

A bilateral free trade agreement between China and Iceland as a European country

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Abstract

A Free Trade Agreement (FTA) between China and Iceland was signed on the 15th of April 2013. The paper discusses the negotiation process and the actual business activities in the respective countries, focusing on the FTA's socio-economic significance. Our study is for the most part an empirical one, an overview of the free trade negotiations, procedures and the topics covered along the issues and the actual activities on the firm level. From the outset in 2004–2005 and up until the negotiation process, the project has had strong political connotations with its geopolitical location but by the time it was finalized, it turned out to be first and foremost a bilateral trade agreement between two nation states.

Key words: Free trade, China, Iceland, geopolitics, European Union

Introduction

The formal negotiations started in April 2007 and went on until the fourth round in April 2008. However, in early 2009, soon after the decision of the Icelandic government to apply for EU membership, China called for a suspension of the FTA negotiation on the grounds that the EU membership would invalidate such a bilateral trade agreement. China and Iceland decided to resume the FTA negotiation during the official visit of the Chinese Premier at the time, Wen Jiabao, to Iceland in April 2012. One year later, after two more formal rounds of FTA negotiations, the FTA agreement was signed during the official visit to China of the Icelandic Prime Minister, Jóhanna Sigurðardóttir. The geopolitical importance of such a free trade agreement with Iceland is historical, as it is China's first

FTA with a European country, or with a member state of the EES agreement. China's FTA negotiation with Switzerland was also concluded soon after the signing of the Iceland-China FTA and, although the present political disputes have stopped the negotiations between China and Norway, both countries have a vested interest.

The geopolitical settings

When a population of over 1.35 billion is negotiating on equal terms with a nation of 320 thousand, the outcome is obviously not just a bilateral trade agreement. A more sensible understanding is to regard it as a further step in consolidating its position in international business for a nation that has become more and more embedded in the global economy. China had become an industrial giant in global manufacturing industries in a matter of decades but was and is not a market driven economy. As late as 2001, China joined the World Trade Organization, long after it had become a major trading partner globally.

A deepening global post 2008 crisis has made it imperative to retain an efficient global trade system. The emergence of 'neo-protectionism' is a matter to be tackled with. USA and EU free trade negotiations just started on 17 June 2013. However, EU is on the defense when it comes to a FTA with China: "Brussels seems to have ignored Beijing's proposal to do a feasibility study to kick off FTA negotiations. Instead, amid a double-dip recession, Brussels has increasingly resorted to trade protectionism to hamper China's exports" (*China Daily*, January 25, 2013).

The present FTA between Iceland and China is hardly an issue in the escalating friction between the world's superpowers in global trade. A more plausible explanation is to regard it as an attempt to retain the diplomatic relations with Icelanders initiated by China in 2002 at a time when dealings with Europe had become problematic due to the worldwide criticism of human rights violations and as a part of the "side door strategy" (Lanteigne 2010). Although it might seem banal today, the initial repeated visits of prominent delegations to Iceland in the early 2000s must be understood in this context; Iceland was a test bed, or a training ground, for diplomats and trade negotiations, but as time goes by it becomes less important in the overall context (Schram 2005).

According to Martin Jacques, “China will take on the challenge of acting according to its global stature: in global rather than absolute terms, obliged to learn about, and to learn from, the rest of the world without the presumption of underlying superiority, the belief that ultimately it knows best and is the fount of civilizational wisdom.” (Jacques 2009, p. 145).

The Memorandum of Understanding between China and Iceland

From April 2012, when Premier Wen Jiabao made Iceland his first stop on his visit to Europe, the bilateral relationship has generated a broad range of cooperation projects. On 20 April 2012, following a bilateral meeting, the following bilateral and business agreements were signed in the presence of Prime Minister Jóhanna Sigurðardóttir and Premier Wen Jiabao.

The MOU covered the following:

- Framework Agreement between the two governments on Arctic Cooperation.
- MOU between the Icelandic Foreign Ministry and the Chinese Ministry of Land Resources on Geothermal and Geosciences Cooperation.
- Letter of Intent between the Government of Iceland and China National Blue Star Group on a Polycrystalline Silicon and Metal Silicon Cooperation Project in Iceland.
- Framework Agreement between Orka Energy Ltd. and China Petrochemical Corporation (SINOPEC Group) on Expansion of Geothermal Development Scope and Cooperation.
- Memorandum of Understanding between Promote Iceland and China Development Bank on Planning Consultancy Cooperation.

In connection with Chinese Premier Wen Jiabo's visit to Iceland, Elkem-owner China National Bluestar signed a joint declaration agreement for building two new plants on the island; a 10,000 metric ton solar silicon plant and a 50,000 metric ton silicons melter to be developed in Iceland. China National Bluestar owns Elkem, which already owns and operates a smelting plant in Iceland. The CEO of Elkem, Helge Aasen, a board member in China National Bluestar, stated: "This agreement shows that there is a strong long-term market outlook for our products. The project is however in a very early stage and there is still much uncertainty related to a possible implementation." (2012)

The silicon smelter, *Íslenska járnblendifélagið*, was bought by the Chinese when Bluestar bought the Norwegian firm Elkem's silicon-related operations such as Silicon Materials, Elkem Foundry Products, Elkem Carbon and Elkem Solar which means that it can be regarded as a project close at hand as the company is already operating a plant there but a MOU *building a plant in Iceland and increasing the Bluestar/Elkem/Járnblendifélagið* in operations in the country is doubtful taken into account the situation on the solar cell market in Europe.

It is however highly unlikely because the solar cell industry is expected to be in trouble for several years to come due to oversupply and trade frictions between EU and China. A decision to erect a new Chinese production facility in Iceland is not a political decision alone but has to fulfil the criteria of profitability. Officially Bluestar is a semi-public company, but is 20% in the hands of one of the biggest and mightiest hedge funds worldwide, Blackstone. Hedge funds do not have hands on management of the firms they invest in but make their decision on arbitrage and political interference is not accepted. The vague statement of Elkem's CEO is rendered close to meaningless under the present situation on the world market or a mere political gesture.

Utilization of geothermal energy in China for heating of houses and production of electricity

The second concrete business related MOU has to do with the geothermal sector, its use for spatial heating and generating electricity. Orka Energy Ltd. and China Petrochemical Corporation (Sinopec Group) signed an agreement on the utilization of geothermal energy in China for heating of houses and production of electricity. Shaanxi Green Energy

Geothermal Development Co. Ltd. (SGE) has been established. Sinopec is a 51% owner but Orka Energy owns 49%. This agreement recognizes Icelandic know-how in geothermal technology in China. Currently Orka Energy is building a central heating system in Xianyang, a city with a population of half a million people in the Shaanxi province.

Sinopec is the 5th largest company in the world with more than six hundred thousand employees, one million employees if subsidiaries are included. Its market share in the petroleum market in China is around 80%. Sinopec Star is a subsidiary of Sinopec and in its strategy renewable energy is to become one of their three most important business areas. Sinopec's operating income is approximately 400 billion USD.

The first joint project will be to continue the development of the heating system in Xianyang. The goal is to enlarge it by 1500%. Currently the system heats one million square meters of housing space but SGE plans to heat 30 million square meters by 2015 and 100 million square meters by 2020. The next project will be in Xiong County in the Hebei province and other projects are in the Shandong province.

The other paragraphs of the Memorandum signify “good weather”, a joint statement to foster the responsive relationship between the two countries.

The development of the China – Iceland FTA rounds

The first round of Iceland-China Free Trade negotiation was held in Beijing on 11-12 April 2007. A total of 40 representatives from relevant departments of both governments participated in the 2-day talks of different working groups. Both sides agreed on the ultimate aim of concluding a comprehensive FTA. Three more formal rounds of negotiations and some expert meetings were held in the pursuant 12 months with positive progress on various issues of a would-be comprehensive FTA, such issues as trade in goods, trade in service, investment, economic cooperation and the text of the agreement. After the 4th round of FTA negotiation in Iceland on 28-30 April 2008, both sides were confident of an earlier conclusion of the FTA.

The following months after the 4th round of Iceland-China FTA negotiation became rather eventful, thus slowing down the good momentum of the efficient negotiation process in the previous year. In China, the biggest earthquake in Wenchuan in May and the Beijing

Olympic in August took most of the nation's effort, while the launching of FTA with Norway in September 2008 and on-going FTA negotiations with other countries also consumed quite some portions of the resources of Chinese negotiators. The situation in Iceland was even more serious as the whole nation was plunged into great difficulty after the collapse of its three biggest banks in early October. A new coalition government was elected; one of whose vowed tasks was to apply for EU membership. The call for Iceland to join EU has cast some kind of uncertainty over the fate of Iceland-China FTA, as the EU membership would invalidate such a bilateral agreement. China asked to suspend the FTA negotiation with Iceland soon after the newly elected coalition government decided to apply for EU membership in mid-July 2009.

In spite of the repeated calls to resume the negotiation from the Icelandic government later on, China maintained a "wait-and-see" attitude, claiming that they did not want to work on signing a Free Trade agreement that may be invalidated immediately after its finalization. By any measures a trade agreement at a time with a micro-state like Iceland on the verge of "bankruptcy", which was furthermore trying to ally itself with the EU, must be regarded as unwise, to say the least.

The suspension dragged on until the first official visit of a Chinese Premier to Iceland in April 2012. At the bilateral meeting between the Premier Wen Jiabao and the Icelandic Prime Minister Jóhanna Sigurðardóttir, the two heads of governments declared to resume the FTA negotiation and expressed their wish to see the conclusion of the FTA negotiations in one year. This significant change of China's position should be carefully interpreted on multi-lateral basis and in a much broader context, e.g. the public opinion in Iceland on Iceland's EU membership, the EU difficulties as well as China's new identity as a defender of free trade. Nevertheless, to both countries, active preparations were made immediately after this historical visit.

The 5th round of Iceland-China FTA negotiation was held in Reykjavik on 18-20 December 2012. The long-awaited round generated constructive progress in all major issues in spite of the 3-year suspension and change of most of the negotiators on both sides, laying a ground for eventual conclusion of the FTA negotiation.

The 6th round took place one month later in Beijing on 22-24 January 2013. Substantial progress on all the major issues was made during

the negotiation. The two parties were determined to conclude the negotiations as soon as possible.

The 6-year Iceland-China FTA negotiations were formally concluded at the signing ceremony in the Great Hall of the People in Beijing, witnessed by the new Chinese Premier Li Keqiang and the visiting Icelandic Prime Minister Jóhanna Sigurðardóttir on 15 April 2013. This is the first FTA China has made with a European country and several Icelandic firms regard it as a window of opportunity to operate on one of the biggest markets worldwide.

The Iceland-China FTA is a comprehensive agreement as envisioned at the beginning of the negotiation, covering a wide range of issues like trade in goods, rules of origin and trade facilitation, intellectual property rights, trade in services, investment, competition, cooperation, institutional provisions and dispute settlement. The agreement is hailed as the most open FTA China has had so far, and both countries also make more commitments than they made to WTO on trade in services. This FTA can be regarded as a guiding light for China's on-going and future FTA negotiations with European countries.

According to information from the Chinese Ministry of Commerce, the FTA will provide zero tariffs to all industrial products from China, which account for 99% of the total exports of China to Iceland at present. At the same time, China will implement zero tariffs to Icelandic products under 7830 tariff lines, accounting for 82% of current Icelandic exports to China, while tariff on a small number of products shall be dismantled after a transitional period of 5 or 10 years.

The FTA as a window of opportunity for Icelandic companies

At the signing of the trade agreement most of the exported products were seafood and fisheries-related products and the total value of the export was 34 million Euros

Figure 1 shows the Iceland-China trade for the period 1999-2011 according to the Icelandic statistics. The trade balance is in favour of China, as can be expected. During this period the export from Iceland to China has grown by 1.400%, while Iceland's import from China has grown by 1.000%.

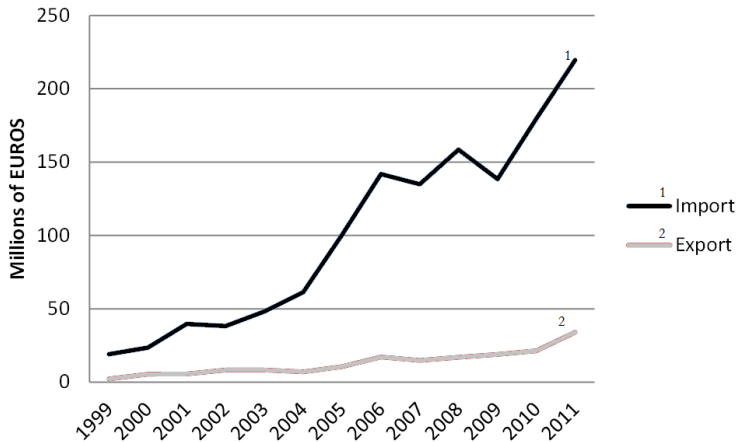


Figure 1. Iceland-China trade 1999-2011 in millions of Euros

Table 1 shows Iceland's export to China 2009-2011. More than 90% of the export from Iceland to China is seafood. Some of the seafood is processed further in China and re-exported. Less than 1 per cent of Iceland's total export goes to China while more than 7% of Iceland's imports come from China and is increasing fast.

Table 1. Iceland's export to China 2009-2011 in millions of euros

| | 2009 | | 2010 | | 2011 | |
|--|--------------|------------|--------------|------------|--------------|------------|
| | Million EURO | Percentage | Million EURO | Percentage | Million EURO | Percentage |
| Export to China | 19 | | 21 | | 34 | |
| % of Iceland's total export | 1 | | 1 | | 1 | |
| Export of seafood to China | 18 | 0,94 | 19 | 86,8 | 32 | 94,3 |
| Export of agricultural products to China | 0 | 0,37 | 1 | 4,1 | 1 | 2,4 |
| Export of manufactured goods to China | 1 | 0,04 | 2 | 8,7 | 1 | 3,2 |
| Export of other products to China | 0 | 0,41 | 0 | 0,4 | 0 | 0,1 |

Despite the relatively minor significance for Icelandic companies in the coming years, the significance of the trade agreement should not be underestimated.

The Icelandic market is of course insignificant which means that the trade agreements must be evaluated primarily on the firm level. At the

outset the agreements have the biggest impact on the trade of fisheries equipment. In the fisheries the Icelandic fisheries sector is in the forefront, and fisheries-related production systems are advanced but, what must be regarded more important, the solutions and the machinery can be used in other sectors. Two of the leading firms here, Marel and Promens, have gained ground in the food processing industry in general.

To exemplify this aspect further, two of the twenty plus Icelandic firms present on the Chinese market originate from the fisheries; Marel; a manufacturer of advanced food processing systems, Promens a producer of insulated food containers. In both cases the companies were start-ups in the early nineties serving the country's fish manufacturers, producing highly specialized processing and preserving facilities. The solutions, applicable for handling fish, an extremely delicate commodity, showed to be useful in other food sectors. In recent years, both Marel and Promens have been operating worldwide and have become significant players in their respective fields, and, up until the 2008 crisis, expanding swiftly through leveraged takeovers. Both companies have sales offices in China, but the presence of the FTA is more likely to become important if the companies decide to operate manufacturing facilities in the country.

In order to evaluate the situation, the following is a relatively schematic overview focusing on the possibilities for further expansion. Although the firms are few in number, their field of operation is somewhat diverse. Seafood trading will profit immediately. So do logistics and transport; water export; clothing subcontractors; prosthetics and online role playing games as well as development and operation of geothermal space heating systems.

Seafood processing trade plays a minor role here and will probably do so in the future, partly because the Chinese firms are becoming less competitive when it comes to subcontracted production of generic commodities, as wages are getting higher and partly because only a handful of Icelandic firms operate on the consumer market.

An interesting niche here is the export of bottled water from Iceland where two firms are operating, Icelandic Spring and Icelandic Glacial. Drinking imported bottled water has become a token for exquisiteness globally. Importing water from Iceland to China gains a competitive advantage because of the trade agreement. Given a successful branding and sufficient profitability, exporting bottled water from Iceland to China might become a rewarding business. In contrast to seafood,

increasing supply is easy, given a fast growth in demand. In contrast, supplying the market for sea cucumbers, of which one company is in its start-up phase, is an incremental process.

Another interesting example is online role-playing games. The Icelandic subscription game company CCP has over 450,000 subscribers worldwide of which nearly sixty five thousand are located in China. Here, as nonsensical it might seem, the market is exponential.

Regarding the FTA from a Chinese point of view, the trade agreement will definitely strengthen individual firms such as Lenovo, a laptop manufacturer, but the imports of products from China to Iceland are increasing rapidly, mainly because the products are becoming more sophisticated and therefore more competitive.

At the time of signing of the FTA, Chinese investments in Iceland are minimal, i.e. only three.

The oldest aluminium smelter in Iceland was built by a Swiss company, Alusuisse, but is now owned by Rio Tinto Alcan. The Chinese aluminium giant CHINALCO is a shareholder in Rio Tinto Alcan and therefore an indirect investor in the Icelandic smelter. The ferrosilicium plant *Járnblendið*, mentioned earlier, is now owned by Bluestar.

The third Chinese investment in Iceland is in a fisheries company, *Stormur Seafood Ltd.* The Cadorie owns 43,75% of the firm indirectly. The sole owner of Stormur Seafood is Skiphóll, which is 75% owned by Austmenn and 25% by the Hong Kong firm *Nautilus*.

However, interest in exploring investment opportunities in Iceland among ambitious Chinese firms may be surging with the conclusion of FTA. The emerging free trade zone between Iceland and China has to do with substantial direct investments coupled with Iceland's strategic location in the Trans-Atlantic and the Arctic area is making Iceland an interesting subject of study for Chinese firms aiming at the Western market and the Arctic development.

Concluding remarks

Through the years the relationship between China and Iceland has been on good terms. In 2002 the then President Jiang Zemin paid a visit to Iceland and a few years later an informal discussion of a possible Trade Agreement between the countries started. The formal negotiations started in 2007, only to be put on hold in mid-2009 when Iceland started a

negotiation process with the EU in the wake the 2008 Meltdown in Iceland. At hindsight it is plausible that the repeated visits of high standing officials were a “tes bed” but as things evolved Chinese diplomats became more seasoned. For Icelanders the FTA had become important as part of regaining trust on the world market. Choosing Iceland as the first European country to be its FTA partner instead of Switzerland must be seen as a generous diplomatic gesture on China’s behalf, while the agreement is an actualization of potentialities already in the making for several Icelandic companies.

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