

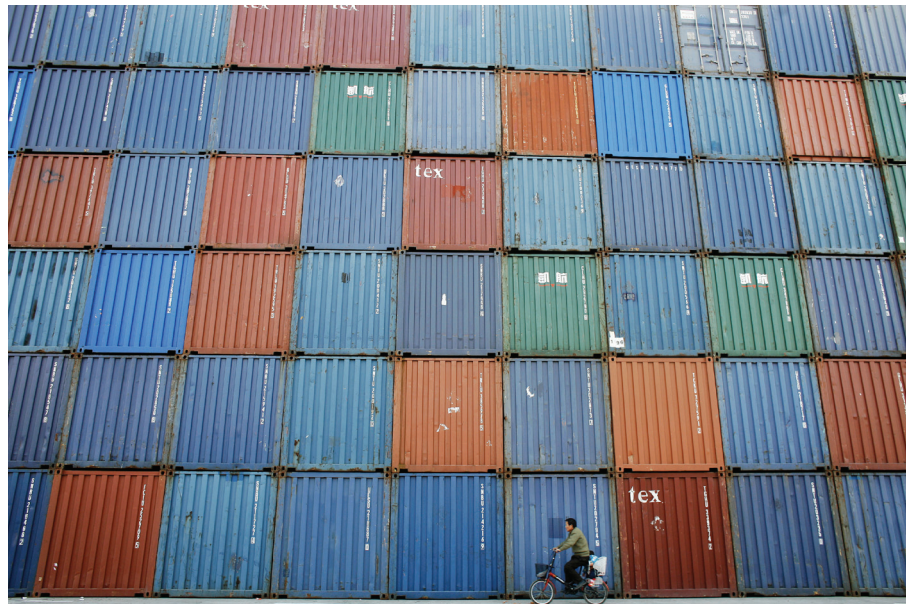
The Sino-Swiss Free Trade Agreement

The free trade agreement signed between China and Switzerland in 2013 is among the most ambitious trade deals signed by both countries to date. The agreement is the first that Beijing has signed with a nation in continental Europe. Although concerns remain about labour rights and the environment, the deal is also seen as a major step forward for Switzerland's engagement in Asia.

By Marc Lanteigne

In July 2013, China and Switzerland signed a watershed free trade agreement (FTA) that has become an important policy event as Beijing continues to pursue liberalised bilateral trade with select partners, including Western economies. In the wake of the agreement, Chinese Prime Minister Li Ke-qiang praised the deal as “the first between China and a continental European economy, and the first with one of the 20 leading economies of the globe.” In the last decade, the tone of China's policies towards free trade has evolved from one of wariness and scepticism to open support and enthusiasm. To date, Switzerland is the largest economy with which Beijing has signed an FTA.

In Switzerland, proponents have recognized the agreement as the most important deal since the FTA with the EU in 1972, emphasizing the benefits for Swiss corporations. These firms will enjoy simplified access to the Chinese market, gaining an advantage over their European competitors thanks to a head start, since in continental Europe only Switzerland will enjoy such privileged access. The FTA with China grants Swiss companies legal certainty, protection of investment, and protection of intellectual property. China is Switzerland's third-largest trading partner after the EU and the US. Switzerland has only a limited internal market and is therefore heavily dependent on foreign trade. The country is also very interested in becoming



A man rides a bicycle past shipping containers at a port in Shanghai. Chinese exports to Switzerland are expected to grow once the 2013 free trade agreement is implemented. *Aly Song / Reuters*

a hub for future trade in Chinese currency as a result of the deal. However, Swiss left-wing parties and NGOs have criticized the FTA with China and have demanded that it be renegotiated, with explicit provisions on human rights and labour protection to be included in the text of the treaty.

Under the terms of the deal, up to 99.7 per cent of Chinese exports to Switzerland would be exempted from tariffs, while ap-

proximately 84.2 per cent of Swiss exports to China would also achieve zero tariffs. In addition to the potential financial gains for both sides as a result of this agreement, the FTA also represents an important step for Chinese economic diplomacy in Europe, underscoring Beijing's commitment to deepening its trade ties with the continent. Moreover, the deal signals China's intention to seek free trade partners of many different types and sizes, and that Beijing is

developing much greater confidence in its ability to craft effective liberalised trading agreements, including with advanced and multifaceted economies. The Swiss agreement will also serve to influence the thinking towards trade with China on the part of the EU, which, despite some tentative steps, has yet to develop a unified approach to liberalising trade relations with Beijing.

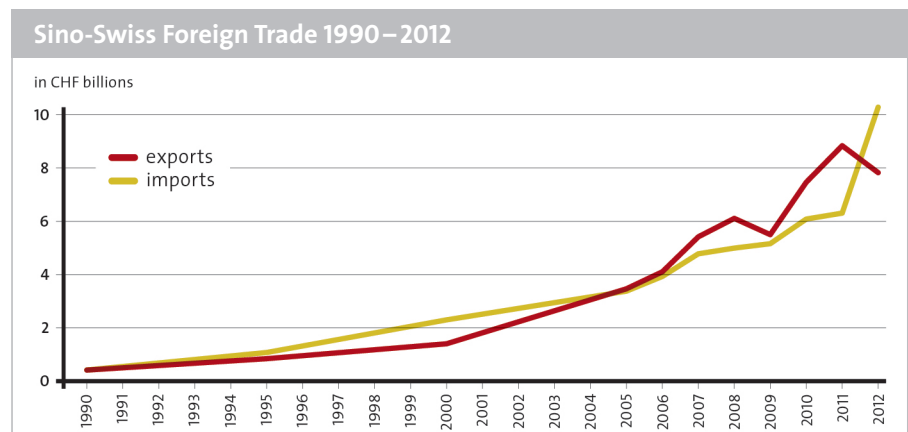
Free trade talks have become an important foreign policy tool for Beijing in its pursuit of enhanced “commercial diplomacy”, permitting Beijing to make extensive economic policy inroads beyond the Pacific Rim into other parts of the world that Beijing views as essential to its own economic growth. Although Beijing has become much more comfortable engaging multilateral institutions over the past two decades, there is still a great deal of emphasis in current Chinese diplomacy on developing bilateral economic relations, especially in regions where China has had a more limited history of direct diplomacy. While still a relative novice to the practice of liberalised trade policies outside of the Asia-Pacific, Beijing has also made use of bilateral FTAs to gain better understanding of the economies of surrounding regions. The agreement with Switzerland, once fully implemented, will provide China with invaluable new exposure to the greater European market. China’s enthusiasm for preferential trade agreements may produce a much more intricate lattice of trade cooperation for Beijing reaching well beyond the Pacific Rim, and Switzerland is in place to become a key component of this strategy.

The New Zealand and Iceland Models

Switzerland is the second European state and the third member of the Organisation of Economic Cooperation and Development (OECD) to complete an FTA with Beijing. China signed a free trade agreement with New Zealand in April 2007,

Switzerland is located in a region that Beijing considers crucial to its expanded cross-regional diplomacy.

which entered into force in October 2008. The effect of bilateral trade on the New Zealand economy has been dramatic, with the value of New Zealand goods exported to China tripling between 2007–12, and total trade increasing from US\$3.7 billion to \$9.7 billion during that same period. China surpassed the US in 2011 to become



New Zealand’s second-largest trading partner after Australia. Chinese trade has been considered partially responsible for sparing New Zealand the same degree of economic trauma faced by the US and Europe following the global financial crisis after 2008.

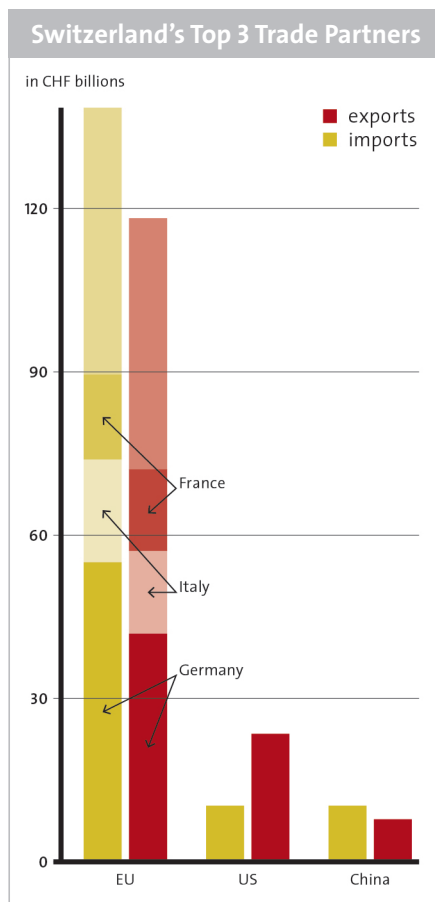
The Chinese FTA with Iceland was a considerably rockier affair. Its outcome was greatly in doubt merely five years ago due to the banking crisis that engulfed the island state in late 2008. Free trade talks between China and Iceland commenced in April 2007, but the post-October 2008 economic meltdown deflated the value of Iceland’s currency and led to talk of the island joining the EU in order to adopt the euro, and Iceland submitted its application for EU membership in July 2009. By that year, the China free trade talks had gone into abeyance due to Chinese concerns that any deal struck would immediately be dissolved upon Iceland’s entry into the EU. By 2012, however, Iceland had recovered from the worst of the crisis, public support for EU membership had cooled in light of the ongoing Eurozone debt crisis, and China began more carefully to consider Iceland as a potentially valuable economic partner while Beijing sought to increase its presence in the emerging Arctic region. In April 2012, then-Chinese prime minister Wen Jiabao visited Iceland, resulting in the revival of the free trade talks, which were finally signed one year later. Iceland is now one of China’s pivotal partners in the Arctic region, and with the decision made in September 2013 by the centre-right Icelandic government to indefinitely suspend any further membership talks with the EU, the country is increasingly looking to China and Asia as it continues its economic recovery.

The cases of New Zealand and Iceland go some way towards explaining why China sought to develop an FTA with Switzerland, and towards understanding the potential future directions of the agreement as it takes effect. As China continues to expand its list of prospective bilateral free trade partners, including potentially Australia and South Korea, the deal with Switzerland will be an important model for future Chinese FTAs.

Why Switzerland?

The attractiveness of Switzerland for China’s free trade ambitions can be viewed from a variety of angles, in terms of the distinct structure of the Swiss economy and the country’s singular role outside of the EU and the European Economic Area (EEA), but within the European Free Trade Association (EFTA). Establishing free trade relations with Switzerland was a gamble for Beijing, however, due to several reasons, including the fact that the Swiss economy is comparatively larger than those of China’s other FTA partners; Beijing’s comparative lack of experience in negotiating liberalised trading with Western economies; the decentralised nature of the Swiss government; and the strong stance taken by Switzerland on issues such as labour rights, environmental protection, and intellectual property, which would need to be part of any negotiations. Nevertheless, China views Switzerland as an essential economic partner in Europe, and the nine rounds of bilateral negotiations between April 2011 and May 2013 produced a deal praised by both sides for its quality and its breadth, covering goods, services, investment, and competition.

The Sino-Swiss agreement was preceded by China’s policy reversal regarding bilat-



eral FTAs. After 15 long and difficult years of negotiations, Beijing finally joined the World Trade Organisation (WTO) in December 2001, allowing the Chinese government to help frame global trade policy, and sought to further improve its trade with selected partners. Until the New Zealand deal, China had largely confined its free trade negotiations to its own special autonomous regions (Hong Kong and Macau) and developing states, including Pakistan and Chile. A deal with Singapore was finalised in 2008, and a wider agreement with the Association of Southeast Asian Nations (ASEAN) was signed in 2002, with the ASEAN-China free trade area taking effect from January 2010. Following the FTA with New Zealand, Beijing expressed interest in adding European states to its list of free trade partners, reflecting the steady growth of Chinese trade with the continent since the 1980s.

Attempts by China after 2004 to begin free trade talks with the EU encountered a series of obstacles. Negotiations between both parties to create a Partnership and Cooperation Agreement (PCA) as a pre-

cursor to free trade produced few results, and there were sharp differences among EU members over how to proceed. Political rifts, including over the question of the status of Taiwan and whether the EU would be willing to lift an arms embargo on Beijing in place since 1989, further complicated the process. Finally, a July 2004 report by the EU specified that China had not reached the level of reform required for the country to attain market economy status (MES), a move that was viewed by the Chinese government as a political move rather than a true reflection of the country's economic performance.

By contrast, the government of Switzerland did argue that Beijing had met the minimum criteria for MES, and in July 2007, China's then-minister of commerce Bo Xilai and Swiss Federal Councillor Doris Leuthard, the head of the Federal Department of Economic Affairs, signed an agreement confirming China's market economy status and setting the stage for a memorandum of understanding (MoU) confirming both sides' interest in free trade negotiations. The MES agreement was also a reflection of the long bilateral diplomatic relationship: Switzerland recognised the People's Republic of China in January 1950, mere months after the Republic's founding and long before several other Western European countries and the US did the same.

Beijing's lack of success with the EU prompted the Chinese government to seek out non-EU countries for partnerships instead, and the EFTA members were an obvious alternative. While there was some early discussion about Beijing negotiating free trade with the EFTA as a whole, ultimately it was decided that China would conduct bilateral talks with each separate member state, with Iceland first in line. The decision to open negotiations with the EFTA states further underlined Beijing's determination to increase its trade presence in Europe, even through indirect approaches. Iceland, due its small size, appeared to be the best partner with whom to begin the process, with Norway and Switzerland following. This plan, however, ran into more problems in addition to the downturn of the Icelandic economy. Eight rounds of negotiations with Norway, beginning in November 2008, were successfully completed before talks were abruptly severed by Beijing as a protest against the awarding of the 2010 Nobel Peace Prize to Chinese dissi-

dent Liu Xiaobo in October of that year. Sino-Norwegian diplomatic relations were downgraded to minimum levels, and more than three years later, there is no overt sign of the free trade talks being resumed, despite changes in governments on both sides. The possibility of a formal China-EFTA free trade mechanism is in doubt until Beijing's diplomatic impasse with Oslo can be resolved.

Switzerland, like Iceland and New Zealand, has the advantage of an independent and largely non-aligned foreign policy, while being located in a region that Beijing considers crucial to its expanded cross-regional diplomacy. Switzerland also has a lengthy history of engagement with China that began well before the founding of the People's Republic. In addition, Switzerland has been experienced in negotiating free trade with a variety of different states and entities since 1960, and has been willing to negotiate in the areas of services and goods. In seeking potential free trade partners, Beijing has favoured economies that have

Thanks to the agreement, Switzerland could be well placed to act as a financial hub for future renminbi transactions.

longstanding experience in conducting such talks, since free trade agreements can deliver much political capital as well as economic gains for China.

In addition to the economic benefits for Switzerland in gaining preferential access to the second-largest economy in the world, the FTA with Beijing also satisfies other Swiss criteria for a potential free trade partner. As stated by Switzerland's ambassador to the People's Republic at the time, Christian Etter, negotiation partners are chosen based on several criteria. These include their current and potential economic importance, the presence of other FTAs concluded by the target economy, a high possibility that FTA talks will be concluded to the satisfaction of both parties, and the compatibility of a free trade partnership with established Swiss foreign policy objectives. The importance of Beijing to Switzerland as a trading partner became more evident as the first stages of the dialogue were planned. China had become Switzerland's largest trade partner in Asia in 2002, and at the end of 2012, bilateral trade had reached US\$26.3 billion, up from \$11.3 billion in 2008. An FTA with China

was widely viewed as fulfilling all of Switzerland's set conditions, permitting the country to gain a level of economic ties with Beijing that the EU has so far been unable to achieve.

The Path to the Agreement

Berne and Beijing decided that the talks would cover areas beyond the trade of goods to include services and investment, but would also seek to deepen bilateral trade liberalisation further than standard WTO guidelines. The idiosyncratic nature of Switzerland's economy compared to the rest of Europe, characterised by the country's high degree of dependence upon international trade, its protected agricultural sector, the large percentage of income earned abroad, and the country's lack of natural resources made for a distinct challenge to Chinese negotiators. At the same time, unlike Iceland, Switzerland lies in the heart of the European continental economy despite its non-EU status; therefore, the agreement had the potential to galvanise change in the EU's perception of trade with China.

With the agreement in place, one question will be the role of Swiss financial institutions in the development of stronger trade ties with China, especially in light of the Chinese currency, the *renminbi*, being more commonly accepted as a medium for global transactions. Thanks to the FTA, Switzerland could be well placed to act as a financial hub for future *renminbi* transactions, especially as Beijing begins the process of reforming its financial sector and allowing Chinese currency to be traded more openly on international markets. It was announced in January 2014 that the Swiss National Bank (SNB) had commenced talks to develop a currency-swap agreement in the hopes of placing Switzerland in a better position to act as a centre for financial transactions using Chinese currency. Other

states, especially the UK, have also been seeking to become a nexus for Chinese *renminbi* trade, but the finalising of the Sino-Swiss FTA may allow Switzerland to compete better in this area. There will also be questions about the possibility of increased investment opportunities as a result of the agreement. In both Iceland and New Zealand, the issue of Chinese investment, including land purchases and leasing, remains a source of political debate despite the free trade agreements.

Protection of the Swiss Flag

Intellectual property protection was also a high priority during the talks, and was a concern for several Swiss industries, in-

"Switzerland is not the world's teacher. There are different stories, different cultures, and that is to be considered too."

cluding those making luxury timepieces and pharmaceuticals, that wish to prevent the sale of counterfeit "made in Switzerland" products in Chinese or foreign markets. There had been some examples regarding counterfeited goods causing rifts between Beijing and its potential free trade partners, one of the most infamous being the sale of local Chinese mussels under the guise of a New Zealand brand in 2001. Even before the Sino-Swiss free trade talks began, a bilateral dialogue on protecting intellectual property rights was established in 2007, and within the framework of the agreement, both parties agreed to adhere to the strictest international standards. The agreement was extended to include enforcement over imports and exports as well as protection against the misuse of national names and symbols, especially important to the Swiss, given widespread international recognition of the iconic national flag. It has been acknowledged by the Swiss government that the agreement will not end

the issue of intellectual property rights, but would allow for disputes to be addressed in a more effective manner. In the case of Swiss watches, it was hoped that the eventual discarding of tariffs would boost sales and discourage the spread of fakes.

Human Rights Concerns

Although there was the possibility that one of the Swiss political parties or cantons would seek to bring the question of accepting the free trade deal to a referendum, the Swiss House of Representatives ratified the deal in December 2013, despite misgivings by some domestic actors, including the Swiss Social Democratic Party and NGOs such as Alliance Sud, that the agreement would undermine labour rights and environmental protection. In commenting on the question of human rights in the context of the FTA in July 2013, Swiss President Ueli Maurer noted that "Switzerland is not the world's teacher. There are different stories, different cultures, and that is to be considered too." The Social Democrats opposed the FTA in its current form and brought forward a motion to negotiate an additional protocol with China that explicitly mentioned the protection of human rights and labour rights. The motion, however, was defeated in the Swiss Parliament in December 2013. Debate in the Upper House of the Swiss Parliament is expected in March 2014 as the final step to full ratification of the agreement.

Dr Marc Lanteigne is Senior Lecturer at the School of History, Philosophy, Political Science and International Relations at Victoria University of Wellington in New Zealand. In the autumn of 2013, he was a visiting fellow at the CSS.

CSS Analyses is edited by the Center for Security Studies (CSS) at ETH Zurich. Each month, two analyses are published in German, French, and English. The CSS is a center of competence for Swiss and international security policy.

Editors: Christian Nünlist and Matthias Bieri

Lectorship: Chris Findlay

Layout and graphics: Miriam Dahinden

ISSN: 2296-0244

Feedback and comments: analysen@sipo.gess.ethz.ch

More issues and free online subscription:

<http://www.css.ethz.ch/publications/cssanalysen>

Most recent issues:

The Future of Conventional Arms Control in Europe No. 146

The Proliferation of Advanced Conventional Weapons No. 145

The Kerry Initiative: Cometh the Hour, Cometh the Man? No. 144

Debating European Defence and Security No. 143

Resilience in Security Policy: Present and Future No. 142

Kidnapping for Ransom as a Source of Terrorism Funding No. 141