

## **Executive summary**

### ***Foreign economic policy in an increasingly volatile world***

*In the year under review, Switzerland's foreign economic policy was conducted in an environment overshadowed by persistent and new uncertainties. The post-war world trade order based on "strong rights" for all rather than on "rights for the strong" is being called fundamentally into question by some of its founding proponents. There is a growing feeling that the rules-based international order – for decades taken for granted as the basis for economic growth and prosperity – is further being eroded. A process of fragmentation from international into national and regional orders is emerging, along with increased competition between systems, which we thought long forgotten. Many countries are seeing the emergence of ground swells of populism and mounting scepticism over globalisation within a general trend towards isolationism and protectionism in matters of trade. In addition, there is growing concern that the process of transformation towards a more sustainable and resource-efficient economy is not moving fast enough.*

*Paradoxically, this trend is taking place at a time when global value chains, i.e. cross-border production processes, are gaining importance. This reinforcement is accelerated by the advancement of technological progress. Digitalisation in particular results in far-reaching and fundamental changes to the global economy. Digital networks penetrate countries, companies and individuals to an unprecedented degree. New services and production models are continually evolving, paving the way for welfare gains – especially in developing and emerging countries. They are also opening up opportunities for more sustainable and transparent value chains, but at the same time are destroying traditional models of business and working practices while creating new ones. This poses a challenge for politicians and regulators worldwide: these changes increase the pressure on the global trading system to adapt and strengthen the centrifugal forces acting on that system. The feature topic of this report (section 1) addresses this situation.*

*Amid the conflicting global forces of political retreat and ground-breaking technological advances, Switzerland's most important challenge on the foreign trade front remains unchanged: as a medium-sized economy with a comparatively small domestic market, the country needs to maintain its high level of competitiveness. Switzerland has advantages to maintain its position: it is an important location for research and education, has a flexible labour market and comparatively few administrative burdens for companies. Externally, the focus remains its proven economic relationships and regulatory interoperability with the EU. In addition, –by combining established with possibly new alliances, – Switzerland needs to promote economic relations that are non-discriminatory, legally secure and capable of evolving dynamically; it needs to strive at the multilateral level for appropriate rules and standards, as well as for their enforcement, and it also needs to expand and deepen its network of bilateral agreements.*

### ***The Federal Council's Objectives for 2019***

*Against this background, the year under review saw the Federal Council work on a number of different levels for the preservation and strengthening of the rules-based,*

*multilateral world trade order. Negotiations with the EU regarding an institutional agreement (InstA) remained a primary focus. The Federal Council undertook a broad-based consultation process regarding the outcome of the InstA negotiations. Several agreements were concluded with the United Kingdom to ensure that bilateral economic relations continue as seamlessly as possible following the UK's exit from the EU. Within the framework of EFTA, a Free Trade Agreement (FTA) was concluded with Mercosur and its Member States.*

*The present report deals with these and other events of significance to Swiss foreign trade policies (sections 2–8). The feature topic (section 1) deals with the emerging opportunities and challenges of digitalisation for Swiss foreign trade.*

*The Federal Council will present in detail the status of progress made on foreign trade policy objectives in its annual report for 2019. A provisional assessment of foreign economic policy during the year under review suggests that its goals were achieved.*

### **Global economic situation and economic policy developments**

*Many regions saw a marked slowdown in economic growth during the year under review. This was particularly noticeable in the EU Member States during the course of the year. However, a gradual slowdown in the pace of growth in recent years was observed in America and Asia. This affected the manufacturing sector in particular – and consequently the global trade in goods. By contrast, the services sector and domestic demand in the major industrialised countries helped to offset the slowdown in the global economy.*

*The main reason for the slowdown in global trade was the ongoing trade conflict between the USA and major trading partners (cf. 2018 Foreign Trade Report). This conflict was exacerbated by numerous increases in tariffs or threats to impose further such increases. The consequences of this dispute manifested themselves most clearly in China: this country saw a weakening in both foreign trade and domestic business, which contributed to a slowdown in overall economic growth. The decline in global trade also had an impact on heavily export-focused economies such as Switzerland and Germany, even though they were not directly involved in these trade tensions.*

*In addition to trade disputes, political uncertainties in Europe (e. g. Brexit) also contributed to persisting uncertainty in global markets. This uncertainty fostered risk aversion among investors and companies as reflected in long-term interest rates, which reached at historic lows.*

*Internationally, central banks – particularly in the Eurozone, the USA and various Latin American countries – maintained or further relaxed their exceptionally expansionary monetary policies. At the beginning of the year and despite global uncertainties, stock markets enjoyed rising prices and low volatility, even if the intensification of trade conflicts temporarily led to price falls – on a massive scale in some cases.*

*By contrast, there were positive signals on the labour markets, which were generally robust. In many countries, the unemployment rate continued to fall during the year under review and unemployment levels reached historic lows. Inflation rates which,*

*among other factors, were strongly influenced by fluctuations in oil prices, remained moderate internationally. For the most part, core inflation rates remained stable. The combination of strong labour markets and low inflation helped to fuel domestic demand. Consumer confidence remained comparatively buoyant in many countries, including the Eurozone.*

### ***Economic situation in Switzerland***

*Swiss GDP growth was also below average in the first half of the year. In comparison to the global trend, however, Switzerland remained in the middle range.*

*Growth was primarily supported by consumer spending, helped in part by the robust state of the labour market. Unemployment remained low and employment growth continued – albeit at a decelerating pace. There were, however, clear differences between economic sectors. While the percentage of employment seekers continued to decline in the services sector, it increased slightly in the manufacturing sector. This trend was strongest in the mechanical and electrical engineering industries. In addition, a slight increase in short-time working was observed for the first time since 2015.*

*The Swiss economy was directly affected by the continuing global economic uncertainty. This had a negative impact on companies' investment activities. The slowdown in economic activity abroad put the brakes on exports: producers of cyclical goods such as machinery (for which exports decreased by an annual average of around 1.5 %) and metals (for which exports decreased by an annual average of around 2 %) were hit particularly hard. In addition, the Swiss franc appreciated moderately due to ongoing political uncertainties, which had a particularly negative impact on manufacturing industry. By contrast, exports of chemical and pharmaceutical products continued to grow robustly in the year under review.*

## **Summary of the contents of the 2019 Foreign Economic Policy Report and outlook for 2020**

### **Feature topic: Digitalisation and foreign trade (section 1)**

Switzerland should continue to be one of the world's most competitive locations for business, creating and preserving jobs with high added value. If it is to retain and promote its international competitiveness and welfare standards, obstacles to the use of digital services and inputs will need to be minimised. This involves firstly identifying and dismantling unnecessary barriers to digital commerce within Switzerland. Secondly, Swiss companies should also be able to access their export markets in a digital environment without being disadvantaged. A crucial requirement is the need to minimise barriers to the cross-border transmission of data which forms the basis for the digital economy (section 1.1.2).

These developments present significant opportunities for Switzerland as a globally-networked and highly-developed economy. Switzerland is already an important location for digital business and research, and the importance of that role is growing. However, Switzerland also faces challenges in such areas as the labour market, tax policy and cyber security. The country would also be disproportionately affected by restrictions on cross-border data flows to key partner countries (section 1.3).

While technological progress is accelerating the process of digitalisation – and thus helping to break down national borders – political counter-movements are emerging worldwide. Countries strive to assert their sovereignty in the networked digital space and seek to intervene in areas of high political priority such as security, law enforcement or the protection of privacy and personal data. Such measures may also be signs of protectionist tendencies in digital commerce. We are starting to see the emergence of regional blocs (section 1.2) which threaten to restrict the open and global nature of the Internet.

International economic law may contribute to transparency and help dismantle or prevent disproportionate measures. Current debates on issues such as data protection show that striking a balance between legitimate public interests – such as privacy protection – and freer trade will help shape the regulation of the international digital economy (section 1.2.4). At international level, working towards international rules and standards that are as universal as possible is in Switzerland's fundamental interest. Ongoing work in the OECD and the WTO's plurilateral e-commerce initiative could play an important role in the medium term, but bilateral instruments may also need to be developed further.

### **Important economic policy developments in Switzerland with a bearing on foreign trade (section 2)**

Domestic and foreign economic policy are more closely intertwined than ever before. The regulations addressed this section focus on the Swiss economy and could potentially have a direct impact on Switzerland's international relations.

On the question of controls on foreign investment in Switzerland, on 13 February, the Federal Council approved the report "Cross-border investments and investment controls" as a response to parliamentary postulates 18.3376 and 18.3233 (submitted by members of the National Council Bischof and Stöckli respectively) (section 2.1).

*The report concluded that the introduction of controls does not currently bring any added benefit. Motion 18.3021 from Rieder "Protection of the Swiss economy through investment monitoring" is still pending before the National Council (lower house). The Federal Council has requested the rejection of this motion, which calls for the creation of a legal basis for investment control of foreign direct investments in Swiss companies. The Council of States (upper house) adopted the motion on 17 June.*

*The Federal Act on Tax Reform and OASI Financing (Old Age and Survivors Insurance) was adopted by popular referendum on 19 May (section 2.2). It entered into force on 1 January 2020. This act will ensure that Switzerland remains an attractive and competitive location for business and will safeguard jobs and tax revenues over the medium to long term. The reform also brings corporate tax law into line with international standards.*

*In the year under review, the Federal Council proposed to unilaterally abolish customs duties on imported industrial goods (section 2.3). In response to a popular initiative for fair prices ("Fair Prices Initiative"), the year under review saw the Federal Council submit a counterproposal which takes account of the core concerns of the initiative while at the same time seeking to avoid economically harmful effects on Switzerland (section 2.4).*

### **Economic relations with the EU (section 3)**

*Switzerland and the EU have been negotiating an institutional agreement (InstA) since 2014 (section 3.1.2). This agreement is intended to consolidate the existing bilateral approach to relations generally and the existing market access agreements specifically while opening the way for its further development. The Federal Council took note of the outcome of the negotiations on 7 December 2018. After several months of consultations with the Swiss stakeholders most affected, it confirmed on 7 June its positive assessment of the draft InstA and decided to request clarification for three issues: wage protection, state aid and the EU Citizens' Directive. If satisfactory solutions are found for these three issues, the Federal Council intends to sign the agreement.*

*After the European Commission decided not to extend the recognition of stock market equivalence for Switzerland due to expire on 30 June, the Federal Department of Finance (FDF) applied on 1 July a previously prepared measure for the protection of Switzerland's exchange infrastructure (section 3.1.3). This measure prohibits trading centres in the EU from offering or facilitating trading in equity securities of companies domiciled in Switzerland. The measure has so far proved satisfactory in terms of achieving its intended protective effect.*

*In the year under review, the agreement with the EU on the free movement of persons demonstrated its ability to support Switzerland's status as an attractive business location without having any negative impact on the level of employment, the unemployment rate or salaries. Net immigration from the EU/EFTA countries remained comparatively low. Making it as easy as possible to recruit skilled workers abroad is an important locational advantage, especially given the advance of digitalisation (sections 1.3 and 3.1.4).*

Parliament supported in principle a second financial contribution to selected EU Member States in the year under review. This should amount to a total of CHF 1.302 billion over ten years. However, Switzerland will not make any commitments as long as discriminatory EU measures against Switzerland remain in force (section 3.2).

As part of the “Mind the Gap” strategy adopted by the Federal Council in 2016, during the year under review an insurance agreement, a road transport agreement, a trade agreement, an agreement on citizens’ rights and two temporary agreements on the mutual admission of natural persons to each country’s labour markets and the coordination of social insurance schemes were signed with the United Kingdom. These agreements will come into force as soon as the bilateral agreements between Switzerland and the EU ceased to apply to the United Kingdom with the latter’s departure from the EU (section 3.3).

In addition, at their meeting in Luxembourg on 10 October, the EU finance ministers decided to remove Switzerland from the EU monitoring list for tax purposes (“grey” list).

#### **International organisations (section 4)**

The crisis in the international trading system, addressed in detail in the 2018 Foreign Trade Report, resulted in various WTO reform initiatives, which continued during the year under review (section 4.1). The pressure for reform has intensified with the blocking of appointments of members to the WTO’s Appellate Body. Through plurilateral initiatives, groups of willing WTO members are pressing ahead with negotiations on selected issues with the intention of raising them in plenary session at a later date. In particular, the areas of electronic commerce (e-commerce) and domestic regulation of trade in services are showing encouraging momentum. Switzerland, along with other WTO members, has filed a dispute with the WTO’s Dispute Settlement Body over USA tariffs on steel and aluminium; work on this case began in the year under review.

In the OECD, progress was made on conceptual work relating to current developments in the field of digitalisation (section 4.2). The OECD member states, including Switzerland, adopted the world’s first recommendations on the use of artificial intelligence. At Switzerland’s initiative, they also exchanged views on the subject of “ageing societies”.

The International Labour Organisation (ILO) marked its centenary in the year under review (section 4.3). The celebrations were hosted by Switzerland. On the occasion of this event, the organisation launched an initiative on the future of work.

#### **Bilateral economic agreements (section 5)**

In cooperation with the EFTA States, Switzerland concluded negotiations on a comprehensive FTA with Mercosur in August (section 5.1). In this context, a targeted environmental impact assessment was conducted for the first time. The Comprehensive Economic Partnership Agreement (CEPA) concluded with Indonesia in December 2018 was approved by Parliament. Exploratory talks with the USA on a possible FTA continued. Switzerland was also in contact with various partners

regarding the further development of existing FTAs and participated in various joint committees (section 9.1.3) and joint economics commissions (section 9.1.5).

Negotiations with several countries on investment protection agreements (IPAs) also continued during the year under review (sections 5.2 and 9.1.4). In addition, the Federal Council approved a negotiating mandate for the revision or conclusion of IPAs with Angola, Bolivia, the United Arab Emirates and Ecuador (section 5.2).

Finally, Switzerland concluded an agreement with Turkey under the Generalised System of Preferences (sections 5.3 and 9.2.3).

### **Sustainability and responsible governance (section 6)**

The issue of sustainability continues to take on greater importance against the background of global warming and the over-exploitation of natural resources. The year under review saw the Federal Council adopt a sustainable development strategy for the implementation of Agenda 2030 in Switzerland (section 6.1). This issue has become more important in FTAs in recent years. Switzerland and the other EFTA States have therefore revised and strengthened the EFTA model chapter on trade and sustainable development, by, among other things, introducing provisions on trade and climate change, trade and biodiversity and an updated approach to dispute resolution (section 6.2).

The Federal Council's action plans on responsible corporate governance, business and human rights and the "green economy" continued to be implemented and updated (section 6.4).

The popular initiative "Responsible Business – for the protection of human rights and the environment" submitted on 10 October 2016 provides for due diligence and corporate liability. The Federal Council rejects this initiative, but works towards internationally coordinated rules. It awaits the conclusion of the parliamentary debate on a counter-proposal. It also considers that the rules on liability should not go beyond legislation currently in force.

### **Economic development cooperation (section 7)**

In the year under review, the Federal Council presented the explanatory report on the dispatch relating to the international cooperation strategy 2021–2024 to interested parties in the context of a voluntary consultation.

Switzerland's international cooperation was reviewed through the peer review of the OECD Development Assistance Committee and the mid-term report on international cooperation 2017–2020 (section 7.2). Among other things, the OECD recommends that Switzerland should pool its efforts and allocate 0.5 percent of its gross national income to its public-sector development assistance. This is in line with the guideline figure set by Parliament in 2011.

The member states of the African Development Bank decided on a capital increase totalling USD 7 billion (section 7.2). In addition, the negotiations on the 19th replenishment of the World Bank Group's Development Fund (International Development Association, IDA) were completed.

### **Export controls and sanctions (section 8)**

*On 17 April, the Federal Council extended the validity period of the Ordinance on the export and brokering of goods for the surveillance of Internet and mobile communications until 12 May 2023 (section 8.1). Licences for export or brokering of such goods can be refused if the goods could serve the end recipients as means of repression.*

*On 26 March, the Business Audit Commission of the Council of States completed an inspection of the Swiss government's participation in economic sanctions (section 8.2). Overall, the inspection judged Switzerland's sanctions policy to be coherent.*

*On 14 June, the Federal Council presented the dispatch on the popular initiative "For a ban on the financing of war material manufacturers" and recommended rejecting the initiative (section 8.3). With the popular initiative "Against arms exports to countries in the grip of civil war (correction initiative)" submitted on 24 June, the initiators seek to enshrine the approval criteria for exports of war material in the constitution. The initiative also intends to reinstate the exclusion criteria for exported war materials that were adopted by the Federal Council in 2008 and adjusted slightly in 2014.*

### **Outlook for the coming year**

*The Federal Council will continue to attach the highest priority to relations with the EU. The focus will be on efforts to reach agreement with the EU on the three above-mentioned points relating to the current draft of the InstA. The EU Commission is expected to rule on whether to extend the adequacy decision for data protection in relation to Switzerland in 2020. At the European level, the preparatory work for the 2021–2027 cohesion policy should be completed in 2020. Swiss border regions will launch new cross-border programmes with their neighbours. The Federal Council will monitor these developments with a view to a second Swiss contribution to selected EU member states.*

*In addition, the Federal Council will support the reform of the WTO. It will use international forums such as the OECD to promote its economic policy interests. The further development of its free trade network and the improvement of Swiss companies' access to foreign markets also remain central pillars of Switzerland's foreign trade policy. The main focus is likely to be on free trade negotiations with India, Malaysia and Vietnam. In addition, the Federal Council intends to continue exploratory talks with the USA.*

*At the end of 2020, the OECD is planning to publish its final report on the "Tax Challenges of the Digital Economy" project, which could result in a substantial overhaul of international corporate tax legislation and would encompass the whole economy and not just digital business models. This development would have major implications for Switzerland, which is home to numerous companies with international operations.*

*In the context of implementing the updated action plan on corporate social responsibility, the Federal Council advocates due diligence checks for responsible corporate governance and encourages companies to carry out sustainability reporting. In particular, the National Contact Point under the OECD Guidelines for Multination-*

*al Enterprises will raise businesses' awareness of the new OECD guidelines on due diligence in lending by financial institutions. In connection with the revised National Action Plan on Business and Human Rights, a Swiss Forum on Business and Human Rights will be launched. With regard the due-diligence procedures to support human rights, the advice of Swiss embassies will be solicited and SMEs will be supported.*

*At the beginning of 2020, the Federal Administration will report to the Federal Council on the implementation status of the measures contained in the report "Green Economy – Measures taken by the Federal government to ensure a resource-conserving, sustainable Switzerland" for the period 2016–2019 and on further developments during the period 2020–2023. The overarching objective of Federal government measures is to reduce the environmental impact of Swiss consumption and production. Measured in environmental impact points, around three quarters of this environmental impact occurs outside Switzerland. One of the priority topics taken up by the Green Economy report therefore related to international engagement.*

