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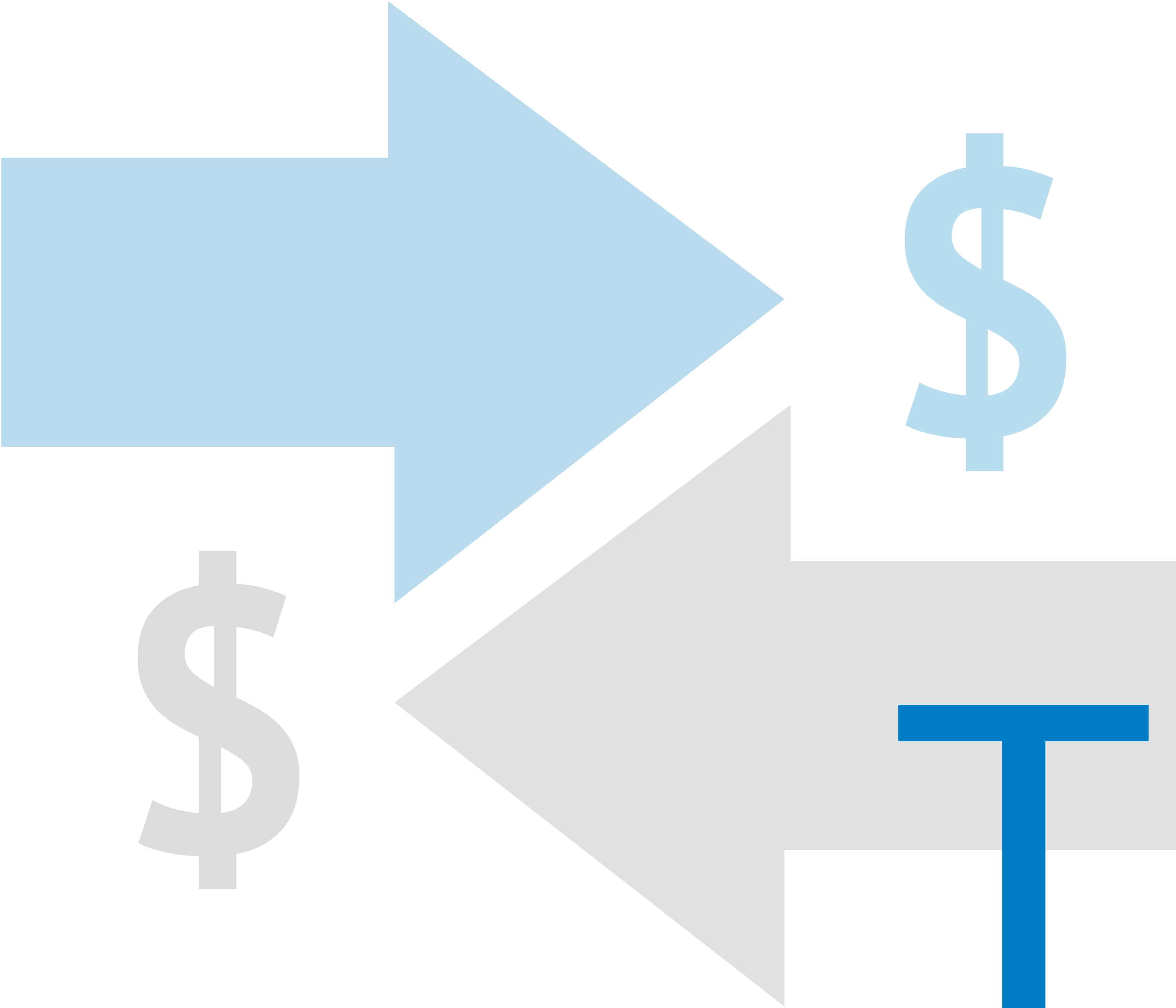

FREE TRADE AGREEMENT

Leveraging Sino-Swiss FTA experience and frameworks:

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Free-Trade Agreements (FTAs) need to be negotiated. Then, upon coming into force, they need to be utilized. This article provides two frameworks based in part on researching the Sino-Swiss FTA, which was signed in 2013 and came into force the following year. The first framework is for the negotiations preceding the FTA and the other relates to its implementation. As Norway and China work on their own bilateral FTA, these frameworks can provide value to both sides.

Sino-Norwegian FTA

Norway and China resumed talks on a bilateral free-trade agreement in 2017. The first round of negotiations since the two nations agreed to normalize ties in December 2016 was held in August 2017, the next in December in Beijing. On the agenda were trade of goods and services, investment, veterinary regulations, and technical trade barriers, competition policies, and questions related to customs. The 11th round of negotiations will be held during the coming spring in Norway.

The free-trade agreement is an important step for increasing trade between Norway and China, and opening the doors for a wider and more extensive trade collaboration. For Norwegian and Chinese businesses alike, a free-trade agreement will lower the risk of investments and hence motivate an influx of business to both countries.

FTAs matter in a world that is closing up to multilateral arrangements, and where the World Trade Organization (WTO) framework is on the defensive from populist and anti-globalization forces. FTAs are an effective second-best solution. The ultimate purpose of an FTA is to provide firms with greater access to international markets. An FTA ought to bring increased demand for exports, more competition, more jobs, and higher public welfare for both parties.

Since the beginning of the 1990s, Switzerland has been building a network of FTAs with numerous countries outside the EU. In January 2003, an FTA between the European Free Trade Association (EFTA) — which includes both Norway and Switzerland — and Singapore came into force. Historically, this was the first transregional FTA between Europe and Asia. It was followed in 2006 by the EFTA-South Korea FTA. In general, Switzerland prefers to conclude FTAs in the EFTA context, but it is ready to go 'bilateral' when necessary, as was the case for the FTAs with Japan (2009) and China (2013). Most importantly, Swiss companies have reached a high level of practical FTA competence — which is valuable since signing an FTA dos not mean that companies will utilize it. What have we learned are the success factors for clinching a valuable FTA with a partner country?

FTA negotiation framework

Switzerland currently has a network of 28 FTAs with 38 partners outside the EU. From the country's ample experience, the following insights for FTA negations have emerged:

1. Don't get entangled in complex situations
2. Don't expect systemic changes
3. Make it worthwhile, FTA are not automatisms
4. Keep the FTA simple and effective
5. Small countries are test beds for China; leverage this privilege

Don't get entangled in complex situations

China, like other East Asian countries, use FTAs to open new markets, avoid exclusion from or discrimination in established markets, and reform domestic enterprises by exposing them to competition, albeit in a controlled fashion (Hoadley and Yang, 2007). Motives behind FTAs are not just economic, but also diplomatic and security-related and what Solis and Katada (2007) called "leverage motives." "Leverage" refers to the fact that East Asian countries frequently choose an extra-regional FTA partner in order to break regional inertia hindering deeper economic integration, to win domestic battles, and to test models that can be used in subsequent intra-regional FTA negotiations. Hence, the fights of domestic political and economic interest groups can make their way into negotiations – agriculture and finance, for example, are two areas that are sensitive. It is advisable that one's FTA negotiations do not become a "nested game," where domestic disagreements negatively distort the outcomes of negotiations.

Don't expect systemic changes

It is unrealistic to expect your FTA partner to implement systemic changes of a legal-institutional or regulatory nature. Unless, that is, a really big player is involved (like the U.S. in the case of the Trans-Pacific Partnership). As part of the FTA deal with Switzerland, Japan accepted the introduction of geographical indications (GI) to the Japanese IPR system. GIs are signs used on products that have a specific geographical origin associated with certain qualities or a reputation. This exception proves the rule.

Make it worthwhile, FTAs are not automatisms

FTAs will be utilized only if there are significant incentives offered. That is, if the potential savings resulting from the lower duties associated with utilizing the FTA are significant (in comparison to not utilizing the FTA). At present, in the fourth year of the Sino-Swiss FTA's implementation, savings potential for Swiss exporters equals about 300 million Swiss Francs or 256 million Euros (Ziltener 2014).

Keep the FTA simple and effective

Long phasing out of tariffs, different treatment of similar goods, and time-consuming paperwork reduce incentives to utilize the FTA. Politicians might be happy at the time of signing, but not business on the ground. What should be done? For instance, consignment rules should be flexible – that is, goods originating from country A on the way to country B should not lose their originating status when transported or temporarily stored in country C, or when a big consignment is split up into smaller ones. Documentary evidence to confirm compliance with the consignment rules is but one example of what should be simple.

Small countries are test beds for China; leverage this privilege

The E.U. has rebuffed attempts to start FTA negotiations with China. An FTA that works with Switzerland — and in the future another that works with Norway – allows the Chinese to show European firms the benefits of having closer economic integration with China. There is also the signaling effect for Chinese firms to partner and invest in countries that have a China FTA. Moreover, China is known for its experimental approach to policy, choosing what works and discarding what does not. An FTA with China allows for original new possibilities. For instance, a small country might explore creative e-commerce clauses or data governance regimes with China.

An additional piece of advice could be; 'make sure the FTA is effective immediately.' Remember, in Western democracies FTAs will be debated domestically. Make sure the FTA is effective upon finalization of negotiations so that the business association stakeholders that benefit are part of the debate that the FTA elicits.

Assuming negotiators have managed to bring about a deep, far-reaching FTA, how can success be ensured?

FTA implementation framework

Informed by simplistic theories based on unrealistic assumptions, there are many — scholars included — who assume that the benefits of an FTA accrue automatically. Our research shows that this is not the case. For a "good" FTA to be successful in practice, we propose a framework with three pillars:

1. Implementation support by government
2. Measuring the FTA and the importance of academic research
3. FTAs as dynamic constructs to be ever upgraded

Implementation support by the government

FTAs have to be actively utilized by companies, and this requires knowledge, expertise, and skills. These are developed at firms if their costs are less that the benefits an FTA bring to firms. In this context, it is very important that an FTA is not perceived by the public as a gift to large firms while remaining irrelevant to smaller ones.

We find that big companies make a disproportionate use of FTAs because of the relatively high initial fixed (legal, administration, training) costs necessary to benefit from an FTA (Schaub, 2012). Increasing the utilization rate of FTAs among small and medium enterprises (SMEs) is therefore a key challenge for policy-makers. Governments can provide training or commission software for small- and medium-sized enterprises (SMEs). Unless SMEs are supported in the initial stage, they will find the costs of utilizing FTAs to be higher than the benefits. They thus end up paying non-reduced import tariffs.

Measuring an FTA with academic research

A proper research proposal for an FTA would include analysis on (a) trade impact, (b) utilization rates, and (c) a managers' survey. On that basis, research can offer (d) suggestions to policy-makers for the upgrade and improvement of the FTA. The University of St.Gallen conducts this research together with the University of International Business and Economics (UIBE) in Beijing at the Sino-Swiss Competence Center (SSCC-HSG).

The economic impact analysis of an FTA tries to answer the basic question of whether and by how much lower tariffs foster trade flows. It is based on an extensive econometric analysis of customs data, which must be obtained from both countries. The work can be enormous. Just for starters, statistics of exports from country A to country B seldom matches imports from country B into country A, even if theoretically they should be the same. Through advanced modeling methods, it is possible to establish whether an FTA increases trade or not. Good FTAs can double trade in a decade. Yet research also finds that only a quarter to half of all FTAs actually promote trade.

The FTA utilization rate measures the degree to which the FTA is successfully used to reduce customs duties. That is, a utilization rate of 60% means that 60% of all exports (according to value) in that year were effectively making use of the FTA. A further differentiation is necessary. The General Utilization Rate (GUR) is defined as the value ratio of goods being traded benefiting from reduced or eliminated tariffs under a specific FTA relative to total trade (imports or exports). The measure is subject to a number of drawbacks since (1) a specific FTA does not cover all tariff lines, and (2) a number of tariff lines are set to zero prior to and independently from the FTA (through unilateral decision, plurilateral agreements such as the Information Technology Agreement, or otherwise). The Adjusted Utilization Rate (AUR) is defined as the value ratio of goods being traded relative to total trade (imports or exports) eligible for tariff exemption under the specific FTA, i.e., excluding trade volume exempted for other reasons, or not covered by the specific FTA for different reasons. The AUR reflects the true extent of an FTA's utilization.

For Swiss exports to Germany on the basis of the Free Trade Agreement with the EU, the FTA AUR is 50%, with another 40% being exported on duty-free basis already — as a result, 90% of Swiss exports to Germany are effectively duty free (Ziltener and Blind 2014). For China, we will publish our GUR and AUR results in 2018.

Of key importance is the manager's survey of firms carried out in collaboration between the business association and universities. Here, a 15-minute questionnaire is delivered to knowledge managers at firms in both countries that trade or invest in the context of a given bilateral relationship. Not surprisingly, the concerns of Swiss and Chinese firms differ — one side might complain about inconsistent application of rules of origin (ROO) while the other sees relevant product categories not covered by the FTA. Unfortunately, bilateral FTAs are not an effective instrument to tackle non-tariff barriers. There is evidence that some countries use non-tariff trade measures to counter or dampen some liberalization effects. The aim of the survey is to uncover the issues in the business trenches that explain the economic impact and utilization rates of the FTA.

FTAs as dynamic constructs to be ever upgraded

It is the combination of the three research approaches (economic impact, utilization rates, and managers' survey) that will enable policy-makers to bring an FTA to the next stage. Joint research on the effects of the FTA (and the obstacles to effective utilization) based on data exchange should be an explicit part of the Sino-Norwegian FTA. After all, an FTA is never "finished." The Sino-Swiss FTA has now a biannual upgrade negotiations mechanism that benefits from such research.

Countries with a China FTA can consider themselves as privileged. It has been said that to the Chinese, an FTA is more than just an FTA. It is a platform for bilateral relations. In the context of China's immense market and its increasing fourth industrial revolution technology powers, this platform can be leveraged in myriad promising directions.

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Sino-Swiss Competence Centre

The Sino-Swiss Competence Center (SSCC) is an academic initiative based at the University of St. Gallen (HSG) in Switzerland and at the University of International Business and Economics (UIBE) in Beijing, China. SSCC's mandate is to develop research to help enhance the academic relationship between China and Switzerland as well as Europe. All its projects seek to produce evidence-based insight and knowledge to support decision-makers, firms and policy-makers. The Center focuses on various subjects such as China's Free Trade Agreements with a special emphasis on the Sino-Swiss FTA, China overseas investment and innovation, and the Belt and Road Initiative (BRI).