three years and then further increasing year by year to a value of 335 Mio CHF annually.

Given the continuously high dynamic development of the Chinese economy, it can be expected that Swiss exports will increase significantly in the years to come. More exports mean also a higher savings potential thanks to FTA utilization.

3. With an annual increase of exports to China of 5% and a FTA utilization rate of 35%, Swiss companies will realize savings in the amount of in 200 Mio CHF 2020. ► Graph 3. This amount will further increase every year and reach a value of 400 Mio CHF in 2028.
4. With an annual increase of exports to China of 5% and a FTA utilization rate of 60% (► Graph 3), savings will reach the 200 Mio CHF line in 3 years already, and 300 Mio CHF in 5 years. It is realistic to calculate that in 2028, savings in the amount of 700 Mio CHF will be realized by Swiss companies using the FTA with China. In this scenario, cumulated savings over the period 2014 to 2028 might reach the value of 5.77 Bio CHF.

3.3.5. Graph 3: Swiss Exports to PR China: Savings through FTA utilization, 2 Scenarios



Growth: Annual increase of Swiss exports to China. AUR: Adjusted FTA Utilization Rate. Units: CHF. Source: Author's calculations.

4. Conclusion

In 2013, for the first time in recent history, more than 50% of Switzerland's exports to overseas markets were covered by FTAs.¹⁴ Research has shown that despite varying FTA utilization rates Swiss exporters were able to save more than half of the duties they would have had to pay without FTA (Ziltener/Blind 2014). FTAs do matter for Swiss companies, even when their impact on total export dynamic and macro-economic growth has not been conclusively proven yet.

In 2014, three new Swiss FTAs have entered into force. Two of them (Central America, China) require a degree of patience for Swiss exporters since the abolishment of duties take place step by step over one or one and a half decade. Depending on the actual incentives, companies will make choices concerning which FTAs to use and from which year on. The FTA with the GCC countries is different: Zero duties with almost no exceptions, trade with industrial goods between Switzerland and the GCC coming close to the ideal of 'free trade' from the very day of entry into force. Exporters of agricultural products to the GCC, however, have to wait for five years to enjoy a significant extension of free trade, and the list of non-covered categories is long.

The FTA with China is special since in this case, despite the long phasing out, the savings potential is considerable even in the first year. Based on a realistic FTA utilization rate of 60% savings of almost 100 Mio CHF can be realized in the first year already, a figure that will double within another two years only (i.e. 2017). It is no surprise that this FTA has attracted much more media interest in the year of enforcement than the two aforementioned ones. But a comparison (► table 2) of the FTA savings potential with the size of these markets (GDP) shows that the FTA with Central America enables potential savings in relation to market size comparable to the one with China, and the one with GCC a even much higher one. In other words:

- China's market is about one hundred times that of Central America (as defined here), and the same holds for the FTA savings potential (plus some 80 Mio USD more).
- The GCC Countries' market is about 5 times smaller than China's, but the FTA savings potential for Swiss exporters are little less than half (42%) of the potential of the FTA with China. GCC's market size is about 18 times bigger than Central America's, but the FTA savings potential for Swiss exporters is almost 50 times higher.

This is not to say that the absolute size of the savings potential is not of crucial importance, especially in terms of incentives both for the conclusion and utilization of an FTA.

¹⁴ In 2013 agreements concluded with free trade partners, with the exception of the FTA with the EU, cover 22.6% of Switzerland's total exports. This corresponds to 51% of Switzerland's exports to markets outside the EU (SECO 2014).

4.1. TABLE 2: MARKET SIZE AND FTA SAVINGS POTENTIAL IN COMPARISON

1) Country	2) Gross domestic product 2013 (millions USD, World Bank 2014)	3) Max. FTA savings potential (millions USD)	4) Ratio 3/2
Saudi Arabia	745273		
UA Emirates	383799		
Qatar	202450		
Kuwait	183219		
Oman	80570		
Bahrain	32788		
GCC	= 1628099	245.7	0.15‰
Costa Rica	49621		
Panama	42648		
	= 92296	5	0.05‰
PR China	9240270		
		582.3*	0.06‰

*1 CHF ≈ 1.0426 USD. Source: GDP: World Bank 2014; Author's calculations.

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ExportHelp

www.s-ge.com/exporthelp

exporthelp@s-ge.com

T 0844 811 812



Switzerland Global Enterprise
Stampfenbachstrasse 85
CH-8006 Zürich
T +41 44 365 51 51

Switzerland Global Enterprise
Corso Elvezia 16 – CP 5399
CH-6901 Lugano
T +41 91 911 51 35

Switzerland Global Enterprise
Avenue d'Ouchy 47 – CP 315
CH-1001 Lausanne
T +41 21 613 35 70

www.s-ge.com