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Support document to the external study 'Effects of Regionalisation of Rules of Origin in Free Trade Agreements'

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## **Enhancing the use of free trade agreements through cumulation of origin: the economic potential of the 'regionalisation of rules of origin'**

### Rules of origin: a key factor in the use of free trade agreements

Switzerland currently has a network of 35 free trade agreements (FTAs) with 73 partners.<sup>1</sup> In recent years, the State Secretariat for Economic Affairs (SECO) has analysed the extent to which Swiss companies utilise FTAs to save on customs duties and examined various measures that can facilitate the use of FTAs by economic actors.<sup>2</sup> This analysis shows that there remains significant potential to improve the use of FTAs and, in turn, for companies to save more on customs duties. Indeed, some CHF 800 million a year in customs duties is unnecessarily levied on Swiss imports and exports to and from partner countries with which Switzerland has an FTA.

### **Complexity of the rules of origin**

Preferential rules of origin are one of the reasons that explains why companies do not benefit more frequently from preferential tariffs under FTAs. SECO's survey of Swiss exporters, conducted in 2021 and 2022, indicates that the use of FTAs imposes additional administrative burdens for companies. The top two obstacles related to the use of FTAs cited by respondents (sample of 418 companies) were meeting the requirements for preferential origin (mentioned 260 times) and having to submit documents to prove preferential origin (240 times).<sup>3</sup> Companies can benefit from the preferential tariffs set out in an FTA if the product in question meets the agreement's preferential rules of origin. This means that, where Switzerland has an FTA with a trading partner, Swiss exporters only benefit from reduced or eliminated customs duties if their product has been produced for the most part in Switzerland. For example, the product specific rule of origin may require the amount of value-added through production in Switzerland be at least 40% of its selling price. Preferential rules of origin in an FTA will vary from one product to another and from one agreement to another, i.e. not all of Switzerland's FTAs contain the same rules. Moreover, the FTAs concluded by other partners (such as the EU) may also contain different rules. The proliferation of FTAs, and thus of applicable rules of origin, has created a phenomenon known as the 'spaghetti bowl' of rules.

### **Relevance for the Swiss economy**

As a highly developed economy with a relatively small domestic market, Switzerland is densely integrated into international value chains and depends on foreign market access for both imports and exports. In sourcing inputs from abroad, Swiss companies risk exceeding the limits for foreign-sourced materials specified in the relevant FTA's product specific rules of origin when exporting their products. These products would therefore no longer qualify for the preferential tariffs under the FTAs.

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<sup>1</sup> [Free Trade Agreements \(admin.ch\)](#)

<sup>2</sup> [Use of free trade agreements \(admin.ch\)](#)

<sup>3</sup> [SECO – Report on the results of the company survey on the use of free trade agreements by Swiss exporters](#)

## Overcoming such challenges

Where there are relatively restrictive rules of origin, there are two ways to overcome this obstacle and facilitate the use of preferential tariffs. The first is to opt for more relaxed product specific rules of origin, i.e. reduce the minimum threshold for a product to qualify as 'originating' (for example, by lowering the required minimum domestic value-added content during production in Switzerland from 60% to 40% of the price of the product). The second way is to allow cumulation of origin, i.e. to count not only Swiss inputs as 'originating' but also inputs sourced from other FTA partner countries. SECO's survey of exporters demonstrates the importance of such cumulation possibilities for companies.<sup>4</sup>

### The concept of 'regionalisation of rules of origin in FTAs'

The number of bilateral and regional FTAs is growing worldwide, with the network of partner agreements increasingly overlapping. In the case of Switzerland and the EU, for example, more than 70% of Switzerland's FTA partners also have an FTA with the EU. While the individual FTAs contain differences in tariff dismantling, they all have in common the elimination of tariffs for most industrial products. Despite this, some economic operators do not benefit from preferential tariffs under these FTAs because they source a large part of their inputs from third (non-FTA) countries. Many partners are now exploring ways to improve the use of FTAs.

Most FTAs today provide only for bilateral cumulation, that is, to meet the rules of origin (e.g. in the Switzerland–China FTA), the domestic value-added content in each country (in this example, in Switzerland and China) can be added together, i.e. 'cumulated', but only between the two FTA partners. The PEM Convention,<sup>5</sup> which has 25 partners, offers Switzerland more cumulation possibilities, such as diagonal cumulation.<sup>6</sup>

One way to overcome the limitations of bilateral FTAs is for partner countries to network their agreements by 'regionalising' the rules of origin. This creates a cumulation of origin zone covering three or more FTAs. In practice, trade within that zone can cumulate all inputs sourced from countries in the zone. For example, both Switzerland and the EU have an FTA with Japan: if the rules of origin in these agreements were to be regionalised, Swiss and EU inputs could be added together when exporting to Japan. This would make it easier for companies in Switzerland, the EU and Japan to comply with the FTAs' rules of origin and thus benefit more fully from the preferential tariffs. Setting up such a cumulation zone would require changes to the rules of origin in the relevant FTAs, so all partners involved must agree. The other clauses in the FTAs, including on tariff concessions, would remain unchanged. An example of such a zone is the Comprehensive and Progressive Agreement for Trans-Pacific Partnership CPTPP,<sup>7</sup> which provides for such cumulation between its members.<sup>8</sup>

### Effects and potential of the regionalisation of rules of origin: findings of the external study

The research and consultancy firm Ecoplan and the University of St. Gallen were commissioned by SECO to conduct a study on the economic effects of regionalisation<sup>9</sup> of rules of origin in FTAs. Applying a multi-country, multi-sector equilibrium model, parameterised using

<sup>4</sup> [SECO – Report on the results of the company survey on the use of free trade agreements by Swiss exporters](#)

<sup>5</sup> [Regional Convention of 15 June 2011 on pan-Euro-Mediterranean preferential rules of origin](#) (in DE, FR, IT)

<sup>6</sup> With a diagonal cumulation zone, the PEM Convention is a pioneer in applying cumulation possibilities beyond the standard bilateral approach. For more information, see: [Cumulation in free trade agreements – FOCBS](#)

<sup>7</sup> The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is a free trade agreement between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam that was concluded in 2018.

<sup>8</sup> [How to read the Comprehensive and Progressive Agreement for Trans-Pacific Partnership \(CPTPP\) \(international.gc.ca\)](#)

<sup>9</sup> The term 'regionalization' used here refers to the creation of 'regions' through the networking of FTAs that link different trading partners. These may, but do not necessarily have to be geographically close.

detailed trade flow data from SECO's FTA monitor,<sup>10</sup> the study investigates the impact of regionalisation with different country constellations, breaking down the results by sector. It covers industrial sectors only (including the food industry) and so does not include the primary or service sectors. Given data limitations and some of the assumptions made, the figures should be interpreted with a degree of caution, particularly in terms of the effects on Switzerland's partner countries.

### **Positive impact of additional cumulation possibilities**

The study finds that regionalisation of rules of origin in FTAs would be positive for Switzerland. Companies would benefit more from the preferential tariffs in FTAs, save on customs tariffs, and gain in terms of competitiveness. In turn, this would result in more trade and an increase – albeit a modest one – in gross domestic product (GDP). At the sectoral level, impact vary depending on the constellation of countries analysed. In many cases, however, the Swiss machinery and textile industries would stand to gain the most.

These figures confirmed by the findings from company interviews. All of the companies surveyed were in favour of more cumulation possibilities and considered that cumulation would promote Swiss exports. Moreover, the interviews identified other positive effects that would flow from regionalisation – some of which were not or only partially reflected in the study model – such as the opening of new markets and securing Swiss companies' position in global value chains.

### **The EU as a natural partner**

The study finds that the EU would be an ideal partner for such regionalisation. Given that the EU is the main source of inputs for Swiss manufacturers, country constellations which include the EU and a third country that is also an important export market (e.g. Canada, Japan, South Korea, Mexico) would be of special interest for Switzerland. The impact is particularly significant for the scenario of regionalisation among Switzerland–EU–South Korea. This would increase Swiss exports by some CHF 55 million per annum (+0.02%) and imports by CHF 85 million per annum (+0.03%). In this scenario, Swiss GDP would grow by around CHF 80 million per annum (or around +0.01%).

Closer to home, a regionalisation approach between Switzerland, the EU and the UK would also reap benefits. The post-Brexit trade agreement between Switzerland and the UK provides for cumulation with EU inputs in Swiss–UK bilateral trade. However, a cumulation of inputs from Switzerland and the UK is no longer possible for exports from Switzerland and the UK to the EU. A Switzerland–EU–UK regionalisation would restore this possibility. Switzerland's GDP would increase by an estimated CHF 75 million per annum (+0.01%) in this scenario.

### **Grouping of large geographical blocs to maximise benefit**

Regionalisation makes it easier for all partners in a cumulation zone to fulfil the rules of origin of the respective FTAs and thus enjoy preferential tariffs. The impact is therefore not limited to Switzerland. For example, the EU also stands to benefit from being able to cumulate inputs from Switzerland and a third country where the third country is an important export market (e.g. Canada, Japan, South Korea). This is reflected in an expected increase in GDP.

A comparison of different scenarios shows that the wider the circle of participating countries, the greater the advantages of regionalisation. In an ideal situation, one large geographical and trade bloc, such as Switzerland, the EU and the UK, would join together with another, such as the CPTPP countries. The study shows that countries benefit from regionalisation when the cumulation zone includes both important input supply markets and export markets. The more countries included in a regionalisation arrangement, the greater the chances of this condition being met.

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<sup>10</sup> [FTA Monitor \(admin.ch\)](#)

## Conclusions and further work

The Ecoplan/University of St. Gallen study demonstrates that regionalisation of rules of origin is an attractive trade policy option. Although the impact on foreign trade and GDP appears minimal at first glance, this impact should be put into perspective. In scenarios that include the EU, the additional tariff savings for Swiss companies through the regionalisation of rules of origin varies between CHF 8 and 40 million per annum. A Switzerland–EU–South Korea scenario, for example, would generate additional savings of around CHF 30 million. In comparison in 2020, the achieved tariff savings for Swiss exporters under the bilateral Switzerland–South Korea FTA was some CHF 108 million, while, according to the FTA Monitor, the achieved savings for the Switzerland–Canada FTA was CHF 24 million.

Furthermore, the study confirms that, even where a bilateral FTA already exists, regionalisation still offers significant potential to intensify trade relations. Given that Switzerland already has FTAs with most of its main trading partners, regionalisation thus remains an attractive option. Also, while the study focuses on the impact on Switzerland, it should be noted that the other countries in the cumulation zone also stand to benefit from regionalisation through the increased use of FTAs.

These conclusions underscore the importance of seeking to include forms beyond bilateral cumulation in Switzerland's FTAs, be it when drafting new agreements or revising existing ones. The conclusions thus support pursuing extended cumulation, as proposed by the European Free Trade Association (EFTA) to its free trade partners. This proposal foresees that EFTA countries can cumulate EU inputs in their exports to EFTA's FTA partners.

In light of current trends in international trade policy, the political feasibility of regionalising FTAs on a large scale is – at present – uncertain. With the formation of geographical blocs and major economic actors such as the US and the EU advocating supply chain 'reshoring', this approach may not currently find favour among some of Switzerland's partners. It is nonetheless an approach worth pursuing, given the potential for additional tariff savings and supply chain diversification.

Apart from regionalisation, simplification in other aspects of rules of origin may also improve the use of FTAs. One avenue to be further pursued is more relaxed product specific rules of origin in FTAs. Generally, it is important to ensure that the origin clauses in FTAs (e.g. tolerance rule, principle of territoriality, non-alteration rule) reflect the position of Swiss economic operators that are highly integrated in international production chains. The complexity of rules facing companies can be reduced by ensuring a degree of harmonisation, or at least correspondence between the rules in the different FTAs. Furthermore, simplification can be sought for the proofs of origin that economic operators are required to submit.

SECO continues to work on improving the use of FTAs by economic operators. In February 2022, the Federal Council tasked the Federal Department of Economic Affairs, Education and Research (EAER) with simplifying and improving the use of FTAs, as part of its strategy to strengthen Switzerland's standing as a place for doing business. This includes proposing and applying specific measures, such as 'regionalisation of rules of origin in FTAs', with a view to making it easier for companies to benefit from Switzerland's FTA network.