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Introduction

At first sight, a free trade agreement (FTA) between Switzerland and the United States seems implausible. Despite centuries of friendship, the countries are not political or military allies, for the simple reason that Switzerland above all prizes its neutrality with the great powers. Switzerland and the United States do not share a common border or even the same continent. Nor do they share the same language: While English is widely spoken in Switzerland, it is not among its four official languages. Both countries are rich and mature, subscribe to market capitalism, and are relatively open to the world economy (as measured by the average height of tariff barriers), but these similarities can be read as reasons not to enter an FTA. After all, what is the purpose of an FTA between two rich countries that embrace similar economic constitutions and are already quite open to each other's exports? Could another FTA just add to the "spaghetti bowl" of confusion that threatens to undermine the world trading system?[1] Finally, in the closing months of the World Trade Organization (WTO) Doha Development Round,[2] does it make sense to divert diplomatic and legislative energy from the overarching goal of global trade liberalization?

1. The virtues and vices of bilateral FTAs have been widely debated. For a critical view, see WTO (2005a); for a sympathetic exposition, see Schott (2004b).

2. The Doha Development Round must conclude no later than early 2007, if Congress is to ratify its terms before the US trade promotion authority expires on June 30, 2007.

Answers to Skeptical Questions: The FTA Case

Some observers, in both Switzerland and the United States, will find in these queries their definitive answer: A bilateral FTA makes no sense. Others will be less critical, but question the timing: Why not wait until after the Doha Round is concluded, and until the EU-25 gets a better sense of its direction? Still others will argue that each skeptical question can be turned into an argument for a bilateral FTA. This study will be of most interest to those in the second and third camps—in other words, observers who do not foreclose the possibility or desirability of a Swiss-US FTA. Before launching into the chapters issue by issue, however, it is worth seeing how the broad skeptical questions can be turned.

Is the Geographic and Political Distance Too Great?

To start, given the certainty of economic hurdles, can support for an FTA gain traction if the partners are not political or military allies, are separated by thousands of miles, and do not even speak the same language? Prior to the mid-1990s, FTAs and customs unions were, to be sure, dominated by pacts between countries that were already, or in the process of becoming, political allies: the European Common Market and European Union, the Association of Southeast Asian Nations, the Australia–New Zealand Closer Economic Relations pact, the North American Free Trade Agreement (NAFTA), and the Southern Cone Common Market (Mercosur). The European Free Trade Association (EFTA), of which Switzerland was a founding member, was a purely economic venture without the overlay of a political alliance from its inception. But in a way, EFTA seemed the exception that proved the rule, as several members peeled off to join the European Union. In short, experience up to the mid-1990s led many commentators to forecast a three-bloc world, composed of contiguous customs unions and FTAs organized around the European Union, the United States, and the Asian powers—China, Japan, or both. The FTAs came to be seen as building blocks for the sort of economic and political integration that characterizes modern geographically contiguous nations. Hence, these blocs might fortify internal political alliances, exacerbating political tensions and erecting walls that divide the global economy.

Simply put, this dark vision proved wrong, even as FTAs flourished. By one count, some 176 new trade agreements have been ratified since the birth of the WTO in January 1995, and the total number threatens to exceed 300 (WTO 2005a). Yet many of the post-1995 FTAs are "out of area," drawing no inspiration from existing or anticipated political alliances. The United States has FTAs with Chile and Singapore; the European Union has FTAs with Mexico and Chile. Japan has an FTA with Singapore, and Switzerland, under EFTA auspices, has FTAs with Chile, Singapore, and

South Korea.[3] Even China's menu of prospective FTA partners seems devoid of political alliances (Hufbauer and Wong 2005). The partners are often separated by thousands of miles and may not speak a common language, as US FTAs with Jordan, Morocco, and Bahrain illustrate. Rather than forming tightly knit geographic units centered on a major power, FTAs are creating crisscross networks spanning the globe, with no clear separation between "hubs" and "spokes." Compared with recent experience, rather than dark visions of the past, a Swiss-US FTA is perfectly compatible with the general FTA movement.

Are There Real Benefits to an FTA?

What about the argument that, since both Switzerland and the United States are rich, subscribe to market capitalism, and practice open economic policies, there is no real point in an FTA? At bottom, this argument echoes the textbooks of an earlier day, which argued that additional trade and consequent economic gains are greatest when two highly dissimilar countries open commerce with one another. According to the classic textbook exposition, large national differences portend sharp comparative advantages and disadvantages, and hence, large static gains from free trade. In a world of fixed technological attributes, no economies of scale or scope, exchange limited to final goods and services, complete factor immobility, perfect competition, and only static gains from trade, the classic thesis is still a good thesis. But that hypothetical world economy never accurately described the real one.

Recent econometric research demonstrates how misleadingly small the projected volumes of new trade and sizes of economic gains are when models are confined to the classic assumptions.[4] When the realities of modern economic systems are given room to play—learning from new competition and new markets, significant economies of scale and scope, international investment, erosion of monopolistic margins, and huge trade in intermediate goods and services with an economic role similar to that of the basic factors of production—the models and experience reveal that similar countries can gain enormously from free trade and investment, even when they already practice open-economy policies.

In the context of Swiss-US relations, it is simply wrong to assert that little or nothing remains to be gained from bilateral free trade and investment. As described in the chapters that follow, even though both countries are relatively open, they both still have significant barriers. Many of these are behind-the-border, nontariff barriers (NTBs). Agriculture, selected

3. The EFTA–South Korea FTA should be signed by the end of 2005.

4. For a short survey of the econometric methods for sizing up the gains from freer trade and investment, see Bradford, Grieco, and Hufbauer (2005).

manufactures, some services, and government procurement are far from the ideal of free trade and investment. Moreover, even when overall barriers are small or insignificant, recent econometric research using a gravity model[5] reveals that an "announcement" or "lock-in" effect appears to augment commerce between FTA partners.[6]

To preview our own econometric research presented in chapters 7 and 8, elimination of all bilateral barriers between Switzerland and the United States might actually double two-way merchandise trade. US foreign direct investment (FDI) in Switzerland, which is already substantial, might increase by as much as 40 percent. Deeper trade and investment links would erode the power of oligopolies in both economies, spur the exchange of technology and skilled personnel, and enhance economic efficiency.

Is the Timing Wrong?

Perhaps the strongest argument against a Swiss-US FTA is the matter of timing. Why distract attention from the final push to complete the Doha Development Round? For both countries, the political and economic payoff from a successful WTO negotiation far exceeds whatever achievements can be realized on a bilateral basis. The Central American–Dominican Republic Free Trade Agreement (CAFTA-DR) won approval from the US House of Representatives on June 28, 2005 by a tight 217 to 215 vote, but the congressional battle was prolonged and bruising, and in the aftermath, there is a certain amount of "trade fatigue" among business and legislative proponents of greater liberalization. A case can be made that these stalwarts need time to rest up before they take on the big battle: congressional ratification of the WTO Doha Development Round package.[7] Similarly,

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5. Chapter 8, authored by Dean DeRosa and John Gilbert, summarizes the gravity model technique. While the technique has been well known since Linnemann (1966), it has been applied to assess the effect of FTAs only since the work of Frankel (1997) and Rose (2000). Most gravity model estimates of the FTA trade-creation effect substantially exceed the forecasts of basic computable general equilibrium (CGE) models (DeRosa and Gilbert 2005). Various explanations can be adduced for the difference, but announcement and lock-in effects are commonly cited.

6. The announcement effect presumably reflects the wake-up call that an FTA conveys to potential investors, exporters, and importers. This could be important for US firms deciding on a headquarters location for their European operations. The lock-in effect reflects the greater certainty that firms can place in a country's trade and investment policies, once barriers are capped in an FTA. In NAFTA, the lock-in effect was an important driver of new investment in Mexico. However, in a Swiss-US FTA, the lock-in effect would probably be modest, since neither country is prone to abrupt protectionist or antiforeign policies that affect the other (US antidumping duties play little or no role in bilateral trade; see chapter 4).

7. To be sure, US ratification of CAFTA-DR has already freed up US negotiating expertise to focus more attention on the sluggish WTO negotiations. However, the scarcest resource in US trade negotiations is not bureaucratic talent, but congressional time and energy.

within Switzerland, a free trade agreement with the United States will inspire a wide-ranging debate over Swiss relations with the European Union and Switzerland's historic protection of agriculture. A Swiss-US FTA may in the end be voted up or down in a popular, and hotly contested, referendum. Clearly, one can argue that this debate should be put off until the WTO Doha Round has been ratified.

The timing arguments would be persuasive if the Swiss-US FTA and the WTO Doha Round were alternatives. But the two agreements are complements, not substitutes. Over the next year, the central focus of the Swiss-US FTA should be negotiation, not ratification, either by the US Congress or the Swiss confederation. The ratification process should either be merged with approval of the Doha package (possibly the best timing in the United States) or initiated after the Doha package is approved (possibly the best timing in Switzerland).

Moreover, as a negotiated text, the Swiss-US FTA can liberalize trade in goods and services to a far greater extent than the Doha Round can. At best, within the WTO, modest progress seems possible on agricultural market-access barriers, although cuts in farm subsidies may be agreed to (Josling and Hathaway 2004). Service negotiations have made so little headway that a crisis has been declared.[8] WTO members are dickering over tariff-cutting formulas to improve nonagricultural market access (the NAMA group), but the foreseeable outcome is far from zero tariffs on manufactured goods. By contrast, in all of these areas and others—such as government procurement, geographical indications (GIs), and sanitary and phytosanitary (SPS) barriers—the Swiss-US FTA should go far beyond what can be achieved in the WTO. In fact, the starting point for liberalization between the two countries should be well ahead of the ending point for the Doha Round. Seen in this light, the Swiss-US FTA can join the array of "gold standard" agreements that serve as templates for the next WTO round, post-Doha.

Will the Agreement Comport with GATT Article 24?

Both the United States and Switzerland have entered into numerous FTAs. Apart from NAFTA, the United States has FTAs with Israel, Jordan, Chile, Singapore, Australia, Morocco, Central America, the Dominican Republic, and Bahrain. Several more are in various stages of discussion and negotiation (see chapter appendix table 1A.1). In the past, apart from its special agreements with the European Union, Switzerland has negotiated all of its

8. The Global Services Coalition, a group of Australian, Chilean, European, NASSCOM, Japan, and US providers, met with WTO officials in Geneva on June 24, 2005, and circulated an alert entitled "WTO Services Negotiations in Crisis; Political Will Must be Mobilized Urgently." Available at the Web site of the European Services Forum at www.esf.be.

FTAs in conjunction with EFTA, which has agreements with Bulgaria, Chile, Croatia, Israel, Jordan, Lebanon, Macedonia, Mexico, Morocco, the Palestinian Authority, Romania, Singapore, Tunisia, and Turkey—and others are pending.[9] From a Swiss standpoint, the exceptional feature of a Swiss-US FTA, apart from the size of its prospective American partner, is that the pact would be the first FTA negotiated separate from EFTA, leaving aside Swiss agreements with the European Union.

None of the US or EFTA free trade pacts have been found in violation of the General Agreement on Tariffs and Trade (GATT) Article 24, perhaps for the simple reason that Article 24 reviews invariably either say nothing or convey only bland misgivings (Schott 2004b). Indeed, only one review group (for the Czech-Slovak pact) reached an affirmative consensus (Sutherland et al. 2004).[10] Nevertheless, it is fair to say that US FTAs generally come close to the Article 24 ideal, eliminating barriers on substantially all of the merchandise trade of the partners. Their major shortcoming is their near exclusion of agriculture, as in the Canada-US FTA signed in 1989, or very long phaseouts for sensitive agricultural products—a conspicuous fault of the US-Australia FTA, at US insistence. The free trade pacts negotiated by EFTA fall somewhat shorter of the Article 24 ideal, in that they achieve only a very limited degree of liberalization in agriculture. Set against their agricultural shortcomings, the FTAs agreed to both by the United States and EFTA liberalize services and investment, areas that the GATT barely touches.

If Switzerland and the United States reach an FTA, it should come as close to the Article 24 ideal as any prior agreements of either party. Long phaseouts and special safeguards will be necessary on both sides for sensitive agricultural products. Otherwise, the coverage should be comprehensive, with rapid elimination of barriers.

Switzerland's Place in the Queue

As mentioned, the United States is engaged in free trade talks with many potential partners, mostly developing countries, though three of the potential partners—Switzerland, New Zealand, and South Korea—belong to the Organization for Economic Cooperation and Development (OECD). Given the relatively long list of potential FTA partners, the US Trade Rep-

9. As a stepping stone toward the negotiation of additional FTAs, EFTA also has Joint Declarations of Cooperations (JDCs) with Albania, Algeria, the Gulf Cooperation Council, Mercosur, Serbia and Montenegro, and Ukraine (EFTA 2005).

10. An agreement can be fully consistent with Article 24, yet one or both parties may owe compensation to other WTO members for trade diversion. Usually, such claims are settled in larger trade negotiations, such as the Tokyo Round or the Uruguay Round.

resentative, Ambassador Rob Portman, will inevitably establish priorities depending on a variety of considerations, among them political alliances, prospective economic payoff, speed and ease of negotiation, and quality of results. Most of these considerations cannot be quantified, but available data does shed light on the strength of trade and investment ties between the United States and its prospective partners, the height of protective barriers, and the degree of social similarity, measured by corruption, economic freedom, and labor and environmental standards.

Before turning to quantitative comparisons, we must emphasize an important aspect of post–September 11 FTA diplomacy. The Bush administration places a very high priority on economic diplomacy that buttresses US national interests in Muslim countries generally and the Middle and Near East specifically. The administration believes that market-oriented economies that are growing and run on democratic principles are far less likely to breed terrorists and far more likely to contribute to world peace and prosperity. That vision stands at the apex of policy, and accordingly, the administration favors new FTAs with countries in the Middle and Near East. Morocco was first on the list, and Bahrain is second. Egypt, Pakistan, and Indonesia are all prospects. Among this cluster of countries, the United States values FTAs for their potential to promote broad economic reform. Obviously, from the perspective of national security, Switzerland ranks near the bottom of the FTA queue, both because Switzerland already ranks among the safest and most stable countries in the world, and because its diplomacy is founded on the principle of neutrality with the great powers.

That said, we turn to an array of quantitative and qualitative indicators that enable comparisons of Switzerland with present and prospective US FTA partners (see chapter appendix tables 1A.1 through 1A.7). Quantitative indicators consist of inward and outward FDI stocks, two-way US merchandise trade, two-way US services trade, and the average most favored nation (MFN) tariff rates for agricultural and nonagricultural products. Qualitative indicators include a corruption index, two economic freedom indexes, and indexes for labor and environmental standards. As mentioned above, current FTA partners include Israel (1986), Canada (1989), Mexico (1993), Jordan (2001), Chile (2003), Singapore (2004), Australia (2004), and Morocco (2004). Prospective US FTA partners are divided into three different groups:

- partners for whom an FTA has been negotiated but not yet ratified: Bahrain, Oman and CAFTA (the CAFTA-DR pact still awaits ratification in Costa Rica);
- partners in the process of negotiation: Colombia, Ecuador, Panama, Peru, Thailand, the Southern African Customs Union (SACU) countries, and the United Arab Emirates;

- partners under consideration: Bangladesh, Bolivia, the Caribbean Community (Caricom), Egypt, Indonesia, Malaysia, New Zealand, Pakistan, Philippines, Qatar, South Korea, Switzerland, and Taiwan.

Quantitative Indicators

Chapter appendix table 1A.1 shows that Switzerland's two-way FDI stocks with the United States exceed those of many other countries seeking FTAs with the United States. The logic for this indicator is that, when two countries have an important base of two-way FDI stocks, the prospect of an FTA will enlist considerable enthusiasm in the business community. Moreover, once an FTA is concluded, firms will take a more favorable view to expanding their stakes in the partner country, creating a follow-on push for trade.

As one would expect, the two NAFTA partners, Canada and Mexico, rank high in two-way FDI stocks. However, with a two-way FDI stock of $199 billion, Switzerland ranks second, behind only Canada ($298 billion) and well ahead of Mexico ($68 billion). Chapter appendix table 1A.1 also shows that outward FDI from the United States to its NAFTA partners accounts for most of the total two-way FDI stocks. By comparison, Switzerland is a net exporter of FDI to the United States. In fact, along with Bahrain, Switzerland is the only country in the list to invest more in the United States than vice versa. The high ranking of Switzerland suggests both business support for an FTA and the prospect of substantial additional investment in both directions if an FTA is concluded.

Chapter appendix table 1A.2 presents US two-way merchandise trade with its current and potential FTA partners. The logic for this indicator follows the logic of two-way FDI stocks. When two countries have an important base of merchandise trade, not only do firms have a tangible reason to support an FTA, but the prospects are also excellent for a substantial dollar increase in bilateral trade. With two-way merchandise trade of $21 billion, Switzerland ranks 11th among current and prospective US partners. This figure is obviously far behind the NAFTA partners—Mexico and Canada total $356 billion of two-way trade with the United States—but it is only moderately behind CAFTA, Israel, Australia, and most East Asian countries (Singapore, Malaysia, Taiwan, Thailand, and South Korea). Moreover, Switzerland's two-way trade with the United States easily exceeds the two-way trade of three current partners, Chile, Jordan, and Morocco, and twenty potential partners situated in South America, the Middle East, and South Africa. Based on its merchandise trade with the United States, Switzerland occupies a solid upper-middle position relative to other current and prospective partners.

Chapter appendix table 1A.3 presents US two-way trade in services with its current and potential FTA partners. The logic of this indicator parallels the previous two. While data on services trade often does not exist for many countries, and is missing for several current and prospective FTA partners, certain conclusions can be drawn from the available figures. Based on these data, Switzerland ranks third in two-way trade in services, just behind Canada and Mexico, and ahead of other current and prospective FTA partners. The high ranking of Switzerland reflects substantial flows of interest, dividends, and royalties, as well as business services in both directions: The two-way trade in services, around $16 billion annually, is almost as large as it is in manufactured goods, around $17 billion annually.

Chapter appendix table 1A.4 presents recent MFN tariff rates for current and prospective FTA partners. The MFN figures are applied-rate averages for agricultural and nonagricultural products respectively. The main rationale for this indicator is that it suggests how difficult commercial negotiations will be. An FTA, by definition, aims at eliminating tariffs and quotas, and this will be easier if the partner country already has low applied MFN tariff rates.

On this indicator, Switzerland's position is sharply split. With an MFN rate of 2.3 percent, Switzerland has one of the lowest average rates for nonagricultural products; it ranks second, just behind Singapore. However, Switzerland has one of the highest applied average MFN rates for agricultural products, ranking 29 out of 31 current and prospective partners. Switzerland's wall of agricultural protection implies difficult FTA negotiations in that area. Looking on the bright side, however, high agricultural tariffs and restrictive quotas mean that the potential benefit of an FTA to both countries is substantial (as discussed in chapter 2). By the same token, freer trade between the United States and Switzerland could divert Swiss agricultural purchases from the European Union, which already enjoys significant preferences in the Swiss market. The possibility of "preference erosion" is discussed more fully in chapters 8 and 9.

The United States has concluded FTAs with countries that had both high and low applied MFN tariffs. Canada, Singapore, Australia, and Chile had relatively low applied MFN tariff rates, on both agricultural and nonagricultural products.[11] By contrast, Mexico, Jordan, Morocco, and Israel have much higher MFN rates. From this spectrum, one might conclude that the United States is indifferent to the level of MFN barriers when it selects FTA partners. But that conclusion ignores the fact that US FTAs with Middle Eastern countries were primarily motivated by geopolitical alliances. A Swiss-US FTA needs to be inspired by economic as much as geopolitical forces.

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11. While the figures in chapter appendix table 1A.4 refer to the situation in 2004, at the time that the FTAs were negotiated, all of these partners had comparatively low average MFN tariffs.

Qualitative Indicators

Chapter appendix table 1A.5 compares the degree of corruption among current and prospective FTA partners. The logic of this indicator is twofold. First, less corruption probably means less political influence from vested interests that preserve the economic rents generated by trade and investment barriers. Second, less corruption means a more desirable environment for expanding trade and investment relations.

Switzerland ranks third-best on the corruption index scale, just behind New Zealand and Singapore. Apart from Morocco, Mexico, and Jordan, current US FTA partners have low levels of corruption. By contrast, several of the prospective partners have somewhat higher levels. Other things being equal, the United States prefers FTA partners that score well in terms of honest government.

Chapter appendix table 1A.5 also presents two different indexes of economic freedom, as measured by the Heritage Foundation and the World Economic Forum. These indexes cover trade policy, fiscal burdens, government intervention in the economy, monetary policies, capital flows and FDI, wages and prices, banking and finance, property rights, and overt and informal market regulation. They suggest that Switzerland and Singapore offer the most attractive business environments compared to other current and prospective partners. Switzerland's honest governance and moderate regulatory environment give the country a very favorable position in the US FTA queue.

Chapter appendix table 1A.6 presents the environmental sustainability index (ESI) for all current and prospective partners. This index reflects water and air pollution, the extent of protected areas, and environmental regulations and enforcement. Switzerland ranks second—behind Canada and ahead of Australia—and seems to hold an advantageous position compared with other prospective partners. Its environmental standards exceed those of the United States.[12] Hence, it is unlikely that a trade agreement between the United States and Switzerland would run into environmental objections in Congress. Switzerland clearly will not face the onerous criticism that Central American countries faced over CAFTA.

Chapter appendix table 1A.7 compares labor standards for current and prospective partners. A labor standard index is constructed based on five different indicators: the right of association—that is, the right to form unions—bargain, and strike; extent of forced labor; extent of child labor; working conditions; and the number of international labor treaties that have been ratified. The labor index for each country reflects whether labor standards are high, medium-high, medium, medium-low, or low for each

12. With an ESI score of 52.9, the United States would rank 10th in the ESI ranking of chapter appendix table 1A.6.

of these five categories.[13] The labor index shows that Switzerland's labor standards surpass those of all current and potential US FTA partners. They are high for each of the five indicators, and are aligned with US labor standards. Clearly, they would not be a negative dimension of a US-Swiss FTA and might instead be a positive feature.

Plan of the Book

Two-way trade in agricultural goods and foodstuffs represents only 2 percent of merchandise trade between Switzerland and the United States. Yet two chapters of the report are devoted to agriculture and the related subjects of SPS and GI issues. The reason is that attention in the report is roughly scaled to the magnitude of barriers rather than the volume of trade. Agriculture and foodstuffs are extremely highly protected in Switzerland, and highly protected in the United States. Chapter 2 depicts the barriers and outlines recommendations for their gradual phaseout in a bilateral FTA. Chapter 3 addresses SPS and GI issues, centered on agriculture and foodstuffs, and again offers recommendations for avoiding unintended SPS barriers and improving the protection of intellectual property inherent in GI rights. The recommendations in chapters 2 and 3 are strongly influenced by US and Swiss approaches in prior FTAs and other bilateral agreements.

Chapter 4 turns to commerce in manufactured goods. Manufactures dominate bilateral merchandise trade, amounting to about $17 billion annually. Fortunately, most of this commerce is free of tariffs and NTBs.[14] The Swiss MFN rate on manufactured imports is only 2.3 percent, while the US MFN rate is only 4.2 percent. Nestled within these low averages, however, are fairly high rates on specific tariff lines. These products attract most of our attention, and the chapter concludes with recommendations for eliminating low tariffs immediately and phasing-out high tariffs over a short period.

Chapter 5 takes up services. Two-way trade in private services, amounting to about $16 billion annually, puts this sector close to manufactured goods in magnitude. Tariffs and quotas usually do not obstruct two-way trade in services; instead, the most important barriers are behind the border, such as licensing requirements and public and private monopolies. Chapter 5 concentrates on four service sectors: financial services; network industries, such as electricity and telecommunications; audiovisual

13. For a review of the detailed methodology for constructing labor indicators, see appendix A.

14. The most important NTBs involve different technical standards and different systems to ensure that products conform to the announced standards. Chapter 4 offers recommendations for more closely aligning US and Swiss systems.

services; and professional services. After reviewing US and Swiss barriers, and solutions devised in prior FTAs, chapter 5 offers recommendations for the Swiss-US FTA.

Chapter 6 reviews government procurement, an area that has proven highly resistant to liberalization in the WTO, and that evokes political sensitivities in individual states and cantons. The United States and Switzerland have opened up their markets on a reciprocal basis for selected entities. That concluded a 1996 bilateral agreement that was later incorporated in the WTO General Provision Agreement (GPA). Both countries have extended concessions to other GPA partners, and to partners in their respective FTAs. Chapter 6 recommends that Switzerland and the United States extend each other the best government procurement terms offered to any other country, either through the GPA or in bilateral FTAs (an unconditional MFN approach).

Direct and portfolio investment links between Switzerland and the United States are substantial, as shown in chapter 7. Among current and prospective FTA partners, Swiss-US links are second only to US investment links with Canada. Bilateral investment frictions are scarce, but still, an FTA could eliminate minor barriers and provide a framework for resolving future disputes. The recommendations offered in chapter 7 are intended to expand already robust bilateral investment ties. Rough calculations suggest that additional investment could boost two-way trade in manufactured goods, perhaps by a quarter. It would also foster the movement of skilled personnel, synergies in science and technology, and the creation of intellectual property embodied in patents, copyrights, and trademarks.

Chapter 8 summarizes estimates based on computable general equilibrium (CGE) and gravity models. The models attempt to forecast the effect of a bilateral FTA on the volume of trade created between Switzerland and the United States, the volume of trade diverted from third countries, and economic gains for the two partners. They suggest that additional two-way trade in agricultural and manufactured goods would certainly be substantial, perhaps doubling the level that would otherwise be reached.[15] Economic gains would be significant, especially for Switzerland.

Chapter 9 explores the consequences of a Swiss-US FTA for Switzerland's relations with the European Union. Geographically, Switzerland sits in the center of the European Union; economically, the preponderance of Switzerland's commerce is with Europe. In fact, Switzerland has more than 100 commercial treaties with the European Union (Hewitt Associates 2002). Accordingly, it must anticipate the effects of a Swiss-US FTA on its rela-

15. Analysis done by Adams et al. (2003) at the Australian Productivity Commission (APC), using a variant of the gravity model, comes to strikingly different conclusions. The authors claim to find very little trade creation between FTA partners, and net trade diversion for 12 of 16 recent FTAs. For reasons explained in chapter 8, we do not subscribe to their analysis.

tions with the European Union. The Swiss-EU Bilateral Agricultural Agreement contains an "evolutionary clause" that commits the two parties to regularly review their agricultural trade.[16] While this is far from an unconditional MFN clause, Switzerland's geographic, political, and economic circumstances ensure that the European Union will carefully examine commercial concessions granted to the United States. However, chapter 9 concludes that a Swiss-US FTA would, at most, inflict a degree of "preference dilution" on the European Union, and might come to be regarded by Brussels as a benign "reverse hub-and-spoke arrangement." Ideally, the European Union will show the same tolerance for a Swiss-US FTA as the United States has shown for the Mexican-EU FTA.

In sum, as we see it, an FTA between Switzerland and the United States could create substantial economic gains for both partners, at only moderate political and economic risk. Moreover, because both countries are highly developed and stable, with robust labor and environmental standards, a Swiss-US FTA could set a new standard in harmonizing domestic policies and liberalizing trade for other countries to follow. Before this can be accomplished, however, both countries must lower their considerable barriers to trade in agriculture, as the next chapter shows.

16. The bilateral agreement is formally known as The Agreement between the European Community and the Swiss Confederation on Trade in Agricultural Products, signed in 1999. Article 13 is the evolutionary clause.

Appendix 1A

Table 1A.1 Foreign direct investment stocks, 2003[a]
(millions of dollars)

Partners	Rank[c]	From United States	To United States	Two-way FDI
NAFTA				
Canada	1	192,400	105,255	297,655
Mexico	3	61,526	6,680	68,206
Other current partners				
Australia	4	40,985	24,652	65,637
Chile	12	9,986	63	10,049
Israel	13	6,208	3,834	10,042
Jordan	32	47	–17	30
Morocco	30	309	–23	286
Singapore	5	57,589	–162	57,427
To be ratified				
Bahrain	26	196	288	484
CAFTA	18	3,435	–29	3,406
Dominican Republic	25	860	18	878
Oman	29	358	–1	357
Under negotiation				
Colombia	20	2,751	–150	2,601
Ecuador	22	1,446	34	1,480
Panama	9	6,497	8,383	14,880
Peru[b]	21	2,659	–137	2,522
SACU-5	26	795	75	870
Thailand	15	7,393	182	7,575
United Arab Emirates	23	1430	39	1,469
Under consideration				
Europe				
Switzerland	2	86,435	112,856	199,291
Middle East				
Egypt	7	18,960	–38	18,922
Qatar	19	3,113	33	3,146
East Asia and Pacific				
Indonesia	11	10,387	27	10,414
Malaysia	14	7,580	208	7,788
New Zealand	17	3,849	607	4,456
Philippines	16	4,700	33	4,733
South Korea	8	13,318	2,337	15,655
Taiwan	10	10,961	2,708	13,669

(table continues next page)

Table 1A.1 Foreign direct investment stocks, 2003[a] (*continued*)
(millions of dollars)

Partners	Rank[c]	From United States	To United States	Two-way FDI
Latin America				
Bolivia	28	375	–5	370
Caricom	6	16,972	9,968	26,940
South Asia				
Bangladesh	31	169	4	173
Pakistan	24	1,074	31	1,105

CAFTA = Central American Free Trade Agreement
Caricom = Caribbean Common Market
SACU = Southern African Customs Union

a. FDI stock computed as direct investment position on a historical-cost basis.
b. Data for 2001.
c. Based on two-way FDI.

Source: US BEA (2004a).

Table 1A.2 US merchandise trade, 2003 (millions of dollars)

Partners	Rank[a]	Two-way trade	US exports	US imports
NAFTA				
Canada	1	445,028	189,101	255,927
Mexico	2	266,618	110,775	155,843
Other current partners				
Australia	10	21,814	14,270	7,544
Chile	18	8,358	3,625	4,733
Israel	9	23,725	9,198	14,527
Jordan	27	1,645	552	1,093
Morocco	28	1,038	523	515
Singapore	6	34,905	19,600	15,305
To be ratified				
Bahrain	31	706	301	405
CAFTA	7	33,430	15,730	17,700
Dominican Republic	17	8,871	4,343	4,528
Oman	30	748	330	418
Under negotiation				
Colombia	15	11,794	4,504	7,290
Ecuador	19	5,951	1,666	4,285
Panama	26	2,136	1,820	316
Peru	20	5,795	2,095	3,700
SACU-5	16	10,237	3,317	6,920
Thailand	8	23,940	6,363	17,577
United Arab Emirates	21	5,205	4,064	1,142
Under consideration				
Europe				
Switzerland	11	20,911	9,268	11,643
Middle East				
Egypt	24	4,435	3,105	1,330
Qatar	29	842	455	387
East Asia and Pacific				
Indonesia	13	13,480	2,669	10,811
Malaysia	5	39,082	10,897	28,185
New Zealand	22	5,043	2,076	2,967
Philippines	12	16,216	7,072	9,144
South Korea	3	72,496	26,333	46,163
Taiwan	4	56,348	21,731	34,617
Latin America				
Bolivia	32	454	194	261
Caricom	14	13,407	5,744	7,663
South Asia				
Bangladesh	25	2,592	289	2,302
Pakistan	23	4,685	1,811	2,874

a. Ranking based on two-way trade.

Source: US Department of Commerce, TradeStats Express, retrieved from http://tse.export.gov/.

Table 1A.3 Trade in US services, 2004 (millions of dollars)

Partners	Rank[b]	Two-way trade	US exports	US imports
NAFTA				
Canada	1	45,869	26,723	19,146
Mexico	2	28,280	16,599	11,681
Other current partners				
Australia	6	8,991	5,833	3,158
Chile	13	1,682	1,032	650
Israel	7	4,136	2,303	1,833
Jordan	n.a.	n.a.	n.a.	n.a.
Morocco	n.a.	n.a.	n.a.	n.a.
Singapore	5	11,819	6,912	4,907
To be ratified				
Bahrain	n.a.	n.a.	n.a.	n.a.
CAFTA	n.a.	n.a.	n.a.	n.a.
Dominican Republic	n.a.	n.a.	n.a.	n.a.
Oman	n.a.	n.a.	n.a.	n.a.
Under negotiation				
Colombia	n.a.	n.a.	n.a.	n.a.
Ecuador	n.a.	n.a.	n.a.	n.a.
Panama	n.a.	n.a.	n.a.	n.a.
Peru	n.a.	n.a.	n.a.	n.a.
SACU-5[a]	9	2,165	1,188	977
Thailand	11	1,800	1,061	739
United Arab Emirates	n.a.	n.a.	n.a.	n.a.
Under consideration				
Europe				
Switzerland	3	16,362	8,014	8,348
Middle East				
Egypt	n.a.	n.a.	n.a.	n.a.
Qatar	n.a.	n.a.	n.a.	n.a.
East Asia and Pacific				
Indonesia	14	1,366	1,088	278
Malaysia	12	1,702	1,208	494
New Zealand	10	2,087	973	1,115
Philippines	8	2,751	1,357	1,394
South Korea	4	12,780	8,402	4,377
Taiwan	n.a.	n.a.	n.a.	n.a.
Latin America				
Bolivia	n.a.	n.a.	n.a.	n.a.
Caricom	n.a.	n.a.	n.a.	n.a.
South Asia				
Bangladesh	n.a.	n.a.	n.a.	n.a.
Pakistan	n.a.	n.a.	n.a.	n.a.

n.a. = not available

a. Using data for South Africa.
b. Based on two-way trade; rank positions exclude countries for which information is not available.

Source: US BEA (2005b).

Table 1A.4 Average MFN tariff rates, 2003–04
(simple average ad valorem rates)

	Agricultural			Nonagricultural		
Partners	**Bound**	**Applied**	**Rank[f]**	**Bound**	**Applied**	**Rank**
NAFTA						
Canada	3.5	3.1	5	5.3	4.2	6
Mexico	35.1	24.5	27	34.9	17.1	28
Other current partners						
Australia	3.2	1.1	2	11.0	4.6	8
Chile	26.0	6.0	7	25.0	5.9	13
Israel	73.0	15.9	19	9.2	4.0	4
Jordan	23.7	19.8	23	19.8	12.1	24
Morocco	54.5	48.6	30	39.2	27.5	31
Singapore	9.5	0.0	1	6.3	0.0	1
To be ratified						
Bahrain	37.5	9.0	10	35.1	7.6	17
CAFTA[a]	42.3	10.5	14	38.2	5.7	11
Dominican Republic	39.6	13.0	16	34.2	7.8	18
Oman[d]	28.0	10.2	13	11.6	5.0	9
Under negotiation						
Colombia	91.9	14.9	15	35.4	11.9	23
Ecuador	25.5	14.7	17	21.1	11.5	22
Panama	27.7	14.8	18	22.9	7.4	16
Peru	30.8	17.2	21	30.0	13.1	25
SACU-5[b]	39.2	9.1	11	15.8	5.3	10
Thailand	35.5	29.0	28	24.2	14.2	26
United Arab Emirates	25.4	n.a.	n.a.	13.1	n.a.	n.a.
Under consideration						
Europe						
Switzerland[c]	n.a.	36.2	29	n.a.	2.3	2
Middle East						
Egypt	95.3	22.8	26	28.3	19.4	30
Qatar	25.7	4.9	6	14.5	4.1	5
East Asia and Pacific						
Indonesia	47.0	8.2	9	35.6	6.7	14
Malaysia	12.2	2.1	4	14.9	8.1	19
New Zealand	5.7	1.7	3	11.0	3.5	3
Philippines	34.7	8.0	8	61.8	4.3	7
South Korea	52.9	52.1	31	10.2	7.0	15
Taiwan	15.3	16.3	20	4.8	5.5	12
Latin America						
Bolivia	40.0	10.0	12	40.0	9.3	20
Caricom[e]	98.0	18.4	22	51.2	11.1	21

(table continues next page)

Table 1A.4 Average MFN tariff rates, 2003–04
(simple average ad valorem rates) (*continued*)

	Agricultural			Nonagricultural		
Partners	**Bound**	**Applied**	**Rank[f]**	**Bound**	**Applied**	**Rank**
South Asia						
Bangladesh	188.5	21.7	25	35.7	19.2	29
Pakistan	97.1	20.4	24	35.3	16.6	27
US comparison	6.9	5.1	7	3.2	3.7	4

n.a. = not available

a. Simple average of observations for Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.
b. Using South Africa average bound tariff. Tariff binding figures are based on simple averages of national averages reported by the WTO and exclude Lesotho.
c. Using ad valorem equivalent (AVE). Switzerland has a 99.8 percent binding coverage, but bindings are in the form of specific tariffs.
d. Data for 2001.
e. Simple averages of observations reported by the WTO for each Caricom member.
f. Ranks based on applied rates, ranks run from low to high rates.

Sources: WTO 2004 *World Report* and *Trade Profiles*.

Table 1A.5 Corruption and economic freedom, 2005
(index values)

Partners	Corruption[a]	Corruption rank	Freedom[b]	Freedom[c]	Average rank
NAFTA					
Canada	8.4	5	4.1	5.1	6
Mexico	3.5	20	3.1	3.9	17
Other current partners					
Australia	8.8	4	4.2	5.2	5
Chile	7.3	7	4.2	4.9	7
Israel	6.3	8	3.6	4.8	11
Jordan	5.7	14	3.2	4.3	14
Morocco	3.2	24	2.8	3.5	23
Singapore	9.4	2	4.4	5.5	1
To be ratified					
Bahrain	5.8	13	3.9	4.5	9
CAFTA	n.a.	n.a.	n.a.	n.a.	n.a.
Dominican Republic	3.0	25	2.5	3.1	26
Oman	6.3	8	3.2	n.a.	n.a.
Under negotiation					
Colombia	4.0	18	2.8	3.8	20
Ecuador	2.5	26	2.5	3.0	28
Panama	3.5	20	3.3	3.6	18
Peru	3.5	20	3.2	3.7	19
SACU-5[d]	4.5	17	3.2	4.3	15
Thailand	3.8	19	3.0	4.5	16
United Arab Emirates	6.2	10	3.3	5.0	12
Under consideration					
Europe					
Switzerland	9.1	3	4.1	5.5	3
East Asia and Pacific					
Indonesia	2.2	29	2.5	3.5	25
Malaysia	5.1	15	3.0	4.9	13
New Zealand	9.6	1	4.3	5.1	4
Philippines	2.5	26	2.7	3.5	24
South Korea	5.0	16	3.4	5.1	10
Taiwan	5.9	11	3.7	5.6	8
Middle East					
Egypt	3.4	23	2.6	4.0	22
Qatar	5.9	11	2.9	n.a.	n.a.
Latin America					
Bolivia	2.5	26	3.3	3.1	21
Caricom	n.a.	n.a.	n.a.	n.a.	n.a.

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Table 1A.5 Corruption and economic freedom, 2005
(index values) (*continued*)

Partners	Corruption[a]	Corruption rank	Freedom[b]	Freedom[c]	Average rank
South Asia					
Bangladesh	1.7	31	2.0	2.9	29
Pakistan	2.1	30	2.3	3.3	27
US comparison	7.6	6	4.1	5.8	2

n.a. = not available

a. Countries with high score are the most transparent (i.e., high score is better)
b. High score = economically more free. Heritage Index scores have been rescaled so that 5 = "economically free" and 1 = "economically unfree".
c. High score = economically more free (World Economic Forum).
d. Using data for South Africa.

Sources: Transparency International Corruption Perceptions Index 2005; The Heritage Foundation 2005 Index for Economic Freedom; World Economic Forum, 2005 Growth Competitiveness Index.

Table 1A.6 Environmental standards

Partners	ESI rank	ESI index[a]	CO_2 emissions damage[b]	Protected areas[c]	Compliance with environmental[d] agreements	Number of treaties[e]
NAFTA						
Canada	1	64.4	High	Low	High	High
Mexico	19	46.2	High	Low	Medium	Med/high
Other current partners						
Australia	3	61.0	Medium	Medium	Medium	High
Chile	10	53.6	Medium	Medium	Med/high	High
Israel	12	50.9	High	Medium	Medium	Medium
Jordan	18	47.8	Low	Medium	Med/high	Medium
Morocco	20	44.8	Medium	Low	Med/low	High
Singapore	13	50.0	Medium	Low	High	Low
To be ratified						
Bahrain	n.a.	n.a.	Low	Low	n.a.	Low
CAFTA	15	49.0	High	Medium	Low	Medium
Dominican Republic	25	43.7	Medium	High	Med/low	Medium
Oman	17	47.9	Medium	Medium	Med/low	Med/low
Under negotiation						
Colombia	7	58.9	High	High	Medium	Med/high
Ecuador	12	52.4	Low	High	Low	Med/high
Panama	8	57.7	Medium	High	Med/low	Med/high
Peru	5	60.4	High	Medium	Low	Med/high
SACU-5	11	52.9	Medium	Medium	Medium	Med/low
Thailand	14	49.7	Low	Medium	Medium	Medium
United Arab Emirates	21	44.6	Low	Low	n.a.	Med/low

Under consideration						
Europe						
Switzerland	2	63.7	High	High	High	High
Middle East						
Egypt	24	44.0	Low	Medium	Medium	High
Qatar	n.a.	n.a.	Low	Low	n.a.	Low
East Asia and Pacific						
Indonesia	16	48.8	Medium	Low	Med/low	Medium
Malaysia	9	54.0	Low	High	Med/high	Medium
New Zealand	4	60.9	High	Medium	High	Med/high
Philippines	22	44.3	Medium	Low	Low	Med/high
South Korea	26	43.0	Medium	Low	Med/high	Med/high
Taiwan	29	32.7	Medium	Low	Med/high	Low
Latin America						
Bolivia	6	59.5	Low	Medium	Low	Medium
Caricom	27	41.0	Medium	Low	Medium	Medium
South Asia						
Bangladesh	23	44.1	High	Low	Low	Med/low
Pakistan	28	39.9	Low	Low	Low	Medium
US comparison	11	52.9	High	High	Medium	High

a. Environmental sustainability index (ESI); countries with high scores have high environmental standards.
b. High = CO_2 damage < 0.5 percent, Medium = CO_2 damage > 0.5 percent and < 1 percent, Low = CO_2 damage > 1 percent.
c. Ratio of protected area to total area: High = ratio > 0.2, Medium = ratio > 0.1 and < 0.2, Low = ratio < 0.1.
d. High = compliance score > 5.8, Medium/high = compliance < 5.8 and > 4.6, Medium = compliance < 4.6 and > 4.0, Medium/low = compliance > 3.6 and < 4.0, Low = compliance < 3.6.
e. High = more than 120 treaties, Medium/high = between 80 and 120, Medium = 60 to 80, Medium/low = between 50 and 60, Low = less than 50.

Sources: Environment Sustainability Index (ESI), 2004 Global Competitiveness Report for Compliance with Environmental Agreements, Word Bank Development Indicators for Carbon Dioxide Emissions Damage, UN Environmental Statistics for Protected Areas, Globalis Human Impact 2002, Environmental Treaties and Resource Indicators (ENTRI) for Treaties Participation.

Table 1A.7 Labor standards, 2004

Partners	Rank[a]	Index[b]	Right of association	Forced labor	Child labor	Working conditions	Conventions ratified[c]
NAFTA							
Canada	4	1.60	High	Med/high	High	High	Medium
Mexico	8	2.40	High	Medium	Medium	Medium	High
Current partners							
Australia	2	1.20	High	High	High	Med/high	High
Chile	4	1.60	Med/high	High	Med/high	Med/high	High
Israel	6	2.00	Medium	High	High	Medium	Med/high
Jordan	13	3.00	Medium	Medium	Med/high	Med/low	Medium
Morocco	19	3.40	Med/low	Medium	Medium	Low	Med/high
Singapore	7	2.20	Medium	High	Med/high	Med/high	Medium
To be ratified							
Bahrain	19	3.40	Medium	Medium	Medium	Medium	Low
CAFTA	8	2.40	Medium	Med/high	Med/high	Medium	Med/high
Dominican Republic	24	4.00	Med/low	Medium	Low	Low	Medium
Oman	22	3.80	Medium	Medium	High	Medium	Low
Under negotiation							
Colombia	13	3.00	Med/low	Med/high	Med/low	Med/low	High
Ecuador	16	3.20	Med/low	Medium	Med/low	Med/low	High
Panama	12	2.80	Medium	Medium	Med/low	Medium	High
Peru	13	3.00	Medium	Medium	Med/low	Med/low	High
SACU-5	27	4.20	Low	Medium	Low	Low	Medium
Thailand	30	4.60	Med/low	Low	Low	Med/low	Low
United Arab Emirates	22	3.80	Medium	Medium	Med/high	Medium	Low

Under consideration							
Europe							
Switzerland	1	1.00	High	High	High	High	High
Middle East							
Egypt	16	3.20	Med/low	Medium	Low	Medium	High
Qatar	27	4.20	Low	Med/low	Med/high	Low	Low
East Asia and Pacific							
Indonesia	24	4.00	Medium	Med/low	Low	Medium	Low
Malaysia	19	3.40	Med/low	Med/low	Medium	Medium	Medium
New Zealand	2	1.20	Med/high	High	High	High	High
Philippines	29	4.40	Medium	Low	Low	Med/low	Medium
South Korea	11	2.60	Medium	Med/high	Med/high	Medium	Medium
Taiwan	16	3.20	Med/low	Medium	Med/high	Med/low	Medium
Latin America							
Bolivia	24	4.00	Med/low	Low	Low	Med/low	Med/high
Caricom	8	2.40	Med/high	High	Med/high	Med/high	Medium
South Asia							
Bangladesh	30	4.60	Med/low	Low	Low	Low	Medium
Pakistan	30	4.60	Med/low	Low	Low	Low	Medium
US comparison	5	1.8	High	High	High	High	Low

Note: Methodology for labor indicators

Collective Bargaining, Right of Association, and Labor Strikes

Low: Collective bargaining, strikes, and right of association are all prohibited.

Medium/low: Some prohibited or government approval needed.

Medium: Not prohibited and no requirement to seek authorization prior to forming unions, but labor rights are not really enforced, or widespread antiunion discrimination exists.

Medium/high: Not prohibited, and labor rights are enforced most of the time.

High: All allowed, and labor rights enforced.

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Table 1A.7 Labor standards, 2004 *(continued)*

Forced Labor

- Low: Pervasive forced labor.
- Medium/low: Law prohibits forced labor, but certain foreigners and local groups are consistently subject to forced labor.
- Medium: Forced labor is prohibited, but some cases are reported.
- Medium/high: Rare cases of forced labor reported.
- High: No cases of forced labor reported.

Child Labor

- Low: Pervasive (child labor exceeds 8 percent of the age group).
- Medium/low: Prohibited, but many cases reported in different sectors of the economy (child labor represents 2 to 8 percent of the age group).
- Medium: Prohibited, but some cases are reported in the informal sector (child labor represents 0 to 2 percent of the age group).
- Medium/high: Prohibited, but rare cases of child labor are reported.
- High: No child labor reported.

Working Conditions

- Low: Low or no negotiations possible with employer, low or no protection, working standards not enforced, substandard living conditions, lack of protections, abuse, and labor law violations.
- Medium/low: Labor laws exist, but protection, safety and health standards, and working hours exist but not well enforced.
- Medium: Working conditions acceptable, usually with acceptable safety and health standards, and premium for working longer hours.
- Medium/high: Most working conditions are satisfied.
- High: All working conditions are satisfied.

a. High rank (e. g., "1") = high index (e. g., "1") and good labor standards.

b. Index based on average of the five indicators: High = 1, Medium/high = 2, Medium = 3, Medium/low = 4, Low = 5.

c. International Labor Organization (ILO) conventions ratified: High = ratified conventions > 50, Medium/high = ratified conventions > 40 and < 50, Medium = ratified conventions > 20 and < 40, Low = ratified conventions < 20.

Sources: Based on WTO and US Department of State (Bureau of Democracy, Human Rights, and Labor) country reports; ILO database; World Bank (2005b).