Knife edge? Switzerland as a base for multinational companies as relations worsen with the European Union[1]

Simon J. Evenett
University of St. Gallen and CEPR

During the past seven years, Swiss-EU economic relations have deteriorated, with the vote by the Swiss people in 2014 in favor of immigration limits bringing matters to a head. Using the latest available data on the financial performance of US multinationals operating across Europe, this paper estimates how large the revenue and cost shocks that could follow a rupture of Swiss-EU relations would need to be to alter return on investment calculations enough so as to possibly induce multinationals to relocate to other European locations. Of Switzerland's immediate neighbors, only Austria poses a potential threat in this regard. Excluding Europe's periphery, returns on US assets invested in the Netherlands fall just short of those in Switzerland.

JEL codes: F15, F23
Key words: Switzerland, European Union, multinational corporations, foreign direct investment, non-tariff barriers, trade costs

Introduction

When countries are on the brink of momentous decisions concerning their relations with regional trading partners, representatives of foreign multinational corporations often seek to influence the public debate. When the UK was deciding whether to join the Eurozone, for example, Japanese multinationals indicated that they would scale back their planned investments if the British pound were retained (Eglene, 2011, 102ff).

Closer to home, the various referenda held in Switzerland in recent years have been followed in leading international newspapers and business magazines, with much commentary from foreign business leaders.[2] Whether or not the concerns of multinational companies (MNCs) are taken seriously by government and voters in the host country depends on many factors, one of which is the credibility of any threats to abandon the host economy in favor of an alternative location, often a neighboring country.

In turn this raises the question of how footloose – or, seen another way, how sticky – are foreign multinational corporations. After decades of liberalization of foreign direct investment regimes,[3] multinational firms have many options. But once they have invested in a host country, what factors determine whether they exercise those options after (or in anticipation of) a profound, adverse policy change?

1 This paper was presented at an *Aussenwirtschaft* conference organised at the University of St. Gallen in October 2014. Comments from conference participants, in particular from Reto Foellmi and Heinz Hauser, were particularly appreciated. Reactions to this paper can be sent to simon.evenett@unisg.ch.

2 See, for example, "Switzerland: Change in the air," *Financial Times*, 4 May 2014.

3 As documented by UNCTAD's annual *World Investment Reports*.

"Footloose capital" may make for an attractive headline or slogan – just as frictionless exit costs may be attractive simplifying assumptions in some economic models – but the reality is that, as Michael Porter showed long ago, many factors determine the attractiveness of a national business environment (Porter, 1990). Moreover, the fact that MNCs can choose where to locate implies that the impact of any major policy change on the relative profitability of potential investment locations is the relevant consideration.

Given the Swiss people's vote for immigration limits in 2014 – a vote that calls into question Switzerland's commitment to one of the four pillars of European integration – foreign MNCs based here cannot rule out further adverse changes to the business environment. Central among them is the potential for worsened access to European Union markets should the latter decide to retaliate.

It may be that an adverse policy change diminishes the absolute profitability of investing in Switzerland but does not alter the relative attractiveness of investing there compared to relevant alternative locations. Indeed, should the return on assets invested by MNCs in Switzerland be much higher than in the alternatives, then, effectively there is a cushion to absorb adverse shocks. The existence of such a cushion would imply that MNC investment in Switzerland is not on a knife edge.

In the light of the strained bilateral relationship between Switzerland and the European Union, an assessment, then, of the relative returns on investing in Switzerland compared to other European locations is called for. Using the latest data available on US MNC investments in Europe, including data on the extent to which Switzerland is used as an export platform by such MNCs, one goal of this paper is to perform such an assessment. This will reveal which European locations, if any, rival Switzerland in terms of commercial attractiveness, at least as far as one significant set of foreign investors are concerned. To the extent that the Swiss government wants to maintain its economy as an attractive entry point into European markets, then the findings of this study could inform their negotiations with the European Commission.

The remainder of this paper is organized as follows. In the next section the deterioration of relations between Switzerland and the European Union is described. An important point made here is that this deterioration predated the 2014 vote on immigration by the Swiss public. If anything, the European Council has been sending stronger and stronger signals to the government in Bern about its dissatisfaction with the current institutional arrangements governing trade and much else. Taken together, the risk of a profound change in Swiss access to European Union markets cannot be entirely ruled out.

Section 3 of the paper describes the extent of US MNC activity in Switzerland and, more importantly, contrasts Switzerland's attractiveness as a location for US MNCs to those in the rest of Europe. In so doing, it is revealed which economies in Europe generate return on assets that are comparable to, or just less than, that in Switzerland.

In Section 4, the implications of the comparative return analysis are discussed. The magnitude of the average cost and revenue shocks that might tip the balance away from investing in Switzerland are computed and discussed. Care is taken in interpreting these results, especially as the Swiss economy has been buffeted by significant – in particular, exchange rate-related – shocks in recent years. Concluding remarks follow in Section 5.

1 Switzerland's Economic Relations with the EU

Switzerland is the third largest trading partner of the European Union (after the United States and China) (European Commission, 2014). In 2014 the EU exported €140.3 billion of goods and €99.5 billion of services to Switzerland. Switzerland, in turn, exported €96.6 billion and €54.2 billion of goods and services, respectively, back to the European Union. Ties through foreign direct investment are strong as well. In 2013 the stock of EU FDI in Switzerland stood at €667.1 billion. Swiss FDI in the EU was worth €430.8 billion in that year (European Commission, 2015). Over a million citizens of EU member states live in Switzerland and another 230,000 persons cross the border to work in Switzerland every day. Some 430,000 Swiss nationals live in the European Union (European Commission, 2014). Given the proximity of Switzerland to the European Union, the strength of such ties is not that surprising.

Following the rejection in 1992 by Swiss voters of membership of the European Economic Area (EEA), alternative arrangements governing relations between the Swiss Confederation and the European Union were negotiated.[4] Over 100 accords have been signed between Brussels and Bern (for additional details, see Swiss Federal Department of Foreign Affairs, 2014).

A key feature of this "bilateral" or "sectoral" approach is that Switzerland is not obliged to adopt unaltered new EU legislation. According to the Swiss Federal Department of Foreign Affairs (2014, 23):

4 It being understood that, as a member of the European Free Trade Association (EFTA), Switzerland's trade in manufacturers has been covered by a free trade agreement with (what is now) the European Union signed in 1972.

> The majority of bilateral agreements between Switzerland and the EU are traditional cooperation agreements. As a rule, the contracting parties retain their independence and each is responsible for implementing and applying the agreements on its own territory. Switzerland does not transfer any legislative or other decision-making powers to a higher, supranational instance – except for air transport.
>
> The bilateral agreements are based on mutual recognition of the equivalence of legislation, as in the case of the dismantling of technical barriers to trade, or the full incorporation into the national legal order of the entire body of EU law ('acquis communautaire.')

The approach to adopting equivalent legislation preserves, on paper at least, Swiss independence but, in the eyes of critics, comes at the cost of eroding legal certainty concerning the terms of access to the Swiss market.

Even before the 2014 vote by the Swiss population on immigration restrictions, the key organs of the European Union had been signaling their unhappiness with the distinctive arrangements enjoyed by Switzerland. This is best demonstrated by referring to the conclusions of the European Council in its periodic reviews of relations with the EEA states and with Switzerland.[5]

As far back as December 2008, the European Council concluded:

> Given the EEA judicial framework does not apply, the Council is concerned with an inconsistent application of agreements between the EU and Switzerland, and calls on Switzerland to fully implement those agreements. (European Council, 2008, 7)

By December 2010, the position of the European Council had hardened:

> In full respect of the Swiss sovereignty and choices, the Council has come to the conclusion that while the present system of bilateral agreements has worked well in the past, the challenge of the coming years will be to go beyond that system, which has become complex and unwieldy to manage and has clearly reached its limits. As a consequence, horizontal issues related to the dynamic adaption of agreements, an independent surveillance and judicial enforcement mechanisms and a dispute settlement mechanism need to be reflected in EU-Switzerland agreements. (European Council, 2010, 7)

5 Indeed, the contrast in the statements made about the state of relations with Switzerland and Norway is quite striking.

In conclusions drawn in its meeting on 20 December 2012, the European Council was prepared to state that, in its view, negotiations with Switzerland concerning its further participation in the Single Market had reached a "stalemate" (European Council, 2012, 5). In this regard the Council felt it had to make the following remark:

> … the Council notes that by participating in parts of the EU internal market and policies, Switzerland is not only engaging in a bilateral relation but becomes a participant in a multilateral project. All in all, [the desired] institutional framework should present a level of legal certainty and independence equivalent to the mechanisms created under the EEA Agreement. (European Council, 2012, 6)

The vote by the Swiss population on 9 February 2014 to back – albeit by a small majority – a referendum "Against Mass Immigration," with its direct implications for the free movement of persons between Switzerland and the European Union, came at a time when the latter was getting more exacerbated with the former. The reaction to this referendum vote from representatives of the European Union was swift and sharp. On 9 February 2014, in a statement to the European Parliament in Strasbourg on behalf of the European Commission, Commissioner Laszlo Andor remarked:

> …the popular vote of 9 February now calls the freedom of movement of persons into question. The Swiss authorities told the Commission that they need time to reflect on how this could be implemented. The Swiss Federal Council has up to three years to implement the vote, so there is no immediate massive crisis. In the meantime, I want to be very clear on this, both sides must continue to fulfil all their obligations under the existing agreements. *Pacta sunt servanda*. A deal is a deal, and selective implementation or even 'cherry-picking' is not an option.
>
> The Commission stands ready to listen to the Swiss proposals which are now being considered and which we haven't seen yet. The ball is in their court. Our *marge de manoeuvre*, however, is extremely limited. **This core principle of the free movement of persons is a cornerstone of our relationship. It is a fundamental right. It is not simply 'negotiable', as some tend to believe.** (Andor, 2014, emphasis in the original text)

In its conclusions on 16 December 2014, arguably the European Council went further than Commissioner Andor by remarking:

> The Council confirms its view that the planned implementation of the result of the vote threatens to undermine the core of EU-Switzerland relations, namely the so-called "bilateral I agreements," and casts doubt on the association of Switzerland to the Schengen and Dublin acquis and the participation of Switzerland in certain EU programmes
>
> The EU expects Switzerland to honour its obligations arising from the Agreement on the free movement of persons and the other agreements concluded with the EU…In case of infringements of the above principles, the Council reserves its right to end the abovementioned institutional negotiations and other internal market related negotiations. (European Council, 2014, 7)

As of this writing, the Swiss Federal Government has not stated how it intends on implementing the new restrictions on immigration that the 2014 referendum called for. The reaction from the European Union, coming as it does on top of growing dissatisfaction with the institutional arrangements governing relations between Switzerland and the European Union, at a minimum generates political risks that foreign multinationals operating in Switzerland are likely to take account of.

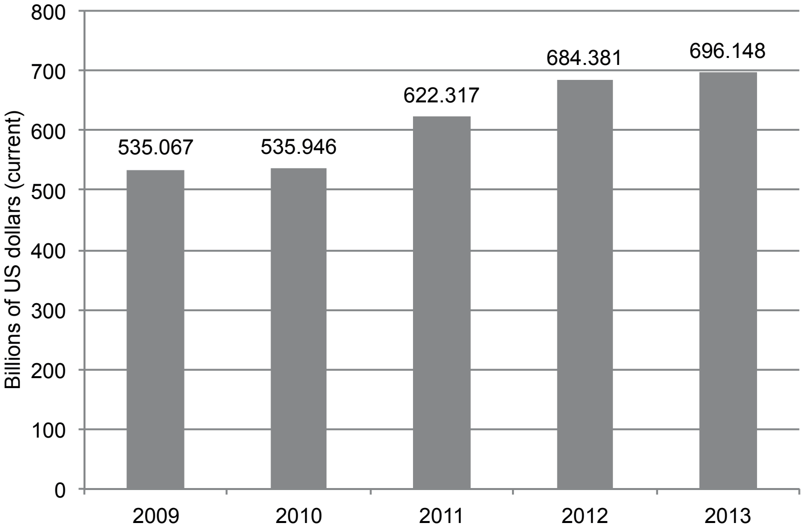
While the probability of a rupture in Swiss commercial relations with the European Union is unknown, and the nature of any such rupture is far from clear, the risk of such a schism cannot be entirely discounted. In turn, this begs the question as to what is at stake for foreign multinational corporations operating in Switzerland.

2 The Financial Performance of US Multinationals in Switzerland

In assessing how much of a cushion, if any, foreign MNCs may have to absorb a breakdown in Swiss-EU relations, in a perfect world the analyst would like to have data on all of the foreign MNCs operating in Switzerland, their future investment plans, determinants of those plans, as well as information on their exposure (in different ways) to the European Union. In reality, remarkably few nations collect detailed data on the operations of their MNCs abroad or on MNCs operating in their host economy – let alone publish such data. Consequently, analysts are left with only a few sources that provide a lens through which to examine this matter.

Fortunately, the United States' Bureau of Economic Analysis collects data on the operation of US MNCs abroad and publishes aggregate totals, admittedly with a substantial lag. The latest update of its data on majority-owned US affiliates operating abroad was made publicly available on 18 November 2015. This update includes preliminary estimates for 2013 as well as annual data on a wide range of indicators going back to 2009. This is the principal source of data used in this study.[6] What follows are summary statistics on the extent of US MNC operations in Switzerland. Where possible, these summary statistics have been compared to information released by the Swiss-American Chamber of Commerce.

Figure 1: US MNC have invested 30% more assets in Switzerland during 2009-2013



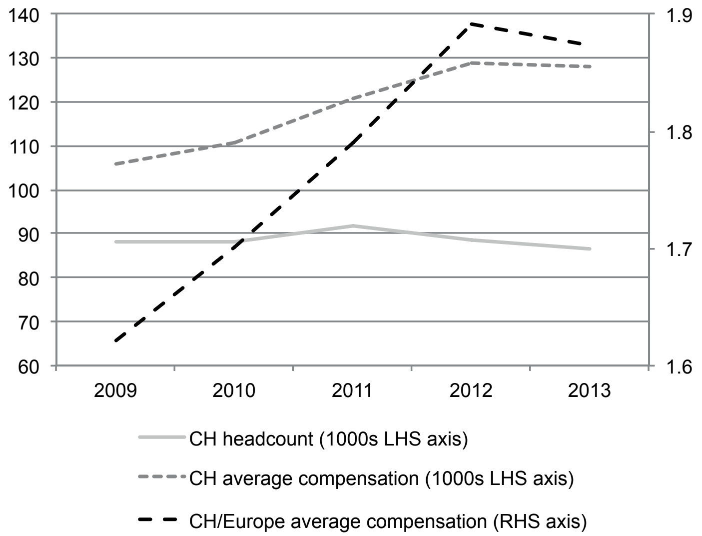
US MNCs have been present in the Swiss economy for decades. Their desire to acquire assets and to set up facilities in Switzerland has not been dented by the global financial crisis. In fact, as Figure 1 makes clear, during the years 2009 to 2013 US MNCs have expanded their total assets in Switzerland by 30%, bringing the total value of the stock of such investments to just under US$700 billion. US MNC investments in Switzerland exceed those in France but are less than those in Germany, Ireland, Luxembourg, the Netherlands, and the United Kingdom. In total, US MNC investment in Switzerland is approximately 3% of the global total and 5% of the European total.

In terms of employment, the head count of US MNCs has been flat since 2009 at just under 90,000 persons (see Figure 2). Average compensation per employee has grown almost a quarter since 2009 to just under 130,000 dollars per employee. US MNCs pay in US dollar terms almost 90% more than their counterparts in

6 This data can be accessed from http://www.bea.gov/iTable/iTable.cfm?ReqID=2&step=1#reqid=2&step=1&isuri=1

affiliates in Europe, a substantial salary premium. Some caution is needed here in interpreting changes in salary changes in recent years because of the sharp appreciation of the Swiss franc.

Figure 2: Flat head count but rising average compensation in US MNCs in Switzerland



Since 2009, US MNCs have sharply increased their annual R&D spending in Switzerland from $1.4 billion to $3.7 billion. This rate of increase is in marked contrast to that found in the rest of Europe (see Figure 3). Consequently, the Swiss share of US MNC R&D in Europe has risen sharply. Given the motivation for this study has been the deterioration in Swiss-EU relations, with its possible implications for Swiss access to the EU's Single Market, then it is important to bear in mind that any rupture in Swiss-EU relations might have very different implications for Switzerland's attractiveness as an R&D base as opposed to its appeal as an export platform to the EU.

In 2013, the sales of US MNCs' majority-owned affiliates in Switzerland totaled $284 billion. Of those sales, $23.3 billion involved shipments back to the United States. Another $69.9 billion of goods and services were sold to Swiss customers. This implies that, at most, two-thirds of US MNC sales from Swiss-based affiliates are to buyers in the European Union.

Figure 3: US MNCs have expanded their R&D activities sharply in Switzerland but not in the rest of Europe

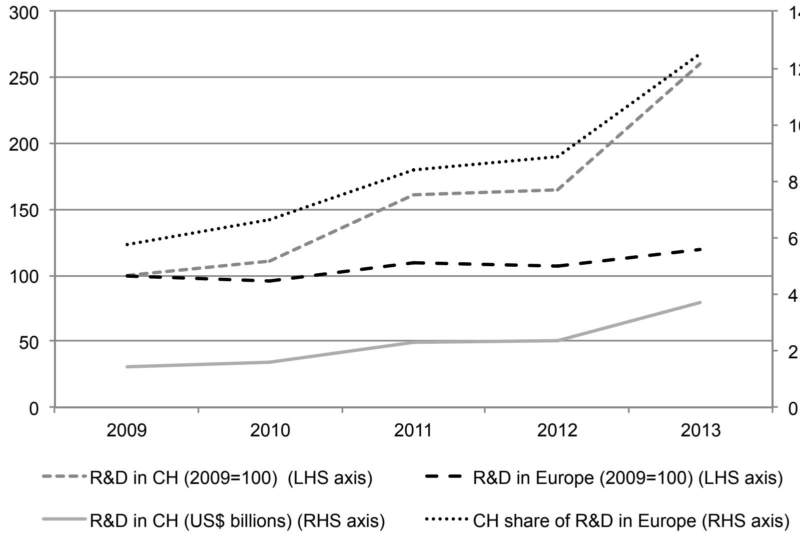
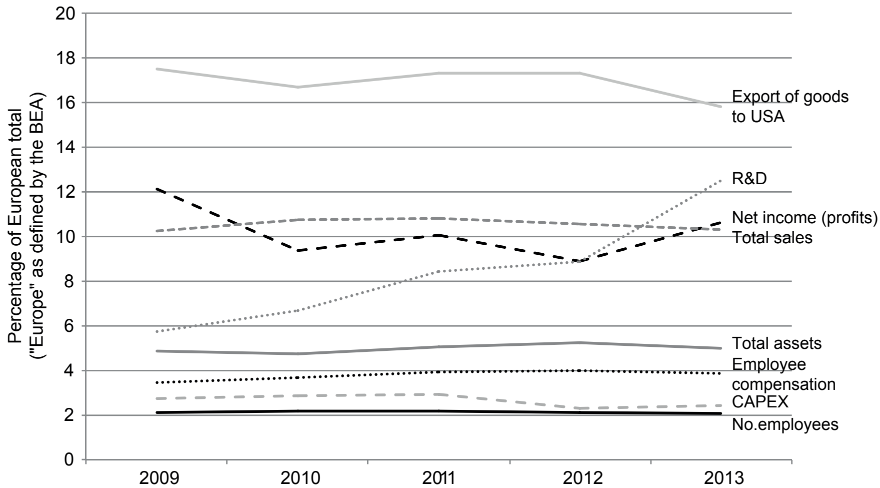


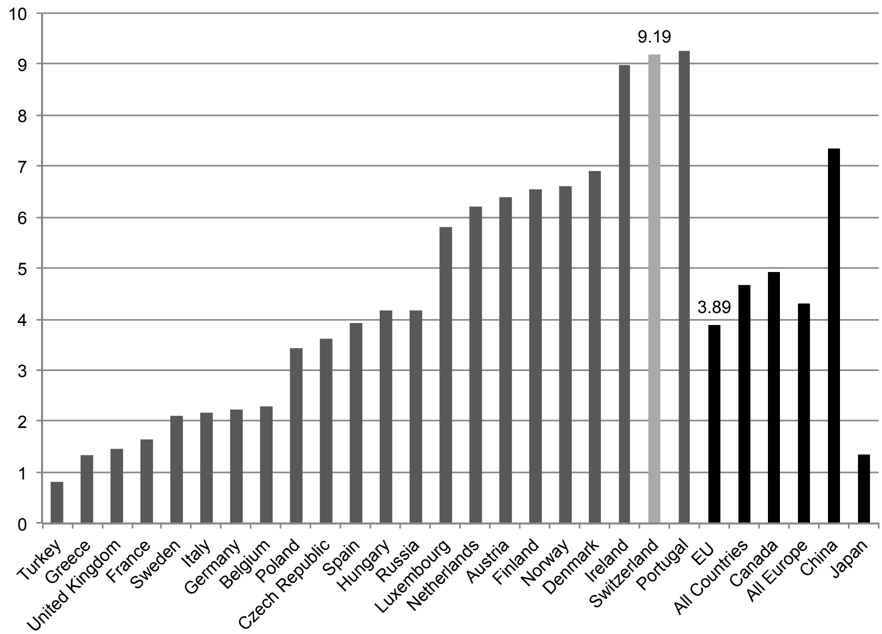
Figure 4: While Switzerland is attracting more US R&D, its use as an export platform to the US is slowly falling



A comparison on key metrics between the Swiss-based affiliates and those in the rest of Europe can be found in Figure 4. The growing share of US MNC R&D in Switzerland and the slow fall in the share of shipments back to the US since 2009 stand out.

The US Bureau of Economic Analysis does not present estimates on the returns on capital invested by the majority-owned US affiliates located abroad. However, totals of "net income" are reported for these affiliates in foreign jurisdictions as well as total amount of assets owned. Consequently, it is possible to construct a measure of the average return on assets for the years 2009-2013 for each of the European jurisdictions where US majority-owned affiliates operate, for "Europe" overall (where Europe is defined as by the Bureau of Economic Analysis), for the European Union, for the world, and for some other comparator countries of potential interest, such as China, Japan, and Canada (the latter being a large recipient of US MNC investment). The findings are summarized in Figure 5.

Figure 5: Away from the periphery of Europe, US MNCs earn the highest average return on assets in Switzerland



Of the nations near the geographic center of Europe, Switzerland stands out for the high level of return on invested assets by US majority-owned affiliates. The Netherlands, an EU member not in the periphery, has US majority-owned affiliates that earn 161 basis points less than the 9.47% return made in Switzerland. Compared to the EU average, the average rate of return on assets in Switzerland is double that of the EU as a whole (4.22%). Returns in Switzerland exceed those earned in Canada, China, and Japan as well. It would seem, then, that there is a cushion available to US majority-owned affiliates to absorb some adverse shocks.[7] The size of that cushion is examined in greater depth in the next section.

One objection to Figure 5 is that it refers to averages for the period 2009-2013 rather than referring to the latest year available (2013), which could be more relevant for contemporary decision-making. Similar calculations to those necessary to produce Figure 5 were undertaken for the year 2013. The return on assets invested in Switzerland fell slightly (to 9.13%), as did the average return in the European Union (to 3.89%). The return on assets invested in Norway fell below that in Switzerland in 2013. As before, however, Switzerland stood out as the location in the center of Europe where returns were highest. In fact, in 2013 the gap between Swiss returns and returns in European locations away from the periphery has grown to at least 230 basis points.

The purpose of this section has been to summarize key statistics on the operations of US multinationals in Switzerland. Despite the turmoil of the crisis era, US multinationals have expanded their presence here, in particular in R&D activities. The average return on assets invested in Switzerland is considerably higher than compared to nearby alternative locations, suggesting that there is some cushion to absorb adverse shocks to the Swiss business environment. Interpreting the size of that cushion, in particular in light of the worsening Swiss-EU trading relationship, is the next task.

7 Having written this, of course, future investment decisions by US MNCs will be based on the expected marginal return of the next investment project and the cost of capital. As we often remind our students, observed averages need not be in line with the relevant marginal metric.

3 Interpreting the Financial Cushion of US MNCs Operating in Switzerland

The headquarters of US multinationals have plenty of locations to choose between when making investments. To attract investments, Switzerland must offer not just decent absolute returns on capital invested, but also higher returns relative to other plausible locales. Fears that Swiss relations with its largest trading partner, the European Union, will deteriorate may cause some US MNCs to revisit their plans for their Swiss operations, now and in the future. The question is how large must the cost or revenue shocks be so that US MNC operations in Switzerland suffer falls in average returns on assets that push them below rival locations on the continent?

Of course, the plans of MNCs are, by definition, forward-looking and may take into account information not presented here as well as expectations and fears – however erroneous – about the future. However, to the extent that past financial performance is taken as an indicator of future performance, then examining the degree to which previous returns are vulnerable to shifts in trading conditions is of interest – not just for the Swiss operations of US MNCs, but also for the alternative locations in Europe where US firms can invest.

Even though US firms based in Switzerland, in particular manufacturing firms, enjoy preferential access to the Single Market of the European Union, as noted in the last section, on average a third of their sales are to Swiss or American customers. In principle, US MNCs can ship to other destinations as well. Unfortunately, the fraction of sales made to EU customers is not known, however, it cannot exceed two-thirds. Consequently, in the revenue-related calculations undertaken below, three scenarios concerning the exposure to the EU Single market are considered. Similar remarks could be made about the costs of US MNCs.

To explain the calculations in Table 1, reason as follows. Over the years 2009-2013, US MNCs earned average returns on assets invested in Switzerland that were 161 basis points higher than in the Netherlands, the alternative country in Europe with the next highest level of returns. A breakdown of Swiss-EU trading relations could result in the imposition of tariffs and non-tariff barriers that reduce the revenues or increase the costs of a Swiss-based foreign affiliate of a US MNC – both of which, *ceterius paribus*,[8] lower average rates of return.

8 Assuming that the foreign affiliate does not take any mitigating action is unreasonable. In fact, one might expect, at the minimum, actions to be taken to reduce the reduction in returns. The implication, then, is that the estimates provided in Table 1 are lower bounds of the cost and revenue shocks necessary to induce relocation of US multinationals away from Switzerland. That many of those lower bounds found in Table 1 are so large is telling.

Table 1: The cost and revenue shocks necessary to tip the balance in favor of investing in alternative European locations

Scenario	Loss in ROA needed	% reduction in sales revenue to EU markets needed to induce required ROA fall			% increase in total costs needed to induce required ROA fall
		All non-US and non-CH sales to EU	75% non-US and non-CH sales to EU	50% non-US and non-CH sales to EU	
Conservative (ROA falls to Dutch levels)	1.61	5.87	7.83	11.74	5.03
Average EU (ROA falls to mean EU level)	5.25	19.17	25.56	38.34	16.41
Local-1 (ROA falls to Austrian level)	2.30	8.41	11.21	16.82	7.20
Local-2 (ROA falls to German levels)	7.71	28.14	37.52	56.28	24.09
Local-3 (ROA falls to French levels)	7.37	26.91	35.88	53.83	23.04
Local-4 (ROA falls to Italian levels)	7.41	27.04	36.05	54.07	23.15

Source: Own calculations based on US BEA data on the operations of majority-owned foreign affiliates of US multinationals operating in Switzerland during the years 2009-2013.

To get a sense of how large a revenue fall is needed to make average returns on Swiss investments fall to Dutch levels, first consider the case in which a foreign affiliate based in Switzerland sells all of the goods not destined for Swiss and US customers to customers in the European Union. Under these circumstances, if newly erected trade barriers against exports from Switzerland reduced total revenues from sales in the EU by 5.87%, then this would lower average Swiss returns to that of the Dutch alternative. If only half of the foreign affiliates sales to customers outside of Switzerland and the US went to the European Union, then the new trade barriers would have to reduce EU sales revenues by 11.74% before average returns on selling from Switzerland would fall to Dutch levels.

Comparable calculations can be performed on the cost increase necessary to eliminate the cushion of excess average returns in Switzerland over the Dutch alternative. In this case, it would take a 5.03% increase in average costs to equalize average returns between these destinations.

These calculations were repeated for five alternative scenarios: one defined by the average returns of US MNCs in the EU as a whole; and four scenarios relating to the countries bordering on Switzerland. The latter are considered just in case a US MNC might be considering alternative locations that are close to any Swiss-based affiliate that it is currently operating.

The cost or revenue shocks that might follow a rupture of trading relations with the EU would have to be greater than 16% (and possibly much more in the case of revenue losses) for average returns of US MNCs in Switzerland to fall below the average level currently earned in the EU. The results are even more striking for France, Italy, and Germany – in these cases, cost increases of 25% or more or losses of 30% of sales revenues in the EU market would be needed to push average returns on Swiss investments below those earned in these alternative locations inside the Single Market. When compared to its large neighbors, the cushion enjoyed by US MNCs operating in Switzerland is substantial.

However, when it comes to investing in Austria, matters differ. On average, US MNC investments in Switzerland earn 230 basis points more than in Austria during 2009-2013. That financial cushion would be eliminated if a rupture in trading relations with the EU raised average costs by 7.2% or lowered EU sales revenues by between 8.41% and 16.82%. The imposition of non-tariff barriers of this magnitude is entirely plausible. In sum, if prior financial performance is any guide, then, two middle-sized continental European nations pose the most plausible alternative locations for US MNCs to Switzerland.

These findings must be interpreted with care, however. That the EU can impose such non-tariff barriers is not to imply that it will do so, nor that such barriers would be imposed immediately (they may grow over time.) Moreover, any adverse developments in the Austrian or Dutch economies would tip the calculations in favor of remaining in Switzerland and would imply that any breakdown in EU-Swiss trading relations require even larger cost and revenue shocks to induce investor relocation.[9] Movements in exchange rates are another relevant, complicating factor. The latter two points provide a useful reminder that many factors – not just the state of trade relations – determine the returns on foreign direct investment.

The purpose of this section has been to translate the size of the excess financial performance of US MNCs in Switzerland into metrics that can be related to the possible consequences of a breakdown in Swiss-EU trade relations. The financial cushion enjoyed by US MNCs is so substantial that threats to relocate to Switzerland's larger neighbors are not credible. Those neighbors may have considerable diplomatic clout, but that has not translated into financial attractiveness, at least as far as recent US MNC performance is concerned. Austria and the Netherlands are, however, relatively more attractive alternative locations for foreign investors thinking of moving from Switzerland. Benchmarking the Swiss business environment against these two medium-sized continental nations over time would be appropriate.

4 Concluding Remarks

Should Swiss trading relations with the European Union take a turn for the worse, no doubt fears will be expressed that loss of access to the Single Market will adversely affect the attractiveness of Switzerland as a base for exporting to the EU. While it is difficult to see how a rupture in trade relations with the EU would make the Swiss business environment more attractive, the question still remains how likely is it that foreign multinational companies will relocate activity to other locations, including to Switzerland's neighbors.

One goal of this paper has been to turn a discussion that could be driven by speculation and exaggeration into one grounded in data – and not just data on the absolute financial performance of multinational corporations in Switzerland, but also relative to plausible alternative locations in Europe. For sure, the empirical

9 In this regard, it is worth noting that both Austria and Netherlands have both fallen in the competitiveness rankings of the World Economic Forum; Switzerland holds the top position in the latest version of these rankings (see http://www.weforum.org/reports/global-competitiveness-report-2014-2015).

lens taken here relates only to US multinationals, but that reflects limits on the availability of data on other countries' multinationals rather than anything else.

Such is the excess return on assets invested by US multinationals in Switzerland that concerns a rupture in trading relations with the European Union would lead to widespread relocation of business activities to member states in the core of Europe, in particular to France, Italy, and Germany, seem unwarranted. This suggests that US multinationals may not be as footloose as some may have thought.

Austria and the Netherlands – two middle-sized economies near the geographic center of Europe – offer slightly lower average returns on assets invested than Switzerland at the moment. However, other things being equal, plausible revenue and cost shocks that might follow a breakdown in trade relations between Switzerland and the European Union could tip the balance in favor of investing in these alternative destinations.

In interpreting this finding, however, bear in mind the caveat "other things being equal." Other things are rarely equal. National business environments change over time, with implications for returns. If a rupture in Swiss trade relations with the EU were combined with a sustained deregulation initiative in Switzerland that lowered costs or enhanced productivity substantially, then this is likely to slow the exit of multinational companies. Worsening economic conditions in Austria and the Netherlands would limit the outflow from Switzerland as well.

Two further points of perspective are needed. The first highlights that, whatever the disruption that might follow loss of Swiss access to the EU's Single Market, the question must arise as to whether the ensuing problems pale in comparison to the sharp appreciation in the Swiss franc witnessed in recent years. This is not to imply that loss of market access is unimportant – indeed, it may be the final straw for some foreign investors. Still, this question should be asked by corporate and political decision-makers alike.

The second point of perspective relates to the changing nature of foreign multinational operations in Switzerland. To the extent that Switzerland is becoming a more important base for innovation by these multinationals, then to what extent are the commercial returns on these activities at risk from a breakdown in Swiss trading relations with the European Union? Unless the EU is going to actively discriminate against intellectual property developed in Switzerland, firms may be tempted to develop new ideas here and manufacture the resulting products in other locations.

It may be tempting for some to read this paper as offering support for a belligerent Swiss negotiating position vis-à-vis the European Union in the months and years ahead, not just with respect to the matter of immigration but also the architecture of Swiss-EU relations (which the EU clearly wants to change). That the threat to Switzerland as an attractive base for foreign multinationals may not be as great as some might fear is only one consideration. It is difficult to see, however, how sustained friction between Switzerland and its largest trading partners can be to the overall benefit of either party.

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