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Why trade supports rather than hinders sustainable development

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Executive summary

Sustainability now has a high priority everywhere, and rightly so. Sustainable development is one of the greatest global challenges of our time. However, focusing solely on the environmental aspects of sustainability is insufficient. After all, sustainability also includes economic and social dimensions as well. Therefore, holistic solutions are required, and a strong involvement of business is the key to success in this area. After all, the UN considers international trade to be a driving force for sustainable development.

Trade in goods and services and foreign direct investment reduce poverty, improve the quality of life of many people and have a long-term positive impact on the environment. This requires good governance in the individual countries and responsible companies. Thanks to their comparably high sustainability standards and premium products, Swiss companies contribute significantly to sustainable development in the world. They are among the most important foreign direct investors, especially in developing countries. This often involves a strong commitment to training and the transfer of modern technologies.

In order to be able to exert a positive influence in the future, Swiss companies must have unrestricted access to global markets. In a time of faltering multilateral trade liberalisation, countries increasingly rely on bilateral free trade agreements. These agreements are essentially economic agreements aimed at reducing trade barriers. Of central importance are also intergovernmental organisations (UN, OECD, WTO, etc.) which negotiate and develop sustainability standards. As in the past, Switzerland should continue to play an active role here.

Contact and requests

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Positions of economiesuisse

- Cross-border trade and foreign direct investment have a positive impact on economic and social sustainability. Since 1990, they have led to enormous welfare gains around the world, lifting more than one billion people out of poverty, while also increasing life expectancy in the world’s poorest countries by an average of 13 years.

- In the long term, world trade has a positive effect on the environment. However, in many countries there is still not sufficient recognition of environmental aspects.
- With their comparatively high sustainability standards and the export of state-of-the-art technology and innovative products, Swiss companies promote sustainable development worldwide.
- Global trade and free trade agreements alone do not create a balance between economic, social and environmental sustainability. But trade gains can and should be used to strengthen and better reconcile all three dimensions of sustainability.
- A holistic approach is needed to strengthen sustainability: bilateral cooperation, regional solutions, international cooperation and multi- or plurilateral agreements can improve sustainability in all three dimensions in other countries, provided local political and economic institutions allow this to happen.

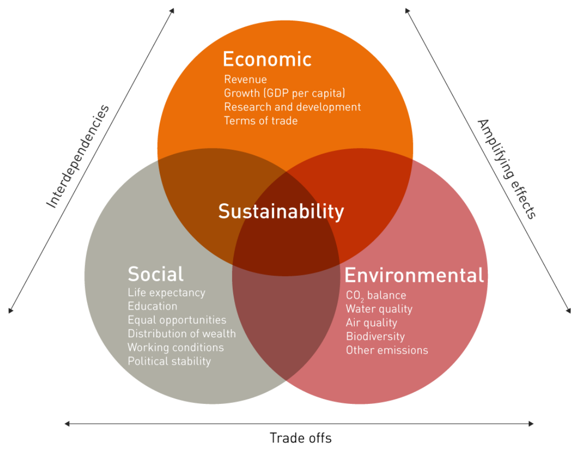
Sustainable development includes several dimensions

Sustainable development is one of the greatest challenges our society is facing. According to the UN World Commission on Environment and Development, “sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs”. In order to achieve globally sustainable development, the UN member states jointly defined 17 Sustainable Development Goals (SDGs) for the period up to 2030. The central elements include, for example, the promotion of inclusive and sustainable economic growth, the protection of human rights and the conservation of the planet’s natural resources. The UN member states agree that these challenges and commitments are interlinked and require integrated solutions. It is therefore necessary to take a holistic view of the SDG Agenda 2030 and to purposely intervene where the greatest impact can be achieved.

Sustainability includes environmental, economic and social aspects

The SDGs also illustrate that sustainable development includes not only a consideration of environmental aspects, but social and economic dimensions as well.

The three dimensions of sustainability and a selection of indicators



Source: own presentation, based on Passet (1979)
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These three dimensions are closely interlinked and mutually dependent. If, for example, one factor affects a particular dimension, sooner or later this may have positive or negative consequences for the other dimensions. These are measured by indicators. However, such measurement methods are the subject of heated discussions, as certain aspects are difficult to quantify. It is not possible to make a clear distinction between the three dimensions because they overlap to some extent and have common points of intersection. The interdependencies within the sustainability triangle can be illustrated using the following example.

If a multinational company creates new jobs in a developing or emerging country, it increases the material standard of living and purchasing power locally **(economic dimension)** by means of knowledge and technology transfers. This enables the local population to gain better access to education and health **(social dimension)**. As income rises, consumption also increases, which is desirable from a social and economic perspective. In the short to medium term, more consumption and more production can indeed lead to an increase in CO2 emission. In the longer term, however, higher incomes allow the local population to invest in more environmentally sustainable goods, such as more efficient air conditioning systems. In addition, the introduction of new technologies by foreign companies often helps to make local production more resource-efficient **(environmental dimension).**

Beware of incomplete sustainability analyses (example of Borneo)
As mentioned above, complex challenges must be considered in a holistic way (as holistically as possible). This includes sustainable development. It is not enough to focus on just one dimension. Otherwise, new problems may arise unintentionally, as the use of dichlorodiphenyltrichloroethane (DDT) on the island of Borneo in the 1950s shows. With the insecticide DDT it was possible to kill mosquitoes and thus stop the spread of malaria on the island. However, it also led to the collapse of rows of cottage roofs on Borneo and to a shortage of food for the population. DDT not only destroyed malaria-carrying mosquitoes, but also wasps, which nourished their offspring with caterpillars. Without the wasps, the spread of the caterpillars increased exponentially. As a result, the caterpillars were able to invade and destroy the roofs of the local population's cottages. In addition, many cats died from the use of DDT, much to the delight of the rodents on the island. Thus, they were able to devour the grain supplies of the local population undisturbed. The example of Borneo shows how a well-intentioned measure to strengthen the social dimension (better health by controlling malaria) led to a change in the environmental dimension (fewer wasps and cats, more caterpillars and rodents) and ultimately to a weakening of the economic dimension (fewer supplies, damage to property).

Business depends on sustainable development

The business community has a strong self-interest in sustainable development. Only a sustainable and careful use of the production factors labour, soil and capital can ensure the economic capacity to act in the long term. Sustainability is therefore the basis of entrepreneurial action, as this is the only way to guarantee economic success in the long term. For this reason, far-sighted companies strive not only for a high short-term return on investment. They also have a fundamental interest in satisfied, healthy and well-trained employees. Such employees tend to be more productive and more willing to stay with the company. Furthermore, companies are dependent on an intact environment that will continue to provide relevant natural resources in the future. In addition, entrepreneurial solutions play a decisive role in overcoming environmental and social challenges.

International trade is a prerequisite for sustainable development

In its 2030 Agenda for sustainable development, the UN made clear that business plays a central role in achieving sustainable development goals. In its view, international trade is a driving force for inclusive economic growth, poverty reduction and the promotion of sustainable development.

However, as trade is a broad concept, it includes an exchange of a wide range of goods (imports and exports). It serves both the production of new goods and their consumption, thus creating important benefits for people. But it is by no means limited to material things. It also includes foreign direct investment and the cross-border provision of services, for example when Swiss specialists repair a machine in another country or advise foreign companies on risk insurance.

Import and export of goods increases prosperity

The exchange of material and immaterial goods increases the prosperity of all countries involved, as each trading partner will only produce what it can do best in relative terms. This specialisation of individual countries leads to an international division of labour: goods are imported when their domestic production is too expensive. On the other hand, goods are exported if their production at home is cheaper than abroad. Imports also increase the choice of goods at home and lower prices for consumers. And exports have a positive effect on employment. This increases the income of the local population. The import and export of goods thus increases the overall prosperity of all trading partners involved. As a result of the global trade in goods and services, local companies are also integrated in international value chains.

Increased trade stimulates competition and thus progress

The specialisation of countries means that certain sectors of the economy are increasingly exposed to greater competition, including from abroad. Individual domestic suppliers may be forced out of the market as a result. Nevertheless, the long-term effects of increased competition are generally positive. Companies are forced to undergo a constant process of renewal. The resulting improvements in production processes not only disrupt existing structures, but also drive economic and technical progress in the market. As a result, particularly innovative domestic suppliers are successful and, thanks to technological and methodological advances, are able to establish themselves in the market, thereby increasing their productivity. This in turn generates additional revenues, which can eventually be redirected to new investments and ultimately create new jobs.

Foreign direct investment generates much more than just jobs

Global trade also includes foreign direct investment. This category of investment is made by Swiss companies with the intention of acquiring a lasting share in a company abroad. Foreign direct investment has both direct and indirect effects. For example, a direct effect is generated when a company opens a branch abroad, employs staff locally and pays their wages. A number of studies have shown that foreign companies in developing and emerging countries tend to pay higher wages than domestic ones.

Foreign direct investment has an indirect impact via so-called spillover effects, also known as externalities. In the case of spillover effects, certain influencing factors (such as the production or consumption of goods) have positive or negative effects on other factors. A positive spillover effect occurs, for example, when a Swiss company trains employees abroad, thereby increasing local knowledge about more efficient production methods. At the same time, air pollution caused by a factory abroad represents a negative spillover effect. In both cases, the advantages or disadvantages are not accounted for in the price, which is why they are external.

Positive structural effects of direct investment

The figure below shows the four different types of spillover effects foreign direct investment can have. For example, foreign companies can bring new technologies and knowledge to a country **(knowledge transfer)**. This increases the productivity of the local economy. Foreign companies can also train employees, who then move to local companies in the target country **(labour mobility)**. New market entrants also increase **competition**, which in turn increases productivity and efficiency in the market. In addition, the influx of foreign companies makes it easier for domestic firms to **access export markets** because they can use the infrastructure and networks of foreign companies for their own purposes.

Effects of foreign direct investment

	Direct	Indirect			
	Capital transfer	Knowledge transfer	Labour mobility	Competition	Access to export markets
Description	+ more jobs + more income opportunities	+ foreign companies teach more productive methods (demonstration effect) + Domestic companies imitate (imitation effect)	+ Skilled workers trained by foreign companies change jobs	+ Foreign companies increase competition	+ Domestic companies can use infrastructure and network of foreign companies
Effect	+ increasing GDP	+ productivity, efficiency and innovation increase	+ productivity, efficiency and innovation increase	+ productivity and efficiency increase - crowding-out effects, domestic companies lose market share	+ Higher GDP and economies of scale

Source: own presentation, based on Lenaerts & Merlevede (2011)
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Foreign direct investment also facilitates the integration of local companies in international value chains. Thanks to positive spillover effects, even companies that act as suppliers or customers of foreign subsidiaries benefit.

Economic dimension: Open markets reduce poverty

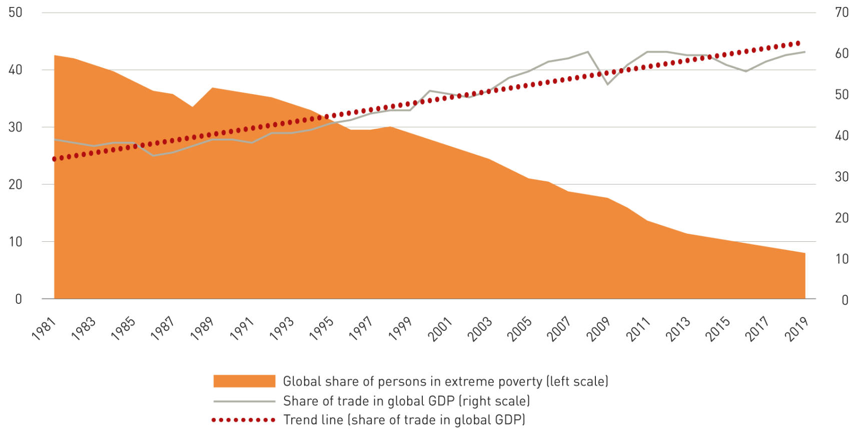
Kofi Annan, former UN Secretary-General, once said: "Open markets offer the only realistic hope for lifting billions of people in developing countries out of poverty while maintaining prosperity in the industrial world". He firmly believed that the cause of poverty and underdevelopment is not too much trade, but too little trade, and therefore always advocated the dismantling of trade barriers. Science confirms this statement: open markets and trade have a positive effect on a country's economic development. For example, they directly increase per capita GDP growth, equity investment and productivity. They also reduce structural unemployment and thus poverty.

Worldwide, the proportion of people affected by extreme poverty has fallen sharply in recent decades. Whereas, in 1981, 42.5 percent of all people lived in extreme poverty, this figure dropped to just 9.2 percent in 2017 (see figure below). Thus, the global poverty rate in 2017 was lower than ever before. For 2019, the global poverty rate is predicted to fall to 8.2 percent. Since the early 1990s, a total of more than one billion people has been lifted out of poverty.

At the same time, the share of trade in global economic growth has increased significantly since 1980. Between 2000 and 2018, the value of the exports of the least developed countries has increased more than six-fold (from 41 to 257 billion USD).

Development of poverty and world trade since 1981

in percent



Source: World Bank (2020)
www.economiesuisse.ch

Trade plays a crucial role in poverty reduction. A study on African countries shows that trade openness and the structural change it triggers reduce poverty in the longer term and that the private sector contributes significantly to poverty reduction. The World Bank and the World Trade Organisation (WTO) draw the same conclusion: the expansion of international trade and the growth stimuli, productivity gains and income increases resulting from it are essential to reducing poverty worldwide. In 2018, the organisations published a joint report that provides eight case studies to show in concrete terms the contribution of trade to poverty reduction in developing countries. According to a World Bank study, per capita GDP in a country increases by one percent if its integration in global value chains increases by one percent.

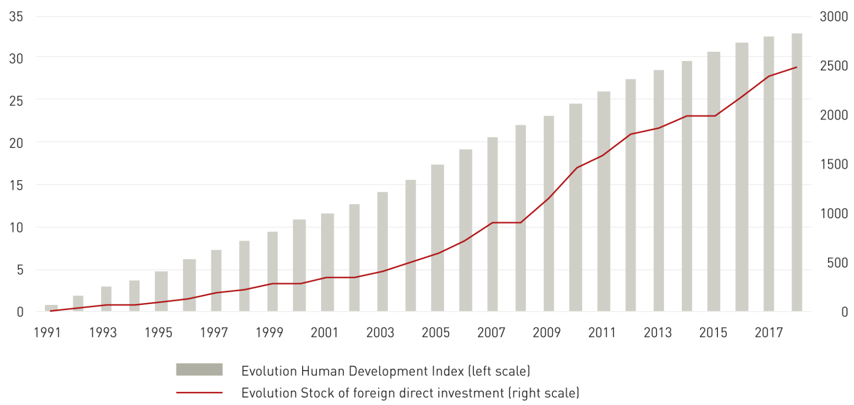
Social dimension: Market openness increases the quality of life

Furthermore, open markets have predominantly positive effects on social sustainability. They increase the population's access to education, especially for women. In addition, market openings go hand in hand with greater participation of women in the labour market and reduce child labour. Since 1990, life expectancy in the least developed countries has risen by an average of 13 years and the global mortality rate of children under five years has fallen by almost 60 percent.

The social aspects are part of the Human Development Index (HDI), which measures the social progress of countries. Various studies have come to the same conclusion: there is a positive correlation between trade and HDI. For example, it has been found that an inflow of foreign direct investment has a positive effect on the development of the HDI in Africa. A look at developing countries since 1991 confirms this positive relationship: the stock of foreign direct investment has increased substantially in these countries, while the HDI has also developed positively in the same countries.

Relative development of foreign direct investment and social sustainability in developing countries

in percent



Source: UNCTAD (2020) & UNDP (2018)
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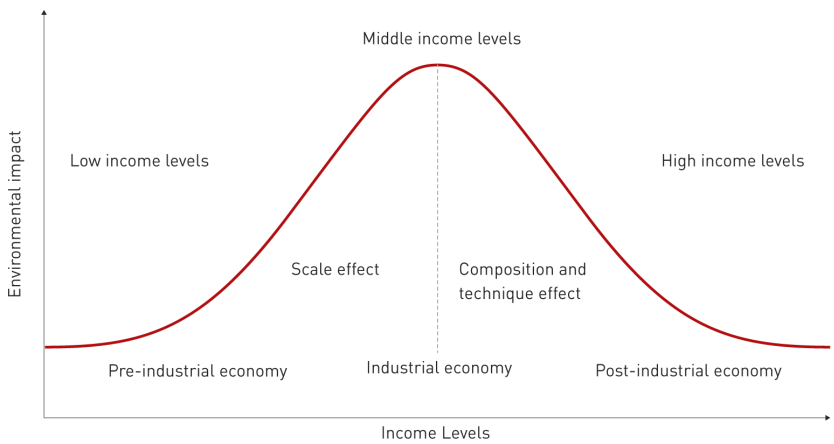
Environmental dimension: Mixed evidence on the environmental impact of trade

The impact of increased trade on environmental sustainability is disputed. Critics of free trade claim that developed countries take advantage of trade liberalisation to shift their environmental footprint to poorer countries with lower standards. According to evaluations by the ETH, however, this hypothesis cannot be empirically proven. On the contrary, liberalisation through free trade agreements does not cause a shift of the ecological footprint to low-income countries.

Another approach to determine the cause-effect relationship can be found in the Kuznets curve (see figure below). The curve describes the relationship between environmental quality and per capita income. In the initial phase of economic growth, the curve shows that pollutant emissions increase and environmental quality decreases. However, this happens only up to a certain level of per capita income. After that, the trend reverses, so that environmental quality improves as per capita income rises. The applicability of the Kuznets curve has been confirmed for various environmental aspects, such as water or air pollution and the ecological footprint.

Thus, in the short to medium term, trading can lead to an increase in CO2 emissions as production and consumption increase. Negative spillover effects, such as a market price that does not reflect the environmental costs of production or consumption, can occur. In the longer term, however, the new technologies introduced by trade will help to make local production more efficient and more resource-efficient (positive spillover effect). In addition, with rising income, the consumption patterns of the local population change as well – after all, people do not buy twice as many refrigerators just because they earn twice as much. Demand for more environmentally sustainable products, such as more efficient air conditioning systems, increases in the longer term and the need for an intact environment becomes more important.

Kuznets environmental curve



Source: own presentation, based on Sarkodie & Strezov (2018)
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The economy is often not sufficiently considered when solving environmental problems, although pricing leads to more efficient production methods and new resources that can be tapped. A perfect example of this is the aluminium can which, in the 1950s, weighed 85 grams. Today it weighs only 13 grams. Thanks to innovation and recycling, it is now possible to save 85 percent of the material. Specifically, for industrialised countries with relatively high income levels, there seems to be a tendency to reduce the consumption of material. In Switzerland, per capita resource consumption has fallen by 30 percent since 1990, while economic output per person has increased by 25 percent.

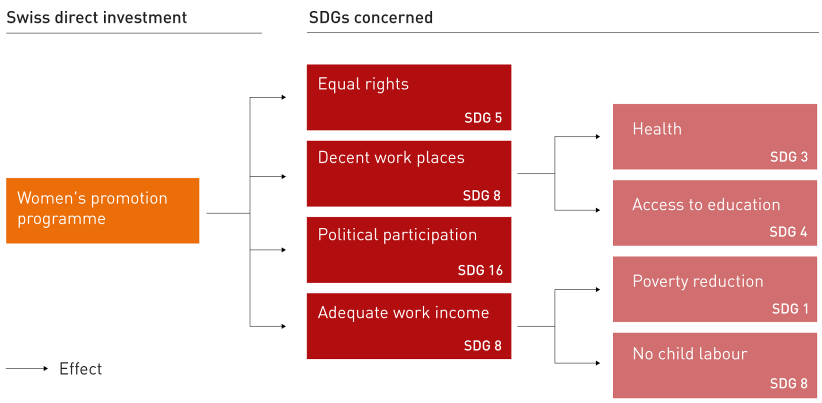
Positive impact of trade is highly context-sensitive

The positive impact of trade on sustainable development along all three dimensions depends to a large extent on the context. This includes the design of legal and political institutions in the country, legal certainty, infrastructure, financial markets, education levels of the population, etc. It also depends on the extent to which foreign companies are embedded locally through their investments and how much they interact with local firms and stakeholders. Through the instrument of international cooperation, Switzerland endeavours to make a positive contribution in the areas of economic foundations, education and infrastructure in developing and emerging countries. However, despite some success, international cooperation is unable to fundamentally change a misguided policy in the local context or an unfair distribution of local wealth gains. Nor can international trade and the associated free trade agreements do so. Institutional reforms must come from within, i.e. they must be politically pursued and called for by the people and decision-makers in the country concerned. This is often a long and difficult process. It is not without reason that the 16th SDG, which includes, among other things, the promotion of inclusive institutions at all levels and the rule of law, is considered the most difficult to implement.

Market openings impact sustainable development via causal chains

In order to comprehensively assess the impact of trade on sustainable development, it is not enough to focus on individual aspects. The causal chains involved must be considered as well. For example, trade liberalisation can have a positive impact on different SDGs over several steps, as the example of a Swiss manufacturer in the figure below illustrates. The company has a programme that promotes women at its foreign branch according to the standards of the headquarters and thus makes a positive contribution to several UN sustainable development goals.

Impact of the women's promotion programme in the subsidiary of a Swiss manufacturer on sustainable development goals



Source: own presentation, based on MVO Platform (2018)
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The timing and impact an effect has can vary as well. For instance, the effect can be negative in the short term, but positive in the long term. This can be seen in African countries, for example. There, parts of the local population may earn less after the market has been opened up because they do not yet have the skills that are now required. However, since the market opening also improves local training opportunities, this will change over the longer term and more local workers will benefit from the new jobs and thus increase their income.

Relevance of trade in services is increasing worldwide
The service sector plays a key role in the context of trade and sustainable development. In 2018, the value-based share of services trade in global trade was already 22 percent. And the opportunities for sustainability are great: trade in services promotes the transfer of knowledge, requires fewer natural resources than trade in goods, causes minimal environmental transport costs and thus generally leads to lower environmental pollution. It enables developing countries to integrate in very profitable global value chains and create highly productive jobs.

Innovation in sustainability thanks to digitalisation and commerce
Many sustainability problems can be solved through innovation. Innovation comes from smart talents and companies, not from the state. Trade is not just about goods, services or investments flowing into another country. It is also a means of exchanging ideas, experience, new technologies and knowledge. In addition, new contacts are made and cross-border networks are formed. Digitalisation serves as an important driver of innovation in the area of sustainability and significantly promotes the global transfer of knowledge. Coupled with political freedoms and

open markets, society will in future be able to make even greater progress along all three dimensions of sustainability. This means that new inventions such as more efficient refrigerators or less energy-intensive cement production will become a reality in developing and emerging countries as well. Together with institutions that benefit everyone and the right economic incentives, such as patents, digitalisation and trade have incredible potential as drivers of sustainability.

How Swiss business contributes to sustainable development

Switzerland is an export nation. It generates a considerable part of its added value by exporting goods and services, and 40 percent of total value added is exported. Nevertheless, in absolute terms, Switzerland does not occupy a leading position when it comes to international trade in goods and services. The situation looks quite different for foreign direct investment: according to UNCTAD (United Nations Conference on Trade and Development), Switzerland is one of the ten largest economic powers. Correspondingly, the influence that Swiss companies exert on global sustainable development through direct investment is large. There is hardly a multinational company from Switzerland that has not committed itself to an international standard regarding social or environmental sustainability – whether through the Global Compact, the Principles for Responsible Investments, the Equator Principles, the UN Principal Guidelines on Business and Human Rights or the OECD Guidelines for Multinational Enterprises.

Swiss companies export sustainability through standards and products

Switzerland occupies top positions in various sustainability rankings. For example, it ranks second in the Green Economy Index and in Robeco's sustainability ranking. In addition, several Swiss companies achieve top rankings in the renowned Dow Jones Sustainability Indices, a family of stock indices that consider not only economic, but also environmental and social criteria. Consequently, the high sustainability standards of Swiss companies have a positive impact on the sustainability of their branches abroad, especially when compared to those of other countries.

Swiss companies also contribute to sustainable development in their partner countries by exporting innovative, technologically advanced and high-quality products. For example, drugs developed by Swiss pharmaceutical companies improve healthcare in other countries. At the same time, Swiss industrial companies export resource-efficient machinery abroad, thus making an important contribution to more sustainable local production.

Apart from this, the preferences of consumers are increasingly shifting towards greater sustainability. As a result, Swiss companies are offering an increasingly differentiated range of products and services in response to the growing demand for more sustainable products and production processes. At the same time, Swiss import and export companies already meet a large number of standards and product regulations. Accordingly, sustainability considerations are of great importance for the Swiss economy.

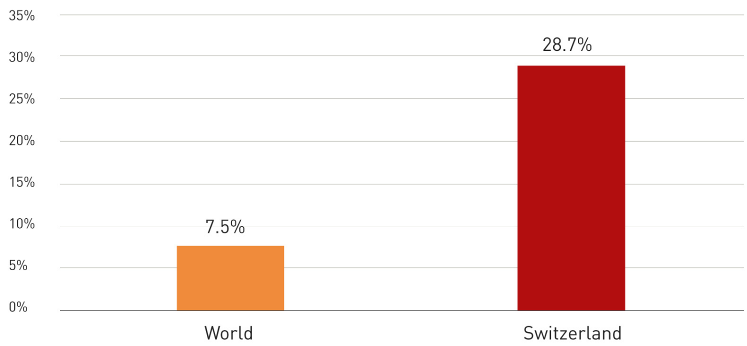
Sustainable Finance: Swiss market is growing rapidly

It is undisputed that the financial industry has a great deal of leverage for positive sustainable development. It is impressive to see how much sustainable asset classes have grown in recent years. The most important financial markets have come together in the Global Sustainable Investment Alliance GSIA (an association of the seven largest member organisations for sustainable investments worldwide). In 2018, they managed sustainable investments of almost USD 31 trillion. This represents an increase of 34 percent compared to 2016. In Switzerland, the market volume for sustainable investments reached CHF 717 billion in 2018. This figure has more than tripled since 2016 (when it stood at CHF 215 billion). The Swiss Bankers Association has produced a position paper on sustainable finance that addresses the most important aspects.

Swiss direct investment is important for developing countries

With capital stock of almost CHF 1.5 trillion, Swiss companies create over two million jobs outside Switzerland. The economic footprint of Swiss companies in developing countries is equally impressive. The capital stock here amounts to CHF 202 billion, with more than 660,000 related jobs. If this stock is put in relation to the size of the Swiss economy and compared with the global ratio of foreign direct investment to GDP, it is striking that Swiss business is almost four times more involved in these regions than the rest of the world (see figure below). This often includes, for example, a strong commitment to training and the transfer of modern technologies.

Direct investment in developing countries as a share of GDP



Sources: UNCTAD, SNB, World Bank (all 2020)
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The Center for Corporate Responsibility and Sustainability (CCRS) at the University of Zurich has been investigating the question of the extent to which Swiss direct investments in developing countries are locally anchored and how they contribute to sustainable development. The case studies provide an impressive illustration of the positive contribution made by Swiss companies to sustainable development on the ground.

Swiss direct investments using the example of Nestlé Philippines
The positive effects of Swiss direct investment in developing countries can be illustrated using the example of the Swiss food manufacturer Nestlé, which has a branch in the Philippines. As part of Nestlé Philippines, the Nescafé brand now not only obtains its coffee beans from the Philippines, but also processes and sells most of its end products in the country. In addition, the majority of employees in management positions are Filipinos. Nestlé Philippines is heavily embedded in the local economy and is therefore perceived by most Filipinos as a local company. At the same time, the company is committed to global CSR standards and has developed the NESCAFÉ plan to ensure that local coffee farmers have access to higher-yielding crops and that coffee cultivation remains sustainable. Together with the Rainforest Alliance (RA) and the Common Code for the Coffee Community (4C), Nestlé ensures compliance with internationally recognised sustainability standards. Since the foundation of its first subsidiary 100 years ago, Nestlé has not only created tens of thousands of jobs in the Philippines, but has also enabled a valuable transfer of knowledge to the local private sector. This helped to build a national economic ecosystem around the production, commercialisation and consumption of coffee. Thanks to a comprehensive capacity development program for suppliers and Nestlé Global's strict social and environmental standards, the company has been able to increase the sustainability of its local suppliers over the past several decades.

Sidebar: International cooperation achieves more than lawsuits
In various countries, and also in the EU, there is a move to broaden corporate responsibility and to increase the possibility of legal action against small and large companies. Specifically, it shall be possible to sue companies at their headquarters for global violations of human rights and environmental protection standards. In November 2020, Switzerland rejected the Responsible Business Initiative (RBI) in a popular vote. If approved, the Swiss government would have been mandated to propose a bill obliging companies not only to conduct vast due diligence in the area of human rights and environmental standards throughout their whole supply chain. It would also have included a new legal liability before Swiss courts and under Swiss law for the Swiss parent company for any violation abroad, even if only economically controlled third parties had been involved.

Instead, the Swiss Parliament adopted changes to the company law which transpose the "Due Diligence" requirement of the UN guidelines into national law and refer to the standards of the OECD and UN. Particularly the regulation in the EU and the Netherlands served as a blueprint for the new regulatory framework. It refrains, however, from introducing new, unclear and counter effective liability provisions with a reversal of the burden of proof such as the RBI required. While avoiding a regulatory stand-alone approach, the new regulatory framework puts Switzerland in the class of the most progressive countries regarding CSR regulation worldwide.

The RBI would not have achieved the objective it intended. The liability provisions foreseen by the RBI would have forced Swiss companies with high human rights and environmental risks to review their foreign investments in developing countries or even substantially reduce their business activities there. Human rights and environmental protection efforts in developing countries are particularly endangered if companies from countries with lower social and environmental standards jump into the gap left by Swiss companies. Thus, the possibility of taking legal action against multinational companies for violation of environmental regulations and human rights at their place of business ultimately endangers the successful model of Swiss development cooperation.

A more effective approach is international cooperation within the framework of the OECD or the UN, that focuses on the continuous improvement of companies' internal due diligence processes. Legal actions whose court decisions have extraterritorial effect should be avoided at all costs. These could not be enforced by Switzerland. In return, Switzerland would lose its attractiveness as a location for multinational companies and thus many highly qualified jobs.

Effective instruments in the field of sustainability from a Swiss perspective

As part of its foreign policy, Switzerland is committed to greater social, economic and environmental sustainability through a variety of multilateral, plurilateral and bilateral instruments. In this context, the benefits of free trade agreements are first described below and then compared with those of other instruments.

Multilateral reduction of trade barriers as the ideal solution

In view of the positive effects of trade on sustainable development, a generally binding and liberal international trade regime is of central importance. Trade liberalisation is most efficient if it takes place within the framework of the WTO, i.e. multilaterally. In this way, they apply to all WTO members and business can plan worldwide with a single, uniform set of rules. However, due to increasing international trade disputes and protectionist measures, Swiss trade diplomacy is also increasingly focusing on the conclusion of preferential free trade agreements. Currently, Switzerland has 32 such treaties with a total of more than 40 countries. Of these, 29 were negotiated within the framework of the European Free Trade Association (EFTA), of which Switzerland is also a member. These free trade agreements reduce customs duties, which in turn reduces trade costs for Swiss companies and their local customers. They also reduce non-tariff trade barriers, such as different product requirements.

Sustainability chapters in free trade agreements: Cooperation is better than coercion

However, international trade is about much more than just reducing customs duties. Free trade agreements create binding rules so that all partners can benefit from the advantages of trade. Since 2010, for example, every free trade agreement concluded by Switzerland contains a chapter on trade and sustainable development. In this chapter, the signatory states agree to binding provisions on environmental and social aspects in accordance with international conventions. These pursue a cooperative approach, which is why they cannot be enforced through arbitration. This does not mean, however, that these regulations cannot be monitored and enforced. Trade-related sustainability issues are discussed in joint committees. This does not mean that the cooperation approach is ineffective. Evaluations of the provisions on labour standards in trade agreements, for example, show that the cooperation approach is more effective in pursuing social sustainability goals than coercive measures.

A review of the model chapter on trade and sustainable development was undertaken by EFTA in 2019, both in terms of the content of the provisions and the approach to dispute settlement. The new provisions cover issues such as the sustainable management of forest and fisheries resources, biodiversity, climate change, inclusive trade and corporate social responsibility. EFTA also strengthened its approach to dispute settlement with its free trade partners. The new approach allows partners to set up a panel of independent experts if problems cannot be solved through the traditional consultation channel.

Why sustainability impact analyses of Swiss free trade agreements are of little use

Impact analyses of Swiss free trade agreements on the sustainability of countries such as Indonesia – often combined with a short time horizon – are not revealing. In terms of trade in goods, Switzerland's exports are absolutely fundamental to our economy, but in relation to the market size of certain partner countries they are too small to make causal statements. Our exports of goods to Indonesia, for example, represent only 0.05 percent of the gross domestic product there. Consequently, it cannot be expected that Swiss exports will be significantly reflected in Indonesia's sustainability indicators, such as CO_2 emissions.

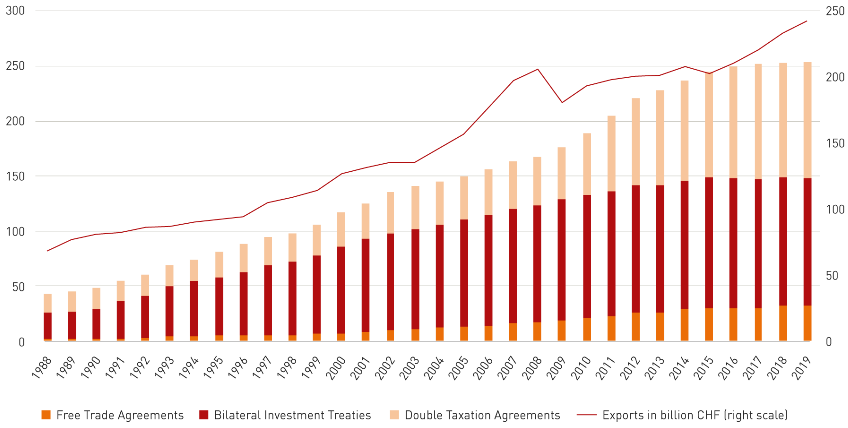
Conclusion of investment protection agreements is central

In addition to free trade agreements, Bilateral Investment Treaties (BITs) are central to sustainable development. Switzerland has concluded more than 120 such agreements. These agreements create legal security by protecting investments by Swiss companies in partner countries and by foreign companies in Switzerland against arbitrary expropriation and discrimination. In addition, these agreements regulate the transfer of capital to the home country. The improved framework conditions resulting from this system have been shown to increase the level of foreign direct investment. The greater the legal certainty, the more willing companies are to make long-term investments in another country.

Swiss free trade agreements strengthen economic integration

Free trade agreements demonstrably increase the international exchange of goods. It has been shown that Swiss companies also increased their investments in partner countries significantly after such agreements came into force. Furthermore, exports to these countries have more than doubled in comparison to the overall growth of Swiss exports. The figure below also shows that, as the number of international economic agreements increased, so too did Switzerland's exports.

Development of Swiss foreign trade agreements and exports from Switzerland



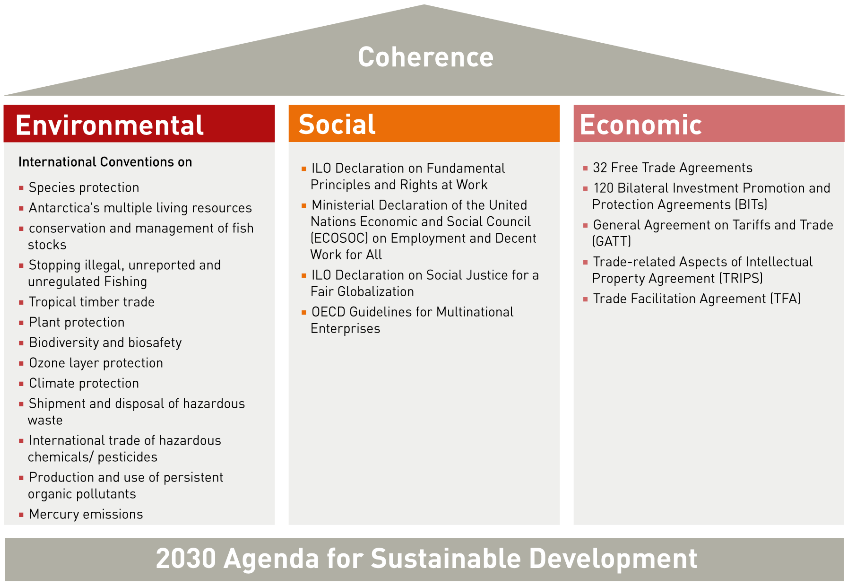
Sources: Federal Customs Administration, Seco, SIF (all 2020)
www.economiesuisse.ch

Switzerland is committed to greater sustainability through various international instruments

Free trade agreements must remain first and foremost economic agreements and minimise trade barriers. They must therefore not be overburdened. The primary objective of a free trade agreement should be to provide Swiss companies with non-discriminatory access to foreign markets. In this way, exports, imports and direct investments enable Swiss companies to make a positive contribution to economic growth and the achievement of SDGs in the target markets.

To make this growth accessible to as many people as possible and to minimise the resulting negative spillover effects, true-cost pricing is an important factor. This means that, in accordance with the polluter pays principle, all costs incurred as a result of actions or omissions are borne by those responsible. At the same time, however, further accompanying measures need to be implemented. These cannot be achieved through bilateral free trade agreements, but with the help of targeted instruments via the relevant multilateral platforms such as the UN, OECD or WTO. Switzerland actively participates in these instruments and the further development of global regulations. It is represented in all important organisations and helps shape standards wherever possible (see figure below). Switzerland incorporates the decisions taken by these bodies in its free trade agreements, thus taking account of its multilateral obligations.

Switzerland has a strong international commitment and contributes to achieving sustainable development goals with a wide range of instruments



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A coherent foreign policy must take this division of responsibilities into account. Free trade agreements must primarily focus on their core function in order to intervene where they have the greatest impact: the removal of international trade barriers. However, in the interests of policy coherence, the concerns of sustainable development should also be considered in free trade agreements. In this respect, Switzerland is not creating new rules, but is instead referring to existing international environmental agreements as well as to the instruments of the International Labour Organization (ILO), for example, in the case of standards for social labour rights abroad. However, the basic standards for sustainable development must continue to be negotiated and developed in the relevant international organisations. This is the only way to ensure that there is a uniform understanding and that the same rules apply in all participating countries. Bilateral free trade agreements are not an effective instrument for further developing rules on labour standards or environmental concerns – after all, no one is asking the International Maritime Organization to dismantle customs duties. If divergent sustainability provisions are laid down in free trade agreements, this weakens the efforts of intergovernmental organisations responsible for developing internationally applicable standards. Nevertheless, free trade agreements reinforce sustainability provisions and contribute to their implementation.