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An ex-post utilization study of the Sino-Swiss Free Trade Agreement in the Swiss Watch Industry

by

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Abstract: This thesis contributes to the growing body of literature which examines the utilization of Free Trade Agreements (FTAs). The Sino-Swiss Free Trade Agreement (SSFTA) was not only China's first FTA with a continental European country, but also a milestone for the Swiss foreign policy. However, the Swiss government needs to demonstrate that the SSFTA works in practice and delivers the negotiated benefits to its export industries. The watch industry is Switzerland's third largest export sector. This study calculated the utilization rate on the import of watch components from China based on Swiss customs data. Furthermore, in-depth interviews were conducted with nine participants in the watch industry to explore the satisfaction level on the export of Swiss watches to China. The results reveal a utilization rate on the import side of 64.9% and realized tariff savings of almost 3 Mio. CHF for the watchmakers on the import of watch parts. Moreover, the qualitative results indicate that the satisfaction level among FTA users has increased since 2014. The most frequent determinants of non-utilization are perceived negligible savings and the administrative burden while it has been found that smaller watchmakers are not being significantly disadvantaged. Despite the fact that a renegotiation of the tariffs would be desirable, the luxury tax imposed by China remains the biggest irritation for direct watch exports to China. These findings contribute to the yet limited knowledge of the utilization on an industry level and provide policy recommendations for a further upgrading of the SSFTA.

Keywords: Bilateral Trade, Free Trade Agreement, SSFTA, Watchmaking, Utilization Rate

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1 Introduction

In times of increasing trade protectionism, the bilateral Sino-Swiss Free Trade Agreement (SSFTA) sent out a powerful signal and is often referred to as a role model for future potential agreements of China (MOFCOM, 2013). Moreover, a variety of economic and geopolitical circumstances made decision making at a multilateral level difficult. In many areas such as trade, international finance or climate change governments have failed to deliver functioning multilateral solutions. Hence, many governments have realized the increased likelihood of striking a deal with a plurilateral approach outside the World Trade Organization (WTO), such as FTAs (Sandoval, 2015). The SSFTA was the first FTA of China with a continental European country and certainly has been the result of a very good bilateral relationship with Switzerland. The landlocked country was not only amongst the first Western countries to acknowledge the People's Republic of China (PRC) in the 1950's and China's market economy status in 2007, but also was the first Western country to set up an industrial joint venture in China. Whereas the SSFTA is the first real test of undergoing an FTA with an advanced Western economy for China, Switzerland has been a nation that strongly believed in free trade since a long time. Unlike the Chinese government, the Swiss government's main intention of the SSFTA was granting exporters market access to China. As with every FTA, also the SSFTA attracted significant interest among the different export industries. However, having such a treaty in place does not automatically imply that Swiss exporters and importers are utilizing it. Feasibility studies have shown that Switzerland's oldest and most representative sector – the watch industry – will benefit significantly from the SSFTA. The watch sector is Switzerland's third-largest export industry and accounted for around 6.7% of Switzerland's total exports in 2018. While Switzerland only exported watches worth a mere 5.3 Mio. CHF in 2001 directly to China, the numbers have skyrocketed to around 1.65 Bn. CHF in 2018. But have the projected benefits for the Swiss watch industry outlined in *ex-ante* studies been materialized? It has become more important over time to know the extent of FTA utilization, rather than estimating effects within *ex-ante* evaluations that potentially never get realized by exporters. Whether the different export industries actually use an FTA has been more of a concern in recent decades for policymakers than the sole intention to increase the

numbers of FTAs (Hayakawa, Laksanapanyakul & Shiino, 2013). Therefore, the results of this thesis should provide lessons learnt about the use of the SSFTA as well as barriers and practical problems encountered by a sample of Swiss watchmakers. These implications can be taken into account in a potential upgrading of the SSFTA or to make other existing and potential FTAs more relevant for business. Role models and lessons from FTAs are of therefore of great importance. Some impacts of the SSFTA could be particularly important for a potential China-EU FTA. The impacts of the SSFTA have not been widely studied, given the topicality of the agreement. Besides a few important studies (Käch, 2015; SSCC, 2018; SwissCham Shanghai, 2016, 2018) there is still a lack of research and it is definitely worth studying the impacts on a continuous basis as most of the benefits are still to be realized.

1.1 Aim and Research Questions

The purpose of the thesis is to contribute to a better understanding of industry level effects five years after the bilateral agreement between Switzerland and China entered into force. The application of a Convergent Parallel Mixed-Method suggested by Creswell (2014) allows not only to quantitatively determine the utilization of the SSFTA on watch component imports from China, but also to explore the level of satisfaction and detect potential difficulties faced by Swiss watch manufacturers on the export side. Thus, the research questions that guide this research are as follows:

- To what degree has the Swiss watch industry used the SSFTA and how high are the potential and realized tariff savings on the import of components from China?
- What are determinants for a non-utilization of the SSFTA amongst exporters of Swiss watches?
- What are the challenges that Swiss watchmakers face when directly exporting to China?

1.2 Outline of the Thesis

The following *Chapter 2* aims to inform the reader about the historical context and the content of the SSFTA, the intended FTA strategies of both countries as well as some

necessary terminology. Furthermore, *Chapter 2* presents the review of all relevant literature. The literature review includes commonly used *ex-post* and *ex-ante* evaluation methods, ranging from CGE Models to preference indicators, such as the utilization concept used in this thesis. In order for the reader to have a comprehensive understanding of Swiss watchmaking, some key historical milestones and the relationship of the Swiss watch industry with China are presented and discussed in *Chapter 3*. *Chapter 4* aims to provide sufficient details about the methodology and should justify the appropriateness of the application of quantitative (analysis of import statistics) as well as qualitative (interviewing watchmakers and experts) methods to answer the aforementioned research questions. In *Chapter 5*, the findings of the quantitative as well as qualitative parts are presented and analyzed. Furthermore, the author explains how the results conform or diverge from similar studies. Finally, *Chapter 6* summarizes the thesis and answers the research questions.

2 FTA Background

The aim of this section is to provide the reader with background knowledge about the bilateral relationship between China and Switzerland, the FTA strategies of both parties, the content as well as some key terminology. Furthermore, a summary of previous research is presented.

2.1 Bilateral Relationship between Switzerland and China

As a result of growing overseas trade, the first Swiss merchants and watchmakers arrived in China in the mid-18th century. However, watches and music boxes from Switzerland were the only goods to generate a considerable interest among the Chinese elite. In 1822, the watchmaker brothers Bovet set up the first long-lasting and important relationship with the Chinese, which played a major role in laying the foundation stone for subsequent industries (Coduri & Keller, 2009). There are still Swiss watches in the museum of the forbidden city in Beijing today originating from that time (Ineichen-Fleisch, 2015). In 1910, watches have been the most important export item and made up around 50% of total exports from Switzerland to China. China as a whole market played a very insignificant role in the Swiss foreign trade (less than 1% of total exports). Nonetheless, an important treaty of friendship was signed in 1918. A policy of neutrality and a non-colonial background made Switzerland an attractive partner for China (Coduri & Keller, 2009). Not surprisingly, Switzerland was amongst the first Western countries to recognize the People's Republic of China, which was proclaimed in 1949. Even though China's importance for Swiss business was negligible, the trade agreement negotiated in 1975 provided a suitable and important discussion platform. One of the most important milestones was the first industrial joint venture of the People's Republic of China with a Western company in 1980, after China's economic opening. They have chosen a Swiss company: the elevator and escalator firm Schindler. Schindler's success has paved the way for many other Swiss companies that started to set up business in China in the following years (e.g. Nestlé, ABB, Novartis, Roche and Sulzer). Switzerland supported

China in its plans to access the WTO in 2001, in return for better access for Swiss tourism agencies (Baumberger & Keller, 2009). In the period between 1980 and 1990 also the political dialogue between the two countries intensified with for instance the city partnership of Zurich and Kunming (Coduri & Keller, 2009).

The extensive bilateral dialogues in economic and financial matters, innovation, research, environmental policies, climate, culture and human rights existing up to date between Switzerland and China have resulted in delegations very frequently visiting each other. The long-standing relationship between the two countries is based on the values of respect and trust. Moreover, the relationship has strongly intensified since the turn of the century and the conclusion of the SSFTA in 2013 was therefore only a logical consequence.

2.2 FTA Status in China

In Europe and the Americas, FTAs and multilateral agreements have a longer tradition than in Asia (e.g. NAFTA, EU or Mercosur). There has been a proliferation of FTAs and multilateral agreements in Asia and especially in China after the turn of the century (Schaub, 2009). As with many other Chinese developmental trajectories, China has adopted an incremental or gradual approach with FTAs. The negotiating parties start with trading goods with China, followed by investment, services and ultimately by an FTA (Kawai & Wignaraja, 2011). For China, FTAs are certainly a stabilizing factor and a tool to maintain harmony with its closest neighbors (Pan, 2014). However, many experts argue that China's current foreign policy is mainly based on economic as well as geopolitical interests (Federal Foreign Office of Germany, 2019; Yu, 2018). Even though it is difficult to guess the real intentions of China's foreign policy a common interpretation certainly is that it is "driven by regional security interests, access to natural resources for her developmental continuity, to be recognized as a market economy with Chinese characteristics and improving access to regional trade networks for her businesses" (Rajeev, 2018, n.p.). Devonshire-Ellis (2017) argues that China wants to align its FTA strategy with the Belt and Road initiative (BRI). The China-ASEAN FTA eliminated much of the tariffs on goods and services and many of the countries are along the Maritime Route of the BRI. The China-Pakistan FTA provides China with a favorable investment environment in Pakistan. The China-Georgia FTA enables China to access the

Caucasus markets and the Black Sea. Not surprisingly, many of the aforementioned countries have decided that if they cannot *beat* China, they better *join* China (Devonshire-Ellis, 2017).

As of April 2019, China has signed 15 FTAs or multilateral FTAs (with ASEAN, Australia, Chile, Costa Rica, Georgia, Hong Kong, Iceland, Korea, Macau, Maldives, New Zealand, Pakistan, Peru, Singapore and Switzerland). All FTAs of China are depicted on a world map in Figure 2-1.

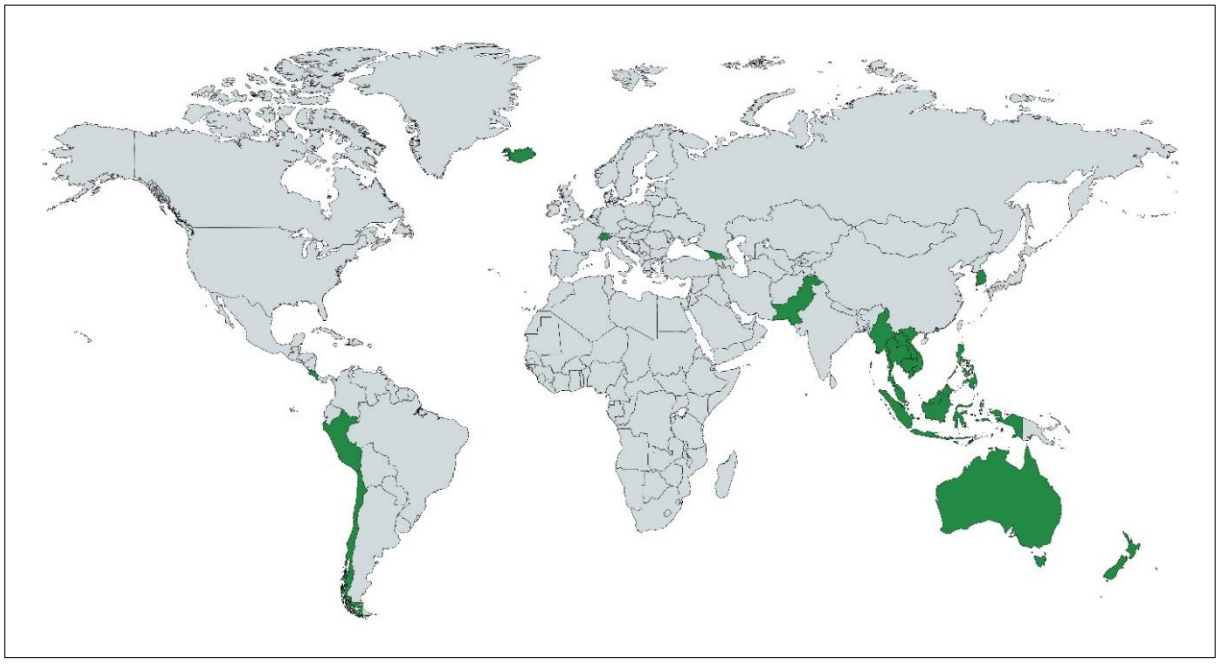

Figure 2-1 FTAs of China (author based on MOFCOM, 2019)

China is currently upgrading existing and negotiating new FTAs with several countries. A few recent examples are the 3rd negotiation round of the China-Panama FTA in September 2018, the 6th round of negotiations on upgrading the China-New Zealand FTA in December 2018 or the 14th round of a potential China-Norway FTA in April 2019. As a matter of fact, these are only very few of all ongoing negotiations and China is having "one of the busiest FTA programs in Asia" (Pan, 2014). The middle kingdom has also expressed interest in an FTA between the European Union (EU) and China. However, these negotiations most likely will not take place unless an investment treaty between these countries is signed (Embassy of Switzerland in the People's Republic of China, 2018).

Iceland, Norway and Switzerland were the first European countries to start negotiations with China in 2007. The Iceland-China FTA was signed roughly three months earlier (on the 14th of April 2014) than the SSFTA, but both of them entered into force on the 1st of July 2014.

Even though Iceland was the first European country, their exports of around 145 Mio. CHF in 2018 certainly are of less importance than the exports of Switzerland to China (30 Bn. CHF incl. gold). According to the SSCC (2018) the SSFTA is amongst the most important FTAs of China.

Whereas market access was much more important on the Swiss side, the interests of the Chinese were to a certain degree different. According to the SSCC (2018), gaining practical negotiation experience, which in turn should be of help for subsequent negotiations (e.g. with the EU), was an important factor on the Chinese side. Switzerland could be perceived as the gateway to Europe by the Chinese. Furthermore, the SSFTA sent a strong signal and was a much-discussed topic, as it was the first ever FTA of China with a continental European country. It is also often mentioned, that the Chinese were convinced of the mutual gains that the SSFTA offers. Some feasibility studies that indicated the benefits for both parties prior to the FTA have been amongst the key success factors.

2.3 FTA Status in Switzerland

The economic welfare of Switzerland is highly dependent on foreign markets due to the fact that the home market is not big enough and the country does not possess a lot of natural resources. Therefore, Swiss exporters enjoyed from the early stages of globalization numerous exporting opportunities in many different emerging countries. Switzerland's share of global trade accounts to around 1.8% (Walti, 2017). However, the import of foreign materials as well as foreign direct investment (FDI) has been equally important (Federal Council of Switzerland, 2004). Switzerland strongly believes in the importance of globalization. An important doctrine of the Swiss foreign policy is that the more countries join the globalization, the higher the welfare for everyone will be. Furthermore, the policy is based on three pillars. The three main goals are to grant market access for Swiss firms in foreign markets within a functioning international set of rules, to strengthen the competitiveness and efficiency of the domestic market and to support developing countries with their global economic integration (Federal Council of Switzerland, 2004). The foreign policy of Switzerland has not changed a lot since the version implemented in 2004, and some critical voices urge for some amendments (Walti, 2017). Furthermore, the Federal Council of

Switzerland selects free trade partners according to the following main criteria (SECO, 2019a):

- The (potential) economic importance of the country
- The extent to which other competing countries are being discriminated through a new FTA
- The willingness of the partner to negotiate as well as the chances of success
- Other considerations (e.g. contribution to economic development of the contracting party)

Switzerland usually concludes FTAs within the framework of the European Free Trade Association (EFTA). The association is comprised of the countries Switzerland, Norway, Iceland and Liechtenstein. Therefore, the majority of FTAs of Switzerland are negotiated together with these countries, with few exceptions like for instance the FTAs with Japan and China. Also in literature, multilateral liberalization is defined as the most effective option, whereas bilateral agreements provide the second-best option (Plummer, Cheong & Hamanaka, 2010). As of April 2019, Switzerland concluded 30 FTAs with 40 partners. These countries are depicted in Figure 2-2.

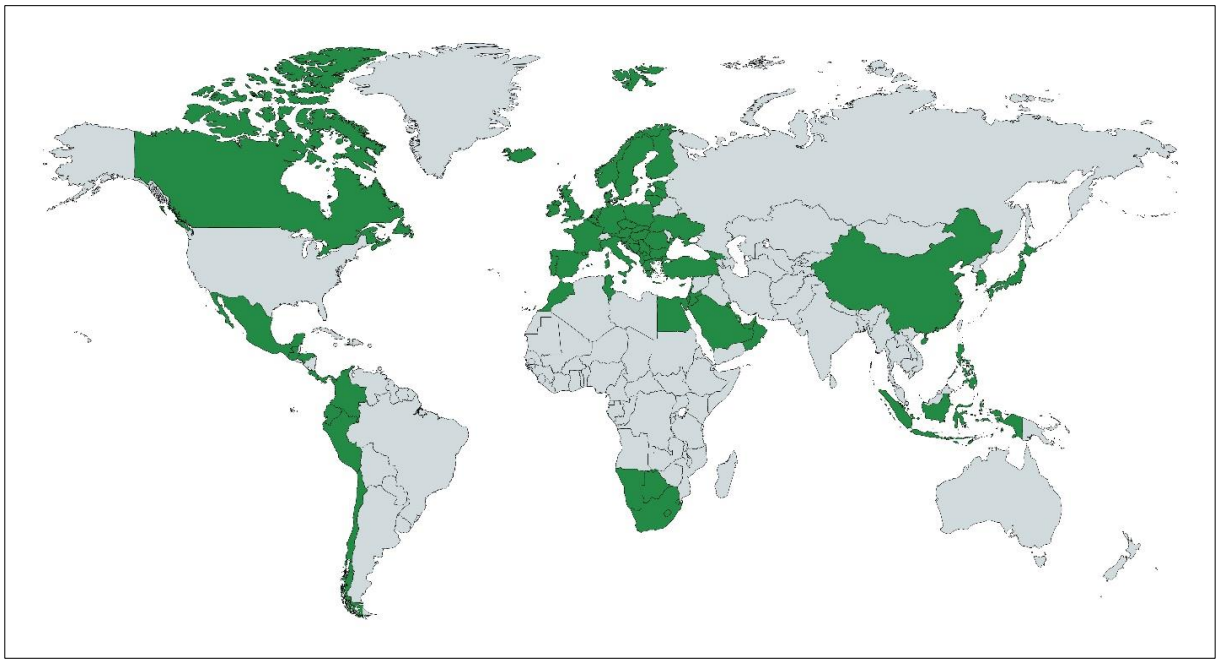

Figure 2-2 FTAs of Switzerland (author based on SECO, 2019a)

The most recent FTA of Switzerland has been concluded with Indonesia. The agreement was signed within the EFTA framework in December 2018 and surely provides market access to

another large country for Swiss exporters and importers. As of April 2019, the EFTA is negotiating FTAs with India, Vietnam, Malaysia, Argentina, Brazil, Paraguay and Uruguay.

The conclusion of the SSFTA in 2013 was one of the biggest achievements of the trade diplomacy of Switzerland (Hirschi et al., 2016; Ineichen-Fleisch, 2015). Thus far, the SSFTA was the second most important agreement signed after the one with the EU. The motivations of Switzerland, compared to the Chinese intentions, are quite transparent and straightforward. The conclusion certainly fulfilled Switzerland's foreign policy goal, which in a nutshell is to "provide Swiss companies with an unobstructed, stable and non-discriminatory market access in these countries [relevant economic partners] compared to their main competitors" (SECO, 2019a). Without any doubt, the SSFTA provides a major competitive advantage for Swiss companies. To date, neither the US nor the EU have concluded a similar agreement with China. Currently, the opposite is the case and especially the US government has a tendency towards protectionist measures.

2.4 Chronology and Content of the SSFTA

A possible FTA between China and Switzerland was first discussed after a visit of a Swiss delegation in China in July 2007. A feasibility study was initiated in January 2009 and revealed in August 2010, that both economies complement each other ideally. It was recommended to conclude an FTA with a broad scope (Hirschi et al., 2016). After initial skepticism on the Chinese part, this feasibility study outlined great benefits of a potential agreement. That is why, negotiations started in April 2011. After a total of nine rounds of negotiations, the SSFTA was signed on the 6th of July 2013. There was no referendum held in Switzerland against the federal decree, and therefore, the Swiss people could not vote for or against the conclusion of the SSFTA (Hirschi et al., 2016). Federal Councilor Johann Schneider-Amman visited China in September 2018 and clearly reaffirmed Switzerland's strong interest in further upgrading the SSFTA (Embassy of Switzerland in the People's Republic of China, 2018).

The SSFTA is a deep and comprehensive FTA and covers Switzerland (including Liechtenstein) and the People's Republic of China (not including Hong Kong, Taiwan and Macao). The depth and coverage of FTAs in general has been increasing over the last decades

ever since their proliferation starting in the 1990's. Besides the conventional provisions in the trade of goods and services, the SSFTA also contains rules for protecting Intellectual Property Rights (IPR) and measures to promote investments. Furthermore, chapter 12 of the SSFTA is fully dedicated to the environment and sustainable development (FDFA, 2013).

Switzerland joined the WTO in 1995, whereas China has been a member since 2001. Therefore, both of their imports are by default subject to the Most Favored Nation (MFN) tariffs (SSCC, 2018). The MFN clause guarantees that a country has to provide the same tariff concessions to all WTO member countries. One of the WTO principles is to "grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members" (WTO, 2019, n.p.). However, there are some exceptions granted by the WTO around this principle, such as for instance FTAs. Within the SSFTA, Switzerland grants tariff concessions on a wide range of products on imports from China, except for agricultural products (up to HS Chapter 24). It is a generally known principle of Swiss foreign policy to offer import tariffs for industrial goods from day one on equal to zero, whenever a new FTA negotiation is initiated. This has been done in previous FTAs and also was the case for the SSFTA. There is also a debate at the moment in Switzerland, whether tariffs on industrial goods should generally be set to zero for every country. This is mainly because the current administrative burden is out of all proportion to the customs revenue (Atteslander & Landolt, 2018). Switzerland immediately after the SSFTA has entered into force in 2014, has removed tariffs on up to 99.7% of all goods imported from China (Wenfei Law, 2013). On the other hand, most of the import tariffs of Swiss products entering China will be gradually reduced or abolished over a time period of 5 to 15 years. 96.5% of Swiss imports are either partially reduced or reduced to zero (Wenfei Law, 2013). Until 2023, tariffs on Swiss imports will be reduced from the MFN average of 9.8% to an non-weighted average of 1.3% (SSCC, 2018). A schedule of the most important tariff concessions for the relevant HS chapters is included in Chapter 3.2.

2.5 Terminology

In order for a Swiss or Chinese product to benefit from the above-mentioned tariff concessions, it must meet certain criteria and rules set out in the SSFTA. The most relevant

provisions and rules of the Chapter 2 (Trade in Goods) and Chapter 3 (Rules of Origin and Implementation Procedures) of the agreement are defined in this section.

Rules of Origin

Whereas non-preferential Rules of Origin (RoO) are mostly used for purposes like anti-dumping and countervailing tariffs or quotas, preferential RoO "are a set of criteria that the good needs to comply with in order to be considered originating in the territory of the trade agreement" (ITC, 2019, n.p.). Even though there is a wide variation in the practice with regards to RoO, the goal of preferential RoO in most cases is to avoid a granting of tariff concessions to products stemming from a third country and not from one of the two negotiating parties (e.g. a good produced in Germany rather than Switzerland or China). In a nutshell, RoO should prevent so-called trade deflection (Housman, 1994). The producers can choose to adjust their production in order to comply with the rules. In that case, the producer needs to produce the goods in a member country (in this case Switzerland and/or China) to receive the preferential tariff treatment. Naturally, this can lead to a substantial increase in costs on the final product, but the competitive advantage over third country producers often outweighs (Nilsson, 2002). According to Article 3.2 of the SSFTA a product can only be labeled as originating if:

1. The product was wholly obtained in Switzerland and/or China. Some examples of wholly obtained products would be mineral products, live animals or products of fishing.
2. The non-originating materials have undergone substantial transformation in Switzerland and/or China. A substantial transformation would occur if "the product undergoes a transformation substantial enough to (a) push the value of non-originating components below a certain percentage of the overall ex-works price of the product, (b) to cause a change in tariff classification, or (c) the product undergoes a specified manufacturing process..." (Wenfei Law, 2013, p. 2).
3. The product has been produced in Switzerland or China with originating materials exclusively from Switzerland and/or China.

Direct Shipment

On a frequent basis, export goods undergo transit through other countries before arriving at their final destination. This is quite common for shipments out of Switzerland, as the country

is landlocked (Wenfei Law, 2013). According to Article 3.13 of the SSFTA, preferential tariffs shall only be granted for direct shipments from Switzerland to China (or vice versa). The goods can still be transported through other territories provided that they "do not undergo operations other than unloading, reloading, or any operation confined to preserve them in good condition" and "they remain under customs control in those non-parties" (FDFA, 2013, p.15)

Accumulation

A product might be jointly produced by the two negotiating parties (e.g. Switzerland and China). The accumulation principle outlined in the Article 3.7 of the SSFTA indicates that "a product originating in a Party, which is used as material in the production of a product in the other Party, shall be considered as originating in the Party where the last operations … have been carried out" (FDFA, 2013, p.13). An example of this could be a Swiss watch containing Chinese watch components, where both, the Swiss craftsmanship and the Chinese components could be classified as originating.

Documentary Evidence

Once the above-mentioned criteria are fulfilled and a company is entitled to receive preferential tariffs rather than the MFN tariff, the exporter has to submit documentary evidence to the customs authority of the importing country. The submission of documentary evidence depends on the status of the exporter. An Approved Exporter (AE) shall send an Origin Declaration (OD) whereas everyone else shall send a Certificate of Origin (CoO).

2.6 Current Research Status (FTA)

By definition, an FTA "is a commitment by signatory members to remove tariffs across member states while continuing to maintain independent tariff regimes on import from outside countries". An FTA is not to be confused with a customs union (i.e. unified tariff regime) or a common market (i.e. also free flow of labor and capital) (Plummer, Cheong & Hamanaka, 2010).

There is an important distinction to be made between evaluation methods before and after an FTA entered into force. *Ex-ante* evaluations of FTAs are carried out before or right after

negotiations of an FTA have started and attempt to estimate how much an FTA is worth for both countries. *Ex-ante* evaluations can be done through the calculation of trade indicators, such as the intraregional trade share and intensity as well as indicators of export similarity, comparative advantage or trade complementarity. However, the most widely used approach is the Computable General Equilibrium (CGE) model which estimates the potential economic impacts of an FTA (Hayakawa, 2012). Derosa and Gilbert's (2006) computations of a CGE model on a potential FTA between Switzerland and the United States for instance predicted a substantial increase in bilateral trade between the two parties.

On the other hand, *ex-post* evaluations of FTAs allow policy makers to take stock retrospectively of an FTA's impacts. The actual effects can be quite the opposite from what previously has been expected, since *ex-ante* evaluations entail the assumption that basically any firm can increase their profitability by utilizing an FTA without any further costs (Brunschweiler & Troller, 2014). Furthermore, the use of FTAs is voluntary and some firms might not see any value in using an FTA (Brunschweiler & Troller, 2014). The aim of *ex-post* analyses is to find out whether preferences were *actually* utilized by companies and whether an FTA in general raised the welfare of both countries. Since the methodology of this thesis is an *ex-post* evaluation, the focus within this chapter is devoted to some key findings of previous *ex-post* evaluations. According to Plummer, Cheong and Hamanaka (2010), FTAs that already entered into force can be evaluated with three types of analyses: preference indicators, trade and welfare indicators as well as the gravity model. The gravity model is a popular econometric tool to estimate trade flows after an FTA entered into force. Many scholars use it since data is readily available and the effects of an FTA on trade can be isolated. Therefore this tool has high explanatory power and is frequently used (Armstrong, 2015; Navarrete & Tatlonghari, 2018). Liu (2018) for instance analyzed all FTAs of China (including the one with Switzerland) and found that the majority of FTAs increased bilateral trade. Another often used approach is the quantitative or qualitative analysis of trade creation and trade diversion (Plummer, Cheong & Hamanaka, 2010). Besides these two approaches, the use of so-called preference indicators is wide-spread. The most popular preference indicators used are the coverage rate, utility rate and the utilization rate. Often the calculations are done based on customs data. Alternatively, the data may be retrieved via firm-level surveys. The most frequently used preference indicator is the utilization rate. Many scholars also argue that it has become more important to "know the extent of FTA utilization" (Hayakawa, Laksanapanyakul & Shiino, 2013, p.2). One way of measuring the utilization

would be to divide the number of FTA using firms by the total number of exporters and importers. However, this method is only seldomly used by researchers. Most studies calculate the utilization on a value-basis with customs data rather than a number basis (Hayakawa, Laksanapanyakul & Shiino, 2013). Studies that are using trade data as a source are quite numerous (Blind & Ziltener, 2014; Hayakawa, Kim & Lee, 2014). Blind and Ziltener (2014) for instance analyzed the utilization rate of multiple FTAs of Switzerland based on import data provided by the target countries. While many countries and regions openly provide such detailed trade statistics (e.g. Canada, EU or Mexico), there are also countries which do not have or do not make the necessary data available (e.g. Japan or South Korea). Few studies also use the number of CoOs as a proxy for the utilization rate (Hayakawa, 2014; Käch, 2015). Some researchers have also conducted utilization studies based on firm-level surveys (PwC, 2018; Schaub, 2012; Thomson Reuters & KPMG, 2015). These firm-level studies are often repeated on an annual basis in order to see a potential improvement. Researchers of PwC for instance, asked Australian businesses about their experience with using FTAs and found that 78% of all importers and 62% of all exporters use at least one Australian FTA (PwC, 2018). Thomson Reuters and KPMG jointly conducted a utilization study covering 11 countries found that around 70% of their responding firms are not fully utilizing FTAs (Thomson Reuters & KPMG, 2015). Hence, most firms are paying more tariffs than they should. This brings us to another major issue on which a vast amount of research has been done: reasons for non-use of FTAs. Oftentimes, utilization studies based solely on trade statistics do no shed any light on the reasons for a given level of utilization. Firm-level surveys can identify such reasons (Plummer, Cheong & Hamanaka, 2010). Schaub (2009) found that cost of information, negligible savings, logistics, restrictive RoO, time consumption, firm characteristics and incoherent RoO among different FTAs are the most common reasons for firms not to use an FTA. Firms often perceive the tariff savings as negligible when the so-called preference margin is too low. Schaub (2009) indicated that a 4 to 10% reduction from the MFN tariff is necessary in order to cover the administrative costs of a FTA. Anson et al. (2003) indicated that oftentimes compliance costs (around 6%) are higher than the average preferential margin of around 4%. In the case of Mexico, an even higher preference margin of 10% is necessary to compensate for the compliance costs that occur (Carrère & Melo, 2004). Also the firm characteristics mentioned by Schaub is found in other studies. Hayakawa (2012) found that larger firms are more likely to utilize an FTA than smaller firms. There is evidence that smaller firms are per se disadvantaged because large

firms are able to increase exports. As a consequence, prices are pushed up in the industry (Ulloa & Wagner, 2012).

Overall, there are more quantitative than qualitative studies. There are however a couple of studies which are mixed methods. Vuento (2013) for instance, applied a mixed-method for his study on the utilization of the EU-Korea Free Trade Agreement.

2.7 Current Research Status (SSFTA)

While FTAs in general are well researched, only few studies have been done on the SSFTA so far (Atteslander & Engelhard, 2018). The Swiss Chinese Joint Study Group (2010) estimated that China increasingly will import goods from Switzerland due to the SSFTA. Hence, Switzerland might take over some market share from other competitors (USA, EU, Japan). Overall, the SSFTA was estimated to enhance bilateral trade and economic welfare of both countries. Furthermore, the SSFTA should positively impact the trade of watches and watch components by "enhancing two-way trade and improving conditions for cross-border business-to-business cooperation" (Swiss Chinese Joint Study Group, 2010, p.55). These findings are consistent with other feasibility studies. However, the primary focus of this chapter is to give insights into *ex-post* research.

Atteslander and Engelhard's (2018) argument that a lack of research still exists is mainly due to the fact that not all effects are cut clear and visible, as the SSFTA only entered into force in 2014. Many benefits have not yet been fully materialized. Nonetheless, there are already a number of scholars that have analyzed the impact of the SSFTA. A business survey from 2015 found that for the vast majority of participants (89%) the SSFTA had no real benefit. The participating firms were moderately enthusiastic and not really satisfied with the SSFTA. As of 2015, the report indicated that "usage and the benefits of the concluded agreement do not seem to be realized that easily and passing through that smoothly" (SwissCham Shanghai, 2016, p.7). 7 out of the 138 participants were watchmakers. In 2017, the survey was repeated and came to improved results (SwissCham Shanghai, 2018). The percentage of firms that saw no real benefit from the SSFTA dropped from 89% in 2015 to 63% in 2017. Moreover, 54% of the firms indicated to use the SSFTA, compared to 38% in 2015. A majority still encountered obstacles when using the SSFTA. It does not only take longer until goods are

processed with the SSFTA than without it, but Swiss companies also face other difficulties such as red tape, complying with the direct transportation rule or a lack of knowledge by the Chinese customs authorities. The most important study was perhaps the one published in September 2018 by the Sino-Swiss Competence Center (SSCC) of the University of St. Gallen with the support of multiple Chinese universities as well as other research partners (SSCC, 2018). The results of their survey are not too dissimilar from the SwissCham business survey from 2017. Almost 40% of the Swiss firms and more than 46% of the Chinese firms were using the SSFTA in 2017. A utilization study based on trade data has also revealed that around 42% of exports from China and 44% exports from Switzerland utilized the SSFTA in 2017. According to this report, the Swiss customs authorities would earn around 300 Mio. CHF if no goods received preferential treatment and were to be imported with the MFN tariff rate. Of course, the SSFTA leads to a substantial reduction in tariff revenue for the Swiss customs authorities but on the other hand "could mean that Swiss customers had to pay less for Chinese products or that Chinese export firms and Swiss import firms could increase their profits" (SSCC, 2018, p.23). Moreover, the report approximated that around 110 Mio. CHF of duties could be saved thanks to the application of preferential tariffs under the bilateral agreement. They also outline the importance of watch components being imported duty free thanks to the SSFTA. The watchmaking industry mostly benefits on the export side. According to their estimation, 75% of all watches are exported under preferential tariff. Since utilization rates for most of the imports from China are still below 50% there is still room for improvement. The report compared the utilization rates to other FTAs of Switzerland and finds that China as of 2017 was somewhere in the middle. The study found higher utilization rates for the FTAs with Mexico (62%) and Korea (59%) but lower utilization rates for the FTAs with Canada (24%) and Japan (27%). For imports from Switzerland's biggest trading partner Germany the study obtained a comparatively high utilization rate of 71%. On an aggregate level, the study concludes significant trade creation effects. Due to the SSFTA Switzerland imported around 2.5 Bn. USD more from China and China around 1.3 Bn. USD more from Switzerland in 2017. Furthermore, their business survey concluded that Chinese firms are significantly more satisfied than the participating Swiss firms (SSCC, 2018). This is another justification for this study and a good reason why the satisfaction level of Swiss firms is to be closely observed in the future.

Interestingly, a master thesis carried out in 2015 specifically focused on the utilization within the watchmaking industry (Käch, 2015). This is so far to the best of my knowledge the only

sector-specific study on the SSFTA. Due to the unavailability of Chinese customs data the utilization rate for Swiss watch exports had to be calculated based on Swiss customs data, such as the number of Approved Exporters and CoOs. The study found high utilization rates on the export of Swiss watches (89%) and on the import of watch components (72%), already in the first year of the SSFTA. Even though the SSFTA led to high savings for watchmakers, the study came to the result that the savings resulting from duty free exports to Hong Kong are still significantly higher. Hong Kong's zero tariff policy still provides huge advantages and Swiss watchmakers would not prioritize a direct export to China (Käch, 2015).

Another organization which is frequently analyzing the utilization of FTAs is Switzerland Global Enterprise (S-GE). S-GE promotes exports of Swiss firms on behalf of the SECO and the Swiss cantons. According to S-GE, importers and exporters that "strategically exploit these FTAs can significantly increase their competitiveness" (S-GE, n.d., p.2). In one of their publications they describe successful business cases. By complying with the relevant rules, many firms are able to make significant savings thanks to the SSFTA. The exemption from import tariffs is a very good selling point for Swiss exporters. Using the SSFTA does not only mean that the customer in China does not have to pay any or a reduced import tariff, but margins in general are being improved. Regardless of how high the tariff savings are, products (at least partially) from Switzerland stand for high-quality and therefore a successful compliance with the RoO can be used as a selling point. The administrative burden with RoO and processes that need to be aligned within a firm is still a major challenge for Swiss firms.

3 Watchmaking in Switzerland

The Swiss watch industry has managed to maintain its leadership and uncontested dominance in the industry for many decades. In order to understand the drivers behind the industry's constant dynamism, creativity and ability to overcome technological and structural difficulties, this section aims to shed light on the uniqueness of Swiss watchmaking, its success path and interests within the SSFTA.

3.1 History of Horology

The first important milestone in the history of Swiss watchmaking was the appearance of the watch and clock industry in Geneva in the 16th century. In 1541, Jean Calvin banned the displaying and wearing of jewelry in the whole area. As there were many goldsmiths situated in Geneva a radical rethinking to another art was needed: watchmaking. Refugees from Italy and France supported these goldsmiths by teaching them how to make watches. Soon watches from Geneva were famous for their high quality and had established a great reputation for excellence by the start of the 17th century. Competition was fierce and the concentration of watchmakers in Geneva rose to a high level. That is why many watchmakers started setting up businesses a little bit North - in the Jura Mountains. Over the next century, watchmaking began to spread to the cantons of Neuchatel, Solothurn and Berne. By the end of the 18th century, the city of Geneva was already exporting 60,000 timepieces (FH, 2019). That time can also be characterized by its many innovations and the industry continued to flourish. The first perpetual watch was created by Perrelet in 1770, Louis Moinet invented the first chronograph in 1816 and Adrien Philippe created the first pendant winding watch in 1842 (FH, 2019). Even though so-called "arm watches" have been developed since the 1570's, the first real wristwatch was created in 1812 by Abraham-Louis Breguet and a team of 17 craftsmen. He carried out an order from Napoleon Bonaparte's younger sister and queen of Naples, Caroline Murat (Breguet, 2019; De Pimodan-Bugnon, 2018). Interesting at that time was that wristwatches were mainly worn by women whereas men wore pocket watches.

In the early 20th century, Swiss watchmakers added new functions to their watches, such as the calendar or the stop watch function. Moreover, Rolex rolled out the first waterproof watch in the 1920's. The first automatic watch was created shortly after in Grenchen (canton of Solothurn). The invention of the quartz watch in 1967 marked the start of the biggest crisis in watchmaking. The Swiss watch industry lost their competitiveness and half of the companies as well as nearly 65% of employment disappeared starting from the 1970's (Donzé, 2012). Japanese and American watchmakers seized the opportunity while Swiss watchmakers failed due to their inability in developing mechanical watches and their mass-production. Cheap and electronic watches from abroad were about to extinguish the tradition of Swiss watchmaking. The introduction of quartz watches greatly disrupted the industry and made mechanical watches almost obsolete. The management consultant and designer Nicolas G. Hayek and his company Swatch rescued the Swiss watchmaking industry in 1983 - an industry that previously had been written off by many people - through the introduction of the Swatch. The Swatch was characterized by a trendy, fun and democratic design at an affordable price that hit the pulse of the time.

Besides dozens of technological innovations, the watchmaking industry has always been operating in a unique institutional environment and has been facing some structural changes. Up until the 1960's, it was neither allowed for Swiss watchmakers to source parts of a watch from abroad nor to invest in production facilities abroad. Outward Foreign Direct Investment (OFDI) was nonexistent except for sales offices. A liberalization of the cartel took place between 1961 and 1965 (Donzé, 2018). This marked the start of multinational enterprises and a globalization of the value chain. Already in 1966, many companies started producing low-value-added parts of the watch (e.g. cases and straps) in places like Hong Kong or Singapore. Another important institutional milestone was the implementation of the Swiss Made Law in 1971, which guaranteed the maintenance of a certain part of production in Switzerland (Donzé, 2018).

After periods of emphasis on traditional know-how, technological advancement and structural changes, the 1990's marked yet another big achievement. It was Jean-Claude Biver who was one of the key entrepreneurs responsible for moving the industry to luxury (Donzé, 2018). First, he relaunched Blancpain with a campaign focusing on tradition and heritage in 1983. Later, he also repositioned the brand Omega in the 1990's. A repositioning of the brand towards its history, the development of the co-axial movement as well as the organization of

events and appointment of brand ambassadors were amongst the core elements of his brilliant marketing strategy which was quickly imitated by other watchmakers (Donzé, 2018). Rolex for instance has for many consecutive years won the award of the world's most reputable brand (Reputation Institute, 2019). Consequently, the watchmaking industry's success took off. Even though the volume of watch exports decreased drastically from 51 Mio. in 1993 to 36 Mio. pieces in 2000, the value of exports skyrocketed from only 5.9 Bn. CHF in 1990 to 9.4 Bn. CHF in 2000 (Donzé, 2018). These numbers stand symbolically for the change from quartz production towards luxurious brands focusing on tradition and craftsmanship.

Over many centuries, the Swiss watchmaking industry distinguished itself through a tremendous innovation ability and is still one of Switzerland's oldest and most representative industry today. Nonetheless, it has always been very sensitive and vulnerable to global economic and political developments due to the industry's dependency of demand of foreign markets. According to an estimation of Credit Suisse in 2013, 95% of the watch industry's production is exported (Feubli et al., 2013). Trade statistics reveal that watches have been the second most important export good of Switzerland during from 1840 to 1937. Today, the watchmaking industry is still of utmost importance for Switzerland, as described in more detail in the next section.

3.2 Sector Profile

The watchmaking industry accounts for around 1.5% of Switzerland's GDP. After the chemical and machine industry it is the third largest export sector. Watch exports from Switzerland to abroad accounted for 6.7% of total exports in 2018 (ITC, 2019a). This value has peaked in 2011 at 8.7% and has remained stable in the last two decades, as illustrated in Figure 3-1. Hence, watchmaking is highly important for creating jobs and welfare, not to mention its reputational benefits for Switzerland in general.

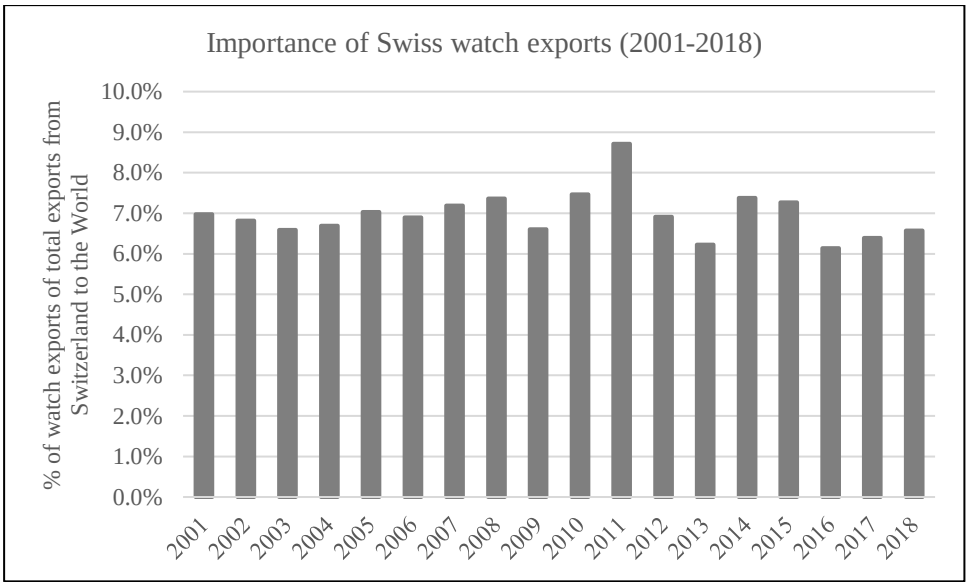

Figure 3-1 Watch Export in % of Total Exports (author based on ITC, 2019a)

Switzerland exported 23.7 Mio. units in 2018, which is around half a million less than in 2017 and compared to the value of around 51 Mio. units in 1993 almost half (FH, 2019a). Interestingly, only quartz watches are steadily decreasing in the number of units over the last few decades, whereas the number of mechanical watches exported are continuing to grow. Whereas Switzerland might be the dominant player in terms of value of watch exports, two countries clearly outperform Switzerland. China (656 Mio. units) and Hong Kong (204 Mio. units) exported a lot more watches than Switzerland in 2018 and are indeed serious competitors for the Swiss watch industry – at least in terms of quantity (FH, 2019a).

Swiss watches priced over 500 CHF grew not only in terms of units but also value. However, low-priced watches declined in both units and value, continuing their downward trend. Steel remains the most popular component for watches (59%) while other materials (24%) and other metals (10%) are ranked 2nd and 3rd, respectively. On average, precious metals only account for 2% in terms of units, but account for 33% of the value of the watch (FH, 2019a).

Since many years, Hong Kong remains the most important export market with watches imported worth around 2.81 Bn. CHF. The United States ranks second with 2.10 Bn. CHF and China third with 1.65 Bn. CHF. Hong Kong (+19.1%) and China (+11.7%) have also been amongst the fastest growing markets in 2018 (FH, 2019a). The big markets behind (sorted in descending order of export value) are Japan, UK, Germany, Singapore, France and Italy. All of these markets combined are still a little bit less important than the three biggest markets together, Hong Kong, the US and China.

Currently there are around 700 watch companies headquartered in Switzerland, most of them in Geneva and the Jura Arc (Presence Switzerland, 2017). The majority of watchmakers are small or midsized and less than 10 firms have more than 500 employees (Swiss Chinese Joint Study Group, 2010). For the purpose of giving an overview of the most important watch brands, Table 1A in the Appendix A has been created and illustrates the major brands in the industry. The three largest watch companies in terms of sales and market share are Swiss: the two conglomerates, the Swatch Group (19.2%) and Richemont (16.3%), and the independent manufacturer Rolex (12%). Ever since the 1990's many of the brands have adopted new marketing strategies. As a consequence, most of them found their unique niche market and clientele. Whereas the conglomerate Richemont and its famous brands such as Vacheron Constantin, Piaget or Jaeger-LeCoultre focused more on craftsmanship and history, the French Conglomerate LVMH developed a strong position in the fashion industry. The Swatch Group owns subsidiaries covering almost every customer segment. Another trend that started in the 1990's was that watchmakers combined their forces. As an example, the Swatch Group owned 11 brands in 1990, whereas in 2019 it owns 18 brands besides owning companies dedicated to produce watch movements or parts, such as ETA or Nivarox. Table 1A in the Appendix A illustrates the different brand strategies that have been followed. Munz (2015) classified their newly established brand identities into five main pillars: luxury, tradition, craftsmanship, history and heritage. The diversification of brands and the comprehensive range of different watches has indeed been one of the major strengths of the Swiss watch industry. There is not only a wide offering of timepieces ranging from sports watches to gold watches with grand complications, but there is also a constant stream of newly introduced watches (FH, 2019b).

3.3 Importance of Hong Kong and China

The combined imports of Hong Kong, China, Taiwan and Macau from Switzerland clearly show the great importance of Greater China. As of 2018, all areas combined add up to almost one third of every watch exported out of Switzerland. This represents almost a doubling of the figures compared to 2000. Hence, it is of great importance to understand the rapid growth of these areas, especially of Hong Kong and China.

For more than many decades, Hong Kong has been an important hub for Swiss watches. The Special Administrative Region Hong Kong is a customs territory independent from Mainland China under its own trade policy. The city does not levy any customs duties. Besides the function of an open market, Hong Kong was and still is a favorable place to do business because of its functioning rule of law system. That is why the port city has been an ideal place for Swiss watchmakers (Feubli et al., 2013). In 2008, Hong Kong took over the leading import position of Swiss watches from the US and kept this position ever since. The export statistics from Switzerland surely overstate the importance of Hong Kong to a certain degree. Firstly, because most of the watches being exported to Hong Kong are redistributed to Mainland China as well as the whole Southeast Asian area. Secondly, most of the buyers in Hong Kong are tourists from Mainland China, as discussed in more detail below.

In 2001, Switzerland exported watches worth only 5.3 Mio. CHF directly to China. Back then, China was not even close to make it for the top 15 export markets for Swiss watches. However, the geographical structure of exports has altered drastically within almost two decades. In 2018, the value of exported watches from Switzerland to China amounted to 1.65 Bn. CHF. This significant increase since the turn of the millennium can be explained through the rise in purchasing power and the expansion of China's middle class and their appetite for luxury goods both, domestically and in foreign countries. As a rule of thumb and rough estimation of experts every second Swiss watch in 2019 is worn by a Chinese.

Indeed, Chinese consumers are currently the main reason for a positive growth trend of luxury spending and their share of global luxury spending is an overwhelming 33% as of 2018 (D'Arpizio et al., 2019). It is estimated that Chinese consumers will account for 46% of all sales of luxury goods worldwide by 2025. By then, half of their purchases will also be made at home in China. Even though Chinese more often do their purchases of luxury abroad as of 2018, their luxury spending at home has grown twice as fast than abroad. Of course, this development would benefit Swiss watchmakers that directly export under the SSFTA and therefore, could perhaps enjoy an even greater competitive advantage than companies situated in a country with a less strong bilateral relationship. There are other figures that also predict a bright future for Swiss watch sales: According to a KPMG Survey, Swiss watches are among the most popular luxury items of the Chinese consumers (Mehra et al., 2013). Furthermore, Switzerland ranks 8th in the best international luxury travel destinations of Chinese and 4th in international destinations for spring and winter holidays (The Hurun Research Institute,

2018). Besides Switzerland, Chinese prefer to do their luxury shopping in Hong Kong, Singapore, Dubai (UAE), France, Germany and Italy (Feubli et al., 2013). There are two main reasons for Chinese to do these luxury purchases abroad. Firstly, the fear of buying a fake product in China is still too big. Secondly, luxury products are more expensive in China mostly due to the fact that China imposes a consumption tax on the import of certain product categories (cigarettes, alcohol, yachts, golf equipment, cosmetics, jewelry, watches etc.). High-value watches (>10,000 CNY) that are being imported have a 20% consumption tax levied on their retail value in addition to a VAT of 17% (State Taxation Administration of China, 2009). That is why many consumers are no longer willing to pay the price premium, especially when they find the same products abroad at a much lower price. This has led to a phenomenon called Daigou, which is a grey market for imports of certain goods to China aiming at avoiding locally leveraged taxes and duties. These activities are usually done by smuggling luxury goods as a tourist or by shipping goods via mail from outside China.

3.4 Watchmaking and the SSFTA

Chapter 2.3 introduced the numerous bilateral relationships that Switzerland holds as of 2019. The extensive experience of negotiating FTAs has certainly helped in setting up the SSFTA. Consequently, the interests of the watchmaking industry are well known by the SECO. A good relationship between the FH and the SECO with frequent interactions helps to update each other on the current negotiations as well as on a possible change of interests. However, the FH aimed at a harmonization of the SSFTA not only with previously negotiated FTAs, but also with current regulations in order to avoid unnecessary complications for the watch exporters. In literature, the issue of conforming to multiple FTAs and different regulations is known as the spaghetti-bowl. The SSFTA is not much different for the watch industry than any other FTA. The Value of Non-originating Materials (VNM) has been set to 40% for the HS Chapter 91 and watchmaking goods. All VNM percentages of the other chapters within the SSFTA were being set to 60%. At first glance, this might seem to impose a significant disadvantage for the watchmaking industry. However, the VNM value on purpose has been set to 60%. This has been specifically requested by the watch industry and the aim of it is to be in line with both previous FTAs as well as the Swiss Made Law. The latter limits foreign contribution at a level of 40%.

In spite of Chapter 11 which is about IPR the most important and tangible aspect of the SSFTA for the watchmaking industry is certainly the reduction of tariffs (FDFA, 2013). The preferential tariff in the whole Chapter 91 for imports from China to Switzerland has been set to zero. A few examples of the most important HS Codes are illustrated in Table 3-1.

Table 3-1 Schedule of Concessions of Switzerland (author based on FDFA, 2013)

HS Code	**MFN Tariff**	**Preferential Tariff**
9111.2000 (watch cases of base metal)	0.12 CHF / each	0 CHF
9113.2000 (watch straps, watch bands and watch bracelets of base metal)	238 CHF / 100 kg	0 CHF
9113.9000 (watch straps, watch bands and watch bracelets, other)	133 CHF / 100 kg	0 CHF
9114.3000 (dials)	88 CHF / 100 kg	0 CHF

Figure 3-2 on the other hand illustrates the non-linear tariff concessions granted by China. It can be seen that watch exports from Switzerland to China are still being heavily taxed as of 2019 and tariffs are either reduced or eliminated over a time period of 10 years.

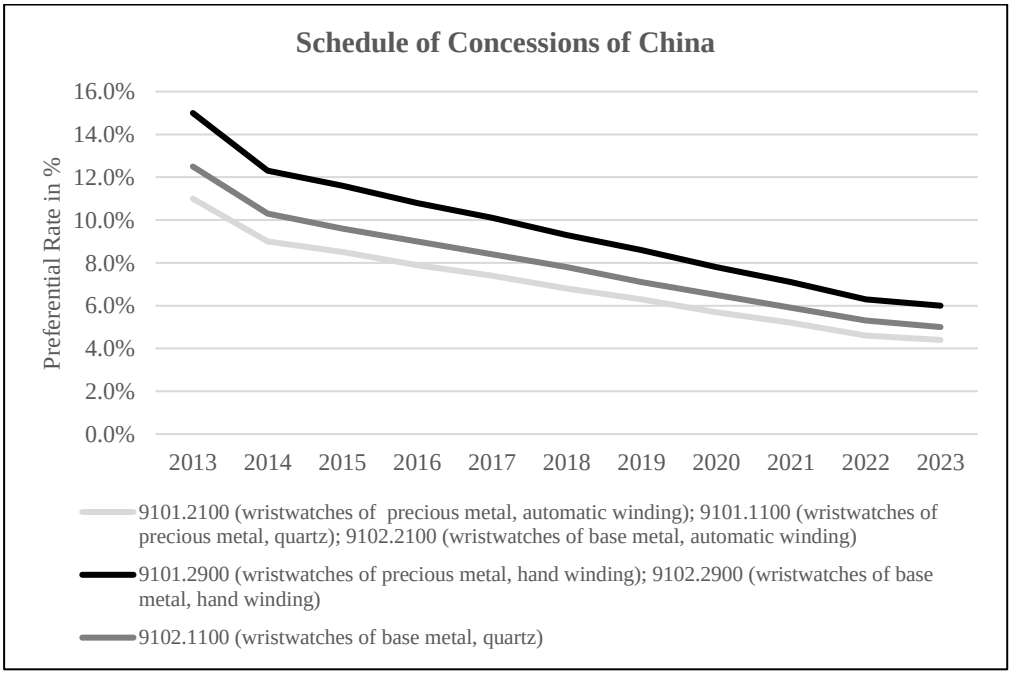

Figure 3-2 Schedule of Concessions of China (author based on FDFA, 2013)

The optimists would say that a gradual tariff elimination allows firms to adapt to the new market environment more smoothly. Nonetheless, the watchmaking industry certainly wished not only for a full tariff elimination but also one that is effective immediately.

4 Methodology and Data

As discussed in Chapter 2.6, the majority of studies that examined FTAs are of quantitative nature. The range of methodologies however is quite broad also including a few types of mixed-method designs. In order to answer the research questions of this study, a Convergent Parallel Mixed-Method provides the most appropriate framework. According to Creswell (2014), in this design "the investigator typically collects both forms of data [quantitative and qualitative] at roughly the same time and then integrates the information in the interpretation of the overall results" (p.44). Figure 4-1 illustrates the applied methodology. A more detailed description of the study design, the data collection procedure as well as some strengths and limitations of the quantitative and the qualitative part of this study are presented in Chapter 4.1 and Chapter 4.2, respectively.

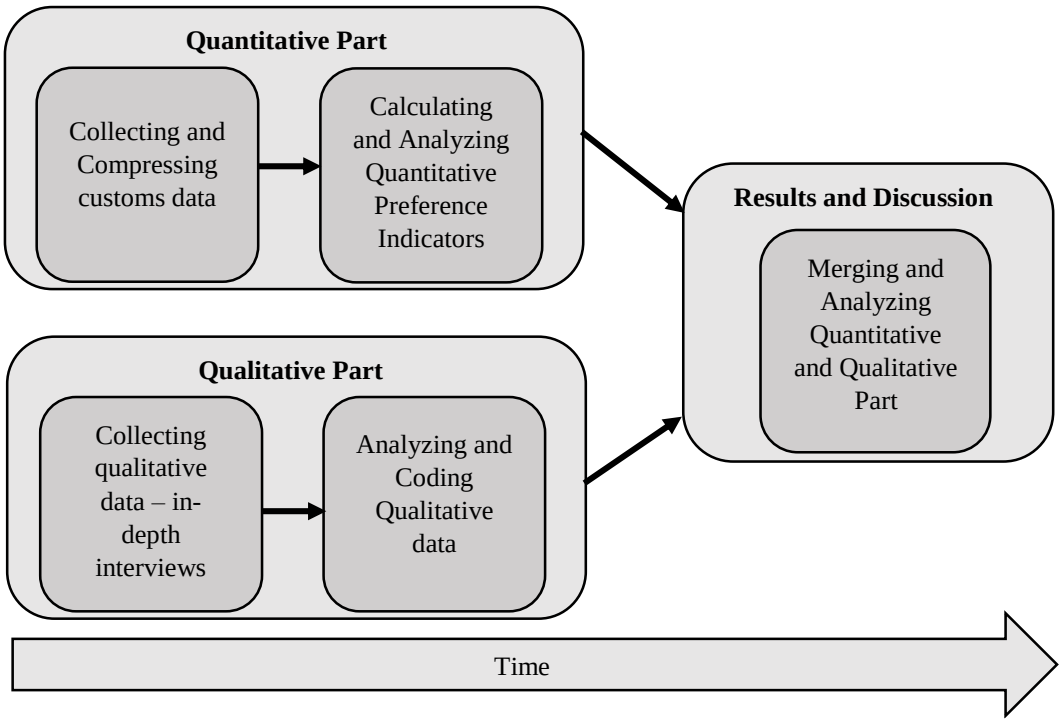

Figure 4-1 Convergent Parallel Mixed-Method (author based on Creswell, 2014)

4.1 Quantitative Indicators

In order to find out more about the degree of utilization on the import of watch components from China to Switzerland three key indicators are calculated. This study uses very similar calculations to the previously mentioned studies by Blind and Ziltener (2014), Käch (2015) and Plummer, Cheong and Hamanaka (2010). The customs data was kindly provided by the Federal Customs Administration (FCA) of Switzerland. The FCA made a usually non-public and very extensive raw dataset available that contains every import of watch components from China to Switzerland over the last four years. This dataset will be used for the calculation of all subsequent FTA preference indicators.

4.1.1 Utilization Rate

Plummer, Cheong and Hamanaka (2010) define the General Utilization Rate (GUR) as "the degree to which preference-eligible dutiable import enter under preferential – rather than MFN – tariffs" (p.76). It is important to note that the utilization rate is not the same as the utility rate, which also takes non-eligible goods into account. The GUR can be stated as follows:

$$\textbf{General Utilization Rate (GUR)} = \frac{\text{preferential imports (under the SSFTA)}}{\text{total eligible imports}} \qquad (1)$$

As can be seen in (1), a greater value of the GUR implies a higher share of preferential imports to total eligible imports. Also, this could imply that the compliance costs of RoO of the SSFTA are certainly not a high constraint. The GUR is not only one of the most frequently used indicator to measure FTA utilization, but the measure is also known as providing a good first overview. The GUR can be easily calculated provided the necessary customs data is made available. Some drawbacks of the measure would be that it shows an overly optimistic utilization (Käch, 2015) and also does not identify any reasons behind a potential high or low utilization.

4.1.2 Realized Tariff Savings

The realized tariffs or duty savings can be calculated by multiplying the goods which are imported under the preferential SSFTA tariff with the difference between SSFTA rate and the MFN rate. In this case, since Switzerland set all of its import tariffs to zero, the denominator is basically just the MFN rate. In order to arrive at the total realized savings, the results of all subchapters of HS Chapter 91 are added together. The Realized Tariff Savings can be calculated in accordance with the following formula (2):

$$\textbf{Realized Tariff Savings} = \sum (\text{imports with preferential tariff} \times \text{respective MFN rate}) \qquad (2)$$

Compared to the basic calculation of the GUR, the realized savings quantifies the actual savings that are made by Swiss watchmakers thanks to the SSFTA. The figure shows the direct benefit for exporters using the SSFTA in a meaningful and precise way (Blind & Ziltener, 2014).

4.1.3 Potential Tariff Savings

On the other hand, the Potential Tariff Savings shows the tariffs that are still paid today by importers but could potentially be avoided. The Potential Tariff Savings can be derived through the calculation of the following formula:

$$\textbf{Potential Tariff Savings} = \sum (\text{all eligibile imports - imports with preferential tariff}) \times (\text{respective MFN rate}) \qquad (3)$$

When interpreting (3), it is important to note that all the savings in each of the positions in HS Chapter 91 are only hypothetical values. These savings could only be achieved if all rules within the SSFTA are adhered to (Blind & Ziltener, 2014).

4.2 Qualitative Approach

In addition to the quantitative analysis, qualitative interviews will be carried out. Previous studies have indicated that it is challenging to receive data from foreign customs authorities (Blind & Ziltener, 2014; Käch, 2015). Hence, this study follows a qualitative approach to

investigate the utilization of the SSFTA on the export side. That is why five watchmakers in Switzerland have been interviewed, either face-to-face or over the phone. These interviews can be classified as repeated, structured in-depth interviews. Many of the large watch manufacturers do have certain policies that prohibit any exchange of sensitive information with students. Due to this reason, the small sample of watchmakers contains three small (50 to 100 employees), one midsized (500 to 1,000 employees) and only one large firm (2,000 to 5,000 employees).

In addition to interviews within the Swiss watch industry, four semi-structured "key informant face-to-face interviews" (high-level interviews) have been carried out in Switzerland and China. For this purpose, the researcher travelled to Beijing for an interview with the Swiss Embassy and to Shanghai for an interview with the Swiss Centers. In Switzerland, interviews with the State Secretariat for Economic Affairs (SECO) in Berne and the Federation of the Swiss watch industry (FH) in Bienne were held. If necessary, follow-up e-mails and phone calls were carried out after the face-to-face interview for further clarification. Moreover, many other informants (e.g. customs office, FTA experts, tourism director, etc.) were contacted on a frequent basis in order to gather further topic-related information. To validate the responses from the interviewees, each semi-structured interview touched upon the same themes enabling the researcher to triangulate answers with high credibility.

In a qualitative study, ethical considerations are of high importance. As the interviews sometimes revealed firm-internal data and confidential information, anonymity of the data has been ensured to all participants. During the whole study no name of the firms as well as participants will be mentioned and anonymity will be fully guaranteed. Throughout the whole analysis part, the interviewed watchmaking firms are given the term "watchmaker" and the key informant interviewees will be named "experts". Furthermore, each participant would get a study report upon request.

As with the quantitative part, also the qualitative part is subject to certain limitations. It is important to bear in mind, that interviews provide information that is filtered through the eyes of the interviewee (Creswell, 2014). Depending on the openness, professional know-how and communicative abilities of the participant, the extent of information provided can vary greatly and it might be difficult to retrieve all the necessary information (Creswell, 2014).

5 Results and Discussion

In this chapter, the results are presented and analyzed with reference to the overall aim of the study. This chapter will build on the previous chapter by applying the methodology outlined. Firstly, the quantitative analysis on the import of watch components from China to Switzerland are presented and discussed. In a second step, this chapter analyzes the collected qualitative data from a total of nine interviews with watchmakers and experts within the industry.

5.1 Quantitative Part

As already described in more detail before, the activities of Swiss watch manufacturers were closely monitored and the import of watch components, such as cases or straps, was completely prohibited until the beginning of the 1960's (Donzé, 2018). But ever since the appearance of multinational enterprises in the 1980's, buying certain components such as dials, straps and cases from abroad has been a common practice. Despite that trend, the partially revised Swiss Made directive of 2017 stipulates that at least 60% of the production cost of a watch are being generated in Switzerland. Furthermore, half of the value a movement must consist of components produced in Switzerland and a minimum of 60% of the manufacturing costs must have occurred in Switzerland. It is no secret however, that less crucial watch components are sourced from abroad (IPI, 2016). The movement of the Swiss watches - the heart of every watch - is so far to the best of my knowledge not being provided from abroad. Less important components such as straps, cases and dials are sourced mainly for watches priced below 2,500 CHF. Players in the luxury segment are able to make these parts in Switzerland at a significantly higher cost, whereas smaller companies are almost forced to import certain parts. Nicolas G. Hayek of the Swatch Group for instance indicated that "no piece made in China concerns our haut de gamme production or the Swatch" (Time Business, 2005). The supply of components from China played an important role since the turn of the millennium. Total imports from the whole HS Chapter 91 (Clocks and watches and

parts thereof) from China into Switzerland from January 1, 2018 to December 31, 2018 amounted to more than 721 Mio. CHF. In the previous years, imports increased in the period of 2014 to 2016 from 790 Mio. CHF to 882 Mio. CHF, followed by a drastic decrease to 627 Mio. CHF in 2017. Despite a temporary fall in imports in 2017 the import numbers have been increasing sharply, especially compared to 2001, when imports were worth only around 179 Mio. CHF. The two main products being imported from China to Switzerland are cases for wrist-watches (HS Code 9111) and watch straps (HS Code 9113).

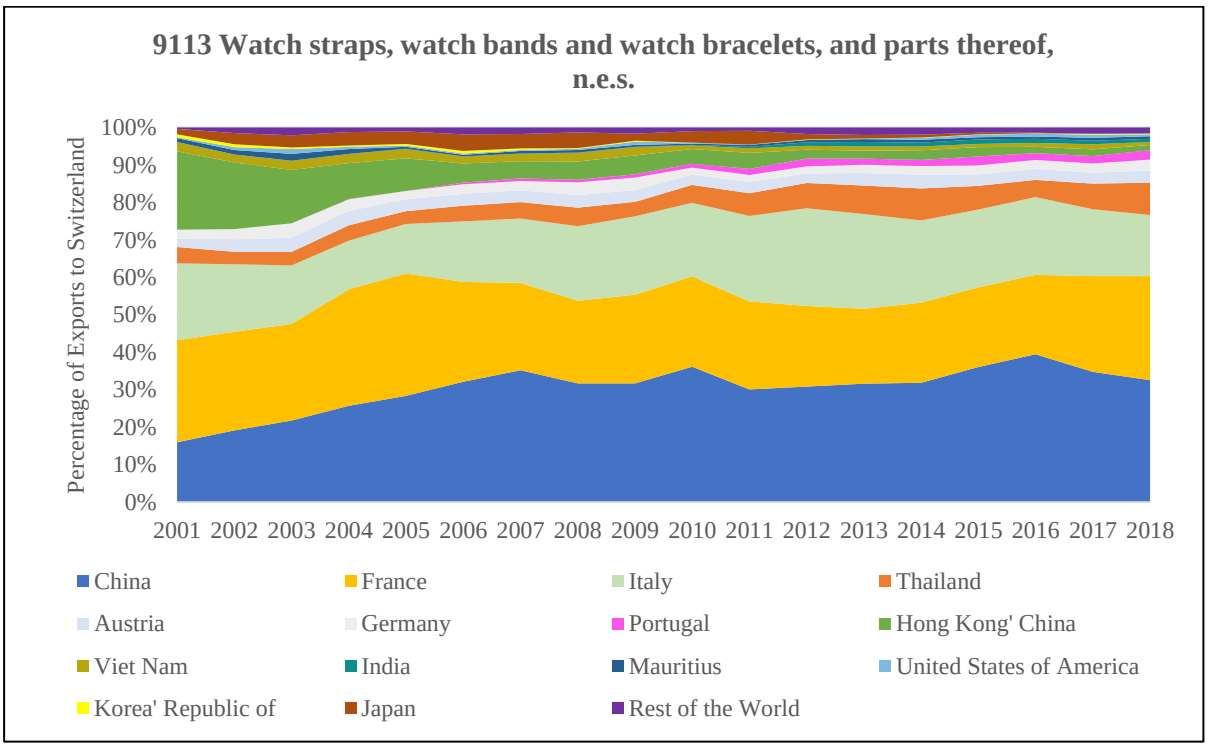

Figure 5-1 Import of watch straps – countries (author based on ITC, 2019a)

In 2018, watch straps have been the most important import positions for the watch industry. Out of a total value of 728 Mio. CHF, watch straps worth around 237 Mio. CHF came from China, followed by France (202 Mio. CHF), Italy (119 Mio. CHF) and Thailand (63 Mio. CHF). The majority of watch straps imported from China into Switzerland are made out of base metals (non-precious metals, also gold- or silver-plated) and amount to 196 Mio. CHF. Whereas China could gain some market share of watch straps in the period from 2001 to 2007, the share of watch straps imported from China stagnated since 2007 at around 30% (ITC, 2019a).

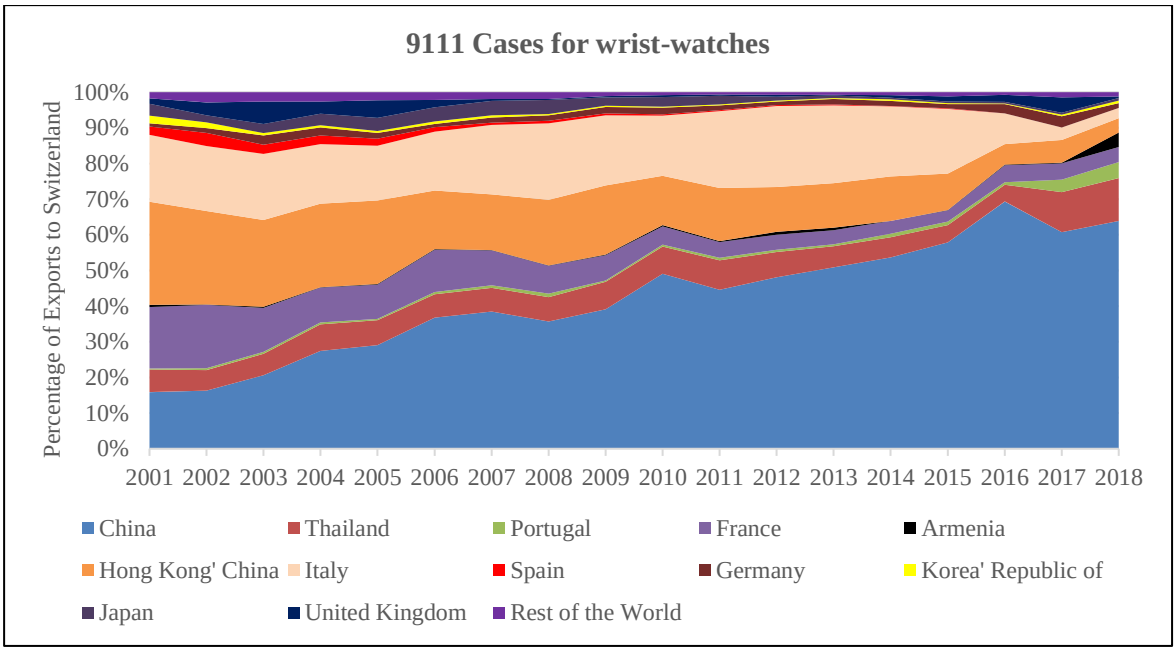

Figure 5-2 Import of cases – countries (author based on ITC, 2019a)

The second biggest position are cases for wrist-watches (HS Code 9111) with total imports of around 503 Mio. CHF out of which around 321 Mio. CHF stem from China (ITC, 2019a). As of 2018, China holds an all-time high of 64% market share of all cases imported into Switzerland. Besides China, Thailand exports cases worth around 60 Mio. CHF to Switzerland. As with watch straps, most cases are of base metal (imports worth 292 Mio. CHF) and only a negligible share is of precious metals (365,000 CHF). This perfectly reflects the fact that watch components from China are mainly used for low-priced watches by small and mid-sized firms. Nevertheless, most of these watches in the lower-priced segment still fulfill the "swiss-made" criteria. China's exports of other watch parts (HS Code 9114 Clock or watch parts, such as dials) with a value of 95 Mio. CHF are not as high as other supplying countries (e.g. Thailand 123 Mio. CHF or France 105 Mio. CHF). This section of descriptive import statistics will be followed by the results in the following chapter, which are based on the previously introduced formulas.

5.1.1 General Utilization Rate

The relevant data stems from a non-public raw dataset (Import e-dec) provided by the Swiss Customs Authorities, covering the years 2014 to 2018. Each yearly dataset contained every shipment of watch components (around 90,000 rows for every year) in detail and included various variables such as date, country of origin, net weight, gross weight, number of units,

amount of customs duty, 8-digit HS Code, statistical value, VAT value and most importantly, whether the respective shipment entered Switzerland under preferential or MFN tariff.

It is important to recall, that an FTA is in no way an automatism – as assumed in many *ex-ante* evaluations. A utilization rate of 100% is therefore highly unrealistic. In order for a company to receive preferential treatment compliance with documentation, shipment as well as the rules of origin is necessary. All of this results in higher costs for the producer. Consequently, many firms decide to bear the duty premium and do not apply for preferential tariff treatment.

Before the SSFTA entered into force on the 1st of July 2014, exports from China to Switzerland could benefit from the General System of Preference (GSP). This system gave China vital market access to Switzerland and in general "allows vulnerable developing countries to pay fewer or no duties on exports" (European Commission, 2019, n.p.). Therefore, certain imports of the Chapter 91 have been duty free already before 2014. With the SSFTA entering into force in July 2014, China's status as a developing country under the GSP was removed. It is argued that China's status would have been removed with or without the SSFTA, since other major economies have also removed China from their GSP list. The EU for instance removed China and could therefore increase the tariff revenue by an estimated 4 Bn. USD. As a consequence, tariffs for imports from China into Switzerland would have been very likely to be increased in 2014 without the SSFTA (Legge, Lukaszuk & Evenett, 2018; SSCC, 2018).

Out of the total components imported from China that are eligible for preferences (around 722 Mio. CHF), approximately 468 Mio. CHF actually entered under preferential tariff. As illustrated in Table 5-1, the GUR increased from 64% in 2017 to 64.9% in 2018. Despite this slight increase, compared to the GUR of 73% reported by Käch (2015), utilization of the SSFTA seems to have decreased. This is surprising considering the average GUR of the last 5 years of around 66%.

Table 5-1 General Utilization Rate (own calculations)

Year 2017	**Year 2018**
GUR: $\frac{401{,}353{,}252\ \text{CHF}}{627{,}089{,}222\ \text{CHF}} \times 100 =$ **64 %**	GUR: $\frac{468{,}294{,}463\ \text{CHF}}{721{,}549{,}048\ \text{CHF}} \times 100 =$ **64.9 %**

Many studies expect utilization to steadily increase over time. In this case, the GUR remained stable between 62% and 73%. Furthermore, this percentage is relatively high compared not only to other HS Codes, but also to other FTAs. There are a few explanations for these patterns. Unlike many other countries, the collection of duties in Switzerland is mostly based on the gross weight. That might be a reason why the weight-based system may not translate into big savings for Swiss watchmakers. Even though Chapter 91 is one of the few were some imports are also calculated on a unit-base, the potential savings are limited. The two highest tariffs imposed by Swiss customs authorities on imports within Chapter 91 are the following:

- 9113.1000, Watch straps, bands and bracelets of precious metal (3,863 CHF/100 kg)
- 9114.1020, Springs (419 CHF/100 kg)

As can be seen in Table 1B in the Appendix B, these positions do not play a significant role compared to other HS Codes. The imported VAT values are significantly higher in the HS Codes 9111 and 9113 of watches of base metal. In addition, the MFN tariffs are relatively low. Hence, many watchmakers might decide to pay the slightly higher MFN tariff and at the same time not go through the whole documentation process that would be necessary under the SSFTA. Another important reason for the non-use might be practical reasons. As will be outlined later, procurements of shipments under the SSFTA can take up to 1-2 days longer than regular shipments. Therefore, many importers would inform their Chinese counterpart to leave out the documentation and not apply for preferential treatment. Besides practical reasons, the import volume and value are other determining factors. For instance, one watchmaker imported 1,100 kg of watch cases of base metal worth 416,877 CHF on the 12th of April 2018. In this case, it made sense for the watchmaker to plan the import and ask the Chinese counterpart to apply for preferential treatment. In doing so, the Swiss watchmaker was able to save 12,100 CHF on one single shipment. On the other hand, the administrative burden imposed on the Chinese supplier might be too big for a very small shipment. The most straightforward reason for a non-utilization of the SSFTA might be that the Chinese products simply do not comply with the RoO and therefore, an application for preferential tariffs is not possible from the start. Overall, the utilization is perceived as relatively high on the import of Chinese watch components despite the slight decline since 2015. Swiss watchmakers were able to directly save money on the import of watch components, as will be outlined in the next section.

5.1.2 Realized and Potential Tariff Savings

The direct benefit of an FTA for a producer (exporter) is limited to lower tariffs on the import of components. For the costs caused by the completion of documents or potential changes to sourcing and production processes the producer (exporter) does not get a direct benefit. The indirect benefit for the producer to bear these costs is only to increase the competitiveness, unless the importing party is a subsidiary of the exporter and overall profitability of the group could be improved. Therefore, the realized and foregone savings outlined in this section are directly saved by Swiss watchmakers. And since China was removed from the GSP list of Switzerland, these savings are likely to be mostly thanks to the SSFTA. As illustrated in Figure 5-3, Swiss watchmakers were able to save almost 3 Mio. CHF in duties in 2018 thanks to the SSFTA.

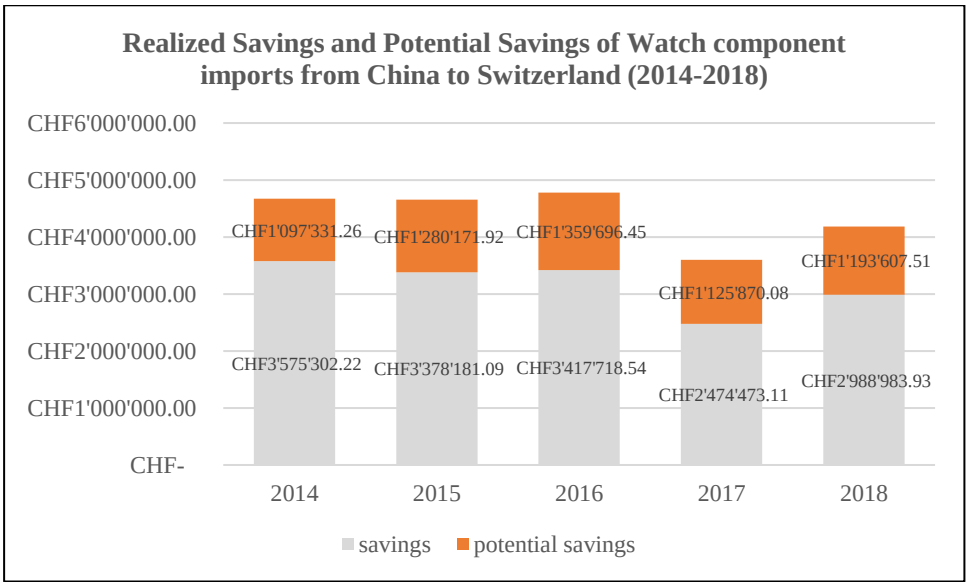

Figure 5-3 Realized and Potential Tariff Savings (own calculations)

On the other hand, almost 1.2 Mio. CHF of duties are still being paid, but potentially could enter under preferential tariffs as well. However, it is important to note that this is just a hypothetical value and the aforementioned reasons outlined why a non-utilization in certain cases is inevitable.

Table 5-2 Realized Tariff Savings (own calculations)

HS Code	Description	Weight/Units	MFN Tariff	Saved Tariff
9113.2000	Watch straps, bands and bracelets (of base metal)	519225.4 kg	238 CHF/100 kg	1,235,756 CHF
9111.2000	Watch cases (of base metal)	9114147 units	0.12 CHF/unit	1,093,697 CHF
9111.9010	Watch cases (backs, front cases with glasses)	1416875 units	0.17 CHF/unit	240,868 CHF
9113.9000	Watch straps, bands and bracelets (other)	128899.3 kg	133 CHF/100 kg	171,436 CHF

The realized savings are concentrated in mainly two HS Codes: Watch straps of base metal (9113.2000) and watch cases of base metal (9111.2000), where the savings amounted to 1.23 Mio. CHF and 1.09 Mio. CHF, respectively (See Table 5-2). It is the same two HS Codes that also have the biggest remaining potential for tariff savings (See Table 5-3). All detailed calculations of the realized tariff savings and potential savings of every HS Code can be found in Table 1B and Table 2B in the Appendix B.

Table 5-3 Potential Tariff Savings (own calculations)

HS Code	Description	Weight/Units	MFN Tariff	Potential Tariff Savings
9111.2000	Watch cases (of base metal)	3232054 units	0.12 CHF/unit	387,846.48 CHF
9113.2000	Watch straps, watch band and watch bracelets (of base metal)	73218.7 kg	238 CHF/100 kg	174,260.51 CHF

5.2 Qualitative Part

In this part, the results of the five interviews with watchmakers and the four interviews with experts are presented and discussed. The interviews were conducted between March and May 2019 in Switzerland and China. Previous studies within the Swiss watch industries have shown that it could be a challenging task to get interviews with Swiss watchmakers. Therefore, I decided to follow a rather unusual way to approach them. I visited many watch companies without any invitation, handed over a letter which stated the purpose of my study and asked to briefly introduce myself to an employee in the export department of the firm. In 40% of the cases this approach worked well and a subsequent face-to-face or telephone interview was scheduled. Despite the fact that this approach was time and cost consuming, I highly recommend it for similar future studies. The interviews lasted between 25 minutes and 1.5 hours. Therefore, an extensive set of data has been collected and a coding into the most relevant themes was absolutely necessary. These themes contain the unmodified key points mentioned by the interviewees and ideally should relate directly to the research questions. In order to maintain anonymity and confidentiality, none of the detailed interview transcripts are being published. Nonetheless, a sample questionnaire of an interview with a watchmaker is included in the Appendix B. It has to be noted that the interviews with the watchmakers followed a structured methodology, whereas the questions for the experts have been adapted to the knowledge and expertise of the specific interviewee.

5.2.1 Importance of Hong Kong and China

As a start into the interview, many interviewees were asked about their opinion on the importance of Hong Kong and Mainland China. As Chapter 3.3 has shown, Hong Kong still is in the lead in terms of import value from Switzerland. Considering Mainland China's tremendous growth on the other hand leads to one important question that has to be asked: Is Hong Kong at risk of being ousted from its leading position for Swiss watch imports by China in the near future?

As discussed in more detail in Chapter 3, the historical context of China is very important. One expert makes a reference to his early days in the watch industry, when a delegation of Chinese regularly came to Switzerland in order to decide on the precise quantity and type of timepieces to be imported to China. Whereas China at that time was largely run by state-owned enterprises (SOEs) who decided on how many watches to be imported and the market was much closed, Hong Kong was a free port for tons of products from early on. Hong Kong turned into the most important hub for the redistribution of Swiss watches to the whole South East Asian area. Therefore, the export statistics certainly overstate the importance of Hong Kong as a market where watches are actually bought. One expert mentioned that a few years ago, 80% of all watches exported to Hong Kong were reexported again. But he also adds that this percentage has decreased for sure. It was only later with the opening of China that Swiss watchmakers started opening up first showrooms and later own distributers in China itself. However, the ease of doing business so far was mainly enjoyed by larger watchmakers. Smaller watchmakers still heavily depend on the redistribution hub of Hong Kong. Setting up a functioning distribution network is still more difficult in China than in Hong Kong, where many watchmakers have loyal distributers. One expert draws attention to the rule of thumb that nowadays every second watch is worn by a Chinese citizen. This fact simply cannot be ignored by any Swiss watchmaker. Hong Kong has certainly lost some influence in the most recent past but will still act as a major hub in the coming years. There is also a consensus of all watchmakers interviewed that China's role as a direct export market will increase further. As half of the tariff reductions still lie ahead, direct exports are expected to continuously increase until 2024. Nevertheless, most of the watchmakers have set up a functioning network with Hong Kong and are still confronted with some major challenges of doing business in China, as will be discussed in the upcoming sections.

5.2.2 Overall Satisfaction Level of the SSFTA

Despite a challenging 2015 and 2016, the watch exports to China have been on an increasing trend in the last few years. Swiss watchmakers are generally speaking satisfied with the development of the Chinese market. The main benefit of the SSFTA is of course the duty reduction. One prevalent nuisance that almost all interviewees agree upon is the fact that tariffs will not be completely eliminated. A renegotiation of the tariff elimination schedule is a matter of principle according to many voices in the industry. According to them, free trade implies zero tariffs. Nonetheless, the savings are still a lot larger than without the SSFTA. According to multiple interviewees there has also been a significant improvement regarding practical aspects of the SSFTA. An important contact point for potential complaints of the Swiss watch industry mentions the two most challenging issues faced in the beginning:

- Shipment delays: Many watchmakers complained about the customs clearance in 2014 and 2015. Suddenly, it took many days for documents to be procured. That is why many watchmakers have switched back to the MFN tariffs in the beginning. As of 2019, these complaints have been non-existent. I interpret this as a sign that the SSFTA is working quite well.
- Document checks: Frequently, double and triple checks have been carried out by Chinese customs authorities on Swiss watch exports. The authorities were unfamiliar with the exact procurement and afraid to make mistakes. One large watchmaker indicates that the FTA with China caused them more problems compared with other FTAs of Switzerland and the interviewee said that “at the beginning it felt like we knew more than the customs authorities”. However, the situation has also improved a lot since around two years.

Another expert mentions the issue concerning the direct transportation rule. As a landlocked country, Switzerland has to trade via other ports in Europe. China has far more entry points than Switzerland and a lot of coordination and training is necessary. Many experts indicate that the procurement situation is good in Beijing, Shanghai and Guangzhou. Things can get more complicated at entry points elsewhere in China due to increased grey zones. Meanwhile, the issue regarding the direct transportation rule has been solved thanks to intensive and regular contact between the two customs authorities.

Overall, it has to be stressed that the majority of issues are not because of the SSFTA but rather a result of different procedures, other legal frameworks and of course, culture. The Chinese customs authorities are very collaborative, practical and open for discussions. The Swiss Center in Shanghai has already set up twice a roundtable, where problems of Swiss companies are discussed with the Chinese customs authorities. There is a continuously ongoing dialogue between the two parties and the frequent exchanges are perceived as exemplary, also considering the different legal frameworks and completely different political systems. Summarizing all the voices in the industry, it can be said that out of the many exporting watchmakers the vast majority is content with the current situation. This finding is in line with the survey results of the SwissCham for instance, that found an increasing trend in satisfaction in their two business surveys from the years 2015 and 2017. There are few watchmakers that complain about implementation issues and another group that simply does not decide to take advantage of the SSFTA for certain reasons, as will be further elaborated upon in the next section.

5.2.3 Determinants of Non-Utilization

To gauge the aggregate level of satisfaction of Swiss exporters is relatively easy, whereas calculating a precise utilization rate on the export of watches from Switzerland to China is much more of a challenge. The impacts on the import side were accurately calculated in Chapter 5.1. Unless the detailed Chinese import statistics are made available, the utilization rates on the export side can only be estimated. Therefore, the focus of this study will not be to estimate a utilization rate on the export side, but rather to find some patterns and determinants of a (non-) utilization of the SSFTA.

Out of the five interviewed watchmakers, two currently use the SSFTA on the export of watches, one used it in the past and another two have never used it before. This fact allowed to analyze both determinants of utilization and non-utilization of the agreement. Given that a firm's product fulfills the RoO, basically any firm is allowed to use the agreement, but it is important to understand that utilization in the end is a corporate policy decision. One expert also mentioned that the agreement certainly is a competitive advantage, but it is not the key. Another expert agreed with this statement by indicating that if a firm has a great product it will find its way to China with or without the agreement. One small watchmaker with around 50-100 employees currently uses the agreement. The firm ships their goods directly to China

via FedEx. Since the company is not registered as an approved exporter, it has to order the CoO from the chamber of commerce. When being asked about the impact that the preferential tariff has on the profit margin, the interviewee hesitates and says: "This is a difficult question. The agreement so far had a rather subtle effect and it is not like I would remember the 1st of July 2014 as a day that changed everything. On the other side however, such benefits can quickly be taken for granted and I believe the impacts will be more felt in 5 years." On the contrary, a large watchmaker is also using the agreement, but is an approved exporter. The firm is present in more than 90 cities in China and has used the agreement ever since the start. On an aggregate level, the preferential tariffs have a quite big effect on the profit margin. This watchmaker had to adjust the whole ERP system at the beginning of the SSFTA in order to comply with all the necessary documentation. Whereas the benefit for the three watchmakers that use(d) the SSFTA is very straightforward and limited to reduced tariffs, the reasons for a potential non-utilization are more diverse as outlined in the literature review. One watchmaker does not use the SSFTA because the potential benefits are relatively small, and a utilization would impose an administrative burden. The interviewee said that "currency fluctuations of 5 to 10% thus play a far more significant role". One other watchmaker also does not use the agreement because the benefits are not perceived as large enough. As outlined also in Chapter 2.6 and in many other studies, this is often referred to as the margin of preference which is the absolute difference between the preferential tariff and the MFN tariff. Of course, the preferential margin has to be related to the cost of utilization. Estimating the cost of utilization is not an easy task and might differ from firm to firm. An important factor that might have impacted the non-utilization is the fact that China has lowered the MFN tariffs on many HS Codes in 2019 (See Table 5-4).

Table 5-4 Preference Margins 2014 and 2019 (author based on ITC, 2019b)

HS Code	MFN 2014	MFN 2019	SSFTA 2014	SSFTA 2019	Preference Margin 2014	Preference Margin 2019	Export Volume 2018
9102.2100	11%	11%	9%	6.30%	2%	4.70%	1.2 Bn. CHF
9102.1100	12.50%	10%	10.30%	7.10%	2.20%	4.90%	374 Mio. CHF
9101.2100	11%	8%	9%	6.30%	2%	1.70%	255 Mio. CHF
9101.1100	11%	8%	9%	6.30%	2%	1.70%	48 Mio. CHF

In the most important tariff line for the watch exports to China (9102.2100: mechanical wristwatches with automatic winding of base metal) the MFN tariff has not been lowered. For other important export positions the MFN tariff has been lowered. This makes the utilization of the SSFTA less attractive and in two cases (HS Codes 9101.2100 and 9101.1100) even led

to a lower preferential margin in 2019 than in 2014, when the agreement entered into force. Overall, the findings indicated that small watchmakers are not disadvantaged per se as found by Hayakawa (2012), but might face a slightly bigger administrative burden. And so far, only a minority of watchmakers are approved exporters and hence for most users usage is not yet facilitated. It can be concluded that regardless the status of the company, all of the interviewed users are reporting about smooth procedures nowadays, after having dealt with some initial implementation issues. And all watchmakers which are currently not using the agreement will consider a utilization in the near future. Until then, they will rely on their distribution network in Hong Kong. All of them have an agent in Hong Kong, who reexports the watches from Hong Kong into China so far. The most common determinants of non-utilization found in this study – negligible savings and administrative burden – can also be found in numerous previous studies (e.g. Schaub, 2009). Additionally, all of the interviewed watchmakers indicated that the compliance with the VNM Rule (maximum value of 40% of non-originating materials) as well as the Swiss Made directive was never an issue, and also is not a decision-making factor against the utilization of the SSFTA. All the interviewed watchmakers indicated that they (would) fully comply with the RoO with the exception of one collection of a small watchmaker. The interviewee indicated that (a not important) collection contained more than 40% foreign inputs and the SSFTA has been one of the reasons why this collection as a consequence was dropped completely. One expert also indicated that watches that contain a lot of gold and diamonds are not able to conform with the RoO and have to be exported under the MFN tariff. None of the watchmakers mentioned that this would be an issue.

The five interviewed watchmakers were also confronted with the previously calculated savings on the import of watch components. All of the three smaller watchmakers said that they use components from abroad. One watchmaker buys its watch straps in China, whereas cases and dials are shipped from Thailand and India. All small watchmakers agreed that they were forced to import components already many years ago, as the firm had to stay competitive compared with large competitors operating in the low-end segment. Another small watchmaker mainly sources cases and straps from China. The interviewed midsized and large watchmakers operating in the premium segment did not indicate that watch components from China played a significant role in the sourcing of inputs. This confirms the prior assumption that mainly smaller watchmakers are forced to outsource production of complete watch components to a certain degree. When confronted with the potential savings, the

watchmakers indicated that the imports have been duty free since a long time already (see GSP system outlined earlier that probably would not exist any longer!). Depending on the import volume, many indicate that some savings can be made. However, these tariff savings are perceived as marginal.

Despite the fact that the overall satisfaction has improved significantly, the interviews still revealed some patterns as to why some watchmakers still may not use the SSFTA.

5.2.4 Other Challenges

Since the effects of the SSFTA so far are perceived by many as marginal, I took the opportunity to also ask the watchmakers about other maybe more relevant issues for their business activities in China. The most frequent challenges mentioned were the economic slowdown, currency fluctuations, Chinese tourism flows, changes in consumer behavior, distribution channels, e-commerce, IPR and most importantly – the luxury tax.

It is not only the import tariff that is still perceived as being too high, but the import tariff, VAT and luxury tax all together. The luxury tax (or also called consumption tax) for high-quality watches above 10,000 CNY was introduced in 2006 (State Taxation Administration of China, 2009). Ever since its introduction, the tax has been amongst the main issues for watchmakers operating in the high-end segment. One of the small watchmakers mentioned in the interview that for his watches (average price between 300 and 600 CHF), the luxury tax does not apply for direct exports to China. On the other hand, one of the large watchmakers that exports massive amounts to China mentioned the luxury tax as being the biggest issue to be resolved. The interviewee indicated that the firm's watches sold in China are priced between 10-15% above the price in other countries, not solely due to the luxury tax but also because of the import tariff and a higher VAT than usually. This figure is coherent with Patek Philippe's activities in China. Rosy Gao of Patek Philippe mentioned in a public interview that their watches sold in China are "around 14-18% more expensive" (SwissCham, 2018, p.22). However, the gap between prices in China and elsewhere seems to be narrowing as one expert mentioned. An industry expert said that the luxury tax is simply a discriminatory fiscal measure and a very easy tool for governments to collect tax revenues. That is why similar luxury taxes are also applied for Swiss watches in other countries, like for instance in Argentina or Chile. There have been some attempts to fight against the tax, for instance by the

former federal councilor Doris Leuthard in 2007 (Gnehm, 2007). None of the efforts so far have led to a result. Therefore, it remains a constant fear within the watch industry that the luxury tax remains in place or even gets raised. However, it is not only luxury suppliers that demand changes but also the Chinese people. One expert mentions that there is an increased pressure for the government stemming from the fact that Chinese citizens want to buy their luxury bags, jewelry and watches at home at an affordable price. Because what happens if the luxury tax remains this high or is even increased? Purchases abroad will increase and with it also smuggling activities. The phenomenon of the Chinese luxury product consumers abroad has been described in Chapter 3.3. It is inevitable for Swiss watchmakers to be up-to-date concerning the Chinese tourist flows. One of the biggest jewelers in Switzerland also generates around 40% of its sales with Chinese tourists. Chinese tourists generally speaking buy almost every type of watch, but there has been a trend in the recent years towards less "bling-bling" and showoff. The average price of a watch bought by a Chinese in Switzerland has decreased. When being asked about the potential impact of a further increase of the luxury tax on the Chinese purchasing behavior abroad, a tourism expert said that watch sales in the tourist hot spots such as Lucerne or Interlaken would surely decrease but certainly not collapse. The emotional aspect and the experience will always play a role and remember Chinese tourists of their holidays in Switzerland. The further tariff eliminations under the SSFTA will make watches in China cheaper, but the next 5 to 10 years will show whether Chinese customers will buy these products increasingly at home, or whether the role of tourism remains pivotal for watch sales.

Another challenge and opportunity for Swiss watch firms that emerged in the last decade and that almost turned into a buzzword in the last few years is e-commerce. Some experts argue that there even need to be special regulations included in the SSFTA. Other FTAs include regulations on, for instance, e-procurement, paperless trading and e-signatures such as the Japan-Switzerland FTA. Whereas digital sales constitute for a large portion of total sales of one of the small watchmakers, larger watchmaker's digital strategies are prudent and hesitant so far. One interviewee of one of the small watchmakers said that their business model is all about e-commerce. As a comparatively less well-reputed brand, e-commerce still offers a broad access to the Chinese consumers for them, but competition as well as advertising costs have dramatically increased in the last two years. Whereas many watchmakers have already started selling watches online in China (e.g. Carl F. Bucherer, Chopard, Zenith, Audemars Piguet, TAG Heuer etc.), only very few (e.g. Patek Philippe) are able to avoid e-commerce so

far but even more so in the long run. E-commerce is not Patek Philippe's world and the brand still heavily relies on personal buying experience. However, not many brands will be able to completely avoid China's e-commerce platforms. Since many premium brands are doing well at the moment, they are certainly less risk taking and not questioning their current business models. As a summary, it can be said that the ones who will be able to well orchestrate the interfaces between online and offline activities will be the successful ones in the long run.

IPR infringement is a systemic problem in China and can to a certain degree be explained by their cultural history. And of course, Swiss watches (mostly mechanical watches) have been counterfeited since a long time already. The SSFTA contains a chapter about IPR. Within the SSFTA a working group for watchmaking has been created. Furthermore, the Swiss Federal Institute of Intellectual Property (IPI) and the MOFCOM were celebrating their 10th year anniversary this year. Moreover, almost every Swiss watchmaker is closely observing the online and offline market for counterfeits and is cooperating with the FH. Therefore, we can say that cooperation and a dialogue between the two countries has long been established, but the counterfeited goods have not diminished so far. IP legislation in China is relatively modern, but IPR enforcement is still a big issue outside of the cities of Beijing, Shanghai and Guangzhou and successful litigation cases in the watch industry remain limited. According to an interviewed expert, "we are approaching a point where the Chinese realize that immaterial value such as a brand idea exists but it will take another long time to understand that you cannot play with that".

6 Conclusion

In times when economic superpowers increasingly engage in trade protectionism and a multilateral approach to global issues becomes more complex, it is important to recall that there has been a global proliferation of bilateral and regional FTAs within the last years. Although the SSFTA has not been the key for success of Swiss businesses in China, it represents a competitive advantage for Swiss watchmakers. Direct exports of Swiss watches to China have experienced tremendous growth in the past two decades. The strong desire for luxury products as well as a growing middle-class will further increase direct exports of Swiss watches to the middle kingdom. The upcoming tariff concessions will support this trend. However, the implementation of the SSFTA is in no way an automatism for utilization. Therefore, it is increasingly important to know the extent of utilization rather than to know potential impacts with *ex-ante* evaluations. This thesis applied a Convergent Parallel Mixed-Method in order to quantitatively assess the potential and realized savings of Swiss watchmakers on the import of watch components from China as well as qualitatively explore the barriers and difficulties encountered by Swiss watchmakers on the export of watches to China. The utilization rate and the savings are calculated based on the e-dec import dataset provided by the Swiss customs authorities. Furthermore, nine in-depth interviews were carried out with watchmakers and experts in the watch industry.

The two major import positions of watch components from China are watch straps and watch cases of base metal. This reflects the trend since the turn of the millennium towards increased usage of foreign watch parts exclusively in the low-end segment. Based on customs data, a utilization rate of 64.9% was calculated on the import of watch components from China to Switzerland. In 2018, the exporting watch companies have saved almost 3 Mio. CHF thanks to the SSFTA, while the foregone tariff savings amounted to around 1.2 Mio CHF. Compared to previous years and former studies this value has slightly decreased but overall remained stable. The biggest realized savings are concentrated in the HS chapters watch straps of base metal and watch cases of base metal. On the export of Swiss watches, the results obtained of this thesis are less quantifiable and accurate. Nonetheless some key determinants of non-utilization have been found. While some small watchmakers still prefer their distribution

network via Hong Kong, others find that the SSFTA presents an administrative burden and offers negligible duty savings so far. Nonetheless, utilization on the export offers a competitive advantage and big savings for others, and the utilization rate is estimated to be larger than on the import side. Moreover, users are increasingly satisfied with the customs clearance and practical problems have been solved within five years. One remaining wish of the industry is a renegotiation of the tariff concession schedule and therefore a complete tariff reduction on the export of Swiss watches to China. According to industry voices, this is a matter of principle of free trade. Besides challenges like China's weakening economy, e-commerce or IPR the interviewees indicated that the luxury tax imposes a significant burden on direct exports to China and makes products up to 18% more expensive than elsewhere. Nonetheless, the SSFTA has offered Swiss watchmakers significant additional benefits of doing business in China and only *time* will show, whether utilization will increase even further in the near future.

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Appendix A

Table 1A: Positioning of watch brands

Production Market	Segment	Price	Swatch Group	Richemont	Bulgari	LVMH	Hermès	Gucci	Independent Brands
Dominated by Switzerland	Exclusive Watches	More than CHF 8,000	Breguet Glashütte Jaquet Droz Léon Hatet Blancpain	A. Lange und Söhne Piaget Vacheron Constantin	Daniel Roth Gerald Genta				Patek Philippe F.P. Journe Audemars Piguet Franck Muller Roger Dubuis Parmigiani Ulysse Nardin
Large Market Share held by Switzerland	Accessible Watches	CHF 1,000 to CHF 8,000	Omega Longines Rado Union	Jaeger-LeCoultre IWC Cartier Van Cleef & Arpels Officine Panerai Baume & Mercier Montblanc Dunhill	 Bulgari	Zenith Chaumet Ebel Louis Vitton TAG Heuer Dior	 Hermès	Bédat & Co. Boucheron Yves Saint Laurent Gucci	Rolex Girard Perregaux Chopard Tiffany Hublot Breitling
Majority of Market Share held by Asian countries (e.g. Japan and China)	Low- and midpriced Watches	CHF 1 to CHF 1,000	Tissot Mido Certina Hamilton Pierre Balmain Endura Swatch Flik Flak						Eterna Festina Maurice Lacroix Mondaine Sector Titoni Seiko Casio

Appendix B

Table 1B: Calculations of Realized Tariff Savings of the HS Chapter 91 (01.01.2018 – 31.12.2018)

Note: The Realized Tariff Savings are either calculated based on the Gross Weight (per 100 kg) or per Unit.

TN	Country of Origin	Preferential Tariff	Gross Weight	Units	FTA Rate	MFN Rate	Realized Tariff Savings	VAT Value
9102.1100	China	Yes	35976.4	339668	CHF -	CHF 0.17	CHF 57,743.56	CHF 2,923,708.00
9102.1200	China	Yes	4436.8	40688	CHF -	CHF 0.25	CHF 10,172.00	CHF 269,858.00
9102.1900	China	Yes	827	7983	CHF -	CHF 0.26	CHF 2,075.58	CHF 61,751.00
9102.2100	China	Yes	236	1358	CHF -	CHF 0.27	CHF 366.66	CHF 66,049.00
9102.9100	China	Yes	551.8	18120	CHF -	CHF 0.23	CHF 4,167.60	CHF 40,782.00
9102.9900	China	Yes	89	1350	CHF -	CHF 0.25	CHF 337.50	CHF 5,175.00
9103.1090	China	Yes	297.9	400	CHF -	CHF 0.22	CHF 88.00	CHF 7,476.00
9105.1100	China	Yes	40238.4	226423	CHF -	CHF 46.00	CHF 18,509.66	CHF 1,250,336.00
9105.1900	China	Yes	904.4	3960	CHF -	CHF 46.00	CHF 416.02	CHF 21,927.00
9105.2100	China	Yes	111727.3	126601	CHF -	CHF 49.00	CHF 54,746.38	CHF 1,410,689.00
9105.2900	China	Yes	480	500	CHF -	CHF 47.00	CHF 225.60	CHF 2,129.00
9105.9100	China	Yes	7537	7123	CHF -	CHF 49.00	CHF 3,693.13	CHF 133,148.00
9106.1000	China	Yes	4432.4	34604	CHF -	CHF 52.00	CHF 2,304.85	CHF 123,032.00
9106.9000	China	Yes	5728.3	35734	CHF -	CHF 52.00	CHF 2,978.72	CHF 105,725.00
9107.0000	China	Yes	22438.7	110005	CHF -	CHF 51.00	CHF 11,443.74	CHF 185,132.00
9108.1100	China	Yes	25	2445	CHF -	CHF 0.49	CHF 1,198.05	CHF 8,165.00
9108.1900	China	Yes	53	12100	CHF -	CHF 0.49	CHF 5,929.00	CHF 3,141.00
9108.2000	China	Yes	0.1	546	CHF -	CHF 0.51	CHF 278.46	CHF 138.00
9110.9000	China	Yes	10	20	CHF -	CHF 88.00	CHF 8.80	CHF 3.00
9111.1000	China	Yes	0.8	2	CHF -	CHF 1.10	CHF 2.20	CHF 13,956.00

9111.2000	China	Yes	465984.5	9114147	CHF	-	CHF 0.12	CHF	1,093,697.64	CHF 205,276,399.00
9111.8000	China	Yes	4703.9	172855	CHF	-	CHF 0.13	CHF	22,471.15	CHF 1,366,339.00
9111.9010	China	Yes	18817.4	1416875	CHF	-	CHF 0.17	CHF	240,868.75	CHF 9,131,045.00
9111.9090	China	Yes	9656.4	108902	CHF	-	CHF 73.00	CHF	7,049.17	CHF 7,613,278.00
9112.2010	China	Yes	1564	3320	CHF	-	CHF 41.00	CHF	641.24	CHF 34,391.00
9112.2090	China	Yes	382	1400	CHF	-	CHF 30.00	CHF	114.60	CHF 23,390.00
9113.1000	China	Yes	43	490	CHF	-	CHF 3,863.00	CHF	1,661.09	CHF 20,095.00
9113.2000	China	Yes	519225.4	8536070	CHF	-	CHF 238.00	CHF	1,235,756.45	CHF 167,842,777.00
9113.9000	China	Yes	128899.3	9151308	CHF	-	CHF 133.00	CHF	171,436.07	CHF 28,505,165.00
9114.3000	China	Yes	33035.9	3794368	CHF	-	CHF 88.00	CHF	29,071.59	CHF 37,399,516.00
9114.4000	China	Yes	7.3	n.a.	CHF	-	CHF 88.00	CHF	6.42	CHF 2,397.00
9114.9000	China	Yes	10823	2016378	CHF	-	CHF 88.00	CHF	9,524.24	CHF 4,447,351.00
								CHF	**2,988,983.93**	**CHF 468,294,463.00**

Table 2B: Calculations of the Potential Tariff Savings of the HS Chapter 91 (01.01.2018 – 31.12.2018)

Note: The Potential Tariff Savings are either calculated based on the Gross Weight (per 100 kg) or per Unit.

TN	Country of Origin	Preferential Tariff	Gross Weight	Units	FTA Rate	MFN Rate	Potential Tariff Savings	VAT Value
9101.1100	China	No	111.2	343	CHF -	CHF 1.10	CHF 377.30	CHF 45,892.00
9101.1900	China	No	8.5	28	CHF -	CHF 1.10	CHF 30.80	CHF 2,764.00
9101.2100	China	No	60.8	98	CHF -	CHF 1.10	CHF 107.80	CHF 785,052.00
9101.2900	China	No	1.6	3	CHF -	CHF 1.10	CHF 3.30	CHF 168,812.00
9101.9100	China	No	66	1031	CHF -	CHF 1.10	CHF 1,134.10	CHF 27,612.00
9101.9900	China	No	11.3	95	CHF -	CHF 1.10	CHF 104.50	CHF 1,660.00
9102.1100	China	No	143885.9	745442	CHF -	CHF 0.17	CHF 126,725.14	CHF 30,614,423.00
9102.1200	China	No	6307.4	43452	CHF -	CHF 0.25	CHF 10,863.00	CHF 850,422.00
9102.1900	China	No	10632.1	41871	CHF -	CHF 0.26	CHF 10,886.46	CHF 1,995,259.00
9102.2100	China	No	6516.9	30474	CHF -	CHF 0.27	CHF 8,227.98	CHF 2,965,197.00
9102.2900	China	No	1282.3	7767	CHF -	CHF 0.26	CHF 2,019.42	CHF 512,747.00
9102.9100	China	No	3179.4	21552	CHF -	CHF 0.23	CHF 4,956.96	CHF 439,648.00
9102.9900	China	No	3854.6	12003	CHF -	CHF 0.23	CHF 2,760.69	CHF 195,982.00
9103.1010	China	No	3	2	CHF -	CHF 0.92	CHF 1.84	CHF 178.00
9103.1090	China	No	3263.1	15210	CHF -	CHF 0.25	CHF 3,802.50	CHF 123,721.00
9104.0000	China	No	162.2	617	CHF -	CHF 0.25	CHF 154.25	CHF 58,432.00
9105.1100	China	No	34930.2	132612	CHF -	CHF 46.00	CHF 16,067.89	CHF 19,706.00
9105.1900	China	No	2077.2	6580	CHF -	CHF 46.00	CHF 955.51	CHF 1,287,822.00
9105.2100	China	No	175530.3	175890.8	CHF -	CHF 49.00	CHF 86,009.85	CHF 62,102.00
9105.2900	China	No	4019.1	3808.3	CHF -	CHF 47.00	CHF 1,888.98	CHF 1,825,409.00
9105.9100	China	No	18292.9	84330	CHF -	CHF 49.00	CHF 8,963.52	CHF 88,038.00
9105.9900	China	No	5919.3	8459.3	CHF -	CHF 48.00	CHF 2,841.26	CHF 327,915.00
9106.1000	China	No	2617.5	1120	CHF -	CHF 52.00	CHF 1,361.10	CHF 103,890.00

9106.9000	China	No	10780.9	151302.3	CHF	-	CHF	52.00	CHF	5,606.07	CHF	100,668.00
9107.0000	China	No	2884.4	11584.4	CHF	-	CHF	51.00	CHF	1,471.04	CHF	354,504.00
9108.1100	China	No	358	19892	CHF	-	CHF	0.49	CHF	9,747.08	CHF	156,885.00
9108.1900	China	No	36.8	527	CHF	-	CHF	0.49	CHF	258.23	CHF	146,967.00
9108.2000	China	No	669.5	31868	CHF	-	CHF	0.51	CHF	16,252.68	CHF	8,292.00
9108.9000	China	No	234.6	29991	CHF	-	CHF	0.45	CHF	13,495.95	CHF	679,862.00
9109.1000	China	No	726	4394	CHF	-	CHF	80.00	CHF	580.80	CHF	169,644.00
9109.9000	China	No	1278.6	3268	CHF	-	CHF	50.00	CHF	639.30	CHF	29,181.00
9110.1100	China	No	169.2	14781	CHF	-	CHF	327.00	CHF	553.28	CHF	23,425.00
9110.1200	China	No	105.7	3780	CHF	-	CHF	88.00	CHF	93.02	CHF	142,624.00
9110.1900	China	No	1	17	CHF	-	CHF	112.00	CHF	1.12	CHF	71,948.00
9110.9000	China	No	290.5	7457	CHF	-	CHF	87.00	CHF	252.74	CHF	530.00
9111.1000	China	No	298.2	8162	CHF	-	CHF	1.10	CHF	8,978.20	CHF	66,060.00
9111.2000	China	No	156509	3232054	CHF	-	CHF	0.12	CHF	387,846.48	CHF	293,520.00
9111.8000	China	No	6866.8	200256	CHF	-	CHF	0.13	CHF	26,033.28	CHF	93,520,529.00
9111.9010	China	No	11174.3	672264	CHF	-	CHF	0.17	CHF	114,284.88	CHF	2,114,726.00
9111.9090	China	No	6880.3	248690	CHF	-	CHF	73.00	CHF	5,022.62	CHF	4,673,706.00
9112.2010	China	No	401.6	4185	CHF	-	CHF	41.00	CHF	164.66	CHF	4,973,395.00
9112.2090	China	No	1536.5	5308	CHF	-	CHF	30.00	CHF	460.95	CHF	87,560.00
9112.9000	China	No	851.2	8041	CHF	-	CHF	41.00	CHF	348.99	CHF	362,519.00
9113.1000	China	No	103.8	5239	CHF	-	CHF	3,863.00	CHF	4,009.79	CHF	201,026.00
9113.2000	China	No	73218.7	1485425	CHF	-	CHF	238.00	CHF	174,260.51	CHF	152,772.00
9113.9000	China	No	50920.9	3386981.3	CHF	-	CHF	133.00	CHF	67,724.80	CHF	32,151,851.00
9114.1020	China	No	0.9	2048	CHF	-	CHF	419.00	CHF	3.77	CHF	16,105,601.00
9114.3000	China	No	42527.7	1772479	CHF	-	CHF	88.00	CHF	37,424.38	CHF	1,952.00
9114.4000	China	No	16.9	284	CHF	-	CHF	88.00	CHF	14.87	CHF	33,532,166.00
9114.9000	China	No	33626.9	3560649	CHF	-	CHF	88.00	CHF	29,591.67	CHF	29,551.00
									CHF	**1,195,365.31**	**CHF**	**20,600,438.00**

3B: Sample of an interview with a watchmaker

- *Does firm A currently use the Free Trade Agreement between Switzerland and China (hereinafter SSFTA)?*

Part A (Utilization):

- Since when are you using the SSFTA (implementation was in 2014)?
- Do you use it for all of your product lines?
- How complicated is the cooperation with the Chinese customs authorities (Red Tape, administrative costs etc.) as of today? Are Certificates of Origins frequently rejected or require further examination?
- Would you say the administrative costs (Rules of Origin, Certificates etc.) in order to receive the preferential tariffs are significantly lower than a non-use and the application of the MFN tariff? Hence, do preferential tariffs have a significant impact on the overall profitability of your watches?

Part B (Non-Utilization):

- Please name the major reasons why you do not use the SSFTA (lack of know-how, high complexity, non-compliance with Rules of Origin, administrative cost of Certificates of Origin etc.)
- Are you planning on using the SSFTA in the future (when tariff reductions have expanded)?

General Questions:

- Do you think China will play a bigger (relative to Hong Kong) as a direct export market of Swiss watches?
- Many watchmakers (small and large ones) have started using e-commerce platforms (e.g. JD.com). Do you see a clear upward trend in the e-commerce related sales of luxury products in the last few years? Or does the majority still buy watches offline in flagship stores?
- One of the big barriers for the Swiss Watchmaking industry clearly is the luxury tax of 20%. The Swiss watchmaking industry fears an increase of the luxury tax in the future. Do you see any indication of a raise/decline of the luxury tax in the near future?
- Going far beyond tariff-dismantling, Chapter 11 for instance is all about intellectual property rights. Since China's WTO accession in 2001 IPR has significantly improved. But how did enforcement of IPR improve since the implementation of the SSFTA and do you know of any successful litigation of Swiss watchmakers?