

strategy report

Navigating troubled waters

Three options for Switzerland in its dealings with China
Patrick Dümmler, Teresa Hug Alonso, Mario Bonato with the cooperation of Jan Averkin



Acknowledgements

The authors would like to thank the members of the Avenir Suisse programme committee, Prof. Dr. Reto Föllmi, Prof. Dr. Karen Horn and Prof. Dr. Giorgio Behr, for their valuable feedback and suggestions for improvement during the external review process. Special thanks are also due to the China expert and managing director of the China Macro Group, Markus Herrmann, for his careful review of the first chapter, as well as Dr. Stefan Legge for his presentation of trade linkages with China and the United States (Figure 4). We would also like to thank the numerous additional interviewees from companies and organisations who shared their knowledge with us, as well as Basil Amman and Patrick Schnell from Avenir Suisse, who supported us in our data research. Responsibility for the content lies solely with the authors of the publication and the Director of Avenir Suisse, Peter Grünenfelder.

Authors	Patrick Dümmler, Teresa Hug Alonso, Mario Bonato with the cooperation of Jan Averkin
Copy editing	Teresa Hug Alonso
Publisher	Avenir Suisse, www.avenir-suisse.ch
Design	Carmen Sopi, Olivia Vilarino
Print	Staffel Medien AG, www.staffelmedien.ch

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Order from	assistent@avenir-suisse.ch , Tel. 044 445 90 00
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Foreword

The world is experiencing a disruptive transformation. The rivalry between the major powers, the US and China, is intensifying. The massive human rights abuses allegedly being committed by the Russian invaders in Ukraine are shaking Europe's post-WWII order to the core. Given the extensive global interconnectedness of the Swiss economy, its strategic approach to the current trial of strength between the United States and China is a balancing act. As the war in Ukraine now shows, preparations by the Swiss government and administration for the issues relating to neutrality, security and economic sanctions are long overdue.

For decades, the Swiss government has believed that the unofficial doctrine of “muddling through” is a viable foreign political strategy; not only in the current struggle between the great power blocs but also regarding its European affairs. Following this approach meant that delicate questions did not have to be answered right away. However, as soon as external events put Switzerland under pressure to act, the strategic vacuumness of such a policy becomes obvious. Policymakers appear to be caught by surprise and completely unprepared.

After Avenir Suisse presented perspectives on Swiss security policy in early 2022 – a few weeks after the outbreak of the Ukraine war, this publication discusses our country's strategic options regarding the People's Republic of China. Any approach cannot focus on “Beijing” alone but must be considered alongside the close economic and political relations we maintain with our European neighbours and the US.

Patrick Dümmler, Teresa Hug Alonso and Mario Bonato have analysed the data on this in meticulous detail. They provide compelling evidence of the economic catch-up achieved by China in recent decades, but also contextualise China's role in relation to the European Union and the US. Today, China is Switzerland's third most important trading partner – and that is not likely to change in the foreseeable future. Our country's key partners continue to be the EU and the US: in commercial, political and cultural terms. Here the economic interdependencies are significantly higher, in addition to the shared democratic values. The “change through trade” hoped for by the West has not materialised, despite a marked increase in prosperity in China, the most populous country in the world. Meanwhile systemic competition between the USA and China remains a reality – and could even intensify.

Thus, our country finds itself experiencing an ongoing conflict of objectives between integration into the Western world and securing market access to our third most important trading partner. Further, China and its authoritarian political system are increasingly being criticised in Switzerland for its neglect of the rule of law, its rigid prevention of freedom

of expression and its oppressive actions towards minorities and pro-democracy movements.

Ultimately, Switzerland only has a few options left when it comes to dealing with China in the future: On the one hand, there is the pragmatic “muddling through” approach – staying just below the radar of public discussion, while simultaneously deepening its economic relations with China. But if the systemic rivalry intensifies, closer alignment with Europe’s China policy is going to become unavoidable. If, in the future, the conflict between the major power blocs escalates, a clearer positioning and aligning to the West remain the only option.

In view of these discomfoting geopolitical realities, Switzerland has no option but to deepen its trading relations with other regions around the world, as a way of strengthening the resilience of the domestic economy. Likewise, it will be necessary to consciously address any conflicting objectives and to prepare ourselves for possible developments in good time. As Albert Einstein once put it: You don’t have to understand the world, you simply have to find your own way around it. This is especially true for our own country when it comes to China.

Peter Grünenfelder, Director of Avenir Suisse

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Executive Summary

The rivalry between the US and China is intensifying. The rules-based order in place since 1945 is losing its meaning in view of what is, increasingly, power-based politics. For a small, open economy like Switzerland, which depends heavily on multilateralism, this is a worrying trend. Geopolitical insecurity has always been there – but recent developments are shaping up to be the biggest upheaval since the end of the Cold War. This study focuses on the geopolitical upheaval triggered by the rise of China, and on its economic and political impact on Switzerland. China's economic catch-up is certainly impressive. Over the last seven decades, its gross domestic product (GDP) has increased twenty times over. The large decline in global income inequality can mostly be traced back to the rapid growth of China's economy. If we compare the GDP (adjusted for purchasing power) of different economies, China has been ranked number one for several years – and has achieved this despite the country being considered a “repressive state”, including in economic terms. Due to the potential of its internal market, China can still attract a considerable amount of foreign direct investment (FDI).

China's race to catch up and the related geopolitical consequences

China's growth can also be seen in direct comparison to the US: While in 2000, trade in goods with the US was more significant than with China for most countries, China has now overtaken the United States. China's “Human Development Index” (HDI) success is impressive: In 1990, this index, which links life expectancy, educational standards and per capita income, still rated China at 0.49 index points. In 2020, the country had already attained 0.76 points. This improvement in the HDI reflects the positive development of livelihoods for hundreds of millions of Chinese.

China is attempting to further expand its regained geopolitical importance internationally, for example with the “New Silk Road” project initiated in 2013, also often known as the “Belt and Road Initiative” (BRI). A country that has managed to rise to the position of a globally respected state within two generations gives Africa some hope that it could do the same. That is why the Chinese presence on the African continent is mostly assessed as positive. Not only bilaterally, but also multilaterally, China is becoming more engaged in international matters. Criticism of China's engagement mainly deals with the excessive pressure that Beijing occasionally exerts on multinational organisations. Particularly China's membership of the World Trade Organisation (WTO) is not without conflict.

For a long time, it was assumed that – thanks to progressive reforms and growing prosperity – Western-style democracy would also prevail in

China. However, the convergence theory – “change through trade” – has not been realised so far. China’s political system continues to be based on the Communist Party’s authoritarian claim to leadership, anchored in constitutional law. In its contest with the US (and ultimately, with the West as a whole) for global leadership, part of the competition between the systems is claiming the superior form of state. In this context, China is not only seeking to reinterpret the definition of democracy, but also to redefine human rights; as seen by the “Chinese development of human rights issues.”

There is no sign of any fundamental relaxation of relations with the West in the near future. However, Russia’s invasion of Ukraine and China’s tendency to take a pro-Russia stance are both expected to lead to closer transatlantic solidarity.

In this context, comparisons cannot be drawn between this situation and the Cold War: The mutual economic dependence between the US and China is many times greater than it ever was between the Soviet Union and the West. A near-total “decoupling” is therefore unlikely. China’s rise to world power status is primarily based on its economic strength and its technology. If the country remains on an economic fast track, its own domestic market as well as the growth of Africa – which has been integrated using the BRI – could become relatively more important to Beijing than product sales in the West. A closer alliance with Russia could prove useful to China in the future. Western democracies are increasingly having to face conflicting objectives: On the one hand, they want to continue profiting from access to the Chinese market; on the other, they need to defend the liberal world order against China. The lived values differ fundamentally from the core values of the West, especially with regard to human rights, democracy and the rule of law – even the redefinition of concepts pursued by China cannot distract from this.

Switzerland and China

Even for smaller states like Switzerland, balancing different interests is becoming an ever-greater challenge. However, Switzerland has fewer options available to it than the major powers: Unilateral action by Switzerland would have little impact on China, while potential countermeasures by Beijing could extract a high price.

Switzerland’s relations with China are close, and official diplomatic contacts have been maintained almost since the founding of the People’s Republic. Switzerland was one of the few Western countries to negotiate a free trade agreement (FTA) with it, in 2014, which further deepened existing economic relations and created an institutionalized platform for political exchanges. Switzerland’s main goal was to gain access to the emerging Chinese market. Although it was economic interests that initially drove this cooperation, bilateral relations were quickly extended to other areas – for example, the dialogue on human rights.

Between 2010 and 2019, Switzerland's goods exports to China grew by an average of 8.4 % per year. Direct investments also grew. Even though Chinese investment more than doubled between 2016 and 2020, China's share of the total foreign capital stock in Switzerland was as low as 1% in 2019. Nonetheless, there have been repeated calls for stricter regulation of foreign investment in Switzerland, although an immediate security risk cannot be inferred from ownership structures alone. Consequently, no effective defence strategy can be defined. Instead, there is a risk of politicising corporate monitoring procedures. Switzerland's greatest growth impulses in recent decades have come from those sectors that were characterised by the greatest openness to foreign investment.

There are increasing political demands within Switzerland for a more critical engagement with China. Even if the FTA were to be suspended, as frequently demanded, trade would continue to take place: After all, Switzerland also trades with the US without any agreement in place. The introduction of new sustainability and/or human rights chapters into the FTA is not a bad idea per se or to be rejected out of hand – so long as both trading partners can reach an agreement. In response to the criticism, the Federal Council has formulated a special China Strategy. Contrary to the hopes of many groups, however, neither the China Strategy nor Beijing's reaction to it have so far helped improve bilateral relations or the situation in China.

The balancing act that characterises Swiss-China relations is becoming increasingly tricky: On the one hand, there is growing pressure on the Swiss Confederation to take a stronger stand internationally in favour of fundamental Western values. On the other, there is the policy of neutrality and the foreign trade objective of keeping access to markets open. The continued diversification of international relations through FTAs strengthens Switzerland's economic resilience and reduces its dependency on major trading partners. But the significance of these measures must not be overstated: In coming decades, the EU and the US will remain Switzerland's greatest trading partners, even if the growth rates of economic interactions with other countries, in particular with China, increase more rapidly.

A realistic strategy for Switzerland

A realistic strategy is based on three levels of escalation:

01_ Neither the US nor China nor the EU are putting much pressure on Switzerland to join in with their sanctions or diplomatic notes. Given less intense pressure on Switzerland, a pragmatic strategy can be adopted that relies on communication skills. Our most important trading partners must be kept happy diplomatically, while domestically the strategy needs to be explained continually. In this scenario, Switzerland should continue to represent its values, but without resorting to preaching. The existing platforms for diplomatic exchange and a deep-

ening of economic cooperation are suitable methods for doing this. High-profile criticism or economic sanctions should be avoided.

02_ If pressure intensifies, for example, because one of Switzerland's major trading partners expects Switzerland to adopt its own stance, the strategy used should consist of voluntary alignment. Moderate pressure may also arise domestically, for example, with demands to take a stronger position against China's behaviour. If there is any increase in pressure, Switzerland should primarily take its inspiration from the EU's resolutions and pursue a two-track approach where China is regarded as both a partner as well as an economic competitor and systemic rival. A regulated relationship with the EU (e.g., by securing bilateral contracts) would form a solid basis for, not least, reducing Switzerland's economic dependence on China.

03_ In the case of major pressure – whereby the USA and China place trade embargoes on each other or even enter into military conflict – a unified approach by the West led by the US can be assumed. A decisive point for Switzerland's positioning towards the US are the largely shared values. In this case, China's response may be very severe. Overall, in this scenario, Switzerland would risk losing its most important trading partner in Asia. To cushion the resulting consequences, Bern should seek economic solidarity, not only with the EU but also with the US.

The bilateral conflict between the US and China is largely exogenous for Switzerland, but nevertheless affects it to an above-average extent. This is because two economic heavyweights, the United States as the second most important trading partner and China as the third, are in dispute with each other. Swiss policy must be agile, so that decisions can be taken quickly, as needed. Swiss companies must prepare to operate in two economic areas, instead of in three (China, Europe and the USA), if necessary. Renunciation of China as a sales market is likely to weigh more heavily than in the current case of Russia; in view of the global escalation scenario, such a corporate decision would be important, but still only a small contribution to the defence of fundamental basic values.

1 China's race to catch up and the geopolitical consequences

“Upheaval” is a term that aptly describes the geopolitical developments of recent years. The growing rivalry between the USA and China, playing out on the economic and ultimately military stages is also increasingly influencing regional conflicts. This is currently the case in the Ukraine war.

Meanwhile, it appears that the politics of the great imperial powers, given up for dead, have been resuscitated. Russia thus justifies its need to create spheres of influence to maintain its own security, while China is not only reaffirming its territorial claims in the South China Sea, but also blatantly threatening Taiwan with military confrontation. The rules-based, multilateral order established after 1945 has thus paled before the increasingly power-based politics.

The first official departure from multilateralism occurred under the Trump Administration as part of its “America First” policy, with the US withdrawing from the Paris Climate Agreement, the WHO and the UN Human Rights Council (Gsteiger 2018; NZZ 2020; Tages-Anzeiger 2020). Following the inauguration of Joe Biden, some of these steps were reversed, nevertheless, many US politicians continue to disdain the constraints of multilateralism (Patrick 2021). This is a source of great concern for Switzerland, a small, open economy that greatly benefits from multilateralism.

More and more governments around the world are turning their backs on liberal trade policies. Mercantilist and protectionist attitudes are gaining the upper hand, and many states are actively promoting ‘reshoring’ or ‘nearshoring’ – with no small collateral damage to third parties. Due to their extraterritorial effect, higher tariffs between the USA and China, the introduction of export controls as well as sanctions against specific companies or persons also affect companies from third countries that export to these countries or operate there as they must subject their business activities (especially the exchange of goods and data) to close scrutiny. The increased market access costs¹ brought about by the trade dispute with China drove many US companies to repatriate their production to the United States from 2019 onwards. The ‘reshoring’ trend was accentuated by supply chains disrupted by the pandemic, forcing many companies to reduce or even eliminate their dependence on foreign supply markets (Kessler 2021).

More and more governments around the world are turning their backs on liberal trade policies.

1 In addition to higher tariffs, domestic protectionist strategies are also responsible for increased market access costs. These include, for example, the US infrastructure plan, which includes “Buy America” demands, or the “Made in China 2025” or the Middle Kingdom’s “Dual Circulation” strategy (cf. Text box 1 below).

While there have always been challenges on the world stage, current developments are shaping up to be the biggest upheaval since the end of the Cold War. The end result of this ongoing upheaval is anybody's guess, however, it is likely to significantly influence the future world order.

This study focuses on the geopolitical upheaval triggered by China's rise, and its economic and political impact on Switzerland.^{| 2} Chapter 1 broaches the issue of China's economic rise, reviews Beijing's growing international influence and assesses the current situation in the country in relation to elementary values of the global community. It further summarises the attitude of the West so far and poses the question as to whether today's situation harkens back to the Cold War. In the wake of recent developments, a comparison with Russia is also made and the likelihood of a Sino-Russian alliance against the West is discussed.

1.1_ Return to past greatness

China's self-image is essentially based on its history. Accordingly, the Communist Party of the People's Republic of China^{| 3} (CCP) has clearly set its sights on overcoming the "Century of Humiliation" that began with its defeat in the so-called Opium War (1839) against the British and ended only after the Second World War (Callahan 2004).^{| 4} The country intends to forge ahead, building on its thousands of years of history. Indeed, in the 15th century, China was more advanced than Europe in many areas of science and technology. A distinct "scientific culture" was nurtured by a higher literacy rate that leveraged the benefits of printing more quickly than in Europe. Steel was produced in higher quality and agriculture was well-organised. Overall, the framework conditions of the Chinese markets were more competitive than those in Europe.

To this day, the memory of China's suffering under imperialism remains an important source of legitimacy for the nationalism championed by the CCP (Kaufman 2011). From the Party's perspective, it was Mao Zedong who ushered in a new start for the country with the founding of the People's Republic of China in 1949. The move away from the Soviet model of a planned economy towards economic reform and opening up from 1978 onwards under Deng Xiaoping led to a rapid increase in prosperity. In the process, many innovations – such as the special economic zones

The Communist Party of the People's Republic of China is intent on finally overcoming the "Century of Humiliation".

2 The consequences of a militarily stronger China are not discussed in depth in this publication, but reference is made to other recent publications (*Kaim und Stanzel 2022*) or (*Kirchberger 2020*).

3 A distinction must be made between the People's Republic of China and the Republic of China. The latter is often referred to as Taiwan. In political matters, Switzerland also speaks of "Chinese Taipei" (*EDA 2022a*). In this publication, "China" refers to the People's Republic of China with Beijing as its capital, while "Taiwan" refers to the Republic of China with Taipei as its capital.

4 The end of the "Century of Humiliation" is also often indicated as being in 1942 or 1947, when the United Kingdom, the USA, Japan and other states dissolved the so-called "unequal treaties" (some of which had been imposed on China in the 19th century), thus granting China more sovereignty. This view, however, is a legitimacy problem for the Chinese Communist Party (CCP), because dissolution of the treaties took place under the leadership of the Nationalist Party and Chiang Kai-shek and thus before the founding of the People's Republic of China in 1949 under the CCP (*Universität Heidelberg 2022*).

– were first tested regionally and, where successful, extended from the provincial level to the whole country. China still uses this approach today.

Up until the 1990s, China's foreign policy maxim had been to, "keep a low profile and never take the lead" (Schoeneborn 2019). Those days are gone. Senior party officials were already calling for an 'active' role for China as early as 2010, culminating in Xi Jinping's 2017 speech in Davos, where he directly addressed China's responsibility and leadership role in the global economy (Müller 2017). Today, China's self-confidence is on full display, during the Olympic Games, for example. The "hard work done from generation to generation" during the CCP's more than one hundred-year-long history is intended to culminate in a "renaissance of the Chinese people" (CRI 2015). By 2049 at the latest, i.e. the 100th anniversary of the People's Republic, the CCP's master plan is to make the country the leading socialist world power. By then, according to Xi Jinping, China is expected to lead in the spheres of, "politics, culture, ethics, society and the environment." (Erling 2017). China is playing the long game, with the aim of supplanting the USA in its regional and, ultimately, global supremacy (Doshi 2021).

Strong economic growth

China's economic catch-up is impressive.⁵ Over the last seven decades, gross domestic product (GDP) has increased twentyfold (Norberg 2017). The large reduction in global income inequality in recent years is largely due to the rapid growth of the Chinese economy and, to a lesser extent, that of India (Grünenfelder et al. 2019). In 1999, 51 % of China's population was still below the 'poverty line', with an income of less than \$5.50/day. In 2016, this figure was only 6.5 % (World Bank 2022). Since 2016, the World Bank ranks the People's Republic among the countries with an income level in the upper middle range (World Bank 2022a).

If one compares the GDP in purchasing power terms of various economies, China ranks first.⁶ Its share of global GDP had already surpassed the shares of the USA and the EU-27 by the mid-2010s (cf. Figure 1) (IMF 2020).⁷

With just over 1.4 billion people, China is the most populous country in the world, (World Bank 2022b) which is why the GDP comparison distorts the actual situation. A more differentiated view is provided by the GDP

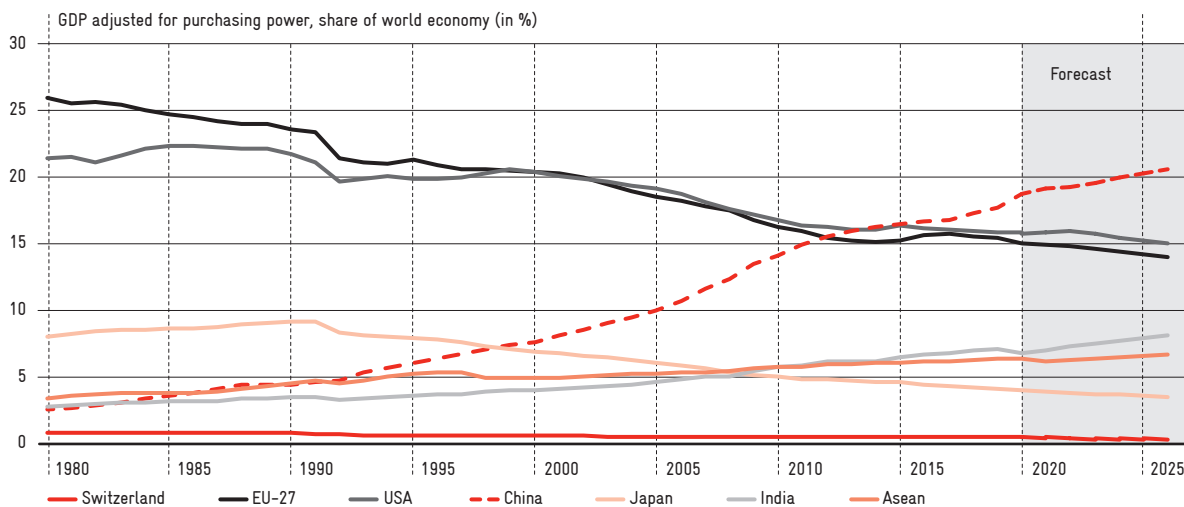
5 Economic growth is essential for China. This is because there are various assumptions of an implicit pact between the State and the Chinese people: Increasing prosperity for the people in exchange for allegiance to the state or the CCP. In 1990, the reformer Deng Xiaoping asked the leadership: "Why do the people support us?" and immediately gave the answer himself: "Because the economy has developed". According to this view, high growth rates of over 7 % are necessary in order to ensure the people's loyalty; low growth rates such as in 2014/15 or as at present are thus viewed with concern (Giesen 2015).

6 GDP adjusted for purchasing power is calculated using purchasing power parities. These are conversion factors that compare the purchasing power of the national currency of different countries and eliminate the influence of different price levels.

7 If, on the other hand, real GDP is considered without adjusting for purchasing power, China still ranks behind the EU-27 and the USA (IMF 2022).

Figure 1
The Rise of China

At the latest since the 1990s, China's economic rise and its decoupling from India and the Asean members has become apparent. By 2015, its GDP in purchasing power adjusted figures surpassed that of the USA.



Remark: China incl. Hong Kong and Macao, excl. Taiwan EU-27 incl. UK; excl. Croatia. Data from Myanmar, Cambodia, Brunei and Macao are partially missing up to the year 2000.

Source: Own calculations, IMF (2021)

per capita adjusted for purchasing power. In China, this is still only about a quarter of the Swiss value, and the gap between it and the USA or the EU is remains large. Yet the People's Republic is catching up.⁸ The comparison with India is interesting: While China and India were on equal footing until the mid-1990s, today China's GDP per capita is nearly twice as high (cf. Figure 2).⁹

Major destination for foreign direct investment

Along with economic growth, China has also seen a sharp increase in foreign direct investment (FDI). In 1980, the Swiss Schindler Group was the first foreign industrial company to enter into a joint venture in China (Schindler 2007). In 1984, the German Volkswagen Group set up its first joint venture near Shanghai together with SAIC Motor – which has gone on to become one of four large state-owned car manufacturers (Volkswagen 2022). The first locally produced model, the Santana, dominated the street-scape of the metropolis for a long time. While there has been strong growth in FDI in China in absolute terms, its share of GDP has remained

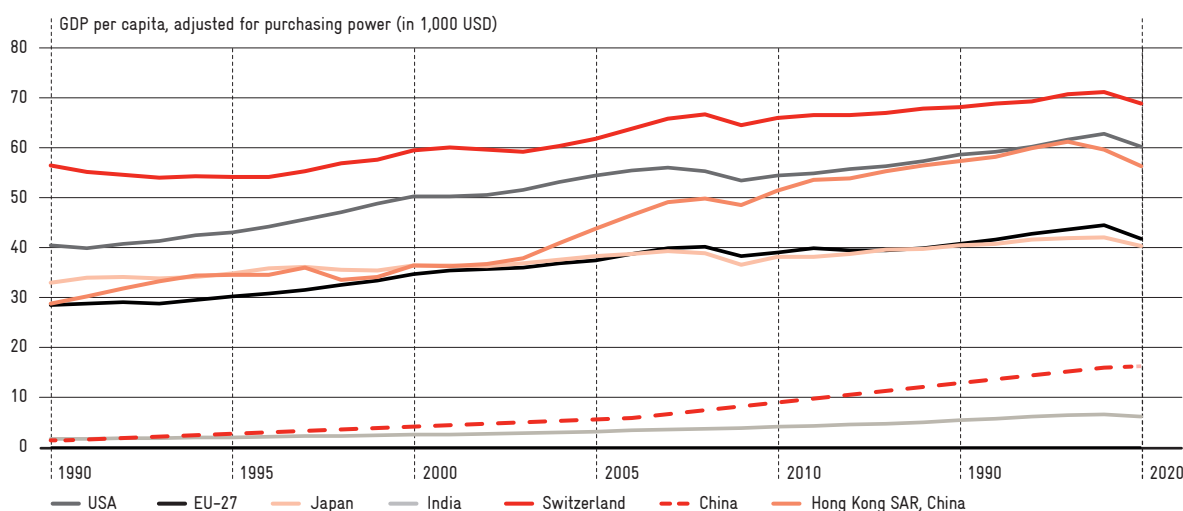
⁸ Hong Kong – once again part of China since mid-1997 – has also increased its GDP per capita and has almost caught up with the USA. The slump of the last few years can also be seen in connection with the closer political ties to the mainland, or the protests that took place because of this, which paralysed the economy.

⁹ A further reason for China to stress the superiority of its own political system over a (at least Western-influenced) democracy like India. The Bertelsmann Stiftung's Transformation Index ranks India 50th in the democracy sub-index. China is ranked 116 out of 131 countries surveyed (Bertelsmann Stiftung 2022a).

Figure 2

GDP per capita adjusted for purchasing power parity

China has been able to significantly increase its GDP per capita over the last thirty years, however it remains far below the levels of Switzerland, the USA, or the EU-27. Only Hong Kong has been able to catch up, although it has weakened in recent years.



Remark: EU-27 incl. Croatia, excl. UK; USD according to constant international USD 2017

Source: World Bank (2022b)

relatively constant. The USA achieved comparable values – with lower GDP growth (cf. Figure 3).¹⁰

By contrast, there are striking differences with regard to economic freedom. According to the “Index of Economic Freedom”, the business environment¹¹ in the USA is significantly better (25th out of 177) than in China (158th). Overall, China is also considered a ‘repressive state’ in terms of economic affairs (Heritage Foundation 2022).¹² The socialist market economy has strong features of state capitalism, with many State-owned enterprises. The private sector is also strongly influenced: According to Chinese company law, party cells can also be established in foreign private companies (EC 2017). “Today’s China is economically more capitalist but politically more communist than it was 20 years ago” (Weber 2020).¹³

The fact that China is nevertheless able to attract large-scale direct investment is mainly due to the potential of the domestic market. Thus, a net total of more than CHF 718 billion is invested in China (foreign investment in China less Chinese investment abroad) (World Bank 2022d). The focus

¹⁰ The large decline in direct investment in Switzerland in 2018 shown in Figure 3 is due to a tax reform in the USA (“Tax Cuts and Jobs Act”). Equity reserves of US subsidiaries were repatriated to the US (Schweizerische Nationalbank 2019).

¹¹ These include the rule of law, the size of the state apparatus, regulatory efficiency and the openness of markets (Heritage Foundation 2022).

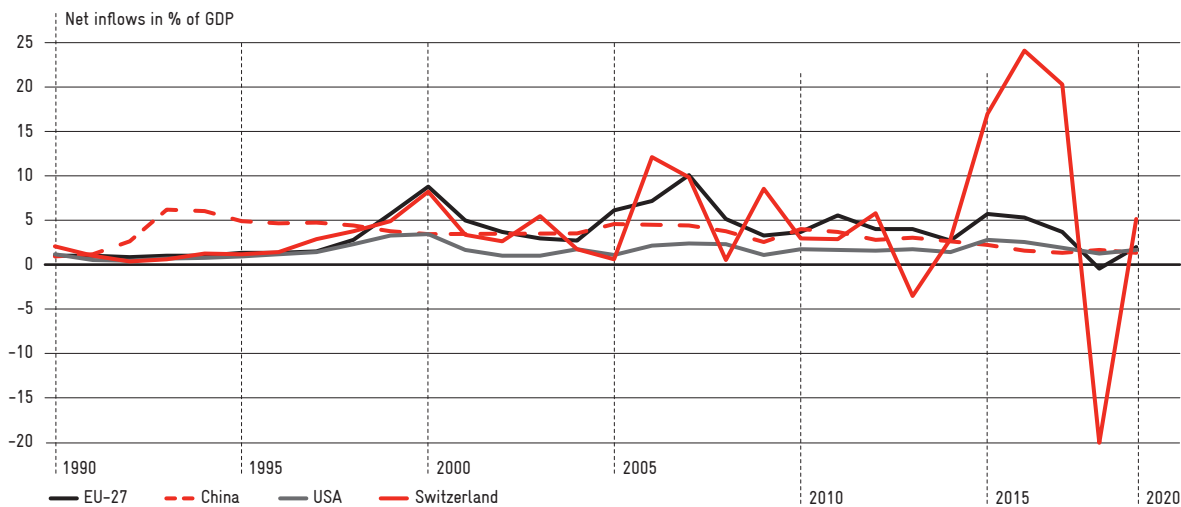
¹² Switzerland is in second place - just behind Singapore and ahead of Ireland (Heritage Foundation 2022).

¹³ The two economists, Haskel and Westlake, have shown that, especially in the case of digital goods, state capitalism can be successful, since intangible goods have different economic characteristics than tangible goods. While private venture capital firms finance digital business models in the US, it is often the State that does so in China (Haskel und Westlake 2017).

Figure 3

Foreign direct investment

China remains an attractive destination for direct investments, consistently recording a positive cash flow since the early 1990s.



Source: World Bank (2022d)

of the commitment of Western companies is not so much on production for subsequent export, but rather on opening up the Chinese market.

Dominance in world trade

Globalisation and China's accession to the World Trade Organisation (WTO) at the end of 2001 have led not only to an increase but also to a shift in global trade flows. Hong Kong (WTO accession 1995) plays a crucial role in this shift, as many goods either enter or are exported from China via this special Administrative Region. While in 2000, trade in goods with the USA was still greater than with China for the majority of countries, the People's Republic (incl. Hong Kong) has now overtaken the United States (cf. Figure 4). The chart provides a clear illustration of why the relationship between the US and China has grown sour. There has been a stark shift in trade flows in the Asia-Pacific region, where the USA has been surpassed in trade with all but a handful of countries such as Cambodia, Bangladesh and Bhutan. The relative superiority of the USA has also been broken in Africa and even South America (Dümmeler and Anhamatten 2019).

On course towards an innovation-based economy

Economically, China seeks to reduce its dependence on exports and strengthen consumption in its domestic market, not by turning its back on the global economy, but rather by developing further up the value chain. It intends to move away from being the "workshop of the world" towards being an exporter of technologically innovative products. China is even aspiring for leadership in certain promising technologies. The

The newest five-year plan places a great deal of emphasis on robotics and smart manufacturing.

latest five-year plan places a great deal of emphasis on robotics and smart manufacturing (Global Times 2021) (cf. Text box 1). Today, there are already more than 800,000 industrial robots in China, roughly one third of the world's total (The Economist 2021). State (co-) financed technologies and their companies are in competition with private Western providers, e.g. in the 5G roll-out. Ultimately, both China and Western countries wish to be at the forefront of this kind of future technology (Müller and Ammann 2020).

Text box 1

"Made in China 2025" and the "Dual Circulation Strategy"

At the centre of the latest five-year plan is the "Dual Circulation Strategy" first mentioned by President Xi Jinping in May 2020. China is aiming to increase domestic demand and domestic value creation ("internal cycle"). The international orientation of the Chinese economy ("external circuit") is intended to support the modernisation and development of the country. However, the government, like that of the USA, seeks to limit its dependence on foreign resources and technologies and even become the world market leader in strategic sectors of the future, cutting-edge technologies and science.

Chinese domination of the financial sector is also expected to continue. Despite efforts to integrate into the global financial system, the Chinese leadership has no interest in a complete liberalisation of capital flows, which is considered incompatible with the country's economic system (Kärnfelt and Zenglein 2019). This represents yet another hurdle for Swiss companies investing in China.

The focus on a high-tech economy is also a goal of the "Made in China 2025" strategy unveiled in 2015. Even if the term is no longer commonplace within China, it is still used. For example, the People's Republic is not only expected to produce world-leading companies in ten key technologies by 2025, but even to become a technological superpower by 2049. To that end, the domestic policy strategy relies on the development of domestic enterprises, whereby foreign know-how and technologies should flow into domestic value chains only in a complementary manner (Zenglein and Holzmann 2025).

This focus on innovation is all the more apparent from worldwide patent applications, 45 % of which were Chinese in 2020. With some 1.5 million registrations, this is almost three times as many as the USA (Wipo 2021). However, this mass of patents gives rise to scepticism, with almost half of the applications qualifying as so-called "utility models", i.e. a separate type of patent application with a reduced term of protection that can be filed without examination. ¹⁴ A similar observation can also be made in the area of science.

In 2018, China overtook the US as the global leader in the number of publications of scientific articles (Tollefson 2018). However, research casts doubt on the quality of these publications. ¹⁵ China has identified the

¹⁴ Furthermore, in the past, incentive systems in China were designed in such way that responsible officials were better compensated for a higher number of patents (The Economist 2010). However, ongoing reforms seek to attach less importance to the number of patents (BMBF 2015).

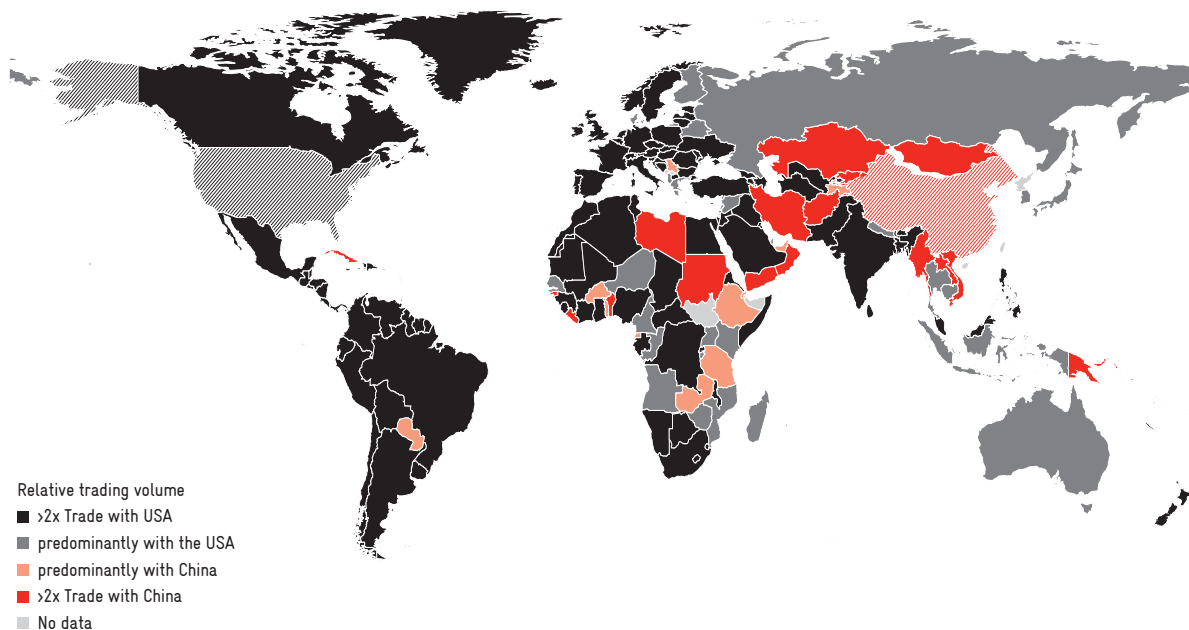
¹⁵ The renowned scientific journal, "Nature", for example, speaks of "zombie studies" and actual "paper mills". A great number of forged or copied studies were found in the samples examined. Similar observations have also been made in Russia and Iran (Else and Van Noorden 2021). It is questionable as to whether a more restrictive political environment – as has been observed in China in recent years – takes sufficient account of the freedom of research required to enable greater innovation in the long term.

Figure 4

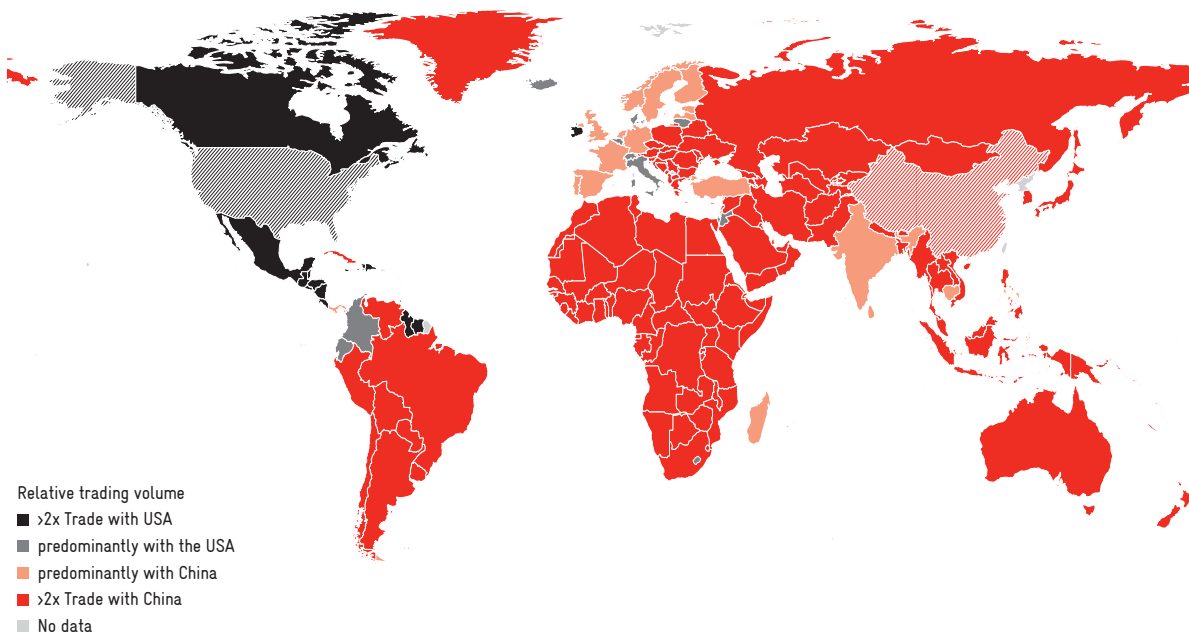
Relative importance of the USA and China (incl. Hong Kong) in terms of trade

Since 2000, there has been a huge geopolitical shift in trade volumes: At the turn of the millennium, the vast majority of countries still had a greater trade volume with the USA than with China (coloured black/grey); in 2020, by contrast, almost the entire world is red (trade volume with China significantly exceeds that with the USA).

Relative importance of the USA and China (incl. Hong Kong) in terms of trade (2000)



Relative importance of the USA and China (incl. Hong Kong) in terms of trade (2020)



Source: Wits (2019); calculations by Legge et al. (2019)

problems and has been keeping a “black list” for problematic journals and articles since 2021 in order to improve “academic integrity”. In addition, China’s efforts to produce more technologically sophisticated products can be seen, among other things, in the broad-based “Global Innovation Index”.¹⁶ Thus, the country climbed into the “Top 15” in 2019, ranking 12th in 2021. In particular, not only does China excel on the “knowledge and technological output” indicator, reaching 4th place in the latest update of the index, the assessed “maturity” of the financial market and the economy, as well as “creative outputs” are now also among the strengths of the Chinese economy (Soumitra et al. 2021).

Fear of the “middle income trap”

By pushing technological development, China wishes to avoid falling into the “middle income trap”. This refers to a state of economic development in which a country has achieved a certain income by leveraging its competitive advantages, e.g. the availability of cheap labour, but stagnates at this level. According to the theory, such countries do not reach the level of high-income countries due to lower productivity growth (Indermit and Kharas 2007). The World Bank sets the lower limit for high-income countries at \$12,695 of gross national income per capita.¹⁷ In 2020, 80 countries exceeded this figure. China is forecast to be above this in 2023, however, this is no guarantee that it will permanently remain a high-income country. For example, in 2020 Romania slipped back into the middle-income category. Older examples are the economically and politically challenged countries of Argentina and Venezuela.

It is worth noting that China will exceed the income threshold despite some 25 % of the labour force still being employed in agriculture (versus roughly 3 % in advanced economies). The rural population accounts for a huge reservoir of around 500 million workers, which could also provide China with a productivity boost in the coming years. However, this will require further investment in human capital as well as infrastructure in rural areas (Büchenbacher 2021a). In China, income disparities between rural and urban areas are high and have also risen sharply over the past 30 years. Urban residents earned an average of 43,834 yuan in 2020, while rural residents earned only 17,131 yuan (Watanabe 2021).

Focusing on the rural population could reduce the urban-rural divide in China and strengthen social stability – an aspect that is not insignificant for the leadership in Beijing, which is intent on retaining power. It could also be used to deal with the challenge of a working-age population that is shrinking overall, while the number of senior citizens is rising.

Focusing on the rural population could reduce the urban-rural divide in China.

16 With some 80 indicators, the World Intellectual Property Organization (Wipo) Global Innovation Index does more than merely analyse a country’s performance in terms of the number of patents or trademarks acquired, scientific texts published or high-tech goods exported. It also assesses the economy’s overall capacity for innovation.

17 The value is updated on a regular basis and is based, among other things, on prices and exchange rates in five major economies. At 1987 prices, the original value was USD 6,000 (*The Economist* 2022).

In summary, China's race to catch up can be described using the "Human Development Index" (HDI). In 1990, the index, which links life expectancy, educational standards and per capita income, still rated China at 0.49 index points. In 2020, the country had already attained 0.76 points. This improvement in the HDI reflects the positive development of livelihoods for hundreds of millions of Chinese. Nevertheless, the country 'only' ranks 85th in an international comparison.¹⁸ The country is still far from the top ranks. Switzerland attains a significantly higher ranking, at second place (0.955 index points), with the USA ranked 17th (0.926) (UNDP 2020).

1.2_ Growing influence on several levels

China seeks to further expand the international geopolitical stature it has regained, for example with the "New Silk Road" project initiated in 2013, also often referred to as the "Belt and Road Initiative" (BRI).¹⁹ This mainly involves projects for the development and expansion of intercontinental trade and infrastructure networks for some 138 countries in Asia, Africa and Europe (as of March 2020) (EBRD O.J.). China emphasises that the BRI is intended to serve not only China, but the whole world by creating a new global growth engine.

Belt and Road Initiative

The BRI is guided by three goals (Jie and Wallace 2021): First, the creation of new trade routes. The majority of China's international maritime trade now passes through the Strait of Malacca, with Singapore as the largest port. Setting up its own terminals in third countries would open up new trade routes. Second, the BRI aims to open up China's interior, or areas far from the coast, thus promoting economic growth in remote provinces. Third, the BRI seeks to open up new growth markets for China's large state-controlled enterprises. This is illustrated by the banks involved in a number of BRI projects: the four largest – and systemically important – banks in the world are now Chinese (S&P 2021).

It is not uncommon to hear the accusation that China is leading poorer countries into a debt trap with the BRI. The People's Republic could be using financial dependence as a means of exerting pressure to expand its own political influence. The countries financed would be forced to cede essential infrastructure, such as ports, to China.²⁰ However, a study analysing Chinese-African relations shows that Chinese loans are not the

¹⁸ India ranks 131st with a score of 0.645, with Norway (0.957) in first place (UNDP 2020).

¹⁹ The land routes to the north are called the Silk Road Economic Belt, while the sea routes to the south are called the Maritime Silk Road. Due to the potential capacities and the higher average costs, the overland route will remain subordinate. The land hub in Europe is Duisburg; by sea it is Piraeus.

²⁰ One example is the motorway project in Montenegro. The country will likely not be able to repay the loans to China and has therefore asked the EU, among others, for refinancing (Kolb und Zick 2021). The think tank, European Council on Foreign Relations, thus called Montenegro a, "textbook example of debt-trap diplomacy" (Shopov 2021).

main cause of debt problems (Singh 2021). Other studies refer to few or no cases in which China has claimed land or infrastructure as compensation for loans that were not repaid. The primary focus of the BRI is on economic aspects and not on political intentions (Deron et al. 2021; Jones and Hameiri 2020).²¹

China has been developing infrastructure in many African countries for years. According to the Chinese Loans to Africa Database (Acker and Brautigam 2021; Boston University 2022), a total of \$153 billion in loans flowed to African governments and state-owned enterprises between 2000 and 2019. This includes Djibouti, in the Horn of Africa, where a free trade zone has been established. This is a key junction for the BRI and China's gateway to Africa. In 2017, Beijing established a military base in this small country with a key geostrategic location. It is located only a few kilometres away from US, French and Japanese bases in the same country. The USA is concerned by the fact that China is Djibouti's largest creditor, since Djibouti could impose restrictions on the activities of the US (Burri 2019).

Many Africans see China as a country that has managed to rise and become a globally respected state within two generations. This raises the hope of them being able to do the same. The Chinese presence is thus considered to be positive by the majority (Blume 2018). European countries and companies, on the other hand, are confronted with their own colonial history in Africa.

Many Africans see China as a country that was able to rise up to a globally respected nation within two generations.

Pressure on multilateral organisations

China is becoming more involved in international matters, not only bilaterally, but also multilaterally. However, this occurs selectively, with a clear focus on agricultural, food security and infrastructure projects in developing countries. In so doing, Beijing is able to position itself as an advocate of multilateralism, a defender of globalisation and, ultimately, an attractive alternative to the US (Paszak 2020).

For this purpose, China actively participates in international organisations and agreements, such as the UN, the WTO, the IMF, the World Bank and the Paris Climate Agreement. Because most multilateral organisations were founded immediately after the Second World War or during the Cold War period – and thus without much consideration of China's interests – the country is also founding new organisations. These include the two development banks founded in 2015, the New Development Bank (NDB)²² and the Asian Infrastructure Investment Bank (AIIB).

21 Actually, before China, the EU had the idea of expanding the land route to Asia. The so-called "Transport Corridor Europe-Caucasus-Asia" (Traceca) gained momentum from 1998 onwards, but the establishment of a transport corridor is still a long way off. So far, 14 projects have been completed, with investment costs of CHF 51 million (Traceca 2022). Another instrument is the EU-Asia Connectivity Strategy initiated in 2018 (EC 2018). This was to take into account Asia's growing economic and political importance. The EU initiative took place against the backdrop of the BRI, with the aim being to show a European way forward.

22 Only seven countries are members of the Shanghai-domiciled NDB, including China, India, Russia, Brazil and South Africa, all of which have equal voting shares (NDB 2022).

Criticism of China's engagement derives primarily from the excessive pressure that Beijing exerts in isolated cases. One such demonstration of power was seen during the Covid-19 pandemic: Although it would have made sense, from a health policy point of view, Taiwan's inclusion in the World Health Organisation (WHO) measures was prevented (Qin 2021). The international community was thus only able to benefit to a limited extent from Taiwan's experience in dealing with the pandemic, despite the fact that the country was one of the early pioneers in the fight against the coronavirus (Dümmeler 2021a).

China has also exerted pressure on the World Bank. Specifically, this concerned the "Doing Business" report, which measured the business climate worldwide. Chinese government officials expressed the view that the country's ranking of 78th place (2017 report) did not reflect its reform efforts. In the run-up to the 2018 edition, the Chinese enquired as to the outcome: 85th place, a deterioration. The methodology was quickly adjusted so that the country would regain 78th place. It was not the first, but the last time that diplomacy and adherence to the facts collided in the preparation of the report. The "Doing Business" series of reports was discontinued due to this incident (Hosp 2021).

Also not without conflict is China's membership in the WTO. Particularly, China's state capitalist economic system is difficult to reconcile with WTO standards.^{| 23} The government exerts excessive influence on the economy through price controls, subsidies, judicial interference and even the management of state-owned enterprises and market shares.^{| 24} As a result, a quarter of all WTO disputes involve China (Wu 2016). The USA has brought 23 cases, with China having brought 16 cases against the USA. In second place are disputes with the EU or its member states: eleven claims from the EU are offset by seven from China. China is also currently at odds with Mexico, Japan, Australia, Brazil and Guatemala (WTO 2022). Nevertheless, the complaints before the WTO follow a rules-based and not a power-based procedure and, to date, China has abided by the rules of the arbitral awards (BDI 2021). Whether this will continue to be the case in the future remains open; the appellate body – vital to the dispute resolution process of the WTO – ceased operation at the end of 2019 (Bown and Keynes 2020).^{| 25} The right of the strongest is thus given greater weight^{| 26}, while the future of the World Trade Organisation remains uncertain (Van

China's membership
in the WTO is
not always without
conflict.

23 For the discussion on China's market economy status, see the EU analysis (Puccio 2015).

24 China still has the status of a developing country at the WTO, which entails a number of exceptions to WTO rules. Calls for Beijing to relinquish this status have been rejected. The main issue involves subsidies in the industrial sector – to companies that are largely state-owned (BDI 2021).

25 Several judges retired due to their age and could not be replaced as the US refused, to consent to the appointment of their successors. A reason for this is the increasing reform backlog within the WTO: there has been little progress in the trade liberalisation rounds and the treatment of China does not meet US expectations.

26 However, China is subject to the WTO's so-called "Trade Policy Review" roughly every other year. One of the aims of this policy is to increase transparency and understanding of countries' trade policies and practices through regular monitoring. The WTO thus continues to play the role of "watchdog" and is to some extent able to promote compliance with trade rules.

den Bossche 2022) – bad news for smaller, less powerful but export-orientated states like Switzerland.

New definition of “soft power”

International influence relies on soft power as much as it does on hard power.^{| 27} The former is overwhelming in the case of the USA: Films, music, comics, food - for each category, names spontaneously come to people’s minds, not only in Europe but in most regions of the world. In contrast, China looks pale and unattractive. The People’s Republic relies on other arguments, defining its soft power differently (Kurlantzick 2007). Particularly the impressive economic catch-up (cf. Chapter 1.3) within two generations is a brilliant story that is especially attractive to less developed countries. With infrastructure projects under the BRI or multinational organisations, the strength of the Chinese development model is marketed as a success (Carminati 2020).

With its “masks and vaccines diplomacy”, China also attempted to position itself as a responsible and cooperative international actor during the Covid pandemic, and to fill the power vacuum generated by the US. As such, China exported around 40 % of the vaccines produced in mid-2021, while the US national vaccination campaign had not even been developed at the time (Nolte 2022). The Biden administration was later able to catch up with this lead through higher exports of vaccines to developing nations, most of which – unlike China’s – were donated.

As a further instrument of its soft power, China relies on its worldwide network founded in 2004 of some 500 Confucius Institutes for the purpose of teaching Chinese culture and language. They are not unlike the Alliance Française, the British Council or the Goethe-Institut. Unlike the European models, however, the Confucius Institutes are located at foreign universities and funded directly by the Chinese government. As such, the institutes’ activities must not violate Beijing’s laws; discussions of Taiwan’s independence, for example, are not permitted. In Western democracies, this clashes with the principle of freedom of expression and academic freedom, and amounts to the instrumentalisation of culture. While the number of Confucius Institutes in North America has sharply declined, new offshoots have been founded in developing countries (Büchenbacher 2021b).^{| 28}

In summary, China’s soft power is not so much based on cultural values or innovations, but rather on facilitating economic success or investments abroad.

27 “Soft power” describes the exercise of political power on the basis of cultural attractiveness, ideology and with the aid of international institutions, without using economic incentives or the potential of military threat to achieve this purpose.

28 The only Confucius Institute in Switzerland was closed in 2020 after only seven years. This was preceded by a dispute as to its alignment; it was said that language training ought to have been given significantly more weight at the expense of cultural education. The Confucius Institutes came under pressure worldwide, being seen as a base from which the CCP was able to spread its ideology. A focus on the language school was intended to counter the criticism. Apparently, however, there was insufficient demand for the training (SRF 1 2020).

1.3_ Convergence remains theory

For several years now, likely starting with the inauguration of President Xi Jinping in 2013, more and more Western observers of the country have come to realise that the promises of the convergence theory will not be fulfilled. For a long time, it was assumed that sooner rather than later – thanks to progressive reforms and growing prosperity – a Western-style democracy would also prevail in China. China's accession to the World Trade Organisation in 2001 further increased the expectations of many Western politicians: “change through trade” was the buzzword, the “End of History 2.0” (Fukuyama 1989) so to speak – was emerging. The notion proved naïve in retrospect, and already it is being argued that China's economic strength is outperforming Western democracies (Groitl 2021).

For a long time it was assumed that China would turn into a Western-style democracy sooner rather than later.

Western expectations were first dampened on 4 June 1989 when the People's Liberation Army violently broke up demonstrations by workers and students in Tiananmen Square. Further evidence was supplied by the rigorous crackdown in Hong Kong on various demonstrations in recent years. In fact, when Hong Kong was returned to China in 1997, the United Kingdom was promised 50 years of far-reaching autonomy for its former colony. In 2020, however, the National Security Act de facto ended Hong Kong's political autonomy (Bertelsmann Stiftung 2022b). In the eyes of many Western observers, the “one country, two systems” approach – the coexistence of liberal Hong Kong and the communist People's Republic – has failed. Instead of the mainland becoming more like Hong Kong, Hong Kong is visibly becoming more like the mainland. The Chinese have become more self-confident, Westerners more contemplative.

Old and new democracies

China is not a democracy. The term democracy comes from ancient Greek and means “rule of the (common) people”. The ancient democracies in Athens and Rome arose as a reaction to the excessive power and abuse of power by the rulers, but they can only be compared to a modern democracy to a very limited extent, for Athens and Rome were class-based societies with slaves who had no rights and unequal rights for the rest of the citizens. It was not until the Enlightenment that philosophers formulated the essential elements of a democracy, which can be summarised, in a modern, liberal interpretation, as follows: The granting of fundamental/human and political rights, observance of the separation of powers, guaranteed exercise of freedom of expression, of the press and of religion, the regular holding of fair elections and the separation of religion and state (Vorländer 2020).

From a Western perspective, China can be described as an authoritarian regime. ²⁹ The most important goal of authoritarian regimes is the

29 In the Bertelsmann Stiftung's so-called Transformation Index (BTI, process towards greater democracy and a market economy), China ranks 116th out of 137 developing and transition economies examined in the “Politics” sub-index: “Since Xi Jinping has been in power, the regime of the Chinese Communist Party has become even more aggressive in propagating its authoritarian system” (Bertelsmann Stiftung 2022b). In 2022, for the first time since 2004, the BTI recorded more autocracies (70) than democracies (67) among the 137 countries.

preservation of their own power and also in many cases enrichment at the expense of the state or its population (Heslop 2020). China's political system is based on the CCP's constitutional claim to leadership. It is thus not comparable to the two- or multi-party systems of Western democracies. Consequently, China has been trying to redefine the term "democracy" for several years, calling itself a "socialist democracy" ^{| 30} – in contrast to the (mostly) liberal democracies of the West. ^{| 31} In the contest with the USA for global leadership (and ultimately, with the West overall), it is also a question of being able to make the claim of having the superior form of government in the competition between systems.

To this end, the Chinese central government presented a white paper at the end of 2021 ^{| 32} contrasting the Chinese interpretation of democracy with the US interpretation, describing the latter as dysfunctional and a failure. The West as a whole is portrayed as weak, decadent and lacking in moral authority. ^{| 33} Overall: In decline. Russia is similarly working on the image of the West that should prevail among its own population. ^{| 34}

Access to non-Chinese media is being restricted. The 2021 World Press Freedom Index ranks China 177th out of 180 countries surveyed. ^{| 35} However, not only the local press is affected, but increasingly also the foreign press, where for example journalists are threatened with the refusal to renew their visas following unwelcome reports (RSF 2021). China's image abroad is to be shaped according to the will of the government in Beijing. The "Fourth Estate" in China largely toes the party line.

By calling itself a democracy, China is shifting the competition to another level along the lines of "do the same thing, just better" (Eyssel 2021; Büchenbacher 2021c). This comparison does not hold up from a Western perspective. Even though US institutions suffered from the erratic policies of the Trump administration – they withstood the attacks and precisely by doing so proved their strength.

By calling itself a democracy, China shifts the rivalry onto another level of competition.

30 A state calling itself democratic even though it does not meet the criteria for a democracy is not a new phenomenon respectively still exists today: One may point to the "German Democratic Republic" (GDR) or the "Democratic People's Republic of Korea", better known as North Korea.

31 It gets truly absurd when two authoritarian states praise each other and assure one another that they are democracies, as happened at the summit meeting between Xi Jinping and Vladimir Putin in February 2022 (Kamp 2022a; Kornelius 2022).

32 The white paper entitled "China: Demokratie, die arbeitet und funktioniert" ("China: Democracy that works and functions"), according to the arguably State-run, German Internet platform China.Org.CN, "presents the Chinese people's democracy in its entirety as the true and most appropriate form of government in the country's context" (CIIC 2021).

33 This is the headline on the Chinese website German.China.org.cn: "Reputation of the USA 2021 as a 'defender of human rights' has thoroughly collapsed" (CIIC 2022a).

34 The storming of the Capitol in January 2021 was grist to the mill of the Chinese and Russian definition of democracy. According to China, the USA's claim to leadership of the West is based on a false image. Reference is made, for example, to the USA's deep-seated problems, such as racism and police brutality (Ruf 2021). The war in Iraq, the camp at Guantanamo Bay, the treatment of prisoners in Abu Ghraib or the use of the death penalty are also often cited to deny the USA the moral high ground and to relativise criticism of China. This is an, "argumentative levelling of the difference in values" (Weber 2020). Unlike China, the US has a relatively independent media that addresses conditions and criticises the government.

35 Russia ranks 150th, the USA is in 44th place, Switzerland is in 10th place – Norway is in first place (RSF 2021).

Re-interpretation of human rights

The People's Republic is not only seeking a reinterpretation of the definition of democracy, but also of human rights; there is talk of a “Chinese development of the human rights issue”. “China’s President Xi Jinping has reaffirmed that respect for and protection of human rights is the relentless pursuit of Chinese communists” (CIIC 2022b). Amnesty International notes a glaring contradiction between China’s constitutional provisions and international commitments, as well as its actual implementation of human rights. This includes in particular dealing with minorities and politically engaged citizens (Amnesty International Schweiz 2021).

Western media and eyewitnesses report of Chinese re-education and surveillance camps in which the local culture is eliminated and rebellious ethnic groups are “brought into line”, at times forcibly (Spross 2019). China, naturally, sees this differently and speaks of interference in its internal affairs as well as of a “big lie”, for example regarding the existence of re-education camps for Uyghurs and forced labour in Xinjiang. China views the West’s accusations as an attempt to provoke the various ethnic groups and turn them against one another (CIIC 2020).

1.4_ China and the West: an uneasy relationship

The relationship between the West and China is complicated, with no fundamental easing of tensions in sight in the near future. Since 2019, the EU has designated China as a partner and competitor, but also as a systemic rival (EC 2019). In 2021, Brussels imposed sanctions on China again – for the first time in over 30 years. The focus is on four people responsible for the oppression of the Uyghurs in the Chinese region of Xinjiang, as well as the “Public Security Bureau”.³⁶ China’s reaction was quick to follow, imposing punitive measures against ten individuals and four EU institutions. This also affects the Mercator Institute for China Studies, whose publications repeatedly analyse China in a critical but well-founded manner.

The USA and China also maintain reciprocal sanctions lists. The trade conflict began in 2018 with punitive US tariffs on imports from China. The country was accused of unfair trade practices and one year later, tariffs were extended and imposed on \$500 billion worth of imports. China responded in kind with tariffs of its own. One goal of the US tariffs was to reduce the trade deficit with Beijing. The escalation spiral was briefly interrupted in 2020; in the so-called Phase 1 agreement, China committed to significantly increase its imports from the US and improve market access for US companies.³⁷ In return, the US would renounce new tar-

36 The last time the EU imposed sanctions against China for human rights violations was in 1989, after the Tiananmen Square massacre. Among other things, this included an arms embargo, which is still in force today. Due to other reasons, for example cyber attacks, punitive measures have already been taken against individual companies and persons (*Süddeutsche Zeitung* 2021).

37 A second agreement has not yet been reached.

iffs and drop the accusation of currency manipulation (Schürpf et al. 2021). The increase in imports from the US set out in the Phase 1 agreement has not been achieved and the US trade deficit with China actually increased in 2021 compared to 2019 and 2020 (Bown 2021; US Census Bureau 2022).

Re-emergence of the transatlantic alliance

With the sanctions against China, the EU also sent a clear signal to improve the transatlantic relationship, (Ernst 2021) since Brussels has so far struggled to find a coherent strategy regarding China. This is criticised in Washington as well as in many EU member states. In principal, the EU is trying to preserve its strategic autonomy and stay out of the confrontation between the USA and China, but without betraying its shared values with the USA (NZZ 2021b). Hence the EU also did not formulate a China strategy, but rather an Indo-Pacific strategy in which it defined the foreign policy principles for this region of the world (EC 2021). It thus avoided - in contrast to Switzerland (cf. Chapter 2.2) – singling out China. The EU approach is “inclusive” i.e. the focus is on cooperating with all partners in the region rather than pursuing a containment strategy vis-à-vis China. Nevertheless, there are different levels of depth in terms of the ambition and scope of the envisaged cooperation with the respective partner countries: the greater the overlaps in interests and values, the more extensive and in-depth the cooperation agenda. Close economic relations with China are to be continued in principle and deepened in the case of “common challenges” such as climate change or biodiversity.

However, Russia’s invasion of Ukraine and China’s tendency to take a pro-Russia stance is now expected to lead to closer transatlantic solidarity. Nato, too, has – at least so far – emerged stronger from the current conflict.³⁸ However, neither the USA nor the EU are involved in shaping the future Indo-Pacific trade architecture, in particular the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). China is already a member of the RCEP and applied to join CPTPP in September 2021: The trade rules of the most important growth region are therefore likely to continue to be shaped mainly by China.

The trading rules of the most important growth region are likely to be influenced largely by China.

(Not) a Cold War?

In the media and opinion columns, the term “New Cold War” is quickly bandied about as an analogy to the conflict between the USA and China (The Economist 2019). Instead of “mind games” such as strategic missile deployments, the focus is now on hacker attacks and 5G mobile technologies (Rachman 2021). Similarly, there are increasing signs of a new Space

38 “Europe is an economic giant, a political dwarf and a military worm” stated the Belgian Foreign Minister Mark Eysken in 1991 during the Gulf War (Puglierin 2020). In essence, this remains true today. However, in view of Russia’s war of conquest in early 2022, Europe’s foreign policy and military weight could increase, at least in the medium term.

Race. Propaganda organs of the Chinese government see themselves unerringly in second place, just behind the USA and far ahead of Russia. Chinese moon bases and Mars missions are mentioned to increase their publicity (HDI Global 2022). In parallel, an economic battle is being waged with punitive tariffs and other industrial policy measures (The Economist 2020). Former US Secretary of State Mike Pompeo said “China, with its economic clout, poses a greater challenge than the Soviet Union” (Zhang 2020).

Indeed, rising tensions between the US and China point to a contest of systems. China’s economic rise (cf. Chapter 1.1) is redistributing the geopolitical cards. With China’s reawakened self-confidence, territorial ambitions are increasingly coming to the forefront, be it through the so-called “Nine-Dash-Line”,³⁹ claims on Taiwan or on disputed territories in India (Hirono et al. 2019). The BRI (cf. Chapter 1.2) can also be seen as an attempt to expand this periphery (Clover and Hornby 2015).

However, analogies between the current conflict and the Cold War can only be drawn to a limited extent. First and foremost, this can be seen when conducting an economic comparison. While China is on a par with the USA in terms of absolute GDP and has already overtaken it in terms of purchasing power (cf. Chapter 1.1), the estimated GDP of the former Soviet Union was always smaller than that of the USA by a factor of two and, at the end (1990), by a factor of three (Maddison et al. 2006). The same applies to the interdependence of national economies. While in the end the volume of trade between the USA and the Soviet Union was approximately \$2 billion annually, trade with China reached \$2 billion in 2019 – per day (The Economist 2019). The mutual economic dependence between the USA and China is thus many times higher than was ever the case with the Soviet Union. An almost complete “decoupling” – as was the case with the USSR and the West – is therefore unlikely. Mutual economic dependence is simply too great.

Another difference becomes apparent when comparing military expenditure: During the Cold War, for example, the USA spent up to 9.4 % of its GDP on military purposes. This was clearly reflected by the power and political reach of the military-industrial complex.⁴⁰ In 2019, military expenditure still amounted to 3.4 % of GDP. Despite this (relative) reduction, US defence spending exceeds that of China (1.8 %) almost two-fold (World Bank 2022f). Thus, the military arms race is still at a significantly lower level than during the “hottest” periods of the Cold War.

The ideological confrontation between the two hegemons must also be judged differently. Whereas during the Cold War, the two world views of capitalism and communism clashed almost head-on, China’s state cap-

39 The so-called “Nine-Dash-Line” refers to an imaginary border demarcated by China in the South China Sea. It makes territorial claims that reach deep into the territories of Vietnam, the Philippines, Malaysia and Brunei (Schneider 2021).

40 The close relationship between politicians and representatives of the military was first described by sociologist Charles Wright Mills as the military-industrial complex (Wright Mills 1956).

italist economic system at least seems closer to the market economy than the Soviet planned economy. Likewise, unlike the USSR, the “exporting” of its own ideology does not seem to play a central role for China (CSIS 2019).

A new Cold War with China in place of the Soviet Union is unlikely; the differences are too great. However, a frostier relationship between the West and China in the future is possible, and the risk of a further deterioration of the relationship should be planned for economically, politically and, if necessary, militarily in terms of precautions by the individual states and their companies.

China’s rise to a world power has so far not been based on its military dominance or ideological persuasiveness, but primarily on its economic might and technological innovations. Overall, few parallels can be drawn between the Cold War and today’s geopolitical upheaval. Ultimately, however, the relevance of many comparisons made in the media and forecasts derived from them on China’s role in the world remains severely limited. The ideological, military and, in particular, economic starting position displays a multi-dimensional movement. French historian Marc Bloch wrote as early as 1990: “It [history] never repeats itself exactly” (Bloch 1990). China is likely to prove him right once again.

A new Cold War with China instead of the Soviet Union is unlikely.

1.5_ Boundless friendship with Russia?

The West responded to Russia’s invasion of Ukraine in a swift and almost united response. The suffering caused by the Russian invasion caused the differences between Western countries to fade into the background. |⁴¹ Russia united the West. China will not have it easy either if it takes a harder line in the future. Nevertheless, the question begs to be asked whether, in light of Russia’s relatively low economic weight compared to China, the West is prepared to incur disproportionately higher costs in a direct or indirect confrontation with China in order to lend weight to its values (cf. Figure 5).

Unequal neighbours

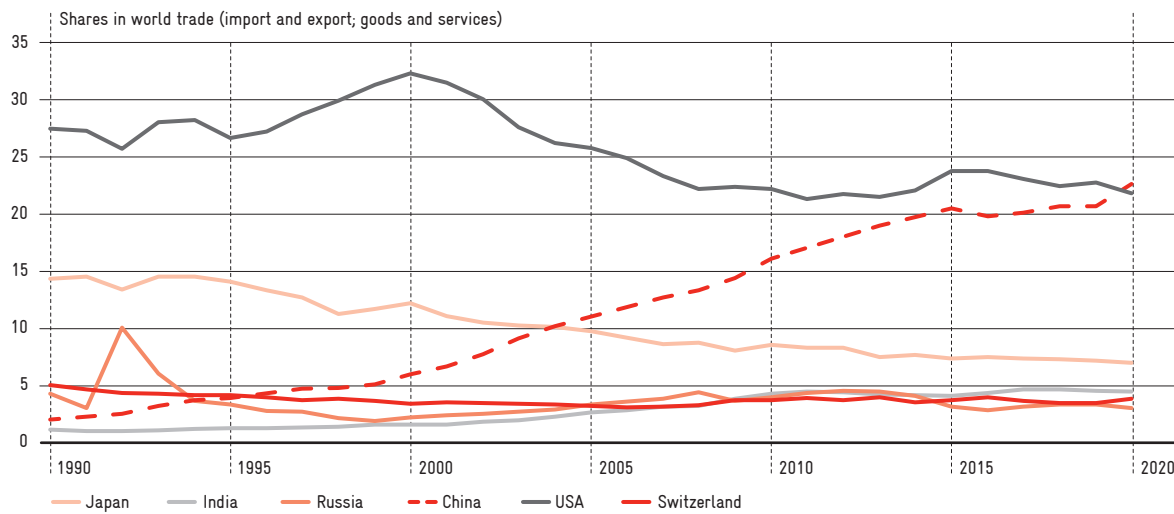
In 2020 – before the Covid pandemic and the Ukraine war - Switzerland played a more important role in global trade than Russia did. China, on the other hand, is responsible for 23 % of global trade volume; more than four times as many cross-border trade transactions as Russia, and growing. Likewise, the composition of exports is entirely different. While two-thirds of Russia’s exports are raw materials (especially oil, natural gas, metals and diamonds), China supplies mostly processed products (machinery and equipment |⁴² account for half of its exports) (OEC 2022). This

⁴¹ This has placed Switzerland under pressure to act (cf. Chapter 2.2, Text box 2). Neutrality as a justification for not imposing sanctions and implementing measures against circumvention would no longer suffice; Switzerland would have isolated itself in the West.

Figure 5

China and the USA dominate world trade

When measured by the sum of imports and exports from trade in goods and services, China overtook the USA in 2020. Russia, by contrast, barely reaches the level of Switzerland's share of world trade.



Source: Own calculations, WDI (2022)

is underpinned by the Economic Complexity Index (ECI), a measure of the ability to produce economically complex products. Here Russia ranks 52nd, the People's Republic 16th (Harvard Growth Lab 2022).⁴³

By analogy, regarding the sanctions against Russia, substituting Chinese exports would be far more costly and burdensome for the West. Mutual dependencies have increased with the interconnectedness of global trade flows. Trade volumes of most EU member states with China are larger than they are with the USA (cf. Chapter 1.1, Figure 4). In this respect, the pressure would have to be very high for the EU to support a stronger US containment policy against China in the future. The opposite is true for Switzerland: The USA is its second most important trading partner after the EU, ahead of China (incl. Hong Kong) and the UK.⁴⁴

The trade volume of most EU member states with China is larger than that with the USA.

New alliances not ruled out

Following the Russian attack on Ukraine, the question is whether the confrontation with the West will encourage closer cooperation between Russia and China. Thus, barely two weeks after war broke out, the Chinese foreign minister invoked the “rock-solid friendship” between the two countries (Kamp 2022b). This is also underpinned by current trade figures: Bilateral trade is growing faster than with the EU and China has not joined the sanctions against Russia.

⁴² Including, for example, telephones, computers, circuits, radio equipment, valves, pumps, centrifuges, etc. (HS2-ID 84).

⁴³ Japan is in first place, Switzerland second and the USA is in 11th place.

⁴⁴ If Hong Kong is added to China, it becomes Switzerland's third most important trading partner (after the USA and before the UK). In each case, always measured by the sum of imports and exports of goods and services.

One consequence of Russia's exclusion from the Swift international payment system could be that Cips, the Chinese competitor system, becomes more established and the renminbi (RMB) increasingly accepted as a trading currency. The basis is the intensified Russian oil and gas deliveries to China. The more frequently the RMB is used outside its own borders, the better China is ultimately protected against exchange rate fluctuations (Kretschmer 2022).

However – in order not to limit its political and economic room for manoeuvre – Russia will hardly forge closer ties with China. Although the two countries are neighbours, their population and economic centres are thousands of kilometres apart (Krugman 2022). Moreover, the mutual benefits might be smaller than they might appear at first glance. On the one hand, Russia can hardly have an interest in becoming dependent on China in a power-based system – towards which we are moving internationally. China's economic power is already almost ten times greater than Russia's (World Bank 2022g), and the difference is likely to continue to develop to Russia's disadvantage.

On the other hand, were Beijing to enter into an alliance with Moscow, it would currently harm the Chinese export economy. The know-how and markets of the West are still important to China's growth. US and EU sanctions against China, on a scale similar to the conditions imposed on Russia, could jeopardise the CCP's implicit contract with the people (limited political participation in exchange for economic growth) and thus its hold on power (cf. Chapter 1.1).

Nevertheless, while this view may be correct in the short and medium term, it is probably wrong in the face of possible irrational actions by Moscow and Beijing over the long term. If China remains on the economic fast track, its own domestic market⁴⁵ as well as the growth of Africa – which is integrated via the BRI – could become relatively more important for Beijing than selling its products in the West. A closer alliance with Russia could prove useful to China in the future, in particular with regard to access to raw materials, agricultural goods and, ultimately, cooperation in military projects as well.

⁴⁵ One goal of China's economic policy – based on its current five-year plan – is to strengthen demand in the domestic market to reduce dependence on exports for growth (Bickenbach and Liu 2021).

2_ Switzerland and China

In recent decades, Asia, under the influence of China, has developed into one of the most dynamic regions in the world and thus gained in attractiveness for Western exports and companies. Having recognised China's potential early on and by nurturing good political relations, Switzerland has also benefited from this. However, China's economic rise has been accompanied by a change in its demeanour. Since Xi Jinping came into power, a more aggressive tone has prevailed and the interests of the People's Republic are being vigorously asserted both in multilateral bodies and in bilateral frameworks.

Western democracies are increasingly facing conflicting goals. On the one hand, they wish to continue to benefit from market access; on the other, they are also under domestic political pressure to defend the liberal world order from China. Even for smaller countries like Switzerland, this balancing of interests is increasingly challenging. Unlike the major powers, however, it has fewer options: Unilateral action would have little impact on China, while potential countermeasures by Beijing could extract a high price. This is a delicate balancing act. While the pressure to take a clearer position is increasing domestically, for example because of human rights violations, in terms of foreign policy, Switzerland is being asked to adopt the measures taken by the USA and the EU as part of the West.

The second chapter of this study shows why – under the current framework conditions – continuing Switzerland's current positioning is the most sensible strategy and why premature partisanship should be avoided.

2.1_ A relationship with a long tradition

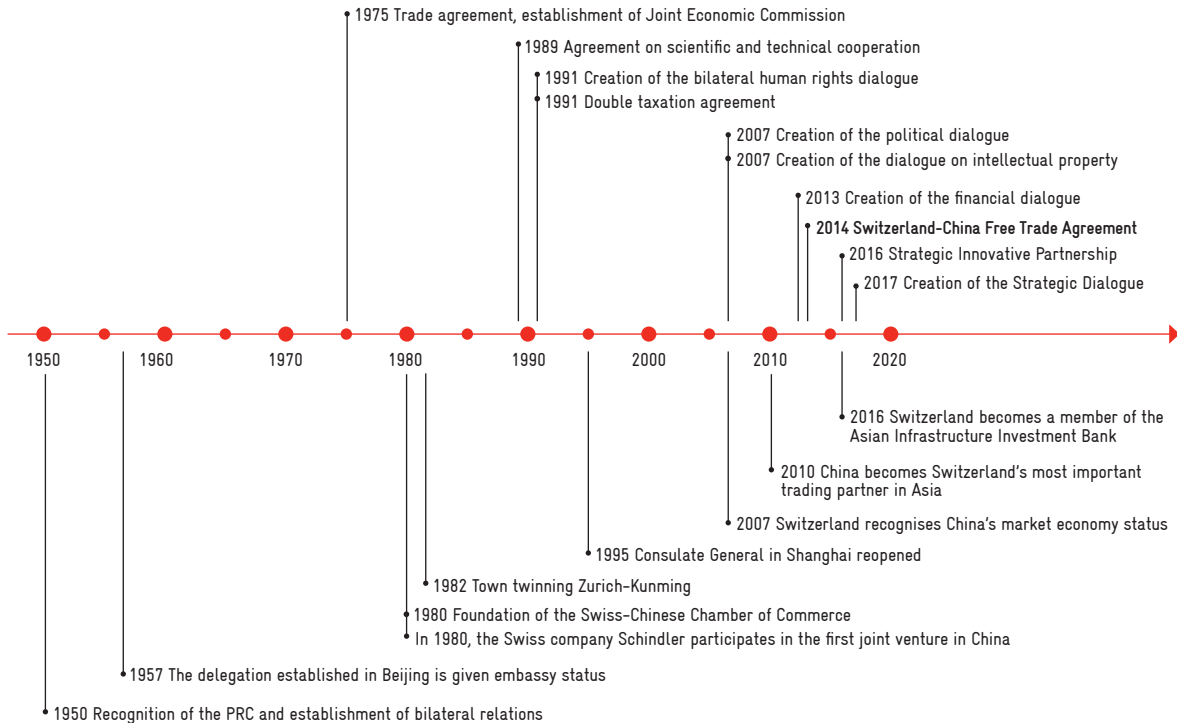
China's rise as a world power has also had an impact on Switzerland. Initially, this manifested itself – when there was still hope for “Change Through Trade” – mainly through the gradual deepening of bilateral, economic cooperation. Switzerland's main goal was to gain access to the emerging Chinese market. Its success in this regard is at least partly due to the special relationship it has with China. Officially, this friendship began as early as 1950, when Switzerland was one of the first Western states to recognise the People's Republic. In 1975, this led to the first trade agreement and the establishment of a Joint Economic Commission. As early as 1980, the Swiss company Schindler participated in a joint venture - the first of its kind in China (cf. chapter 1.1). Internationally, Swiss companies also played a pioneering role in developing the Chinese market and investment location. This led to a well-established contact network of companies, associations and local representatives that is still in existence (EDA 2021).

Figure 6

Close bilateral relations with China since 1950

Since it recognised the People's Republic in 1950, Switzerland has been able to deepen both economic and social cooperation with China.

Important agreements and dialogues



Source: EDA (2021)

This development was accompanied by the conclusion of further agreements (cf. Figure 6): An agreement on scientific and technical cooperation was concluded in 1989, a double taxation agreement in 1991 and a free trade agreement (FTA) in 2014. Although it was economic interests that initially drove this cooperation, bilateral relations were quickly extended to other areas. Thus, a dialogue on human rights was launched as early as 1991, with the political dialogue following in 2007. In addition, official dialogues on labour and employment conditions have been held within the framework of the FTA since 2014.

Untapped free trade potential

The FTA, which entered into force on 1 July 2014, is intended to improve mutual market access for goods and services and to promote bilateral cooperation between the two countries. Specifically, in order to strengthen trade relations, legal certainty must be increased, especially with regard to the protection of intellectual property. Existing tariffs on the majority of bilateral trade are to be entirely or partially dismantled⁴⁶

⁴⁶ The dismantling of Chinese industrial tariffs is subject to transition periods for certain products, which in some cases amount to 15 years from the entry into force of the FTA (Seco 2013).

and non-tariff trade barriers are to be reduced through various cooperation agreements. Overall, the FTA not only improves access for Swiss goods and services exports to the fast-growing Chinese market, but also gives the Swiss economy a competitive edge over foreign competitors. Neither the EU nor the US has an equivalent agreement with China.

Even if the FTA is not yet exploiting its full potential due to some lengthy transition periods, Swiss companies have been benefiting from it since it came into force. Between 2014 and 2018, for example, costs of around CHF 100 million per annum were saved on Swiss exports to China (SWI 2018). However, this figure should be taken with caution, given the low rate at which Swiss exporters make use⁴⁷ of the FTA. In 2018, it was only 36 % whereas the average rate of other FTAs in Switzerland is 80 % (Legge and Lukaszuk 2019). The situation is similar for imports: at just under 42 % (2018) (Legge und Lukaszuk 2019), it was significantly lower than the average utilisation rate of Swiss FTAs (73 %) (Legge and Lukaszuk 2020). With such low utilisation rates, Swiss companies are foregoing more than double the realisable customs savings.⁴⁸

The low utilisation rate of the FTA is due in particular to the fact that the traded goods must comply with the rules of origin. In order to export products from Switzerland to China at preferential tariffs, a sufficiently large share of the value creation must have taken place in Switzerland. However, due to global value chains, it is difficult to meet this requirement. Companies must document the manufacturing process in detail, a significant additional expense that often cannot be justified by a reduction of duties (Legge and Lukaszuk 2020). Switzerland should therefore make use of the FTA's evolutionary clause. It notes that discussions can be initiated with Chinese authorities to further reduce barriers to trade. Thus, the administrative burden associated with the use of the FTA would be simplified and certain tariffs further reduced. However, the question arises as to how realistic it is to expand the FTA with China (cf. Chapter 2.2, Footnote 56).

Switzerland should make use of the evolutionary clause of the FTA.

China as a trading partner and investor

China is an attractive market for foreign companies due to its strong economic growth (cf. Chapter 1.1) and the associated business opportunities. Between 2010 and 2019, Switzerland's goods exports to China (in each case including Hong Kong) grew by an average of 8.4 % per year (cf. Chapter 2.3, Figure 9). In absolute terms (2019), this amounts to CHF 31 billion, while imports from China amounted to CHF 19 billion (BAZG 2022). This corresponds to 10 % of all Swiss exports and 7 % of all goods imports. Bilateral trade in services is proportionally less important. Nevertheless, in 2019, revenue attributable to China amounted to CHF 6 billion. Almost a quar-

47 The sum of all imports and exports subject to customs duties under the FTA in relation to total foreign trade with China.

48 Those tariff savings that occur when FTA customs clearance is fully utilised by Swiss exporters.

ter (22.5 %) of this is attributable to Chinese tourists (SNB 2022a). In total, an estimated 132,000 employees in Switzerland benefit from the export of goods and services to China (source: Own calculations based on Dümmler und Grünenfelder 2019). Without Hong Kong, China is Switzerland's fourth largest trading partner. Including Hong Kong, it is actually the third.

Switzerland is an attractive destination for foreign direct investment, with foreign capital stock invested in Switzerland almost doubling between 2011 and 2019. This sharp increase is due in particular to direct investments from the USA and the EU, which were by far the largest investors in Switzerland in 2019 with capital holdings of 49 % and 27 % respectively (cf. Figure 7).⁴⁹ Even though Chinese investment more than doubled between 2016 and 2020, China's share of the total foreign capital stock in Switzerland was low at 1 % in 2019 (SNB 2022b).

Despite China's small share, there have been repeated calls for stricter regulation of foreign investment in Switzerland. The impetus for this was provided by prominent acquisitions of Swiss companies by Chinese investors, such as that of Syngenta by the state-owned Chem China to the tune of CHF 43.7 billion.⁵⁰ Contrary to the Federal Council's recommendation, the Rieder motion calling for Swiss investment controls was adopted by the Council of States in 2019 and by the National Council in 2020. The consultation draft should be available in 2022. The motion's arguments are based on the fact that it is, "the stated aim of many of these states to invest specifically in Western know-how and to make this know-how usable for themselves and their economies" (Das Schweizer Parlament 2018). Specifically, this refers to the "Made in China 2025" strategy, which provides for targeted investment in foreign high-tech firms (Kunze and Windels 2018).

The Swiss side complains that there is no reciprocity in the investments. Chinese investors have thus been able to buy Swiss companies largely unhindered, while Chinese investment controls also apply to Swiss companies despite the FTA.⁵¹ Reciprocity does not automatically lead to a profitable relationship - after all, Switzerland benefits greatly from the Chinese market even without full access. Nevertheless, reciprocity is an important prerequisite for a rules-based trading system and should therefore be sought in all trade relations. If Switzerland now introduces investment controls, its multilateral call for a reduction of market access barriers will lose credibility.

⁴⁹ In each case measured against the ultimately eligible investor.

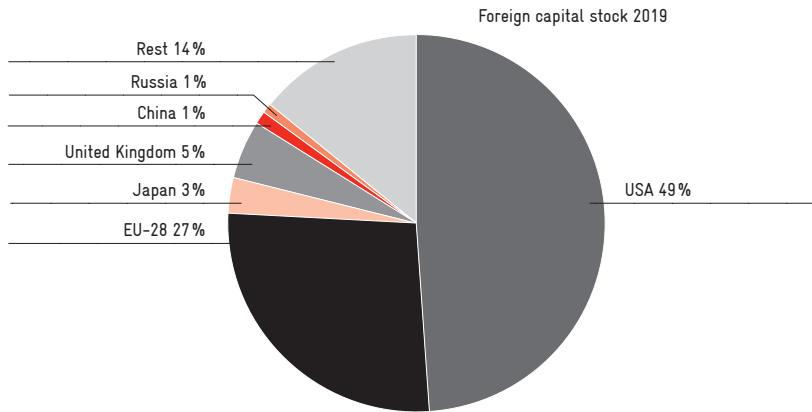
⁵⁰ Cf. also the Badran parliamentary initiative submitted in 2016. It demands that "strategic infrastructures of the energy industry" be made subject to the Lex Koller rule so that sales to persons abroad are categorically excluded (Das Schweizer Parlament 2016).

⁵¹ In January 2021, China adopted the "Security Review Measures", which will result in foreign investment in certain areas being reviewed in relation to national security issues (PwC O. J.). Chinese authorities can now review foreign investments in the military, agriculture, energy, transport and information technology.

Figure 7

Western capital as the most important source of FDI in Switzerland

By far the most important investor group in Switzerland comes from the USA, accounting for almost half of foreign capital. By contrast, Chinese and Russian investors play a subordinate role.



Remark: Capital stock by ultimately entitled investor.

Source: Own calculations, SNB (2022)

In addition, investment controls are also inappropriate in preventing strategic trade dependencies, hostile technology transfers or sabotage of critical infrastructure (Salvi 2018). On the one hand, no immediate security risk can be derived from the ownership structure alone and consequently no effective defence strategy can be defined. Protecting critical infrastructures from hostile takeovers cannot be used as a plausible argument either, given the fact that the majority of these are already owned by state- or state-related institutions. Furthermore, there is a risk of politicisation of the control procedure, as the Federal Council pointed out in 2020 (Bundesrat 2019). In the case of company takeovers, regional and industrial policy considerations could also be decisive for the rejection of foreign direct investment. In the USA, for example, due to specific interests, the concept of security was extended to the point that the takeover of a US pork producer was scrutinised in detail.

Overall, investment controls increase legal uncertainty for potential foreign investors, for example due to lengthy inspection times, and they reduce the attractiveness of an investment location. In Switzerland, there continues to be a great deal of room for interpretation in the legal interpretation of individual terms such as critical dependence, the demarcation of domestic and foreign companies or a significant distortion of competition. Even if the Federal Council takes care to maintain openness to foreign investment when introducing investment controls, a state control bureaucracy would make investment activity in Switzerland more difficult. Not only foreign economic relations with China, but also with the more important partners, the USA and the EU, would be affected.

Overall, investment controls increase the legal uncertainty for potential foreign investors.

Switzerland's greatest growth impulses in recent decades have come from those sectors (pharmaceuticals, wholesale, machinery) that were characterised by the greatest openness to foreign investment (Salvi 2019).

2.2_ More intensive discussion of values in foreign trade

Relations with other countries are of great importance for an open and globalised Switzerland. Only through access to foreign markets that is as free of obstacles as possible can the foreign trade sector continue to make its previous, substantial contribution to growth. Updating the FTA with China would be important not only from a business perspective, but would also generate economic benefits. However, the mood of many policymakers and the population towards the People's Republic has turned sour, and further trade facilitation does not enjoy much support.

Besides China's behaviour within its own borders, Beijing's reactions to criticism from abroad are also contributing to the deterioration of its reputation. After Switzerland joined other states in calling on the country to end the detention of Uyghurs in 2019, China postponed the planned human rights dialogue meeting indefinitely (Das Schweizer Parlament 2019a). This had never happened before – not even after the temporary deterioration of relations in 1999, when then Chinese President Jiang Zemin met a Tibet demonstration on the Bundesplatz in Bern (Poletti et al. 2021).

China's reactions are not limited to the Swiss government and its officials. Companies, organisations or individuals also run the risk of being targeted for critical statements and fear adverse effects in their exchanges with China. These intimidation tactics are now so pronounced that in some cases there is self-censorship or deliberate distancing from critics of the regime. ⁵²

Free trade agreements as a platform for discussion

Political demands for critical engagement with China are increasing in Switzerland (Das Schweizer Parlament 2020a, 2020b). For example, there are calls for Switzerland to be more consistent in upholding its values and therefore to suspend the FTA with China. It is argued that this would clearly signal where the country's priorities lie (Das Schweizer Parlament 2019b). However, even if the FTA were to be suspended, trade would continue to take place - after all, Switzerland also trades with the USA without having an agreement. If stopping trade were the goal, demands for sanctions would be more honest - although this should be taken into consideration in the context of neutrality policy (cf. Text box 2). The example of China in particular shows how good economic relations can be used: the establishment of platforms for dialogue on various topics, including human rights and

52 A recent example is a professor at the HSG who feared that China might deny her entry because of her doctoral student who was critical of China (Büchenbacher 2021d). Although there was no evidence of pressure attempts from China, she cut all ties with the student.

labour and employment issues (cf. Chapter 2.1, Figure 6). Even if the human rights dialogue is currently suspended, Switzerland can attempt to bring China back to the table within the framework of the institutionalised dialogue on the FTA. Countries where the human rights dialogue has also broken down that do not have an FTA with China must first re-establish contact.

Text box 2

Pressure on Switzerland's understanding of neutrality

When the EU imposed sanctions on China at the beginning of 2021, there was a debate in Switzerland as to whether to join in – this did not happen. For many, the adoption of sanctions is not compatible with a strict interpretation of neutrality.

Thus, it is repeatedly criticised that Switzerland hides behind the concept of neutrality and is reluctant to take a stand (Gafafer 2022). The Federal Council also took its time in taking a position on Russia. Bern's fear was that Switzerland would jeopardise its credibility as an independent bridge-builder if it automatically adopted the EU sanctions (Handelszeitung 2022). This means that it can no longer offer its "good offices" and mediate between the warring parties, as it has been doing, for example, in the conflict between Russia and Georgia since 2009 (Fischer 2022).

The question remains as to whether Switzerland is placing its neutrality at risk by adopting sanctions. To answer this question, a distinction must be made between the conception of the term under international law and the political conception. Under international law, neutrality means that a country does not take part in any military conflict between other states, does not make its own territory available to the warring parties and that no weapons may be supplied to the parties to the conflict by state organs (EDA 2022b). The political conception of neutrality, on the other hand, demands general equality of distance from the parties to the conflict (Tribelhorn 2020).⁵³ As a rule, Switzerland interprets the policy of neutrality very narrowly; it almost resembles a policy of non-interference (Rühli und Rogenmoser 20220). Such an interpretation is increasingly interpreted as ambivalent or even as implicit approval of the aggressor's actions. The accusation then naturally follows that Switzerland is only neutral for economic reasons to be able to continue to trade with all parties to the conflict without restricting itself by imposing sanctions.

Growing weight of social and environmental issues

Directly linking FTAs to human rights, labour standards or sustainability issues displaces the core of such agreements: the reduction of tariffs, technical barriers to trade and quantitative restrictions such as import quotas. Ideally, social and environmental aspects would be resolved in the relevant multilateral forums and regulated by separate agreements that apply equally to all member states. In practice, however, this approach often fails due to the lack of a binding nature and effective enforcement mechanisms. For example, in the case of the Paris Climate Agreement or the ILO Convention on Labour and Social Standards, the associated multilateral organisations cannot force any country to abide to the international commitments it has signed

⁵³ The policy of neutrality also includes all measures a neutral state takes on its own initiative in order to ensure the predictability and credibility of its neutrality (EDA 2022b).

More and more countries – including Switzerland ⁵⁴ are thus resorting to bilateral trade agreements to regulate not only directly trade-related issues (Lechner 2019). ⁵⁵ This development was originally driven by societal pressure in many Western countries, but developing countries are also increasingly open to including non-trade provisions in their FTAs. One example is the Swiss trade agreement with Indonesia: To promote sustainability in palm oil cultivation, tariff reductions are linked to compliance with international standards (Seco 2022). For a long time, such additional provisions were criticised for being only cosmetic in nature. However, a study that analysed 487 trade agreements between 1990 and 2015 shows that this is not the case, at least for labour law (Raess and Sari 2018). FTAs that establish an institutional framework for monitoring and implementation, as well as strengthen bilateral cooperation, lead to fewer violations of labour rights such as the right to organise and the right to collective bargaining (Sari et al. 2016). The introduction of chapters on sustainability and/or human rights is therefore not bad or to be rejected per se – so long as both trading partners agree on them, they can and ought to be included in agreements. The case is different in the case of extra-territorial application of domestic law (cf. Text box 3).

Text box 3

Problematic extraterritorial application of domestic law

In addition to linking foreign trade to additional issues, there are increasing calls for international enforcement of domestic regulations, such as the Corporate Responsibility Initiative (CRI), which was narrowly rejected by Swiss voters. The increasingly required extraterritorial application of domestic law creates inconsistencies, for example through the application of domestic production standards abroad, and leads to significant additional work for companies in the case of due diligence and reporting obligations. The trend towards greater legalisation of business relations with foreign actors is unbroken despite rejection of the CRI. All in all, this creates new trade barriers and Swiss companies will increasingly weigh up the risks and withdraw from countries that are perceived as being problematic. It remains to be seen whether investors from other countries who might step into the gap will offer better conditions to the local population.

This is because it is often internationally positioned Swiss companies that commit to standards and behaviours that go beyond local requirements when it comes to workers' rights and environmental concerns. This is reflected in the high penetration of "Corporate Social Responsibility" (CSR) rules in business. Currently, a total of 84% of industry associations have such a set of rules concerning the environment, human rights or other concerns, such as transparency. Compared to five years ago, this is an increase of 16 percentage points (Dümmler und Schnell 2019). This comparison shows over time that companies are becoming more aware of the specific problems in their sectors and very often react to them independently with suitable measures.

⁵⁴ The value of the FTA with China as an institutionalised platform for dialogue has been recognised by some parliamentarians – they are calling not for a suspension, but for an update of the FTA and the addition of a human rights chapter (Das Schweizer Parlament 2021).

⁵⁵ For example, 81% of 654 trade agreements signed since 1990 contain at least one non-trade provision (Lechner 2019). This refers primarily to civil, political, social, sustainability and security standards.

Dispute over Switzerland's China strategy

Switzerland's dealings with China are now not only a matter of concern to classic left-wing groupings. Numerous parliamentary motions on foreign policy deal with this issue; left-wing parties in particular stand out, but critical interventions have also been submitted or co-signed in part by the centre and the SVP (Häfliger 2021). In response to the concerns of these groups, the Federal Council felt compelled to take an explicit stance and published its China strategy on 19 March 2021 (EDA 2021). The Federal Council makes direct reference therein to the authoritarian tendencies, suppression of minorities and general deterioration of the human rights situation in the People's Republic (Häfliger 2021). Compared with the China policy of other Western countries, Switzerland's China strategy is considered cautious. Accordingly, domestic reactions were rather sober and there was criticism that the strategy amounted to nothing more than "pretty words" (Birrer 2021). Many representatives of politics and society find the strategy too vague, not only in its defence of Swiss values, but also in the intentions for action outlined (Roth 2021). Federal Councillor Ignazio Cassis admitted, when the strategy was presented, that it was not a revolutionary change of course. Neither was that the goal. Rather, the "Whole-of-Switzerland" approach was intended to improve the coherence of China policy among the departments, so that they would increasingly speak with one voice in future (Häfliger 2021).

For many observers, the strategy is too vague, not only in its defence of Swiss values, but also in its action plan.

It is understandable that the China strategy has raised hopes of a clear position vis-à-vis China; after all, the Federal Council had not yet adopted its own strategy for any other country.⁵⁶ China's special role was justified, among other things, by the fact that the country is not only a locomotive of the global economy, but as a great power with far-reaching geopolitical ambitions, it is changing the framework conditions of international relations (EDA 2021). However, this also applies to the USA. After all, despite its slower growth compared to China, it remains a major economic power and continues to shape the international community. One could thus argue that Switzerland should also develop a US strategy. Instead, the United States is only mentioned in the Federal Council's regional strategy on the Americas.

This special treatment did not escape China's notice and promptly led to protest. Shortly after the Federal Council published its China strategy, China's diplomatic representative in Switzerland hosted a virtual media conference. This is unusual in that it is not normally part of a diplomat's job description to actively communicate with the media. But apparently, Chinese officialdom felt compelled to present its view. Criticism was levelled at what the Chinese saw as, "unfounded accusations and attacks on

⁵⁶ In principle, the priorities and focus areas set out in the foreign policy strategy apply to foreign policy. These can then be specified in regional follow-up strategies for geographic regions. In addition to the China strategy, there are follow-up strategies for the Middle East and North Africa (Mena), for sub-Saharan Africa and for the Americas (EDA 2022c).

the political system, minority policy and China's human rights record" (Kamp 2021). The undiplomatic words used by Beijing's representative can be interpreted as a possible example of the "wolf-warrior" strategy, which encourages China's diplomats to be offensive and uncompromising towards critics abroad. In Switzerland, this in turn led to politicians and the population feeling vindicated in their unease towards China. Neither the China strategy nor Beijing's reaction have so far helped improve bilateral relations or the situation in China.

2.3_ How should Switzerland position itself?

The current geopolitical upheaval means that the balancing act of the Switzerland-China relationship is becoming increasingly delicate. On the one hand, domestic and foreign policy pressure is growing, forcing Switzerland to take a stronger stand internationally for fundamental Western values. On the other hand, there is the neutrality policy and the foreign trade objective of keeping market access open to the most important export destinations. In the coming years, Switzerland will have to be increasingly careful if it wants to stay out of the firing line of US (and possibly EU) sanctions against China.

Asymmetric trade relations

From Switzerland's perspective, the EU, USA and China are jointly responsible for 70 % of Switzerland's trade in goods (imports and exports) (BAZG 2022). The balance is similar for services: the same top 3 trading partners account for 75 % of the total volume, with China's share below average at 3 % (cf. Figure 8). The importance of foreign trade to Switzerland is also reflected in the employment figures: an estimated total of 2.1 million employees benefit directly from exports (source: Own calculation based on Dümmler und Grünenfelder 2019), 48 % of which are attributable to exports to the EU-27, 17 % to market access to the USA and 6 % to exports to China (incl. Hong Kong) (cf. Chapter 2.1, p. 34).

On the other hand, for the major powers such as the USA and China, Switzerland represents a negligible quantity. In 2019, it accounted for 1.5 % (USA) and 0.7 % (China) of total foreign trade in goods (imports and exports) (Wits Data 2022). For the EU, Switzerland is of greater relevance. Still the fourth largest trading partner in 2019, it weighed in with a 6.3 % share of the goods trade volume. Worldwide, Switzerland created a mere 0.81 % (2019) of economic output.

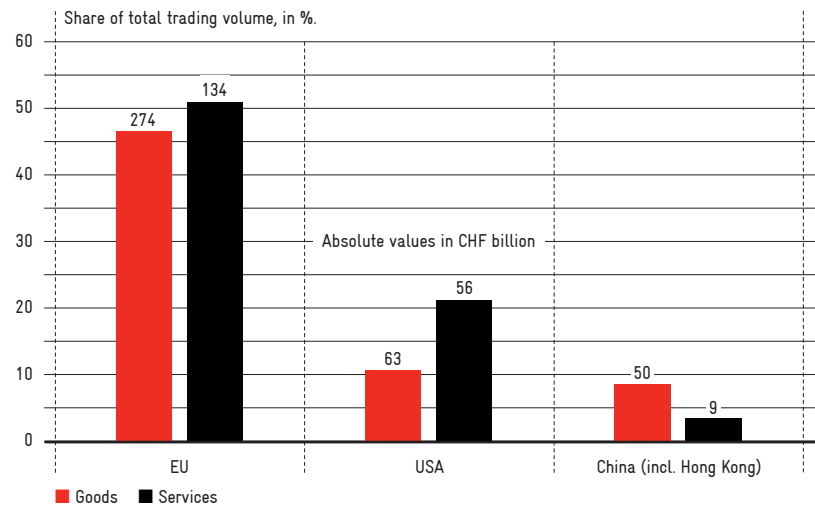
Stalled expansion of the free trade network

Given these figures, it would be presumptuous to believe that Switzerland – especially in an increasingly power-based international system (cf. Chapter 1) – would have a significant impact on the geopolitical conflict between the major powers. Rather, this conflict is a largely exogenous factor for Switzerland. However, it can attempt to position itself in a way

Figure 8

Trade volume of Switzerland's top 3 trading partners in 2019

While trade with China consists largely of goods, the relationship with the USA is dominated by trade in services.



Source: BAZG (2022), SNB (2022)

that minimises the potential damage, depending on the intensity of the pressure placed on it. This includes further diversification of international relations through FTAs in order to strengthen Switzerland's economic resilience (WBF 2021). This makes it possible to reduce dependence on individual states and, if necessary, to expand already established supply chains or sales channels with third countries.

Switzerland already maintains a large network of economic agreements, which counts as one of the densest in the world. It currently has 38 agreements with 77 countries (Seco 2021),⁵⁷ meaning it covers around 55% of the global market - measured in terms of GDP. Singapore manages a much higher coverage of the world market (77.9%) with far fewer countries (36) (Bonato 2021a). Unlike Singapore, Switzerland has concluded a number of agreements with very small partners, such as with North Macedonia (GDP: \$34 billion), Albania (GDP: \$40 billion) or Georgia (GDP: \$56 billion). On the other hand, it has no agreement with the USA (Dümmli und Anthamatten 2019). Switzerland is finding it increasingly difficult to successfully conclude existing trade negotiations and to update older FTAs already in force (Dümmli 2021b).⁵⁸ As the "low hanging fruit" have already been picked, Switzerland would have to make concessions for further agreements. Thus, for example, in May 2021, the Federal Council

Switzerland is facing increasing difficulties successfully concluding existing trade negotiations and updating older FTAs.

⁵⁷ Seco's website only shows 43 partners, as they count customs unions (e.g. the South African Customs Union Sacu) and associations of states such as the EU and Efta as one partner each.

⁵⁸ For example, it appears unlikely that the existing FTA with Japan will be renewed, mainly because Tokyo has no interest in negotiating (Kölling 2022).

rejected the institutional framework agreement with the EU, which would have enabled it to update and consolidate trade relations with its most important trading partner in the long term.

Bronze medal for China

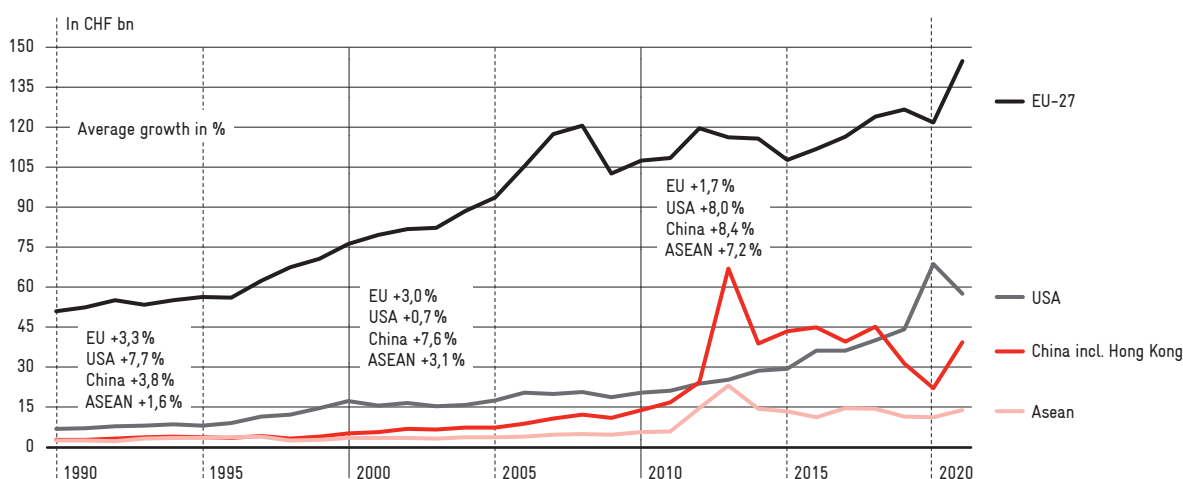
To date, the review of the development of Swiss goods exports allows two conclusions to be drawn: Growth rates with the Indo-Pacific region and the USA are substantially higher than with the EU, yet the gap between these and the EU remains large (cf. Figure 9). The strong economic ties between Switzerland and the EU can be attributed, among other things, to their geographic proximity. For example, the gravity model used in foreign trade theory assumes that greater geographical distance and increasing cultural differences have a negative impact on the volume of trade exchanged bilaterally. Conversely, more trade is conducted with countries closer to home than with countries further away. A common language or history supports this effect. The gravity model is supported by economic research and is considered to have been empirically proven.⁵⁹

What does this mean for the future of Swiss foreign trade? A rough forecast, subject to highly simplified assumptions (constant growth of Swiss exports relative to the respective trading partner), shows that by 2050 the USA could surpass – albeit just – the EU’s share of Swiss exports. China would still only be in third place (cf. Figure 10a). If, on the other hand, GDP growth forecasts are taken into account (with constant import

Figure 9

Development of goods exports between 1990 and 2021

The high increase in exports to China in 2013 is likely due to the Efta-Hong Kong Free Trade Agreement, which entered into force on 1 October 2012.



Remark: Asean comprises Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.

Source: BAZG (2022), own calculations

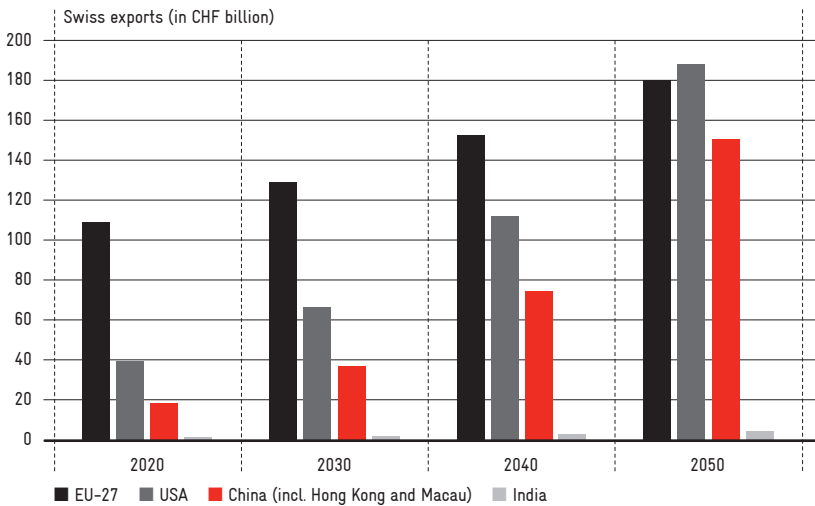
⁵⁹ Cf. review study on the effect of distance on trade by (Disdier und Head 2008).

shares of GDP), the EU would still be Switzerland's largest trading partner in 2050 (cf. Figure 10b). The bottom line is that the benefits of deepening bilateral relations with China are unlikely to outweigh the benefits from

Figure 10a

Estimated Swiss export volume

If Swiss exports were to grow at the same rate as the last 20 years, the EU would still be one of Switzerland's most important trading partners even in 2050, just behind the USA but ahead of China.



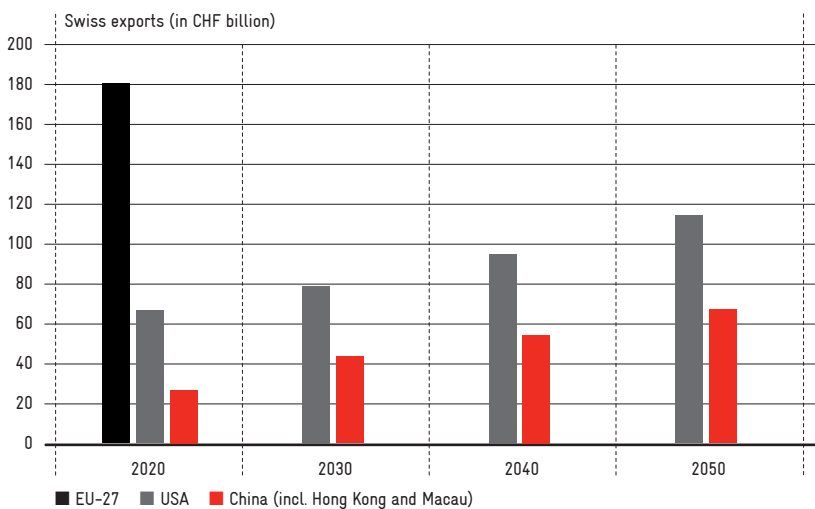
Remark: Forecast based on the average Swiss export growth rate over the last 20 years.

Source: EZV (2022), own calculations

Figure 10b

Estimated Swiss export volume – basis trade growth

If the Swiss export shares of the respective GDP were to remain constant and develop according to PwC's forecasts, the EU would remain Switzerland's most important trading partner by far in 2050.



Remark: Share of Swiss exports in respective GDP remain constant. GDP forecast according to PwC.

Source: EZV (2022), own calculations

trade relations with the US and especially the EU in the coming decades
– despite persistent claim by opponents of the institutional framework
agreement (Martullo-Blocher 2021).

Text box 4

Methodology

For the forecast in Figure 10a, it is assumed for simplicity's sake that Swiss exports to the respective countries will continue to grow constantly in the future by the average growth rate of the last 20 years. In Figure 10b, a different calculation is made: The share of Swiss exports – measured in terms of the GDP of the buyer country – is kept constant. The variable is therefore GDP growth, which is extrapolated based on the forecasts by PwC. As there are no GDP forecasts available for the EU over the period under consideration, only the 2020 value is given for the EU.

3_ A realistic strategy for Switzerland

Let us summarise: Based on its strong economic growth, China is (re)establishing itself as a world power and its international influence is growing, including in multilateral institutions. The West's hope that a Western-style democracy would prevail in the People's Republic as a result of rising per capita income has been put to rest. The spirit of optimism in the wake of WTO accession has also faded. Today, the regime can be described as authoritarian. Lived values, especially with regard to human rights, democracy and the rule of law, differ fundamentally from the core values of the West and even the redefinition of the terms sought by China cannot distract from this. Despite the parallels often made in the media, one cannot speak of a re-make of the Cold War. The economic interdependence between China and the West is many times greater than it ever was with the Soviet Union.

Switzerland's relations with China are close, and official diplomatic contacts have been maintained almost since the founding of the People's Republic. Switzerland was one of the few Western countries to negotiate an FTA, which further deepened existing economic relations and created an institutionalised platform for political exchange – even beyond economic issues. Despite these diverse contacts, there is still a great deal of scepticism towards China, which has probably even increased in Switzerland in recent years. Chinese takeovers of Swiss companies are viewed critically, even though direct investment from the People's Republic accounts for just 1 % of all foreign investment in Switzerland.

The fact that they must nevertheless be more closely regulated in the future is in line with the trend that Swiss foreign economic policy is increasingly being shaped by values, while core elements of trade policy such as the reduction of tariffs and non-tariff trade barriers are sometimes relegated to the background in the public discussion. The social and political pressure for extraterritorial application of domestic law is increasing. Against this backdrop, the Federal Council published a China strategy to make the political guidelines and approaches public. China's official protest followed immediately, while, for some actors in Switzerland, the China strategy did not go far enough in its criticism of conditions within China.

Switzerland cannot escape the competition of systems - authoritarian regimes against the liberal democracies of the West. Their ability to exert any influence, especially on China and the USA, is limited. However, it can attempt to position itself in a way that minimises the potential damage. This includes further diversification of international relations through FTAs in order to further strengthen the country's economic resilience. However, this approach is proving to be increasingly difficult; the "low hanging fruit" have already been picked. For further agreements,

Swiss foreign economic policy is increasingly influenced by principles, while core elements of trade policy such as the reduction of tariffs fade into the background.

Switzerland would have to make substantial concessions, for example in the agricultural sector. China (incl. Hong Kong) is now Switzerland's third largest trading partner, the USA and the EU are more important and are likely to remain so for the next 30 years or so – despite higher growth rates in the People's Republic. A close alignment between Switzerland and China would therefore not be a sensible strategy, not only ideologically but also economically.

Chapter 3 takes up these findings and attempts to design a realistic strategy for Switzerland based on three levels of escalation. Chapter 3.1 describes the behaviour in the event of low pressure on Switzerland from one of its trading partners. In Chapters 3.2 and 3.3 the pressure is increased and the recommended behaviour is adapted accordingly. The conclusion in 3.4 rounds off the publication.

3.1_ Low pressure: "Pragmatism"

The initial situation in the "low pressure" scenario is as follows: Neither the USA, China nor the EU exert much pressure on Switzerland to support their trade restrictions or diplomatic stance towards any of the parties to the conflict. Switzerland is not under threat of ending up on a "black list" or even being confronted with its own hurdles if it fails to follow suit. Switzerland's behaviour may lead to irritation and the need for additional explanations on Bern's part, however, the Confederation will not incur any specific disadvantages from its behaviour. Switzerland can thus pursue a pragmatic foreign economic policy. Any opportunities to deepen economic and political relations should be seized after conducting a risk assessment and provided they are in the mutual interest of all trading partners.

In this scenario, Switzerland should continue to consistently defend its values, yet without proselytizing while doing so. The existing platforms for diplomatic exchange (jointly created by the trading partners) provide a suitable channel for this purpose. Further opportunities can arise if the primarily economically motivated cooperation is intensified. Holding high-profile media conferences to criticise the trading partner or even applying its own economic sanction instruments should be avoided.

The pragmatic scenario is a balancing act that relies on Switzerland's diplomatic and communicative skills. In terms of foreign policy, the aim is to maintain equally sustainable diplomatic relations with the most important trading partners. Domestically, the strategy must be explained constantly without snubbing trading partners.

The economic benefit of this scenario for Switzerland – compared to further escalation between the USA and China as well as increasing pressure on the Swiss Confederation – would probably be greatest. While trade with key partners continues, Switzerland's free trade network can be expanded – not only with the USA or India, but also with comparatively smaller economies, such as Nigeria, Pakistan or Bangladesh (Bonato

2021b). Updating the FTA with China would probably also be possible, provided this finds majorities in domestic politics.

All in all, the pragmatic path is likely to find a political majority, provided that all forces close to the economy pull together and credibly point out the advantages and disadvantages of alternative scenarios and weigh them against one another. Switzerland's neutrality and sovereignty would continue to be formally preserved in the best possible way. There is no joining of a power-political "bloc", and no leaning to one side of the conflict. Which is not to say that Switzerland cannot achieve progress in the thick of geopolitical tensions. With its broad network of FTAs, Switzerland has the best prerequisites for initiating positive developments through targeted dialogues (cf. Chapter 2.2). Overall, this approach is also likely to come closest to the Swiss understanding of neutrality.

However, it remains to be seen how long Switzerland – given the potential for escalation of the conflict between the USA and China – can maintain this recommended path of action. Singapore is often cited as an example of a pragmatic foreign policy. The path described above is similar to the one taken by the city state itself – but Switzerland can only be partially compared to Singapore, particularly because of its political system (cf. Text box 5).

Overall, the pragmatic path is likely to find a political majority.

Text box 5

Singapore: the Switzerland of Asia?

Switzerland and Singapore have a lot in common. Even today, the small city state is referred to as "the Switzerland of Asia" (Ruehl 2020) and many describe Singapore as something of a model for Switzerland (Schwarz et al. 2014). Both small states have a high per capita income, a high standard of living and a strong financial centre in common (Müller 2014). Furthermore, both countries have a high degree of political stability and benefit from a solid monetary system. The interests are similar in that both are actively involved in multilateral organisations (Governance Matters 2021).

But the similarity also has its limits - and ends with the state-political structure. Political rights and civil liberties in the Republic of Singapore are severely restricted (Freedom House 2022) and the population plays a very subordinate institutional role. State censorship is enforced with draconian prison sentences and, in the world ranking of press freedom, Singapore finds itself near the bottom (RSF 2022). The generous economic freedoms are counteracted by severe restrictions on civil liberties. While Singapore ranks 88th in the international freedom ranking, Switzerland is in first place (Vásquez et al. 2021).

The foreign policy implications are thus also different. The lack of popular involvement enables Singapore to behave in an opportunistic manner that is normatively incoherent. In Switzerland, the democratically legitimised government and the direct democratic influence of the population prevent overly opportunistic behaviour. Singapore's "blindness" to China's actions in the South China Sea or its repression of the Uyghurs, for example, is not an option for Switzerland.

But even the city-state, which has navigated successfully so far, is not immune to the deterioration of the relationship between China and the USA (Fook 2018). Every step it takes towards one side is followed by a similar step towards the opposite side (Choong 2021). In this way, the small city state is mastering the policy of "brinkmanship" vis-à-vis the USA and China. Recently, however, the relationship with the two great powers has been increasingly determined by exogenous factors and is thus beyond Singapore's control (Fook 2018). The once elegant dance is degenerating further and further into a walk on hot coals.

3.2_ Medium pressure: “Autonomous implementation of foreign regulation”

Medium-strong pressure on Switzerland may arise due to the following events: Firstly, one of the three trading partners, the EU, the USA or China, expresses increased expectations of Switzerland to behave in their interests. Secondly, domestic pressure is increasing to take a stronger foreign policy stance against China’s behaviour.

Russia’s invasion of Ukraine, in breach of international law, is an example of how Switzerland can quickly come under medium-strong pressure. Within days of the announcement of EU and US sanctions against Russia, it had to decide whether it was part of the Western shared values – or not. Otherwise, countermeasures by the EU and the USA could have been expected. For example, the new US ambassador in Bern was quoted as saying that “there will be negative repercussions if the assets of the sanctioned persons are not traced.” (Cassidy 2022). The Swiss strategy of “autonomous implementation” – the independent decision to adopt the regulations of other states (often unchanged) - was applied.^{| 60}

Should pressure on Switzerland increase, it is primarily expected to follow the decisions of the EU. In doing so, it would be taking a more pragmatic stance than if it were to position itself entirely in line with the US. Compared to this latter, the containment strategy currently pursued by Brussels vis-à-vis China is less strict, although voices critical of China have recently become louder within the EU as well. Switzerland, like the EU, would pursue a two-track strategy whereby China is both a partner, as well as an economic competitor and a systemic rival (cf. Chapter 1.4).

Shared European values and preservation of autonomy

In a community of shared values with the EU, Switzerland would be more active than in the pragmatic scenario in promoting human rights, democracy, the rule of law and compliance with international law.^{| 61} Accordingly, Switzerland could also counter domestic political pressure and would not stand idly by in the event of human rights violations (cf. Chapter 2.2). Switzerland would retain its autonomy in foreign policy and foreign economic affairs, and its neutrality status would also be fundamentally preserved. It can thus interpret neutrality in the classical sense, as Austria, Ireland or Malta do, or in the style of “non-alignment”, as Sweden and Finland currently (still) define it (Lottaz 2019). Due to its deeply rooted understanding of neutrality, Switzerland would probably choose the first option. The Confederation could probably continue its mediator role in most cases - such as between Georgia and Russia or the USA and Iran.

60 The term is borrowed from Swiss European policy (EDA 2015).

61 Swiss diplomacy showed a remarkable reaction at the beginning of 2022 when it publicly denounced via Twitter an action by Beijing to restrict freedom of expression (Reichen and De Carli 2022).

Were Switzerland to align itself with the EU, Bern would in principle be treated equally by the USA. The same would probably apply to China: China's existing sanctions against the EU would be extended to Switzerland. However, Beijing might also be tempted to make an example of Switzerland, i.e. to react more harshly instead of punishing the EU as a whole. This tactic has often been used by China against smaller states. |⁶²

The EU as a shield of prosperity

The economic impact of Switzerland aligning with the EU is likely to depend on the degree of integration. While retaining formal foreign policy autonomy, Switzerland would have several options at its disposal. These range from mutual trade on the basis of WTO rules, an (updated) FTA and the Bilateral Agreements (with or without an institutional framework agreement) to EEA accession (Hug Alonso et al. 2021). None of these solutions restricts Switzerland's foreign economic policy. |⁶³ On the other hand, with each level of integration, the conditions for access to the EU internal market would improve, and bilateral relations between Switzerland and the EU would be strengthened. This would be particularly advantageous in light of the fact that the EU - similarly to the USA (cf. Chapter 1) - is increasingly localising many production processes (reshoring), thereby creating new sourcing and trading opportunities for Switzerland. A regulated relationship with the EU would thus form a solid basis for reducing economic dependence on China.

Switzerland has multiple options at its disposal while maintaining formal autonomy over its foreign policy.

This is important because, although Switzerland continues to seek good trade relations with China along the lines of the EU, it would adopt a more active foreign policy position in the event of heightened geopolitical tensions. In view of China's increasingly aggressive reaction to international criticism, Switzerland would have to accept that the balancing act between economic cooperation and disagreement on fundamental values is no longer viable, and that bilateral trade could suffer. In this respect, it remains important in the interest of Swiss prosperity to have secure market access to the EU, which is the most important trading partner today, and will remain so in the future (cf. chapter 2.3). The better the market access to the most important trading partner, the bigger the economic shield.

62 Norway, for example, entered a six-year political and diplomatic ice age with China when the Nobel Peace Prize was awarded to human rights activist and writer Liu Xiaobo in 2010. The subsequent resumption of relations was justified in China with the words "Norway has learned its lesson" (*CHIC 2016*).

63 Were Switzerland to join the EU, it would have equal access to the internal market, but Bern would have to accept restrictions in foreign policy. Since the EU is an association of states, it can only act in areas for which it has been authorised by its member states. In foreign policy, for example, the common trade policy is one of the few EU policy areas that is fully "communitarised". Accordingly, Switzerland would have to dismantle its network of FTAs and adopt the EU's FTAs. Certain trade advantages have ceased to exist, for example, facilitated market access in China based on the bilaterally concluded FTA.

3.3_ High pressure: “Closing ranks in the West”

The geopolitical situation could escalate even further. For example, with the USA and China imposing an almost complete trade ban on each other, or even spiraling into an indirect or direct military confrontation. In this scenario, the positioning pressure on Europe, the EU and all other Western-oriented states would increase considerably. It can be assumed that, similarly to the Ukraine war, a closing of ranks between the USA and the EU would take place.

In view of Switzerland’s proposed stance in the case of moderate pressure, there would be no question about Switzerland not joining the West’s stance in the event of high pressure. It would continue to take its cues from the EU, which – in contrast to moderate escalation – is now increasingly adopting US measures. Switzerland would adopt all economic measures to the greatest possible extent. However, the application is limited to diplomatic contacts, because politically, Switzerland, still a legally neutral state, could attempt to build bridges between the parties to the conflict. Further, military action by the USA or the EU would not be supported.

A decisive factor in Switzerland’s alignment with the USA is – in contrast to China – the largely shared values.^{| 64} Often, Switzerland and the USA are even referred to as sister republics due to their common institutional foundations. Nevertheless, differences in values with the USA can also be observed. On the one hand, an “imperial hegemonic power in the USA”, on the other “a powerless and, due to its ineptitude, largely defenceless Switzerland” (Tanner 2016).^{| 65} The US government often obstructs multilateral rules and regulations^{| 66} in order to promote its own interests. This observed shift away from multilateralism contradicts Switzerland’s fundamental interest in promoting a rules-based world order.

Momentous decision

China’s reaction is likely to be severe if Switzerland becomes fully aligned with the US. Beijing would probably downgrade its contacts with the Swiss Confederation, firstly because Switzerland is a country of relatively little relevance to China (cf. Chapter 2.2) and secondly, in order to unmistakably demonstrate its own attitude towards third countries by taking measures against Switzerland. It can be assumed that tariff and non-

64 For example, Jean-Jacques Burlamaqui (1694–1748) of Geneva defined the “pursuit of happiness” as a natural human right, probably inspiring the famous phrase “pursuit of happiness” in the United States Declaration of Independence of 1776 (Tanner 2016).

65 In more recent times, this has manifested itself as pressure from the USA on Switzerland on issues such as dormant Jewish assets, bank client confidentiality, and the tax dispute.

66 In 2020, for example, the Trump administration blocked the appointment of the new Director-General of the World Trade Organisation (WTO), Okonjo-Iweala, because it was feared that, as an avowed multilateralist, she would be less able to represent Washington’s interests. Furthermore, since President Obama’s administration, the USA has blocked the appointment of new judges to the WTO’s dispute settlement procedure (cf. chapter 1.2), undermining the stability of this multilateral institution (NZZ 2019).

tariff trade restrictions would be enacted against Switzerland, thereby effectively invalidating the FTA. In addition, US regulations – which Switzerland would implement – complicate the hitherto growing trade with China (cf. Chapter 2.1).

Overall, in this scenario, Switzerland would risk losing its most important trading partner in Asia. This would be a serious blow to the domestic economy. China is not only an important export market, but many preliminary products are also sourced from China. Already in the past, a certain dependency has been identified in certain areas (Horowitz 2018). In extreme cases, a large number of Swiss companies would have to find alternative sources of supply, with corresponding cost consequences in the short and medium term. A decline in economic relations with China would also affect the diversification of Swiss trade relations (cf. Chapter 2.3). Ultimately, Switzerland's relations with countries that may become more closely aligned with China in future could also become more complicated. ⁶⁷

Overall, in this scenario Switzerland would risk losing its most important trading partner in Asia.

To cushion against the consequences of the largely frozen relations with China, Bern would need to seek economic solidarity with the USA. ⁶⁸ The signing of an economic agreement would facilitate bilateral trade and mutual investment while promoting cooperation between universities for research and education purposes. ⁶⁹ Product standards and professional qualifications could also be mutually recognised, further promoting bilateral exchange. ⁷⁰

However, too much dependence on the US economy could also be Switzerland's undoing, as for example in the event of an economic crisis, or the election of an impulsive and exclusively US-orientated president like Donald Trump. To cushion against such exogenous events, the diversification of economic relations remains essential, even in the event of high geopolitical tensions (cf. Chapter 2.3). In addition to direct trade relations with the United States, economic relations with its strategic partners such as Canada, Mexico, Israel, Singapore, Japan, South Korea and Taiwan should also be strengthened. New or updated comprehensive FTAs should be forged. In particular, one could be negotiated with Taiwan, thereby facilitating exchanges with one of the most innovative economies (Anthamatten 2019).

⁶⁷ Russia comes to mind, for example (cf. Chapter 1.5).

⁶⁸ Relations have been developing in an extremely dynamic manner for years. Trade in goods with the USA more than doubled between 2010 and 2021, while trade in goods with the EU increased by only 13 %. The USA has been the largest foreign investor in Switzerland (SNB 2022a) for more than ten years and, since 2021, it has been the most important destination for Swiss exports, replacing perennial first place holder Germany (BAZG 2022).

⁶⁹ According to one analysis, the conclusion of an FTA with the USA would create 13,500 new jobs in Switzerland over the five years following as a result of intensified trade in goods (Dümmler and Anthamatten 2019). In addition, further enhancement of legal certainty through the harmonisation of standards would increase investment volume between Switzerland and the USA. In addition to material advantages, this would increase legal certainty for Swiss companies when trading with the USA and offer a strategic advantage over foreign competitors.

⁷⁰ The Swiss agricultural lobby is likely to be the first to lobby against an FTA with the USA, as it does not wish to face competition from more US food. A “chlorinated chicken” discussion could also be expected in Switzerland. Differences with US regulations would be branded above all as a “race to the bottom” in which Switzerland would now have to participate in order to survive economically. Finding a domestic political majority would be no mean feat.

Neutrality issues

Turning towards the USA would most likely not only meet with a backlash from China, but would also provoke domestic political resistance. Although Switzerland's neutrality would continue to be legally preserved, its political form (cf. Chapter 2.2) would be strongly affected by the orientation of the USA. From China's perspective, Bern could no longer serve as a neutral platform for talks. Switzerland's image as a politically independent and economically stable country in uncertain times would lose credibility and attractiveness overall, and it would become more difficult for it to provide its "good offices". However, especially since the war in Ukraine and the peace negotiations have largely taken place outside Switzerland, the question arises as to how Switzerland's "good offices" may continue to be relevant in crisis situations. ⁷¹

On the Swiss political scene, even if the economic conflicts between the USA and China were to escalate, it would be difficult to find majorities for a clear positioning of Switzerland in alignment with the United States, even with high pressure on Switzerland. On the other hand, in the event of a military threat to Switzerland – or, more realistically, to Europe as a whole – alignment with the USA could gain the necessary political support.

3.4_ Conclusion

The geopolitical upheaval is underway. Based on its economic strength, China is steadily gaining in political and military influence. Together with the weakness of the multilateral organisations, a new world order is in the making. As a small and open economy, Switzerland, whose prosperity depends heavily on access to foreign markets, is strongly affected by this upheaval. Uncertainty around future requirements is increasing, both at the political and at the corporate level.

The bilateral conflict between the USA and China is largely exogenous for Switzerland, but it is nevertheless affected to an above-average extent. With the United States as its second and China as its third most important trading partner, two economic heavyweights are in dispute. Swiss politics must be agile in order to be able to make decisions quickly if necessary.

An international escalation scenario in which Switzerland has to choose between one country or the other is not unlikely. The war in Ukraine can serve as a template for this. Sitting on the sidelines was not an option for Switzerland amidst the sanctions on Russia initiated by the West. Switzerland had already come under pressure with the Ukraine war. In the US-China scenario, this pressure would be far greater and its

71 Negotiations took place in Turkey, for example. A Nato state, the Turkish government nevertheless does not support the West's sanctions against Russia.

economic implications more serious. A forward-looking strategy, as well as diplomatic and communications skills, are thus crucial for guiding the Confederation through the escalation that may be imminent. There would be little to gain if Switzerland were to side with the US or Chinese camps without coercion. There would be much to lose economically and precious little to gain politically. This study has sought to outline a realistic strategy that draws a distinction between three escalation levels.

With little pressure on Switzerland, it would be well advised to choose a pragmatic path for as long as possible. It is trading with both adversaries and attempting to keep the most important trading partners equally happy diplomatically in a balancing act.

As pressure increases, it will be important to focus on the most important trading partner. According to the scenarios presented, the EU is and will remain the most important sales market for Swiss companies over the next 30 years or so, even if Asia grows faster. An open conflict between Switzerland and the EU over their positioning towards China would have adverse economic consequences. The current erosion of the bilateral relationship would only be a warm-up by comparison. The path of “autonomous implementation of foreign regulation” would be the strategy of choice in this situation. Switzerland remains independent, but relies on the EU with regard to economic measures towards China. It can be assumed that at a moderate pressure or level of US-China escalation, the EU will be able to maintain its more pragmatic stance towards China compared to that of the USA. The measures against the People’s Republic are likely to be noticeable, but not as drastic as if the US sanctions were adopted.

Should the conflict escalate further, Switzerland, trailing behind the EU, will move closer to the USA’s position. As in the Ukraine war, the West would stand together and enact largely homogeneous measures against China. It would be fatal for Switzerland to stand aside from imposing economic sanctions, but as a neutral country it would be able to count on the understanding of its Western partners for non-participation in any military operations.

Swiss companies must prepare to operate in two economic areas instead of three (China, Europe and the USA), if necessary. The cost of forgoing the Chinese market is likely to be much greater than the cost of exiting Russia. In view of the global escalation scenario, such a corporate decision would be important, but still only a small contribution to the defence of fundamental basic values.

The question remains: Will it come to that? Will the USA and China attempt to ruin one another economically and possibly militarily in the near future? Hopefully not. There are a number of reasons that argue against this. For instance, economic interdependence is far deeper today than it was during the Cold War, and the losses to be shouldered would be enormous. Neither does China have any interest in escalation, as it

If necessary, Swiss firms will have to prepare themselves to be active in two instead of three economic regions.

will continue to depend on the West as a key market for some time to come. Without economic growth, there is a risk that political unrest in the country will increase and that the CCP regime will be overthrown.

So, all clear? Yes. Wars can also be instigated for ideological, non-rational reasons. In such scenarios, strategic considerations are superfluous, because it can be assumed that the conflict partners will go to extremes. These are indeed difficult times.

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