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Lording it over the Rest of the World

Why Switzerland should resist the temptation of legal imperialism

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policy brief

Despite growing prosperity, free trade is coming in for criticism in many countries. Some fear competition from abroad, while others believe globalization is enabling the circumvention of regulations and exploitation of less economically developed countries. There is currently talk of trade barriers designed to restrict the exchange of goods by means of administrative hurdles rather than tariffs. The idea of applying laws extraterritorially is also gaining currency in Switzerland. But this runs counter to the principle that international trade should be based on a common set of rules – rules that are especially beneficial for a small, export-oriented country such as Switzerland. Swiss companies already have comprehensive corporate social responsibility frameworks in place. Rather than posing a threat to the emerging economies where they do business, they generally have a positive impact on human rights and the environment in these countries.

1 _ Anonymous markets trigger fears

Criticism of globalization is running high in many western industrial nations. The negative repercussions include faltering negotiations around the World Trade Organization (WTO), the Brexit referendum, the success of slogans such as "America First" with voters, and political initiatives to protect domestic business. Shutting out the economic reality to prey on the diffuse fears of voters, all this ignores the fact that globalization has achieved more within a very short space of time than the entire development policy of the previous decades. Globalization has taken people out of poverty and given them access to food, health, and education. Free trade and the international division of labor have helped create greater prosperity, purchasing power, and product diversity in largely industrialized countries as well (Dümmler 2016). They have also reduced inequality. Millions of people have advanced to the middle class in Asia alone.

These often diffuse fears of globalization are evident in the way new barriers to trade are being erected in many countries – almost 5,000 of them in the last ten years. [1] They range from tariffs and competition-distorting subsidies for domestic industries to rules making it more difficult to import products. Besides technical requirements, and mandatory certifications in areas such as consumer electronics and medical technology, these measures also include rules requiring proof of compliance with social and environmental standards.

International value chains

Many trade barriers stem from unease in the face of the complexity and depth of economic processes, often combined with a general skepticism about growth or fears of losing prosperity. International value chains often come over as anonymous to consumers, and people end up projecting all sorts of negative conjecture onto them concerning, for example, human rights, animal welfare, and environmental standards. But it is precisely this "anonymity" that is a strength of the free market system (see Box 1).

Box 1

Anonymity as a strength of free market enterprise

One of the great strengths of the free market system lies in the anonymity of value chains, as Nobel laureate Milton Friedman (1980) once illustrated with the example of a pencil: thousands of people are directly or indirectly involved in the manufacture of this household product, from the workers in the pencil factory to those who supply the wood or provide the saws, whose manufacture in turn requires metal from faraway countries. Most of the people involved in making the pencil do not know each other, and probably would not spontaneously trade with each other even if they did. The goal of jointly producing pencils brings together a larger number of people than you could ever imagine.
(see Figure 1)

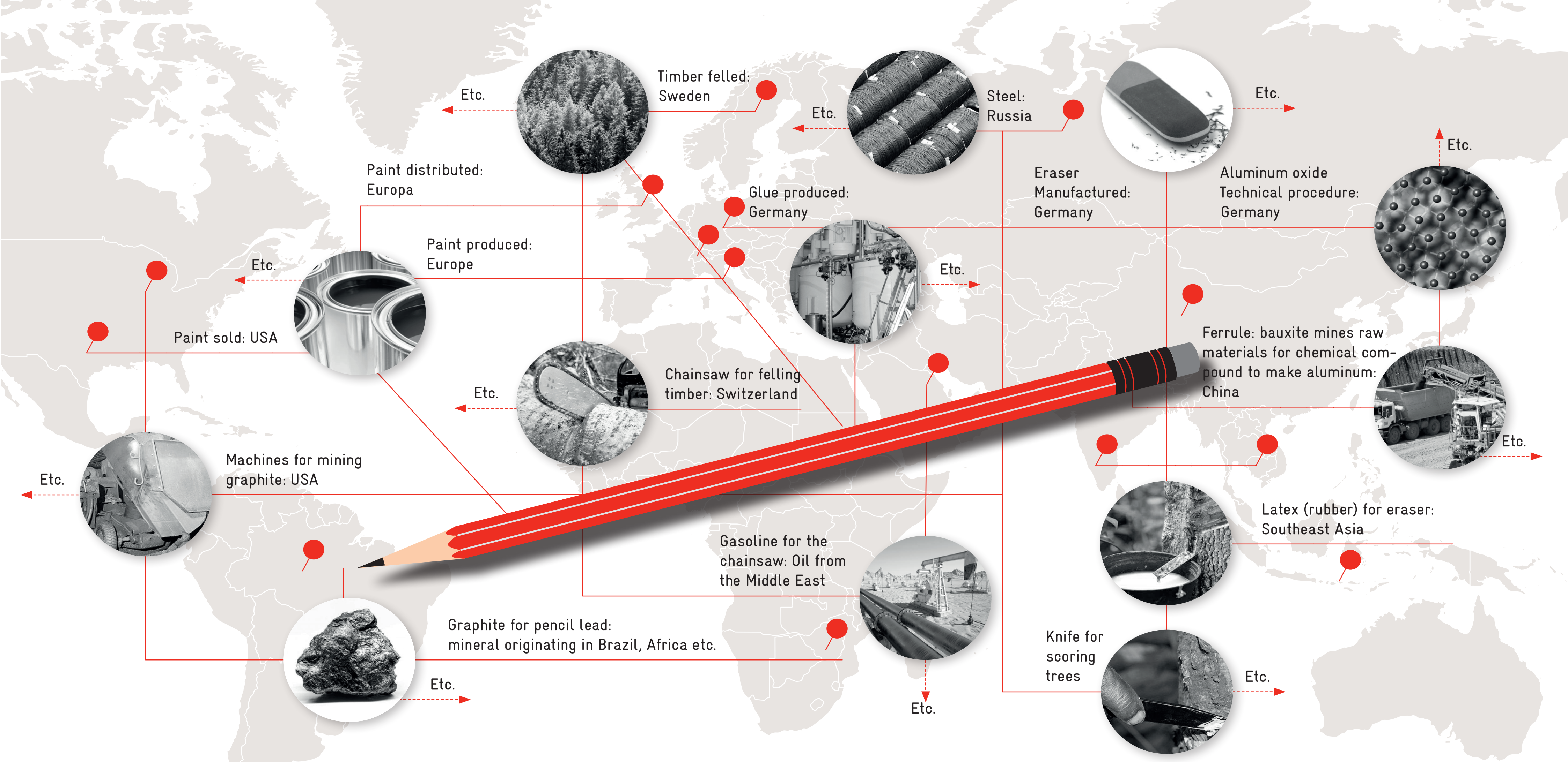
The globalization of value chains implies that in principle the trading partner's legal system is accepted, or that everyone involved recognizes globally valid rules such as those set down by the WTO when they exchange goods and services. These kinds of multilateral rules particularly benefit small, open economies such as Switzerland. [2]

1 Period 2009 – 18, data from *www.globaltradealert.org* (Global Trade Alert 2018).
2 See Grünenfelder and Schellenbauer (2018).

Figure 1

The complexity of value chains illustrated by the example of the pencil

The manufacture of a pencil is much more complex than it appears at first glance. Thousands of people in the global economy are involved, directly and indirectly. They do not have to know or talk to each other. What allows them to create this pencil is the price system inherent in a free market economy.



Source: Own representation based on Milton Friedman (1980)

Applying national laws extraterritorially, on the other hand, creates inconsistencies between legal systems. These inconsistencies can potentially lead to a situation that every time a company engages in economic exchange, it is standing with one leg in illegality, because it is literally impossible to do right by everybody. The consequence of this would be serious juridification of business relationships, with less trade and economic cooperation overall – which would have a negative impact on prosperity in all the economies involved.

2 _ "Good" Swiss law

In Switzerland, too, sections of the population are uneasy about globalization, with frequent political calls for the greater protection of domestic value creation because people see free trade as a threat to the economy and jobs in this country. In many cases, calls to restrict foreign trade are also motivated by developmental and environmental considerations.

It is against this backdrop that the trend to also apply "good" Swiss law – in other words rules shaped by our moral values – has to be seen. Such endeavors are driven by a self-image of superiority and the idea that an economically and legally highly developed nation could show other countries how it is done "right." [3] By this logic a foreign manufacturer wishing to export to Switzerland has to bow to Swiss ideas of what is morally proper.

Such impositions spell bad news for the free market economy: they encourage uniformity among the products available on the domestic market (because all products meet the same standards) and limit consumer choice and manufacturers' scope for differentiation. Not all consumers share the same values. As soon as high standards are implemented across the board, there is less freedom of choice.

Increasing number of popular initiatives with an extraterritorial impact

There are various examples of popular initiatives in Switzerland that aim or have aimed to extend Swiss law to other countries. These include the Fair Food Initiative, which was rejected by 61.3 % of voters in 2018. One of the main aims of the initiators was to impose Swiss social, sustainability, and animal welfare standards on imported foodstuffs as well. While the initiative was rejected, the notion

3 The term "legal imperialism" often crops up in this context. It was originally used in connection with the United States' practice of taxing its own citizens even if they live outside national territory. The only other country with this kind of arrangement apart from the United States is Eritrea.

that it is only ethical to consume products produced in line with Swiss rules is still widely held.[4]

Other comparable initiatives launched in the past included a referendum to ban factory farming in Switzerland, which despite the name demands the same standards for foreign products as for those in this country. Another example of an initiative with extraterritorial impact is "For a Switzerland without Synthetic Pesticides."[5] Not only does this call for a ban on such products in this country, but it would entail a ban on all imports of foods produced using synthetic pesticides.

A yes vote to the popular initiative calling for businesses to take responsibility for the protection of people and the environment, the "Responsible Business Initiative," would also have far-reaching consequences. The initiators want to impose more stringent liability rules on Swiss companies in an effort to protect human rights and the environment (see Box 2).

Box 2

The extraterritorial impact of the Responsible Business Initiative

The aim of the Responsible Business Initiative is to require companies to do mandatory, risk-based due diligence on all their business relationships. They would basically be liable for violations of human rights or (as yet undefined) environmental standards. This liability would not be limited to damage caused by the company itself. It would also extend to subsidiaries abroad, and could even affect foreign suppliers if they were "economically dependent" on a Swiss company or its subsidiary (the term "economically dependent" is not defined in any more detail in the text of the initiative). In some cases, the text is interpreted even more broadly. On the basis of the value chain model, the Swiss company would be liable for all economically dependent agents involved in the joint creation of goods and services, in other words also for all of a supplier's suppliers, and their suppliers as well; the complexity of value chains would in effect make these rules impossible to enforce (see Box 1).

Victims of human rights violations or environmental destruction for which, under the terms of the initiative, a Swiss company could be liable, would in future be able to sue for damages in Switzerland or be represented, for example by an NGO, in litigation. In the event of conflict, the burden of proof would be reversed: if a company in Switzerland were unable to prove it exercised comprehensive due diligence, it would be held to be at fault.

Figure 2 shows the complexity of the various dependencies, duties, and litigation options under the initiative. Böckli and Bühler (2018) come to a negative conclusion in their legal evaluation of the Responsible Business Initiative. Among other things they find fault with the overextended duty of due diligence outside the control of the group, claiming that the result of this would be to disadvantage foreign companies supplying and receiving goods, with negative consequences for the economic development of the countries in which they were based.

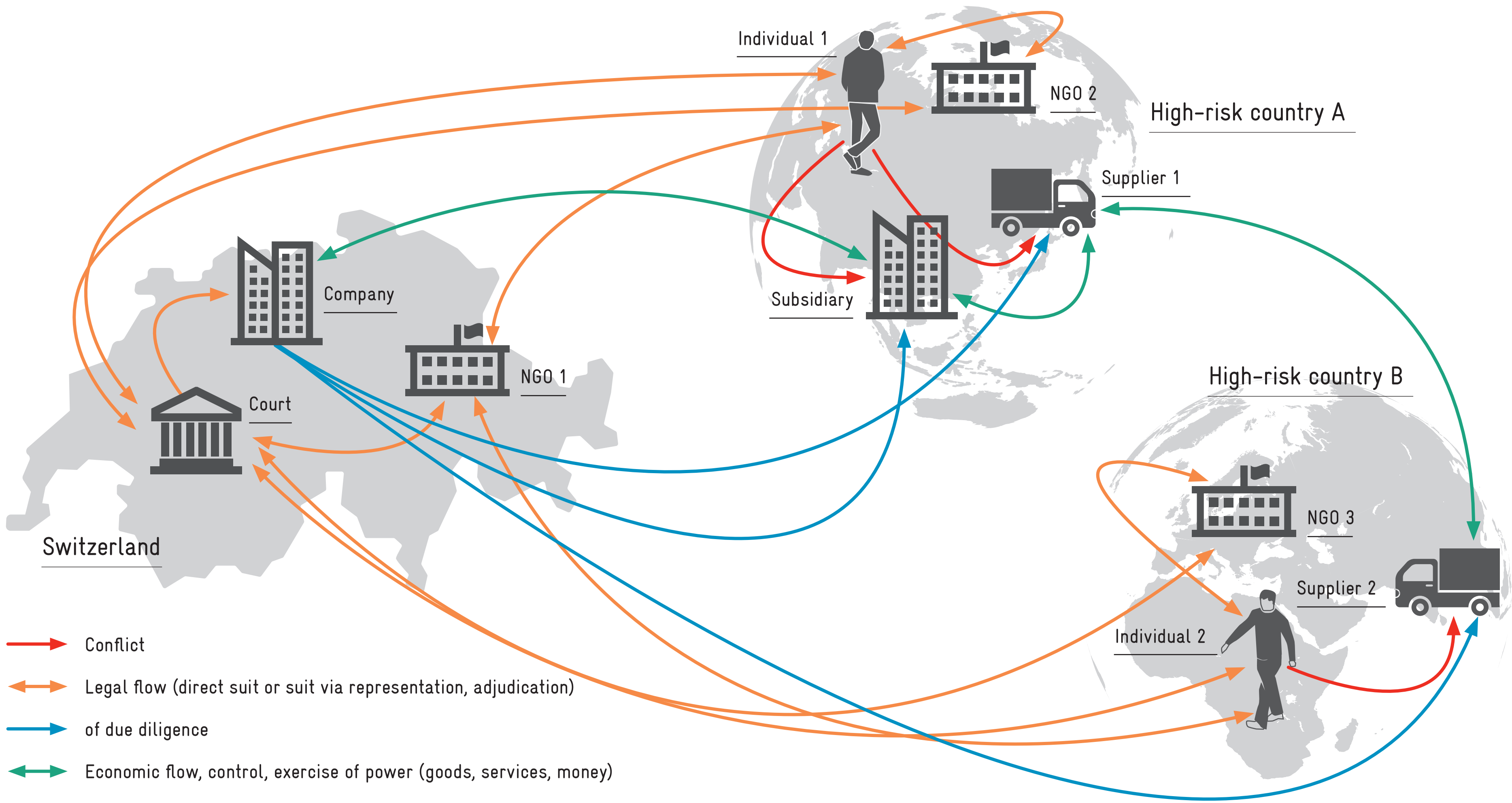
4 The thinking behind parliament's call for amendments to the Federal Act on Public Procurement is similar. Government contracts could only be awarded to companies that meet Swiss environmental norms, even if they manufacture abroad. With government procurement contracts amounting to around CHF 40 billion a year, Swiss business would be given a competitive advantage that would tend to increase the costs of procurement and thus the expense to taxpayers. From a regulatory point of view, also using the legislation in pursuit of industrial and environmental policy aims is questionable.

5 The Fair Price Initiative likewise falls into this category in a broader sense.

Figure 2

Complex international creation of products and services results in high liability risk

Example: A company in Switzerland receives intermediate products from a subsidiary in high-risk country A. This subsidiary has a business relationship with supplier 1, who in turn has a relationship with supplier 2 in high-risk country B. The Responsible Business Initiative can be interpreted to mean that the company in Switzerland has to do due diligence not only on its subsidiary, but also on the legally independent suppliers 1 and 2. In the event of conflict, an individual can be represented either by a local NGO or an NGO in Switzerland; they can also go directly before a Swiss court.



Source: Own presentation

Extraterritorial impact and isolationism always come at a cost. For example, Switzerland had the most complex customs and tariff system of any of the 140 countries investigated in a study.[6] The main culprit here is agricultural import protection. This is particularly significant from a development policy point of view. If less developed economies are to have a shot at economic growth and social development, given the typical structure of such economies this will also involve agricultural exports. The trade barriers put up by Switzerland hinder the development potential of many of these countries. So from a social perspective, it would be particularly important to reduce rather than increase these obstacles to trade. A yes to the Responsible Business Initiative would also have cost implications (see Box 3).

Box 3

A simple estimate of the costs of applying laws extraterritorially, using the example of the Responsible

The proponents of various initiatives to apply Swiss law extraterritorially generally dispute the idea that implementing their political ideas would result in economic costs. And indeed, it's almost impossible to calculate these costs before the event using standard empirical and theoretical approaches, as only very rarely are there examples of interventions that would enable a comparative analysis. Despite this methodological problem, below we present a possible approach to estimating the cost implications using the example of the Responsible Business Initiative.

Doing a precise calculation of the costs resulting from the Responsible Business Initiative would involve having detailed insights into the structures and strategies of all the companies involved, which is of course not possible. Even so, it appears fairly clear that the costs would increase with the amount of foreign exposure. This exposure for its part correlates closely with the relevant foreign direct investments. To be able to work out the extent to which costs would increase in relation to foreign direct investments, we gathered the relevant data from a number of affected companies. We analyzed the additional costs they anticipate in relation to their foreign direct investments – both the one-time costs and the recurring annual costs – in the event that the Responsible Business Initiative is accepted.[7]

Swiss legal imperialism comes at a cost
Finally, we estimated the costs on the basis of the unweighted mean of the data multiplied by Swiss companies' total direct investment abroad. Based on the figure for total foreign direct investment in 2016, we estimated one-time costs of CHF 5.1 billion, and recurring costs of CHF 2.1 billion a year. These are not inconsiderable sums, and would have a tangible impact on Swiss business.

Cost estimate extremely conservative
Our estimates were extremely conservative, and should be seen as the very minimum. There are two main reasons for this: firstly, our estimate is based exclusively on direct investments, so it neglects pure trading relationships without local engagement. However, the Responsible Business Initiative explicitly states that economic dependency is sufficient for an entity to be affected by the initiative. So, for example, if a Swiss company imports sufficient input work from a foreign supplier, any due diligence on its business would have to include this supplier. Secondly, the companies we surveyed were medium-sized and large enterprises. In most cases, these companies already have highly developed compliance and due diligence processes. The one-off costs of setting up the relevant compliance structures would thus be higher for smaller companies than for larger entities.

6 World Economic Forum (2018).
7 To give a more differentiated view, we distinguished between four of the regions potentially particularly affected by the Responsible Business Initiative: Central and South America, Asia, Africa, and Eastern Europe (excluding EU member states).

3 _ Extraterritorial application of the law harms the presumed victims

Another motive for the increased extraterritorial application of Swiss law lies in the general criticism of western companies' activities in developing and emerging countries. Some people, for example, see direct investment, alongside trade, as more of a threat than an opportunity. A claim often heard in this context is that multinationals primarily invest in emerging countries because they want to exploit lower labor protection, environmental, and social security standards in these places. Environmental economists talk in terms of a "pollution haven." On the basis of their calculations, Peters and Hertwich (2008), for example, conclude that in terms of global greenhouse emissions, this shift is responsible for around one-sixth of carbon emissions. [8] But they weren't able to demonstrate a causal link with the exploitation of lower standards outlined above. [9] The described shift is also accompanied by fears that the various locations are engaging in a race to the bottom, constantly trying to undercut each other in regulatory terms in an attempt to attract companies. Taking this view, it seems reasonable to assume that the extraterritorial application of Swiss law could counter this development.

Investments with positive spillover effects for host countries

This, however, is a false conclusion that runs diametrically counter to the findings of economic research. It can be regularly observed that when multinationals enter an emerging or developing economy, production standards in that country improve and people, the environment, and the economy benefit from spillover effects. For example, Ning and Wang (2017) show that the involvement of foreign companies in China resulted in a reduction in local sulfur dioxide pollution, with the effect even spilling over into other regions, albeit slightly more weakly. In an overview, Erdogan (2014) also concludes that while the pollution haven hypothesis can come into play in individual cases, there is no empirical research evidence suggesting any systematic correlation. [10] An even more recent meta-analysis by Cole et al. (2017) confirms the positive effects of foreign direct investment on the consumption of resources and environmental stress, although in fairness it must be said that these effects can be weakened for a certain time by economic growth benefiting the population.

There are many reasons for the positive spillover effect of foreign direct investment:

- Firstly, foreign companies to a large extent keep to their standards when they enter such markets. This can have to do with compliance with corporate social responsibility (CSR) guidelines (see Section 4), but it is also in a company's immediate economic interests, for example because it assures quality requirements are met and helps avoid production downtime. Added to this, even if only for reasons of corporate reputation, investing companies have a vested interest in ensuring that the relevant standards are complied with. These standards have a knock-on effect on other sectors of the economy. Nyuur et al. (2015) identified the same specific effect in Ghana, where the presence of foreign companies had a positive impact on the

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8 Added to this are the emissions resulting from the transport of goods. In individual cases, these may be relevant, for example if goods are primarily transported by air, but in most cases the type of transportation is of secondary importance in terms of overall emissions compared with the environmental-friendliness of the production process itself.

9 The paper compares the carbon footprint of goods produced in industrial nations with the footprint of the goods they consume. As a rule the goods consumed have a bigger footprint; the "gray" energy involved in importing goods also has to be taken into account. The problem is, however, that for various reasons a country like Switzerland is no longer competitive when it comes to emission-intensive goods. To all intents and purposes, highly developed economies no longer have any comparative advantage in this area. While different environmental standards can come into play, in such a setting it is not possible to make them solely responsible for higher emissions.

10 Although the meta-study by Meyer (2003) is somewhat older, it comes even more firmly to the same conclusions.

Governments in developing and emerging countries have an incentive to improve their human rights situation or environmental conditions, because this makes them more attractive for foreign direct investments.

CSR standards of companies already established there.

- Secondly, foreign direct investment always involves a transfer of technology and know-how. A company has an intrinsic interest in manufacturing as efficiently as possible, and thus using as few resources as possible; a fact that favors the deployment of modern technology. This knowledge transfer benefits the entire economy, as the know-how can be applied in other areas as well. A typical example is productivity improvements in farming.
- Thirdly, western companies don't generally invest in countries where there is too much legal uncertainty (for example because of a lack of rights of ownership) or systematic violation of human rights. As Garriga (2016) demonstrates, the risks involved, including reputational risks, are simply too great. In a highly respected paper, Harms and Ursprung (2002) also show that governments in developing and emerging countries have an incentive to improve their human rights situation or environmental conditions because this makes them more attractive for foreign direct investments.

Extraterritorial application of the law undermines involvement in developing and emerging countries

It could be objected that imposing Swiss standards and legal norms would amplify these positive effects. But this assumption is false. This is most easily illustrated by the example of the Responsible Business Initiative. The liability it postulates would mean that any investment in a developing or emerging country would entail additional risks. But risks make investments less attractive, and in the worst case completely discourage investment because the expected returns are not sufficient to justify the risk. As a consequence, companies will choose to concentrate their production facilities in more highly developed locations with lower risks (for example Asia rather than Africa), or even avoid foreign investment completely – which of course is to the detriment of the poorest countries. So, if there is a yes vote, we can expect the effect to be even more pronounced, because the initiative calls for companies from Switzerland also to be liable for the activities of "economically dependent" suppliers. Since they have no way of monitoring or controlling these suppliers (see Box 2), this kind of rule could even result in the complete cessation of economic exchange with the developing and emerging countries affected.

But even if a company basically wanted to continue operating in these places, there would be negative consequences for the countries concerned, because to assure Swiss standards in the manufacturing process (or the entire value chain) and eliminate the liability risk, companies would be forced to isolate themselves from local markets. With the main concern to avoid liability, the result would be a kind of "tick-the-box" mentality. But if foreign companies were to operate only in this kind of "offshore islands," the spillover effects on the national economy described above, and the chances of economic development, would be sharply reduced.

4 _ Extensive adoption of CSR rules in the business community

Historically, it has been industries and companies themselves that have been first to adopt their own standards and codes of conduct. They haven't done so out of pure altruism, but rather to maintain the trust of consumers in their products and services. These days Swiss companies have high standards when it comes to protecting the environment and workers all over the world. This is best illustrated by the degree to which the business community has adopted corporate social responsibility (CSR) rules. To evaluate this, we looked at 85 relevant Swiss industry associations whose members either do a high proportion of their business abroad or whose industries are often associated in the public perception –[11] with manufacturing conditions that violate human rights or harm to the environment. –[12] Figure 3 shows the extent to which different industries have adopted CSR rules. Associations representing the oft-criticized financial services and insurance industry (79 %), textiles and primary materials (73 %), and food and tobacco (73 %) have particularly high rates of adoption.

Of all the industry associations surveyed, 68 % have CSR rules, self-regulation, an environmental charter, core values, or guiding principles. It emerges that the most frequent areas of focus are transparency –[13] and responsibility vis-à-vis employees and society (50 %), followed by the human rights situation (43 %) and the environment (40 %; see Figure 4).

Just because an industry organization does not have this kind of standard in place does not mean that the same applies to all its members. In other words, the results of the survey underestimate the degree to which CSR rules have been adopted by Swiss business, because if there are no industry solutions in place companies often impose their own

11 For example, Fact Sheet V produced by the initiators of the Responsible Business Initiative talks of "high-risk sectors"; it explicitly mentions mining or trading in commodities, precious metals and stones, and tropical timber.

12 No mention is made of domestically oriented bodies such as the cantonal commercial or farming associations or chambers of industry and commerce.

13 An example of transparency is the fact that media and people working in the media undertake to mark paid content appropriately.

Figure 3

Adoption of CSR rules by Swiss industry associations

Example of how to interpret: 79% of all financial services and insurance industry associations have on their own initiative drawn up CSR rules for their members.

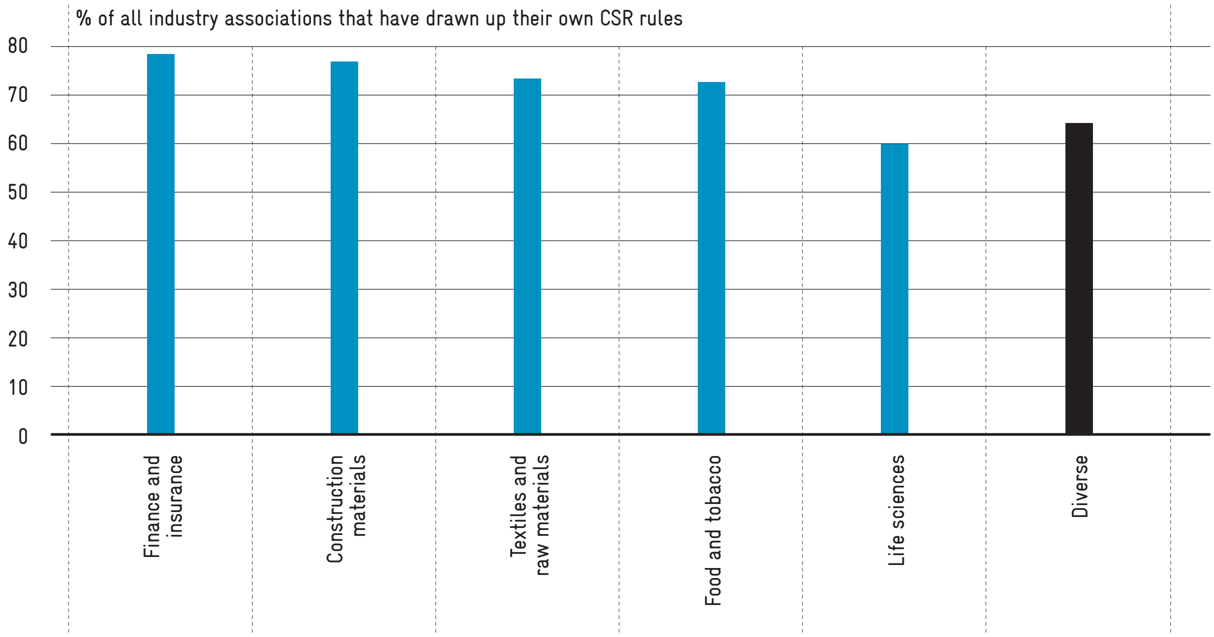
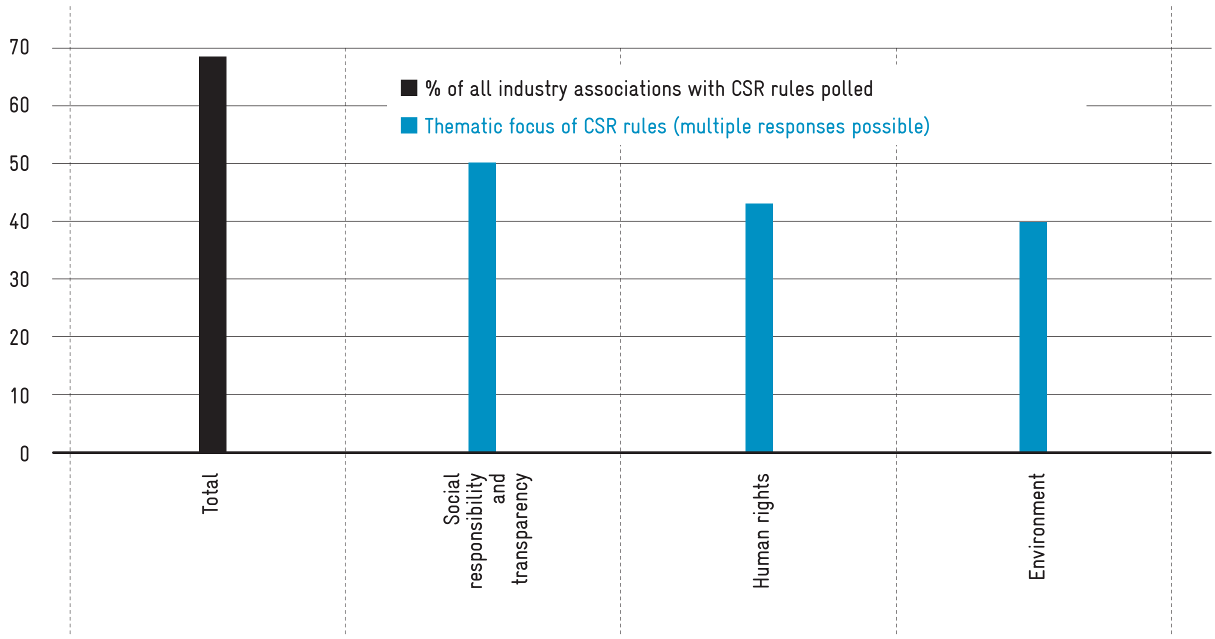


Figure 4

CSR rules at Swiss industry associations, by area of focus

Example of how to interpret: 68% of all the industry associations surveyed have drawn up their own CSR rules, with 50% of these addressing social responsibility and transparency.



Source: Own survey

CSR rules. Even if increasingly dense regulation plays a part, especially in the financial industry, this can be clearly seen in the growing importance of the compliance officer in the world of business. A snapshot of an online job portal on a random date shows that this role is no longer something exotic: at the end of 2017, there were 1,408 compliance-related vacancies in Switzerland.[14] Around a year later this figure had climbed to 1,764.[15] Besides monitoring a company's legal obligations, candidates are expected to also keep a critical eye on its social and environmental duties within the framework of CSR.[16] Compliance people are supposed to intervene before damage occurs and reputation – one of a company's key non-monetary assets – suffers as well. Even so, it's worth remembering that too many standards can also inhibit economic development. Competition is also supposed to offer the opportunity of being different, which in turn is a prerequisite for innovation.

Another study shows that 84 % of the 50 largest companies in Switzerland – and thus probably the businesses with the greatest foreign exposure – have a code of conduct (KPMG 2015).[17] In 80 % of the codes the behavior of employees is addressed, particularly in relation to bribery and corruption. Environmental aspects were covered by 70 % of the codes, with a third of all codes going into detail and providing practical examples (KPMG 2015).[18] Switzerland compares well with other countries. Only 76 % of Fortune Global 200 companies have a code of conduct; in Asia the figure is only 42 %.

In addition to internal assurance mechanisms such as the compliance function, external agents also play an important part: through their critical research and publications, NGOs and the media exercise an oversight function, disclosing wrongdoing and naming and shaming in public.[19] To this extent every individual can help increase respect for human rights and environmental rules by steering clear of products and services provided by companies associated with misconduct.

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14 Accessed on 20 December 2017, 11.40 am; search term "Compliance" *(JobCloud 2019)*.

15 Accessed on 14 January 2019, 3.48 pm; search term "Compliance" *(JobCloud 2019)*.

16 Companies are particularly cautious when it comes to the US market, because quite apart from the damage to reputation, proof of legal violations can rapidly result in costs of tens of millions. Compliance officers therefore have a key role to play.

17 It should also be noted that Switzerland has one of the lowest rates of public-sector corruption in the world, and is considerably better than its neighboring countries, for example *(Transparency International 2019)*.

18 A 42-page work that many organizations orient themselves by is the UN's "Guiding Principles on Business and Human Rights" (2011); further international examples with relevance for Switzerland can be found in Section 2.2 of the dispatch on the Responsible Business Initiative *(Swiss Federal Council 2017)*.

19 This can prompt a rapid change in the behavior of companies coming in for criticism. A well-known example of this is Greenpeace's campaign against the sinking of the Brent Spar oil storage and tanker loading buoy in the Atlantic in 1995. Even though various subsequent studies showed Greenpeace's environmental allegations to be mistaken, the campaign led to a ban on disposing of oil platforms in the North Atlantic in 1998.

5 _ Conclusion: lording it over the rest of the world is counterproductive

In the postwar period, international trade and globalization have been a constant target of criticism, as Aerni (2018) explains in his book on the impact of multinational corporations. It has been frequently alleged that networked business destroys local economies, and free trade puts pressure on wage earners in all countries and encourages a regulatory race to the bottom. But the opposite is known to be the case: liberalized markets and trade have brought industrial nations and many emerging economies unprecedented progress and prosperity. From poverty, starvation and malnutrition, infant mortality to life expectancy, there is no indicator that does not reflect this improvement.

Despite this, particularly in the wake of the 2008–09 financial crisis, measures to impede the free exchange of goods and services and the free flow of capital have once again become acceptable. Only rarely does this take the form of the kind of customs tariffs that figure in the current trade war between China and the United States. The mechanisms are almost always of a non-tariff nature, for example administrative hurdles created by changing the norms governing the import and export of goods. If implemented, the notion of applying law on an extraterritorial basis currently being discussed in Switzerland would have precisely the same effect; it would constitute a de facto trade barrier.

It is one of the essential principles of global trade that the countries involved, within a defined framework of rules set by a body such as the WTO (which particularly benefits small, open economies such as Switzerland), have differing legal systems to take account of local circumstances and cultural differences. Indeed, Switzerland itself in some cases has different rules by dint of its federalist set-up. Emerging economies get the chance to develop a legal framework best matching their needs. This not only boosts acceptance of trade with other countries, but also, in a certain sense, enables competition between systems. This in turn allows countries to learn from each other [20] and arrive at the best possible results by a process of trial and error.

There is a certain irony in the way political movements that rightly brand the colonial era as a dark chapter in western foreign policy now want to disqualify the very countries affected back then from developing and upholding their own systems of law. This does not mean that Switzerland and other industrial nations should not be doing everything in their power to support these places. But trying to lord it over these countries by applying Swiss laws extraterritorially is counterproductive, and in the medium term could damage relations between established and emerging economies. Given its own founding myth, Switzerland should know this.

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20 An example from history is the way Turkey autonomously adopted the Swiss Civil Code, almost word for word, shortly after its founding.

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