

***The Falcon and the Dragon:  
Commercial Diplomacy  
and the Sino-Icelandic Free Trade Negotiations***

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### **Foreword**

The Centre for Small States Studies at the University of Iceland has two sets of publications, CSSS Occasional Papers and CSSS Working Papers. The Working Papers, of which this is one, reflects research in progress, and they are edited and refereed before publications. As chair of the editorial board for both series, I would welcome approaches by those who wish to publish research work on any aspects of small states. Potential contributors should first consult the *Guidelines* at the web-site: [http://www.hi.is/page/ams\\_publicationseries](http://www.hi.is/page/ams_publicationseries) for details of what is required to submit material for the series.

Clive Archer

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***Abstract***

As China continues to modernise its economy and expand its trade interests, it has turned its attention to pursuing commercial diplomacy via bilateral preferential trade agreements (PTAs) in Asia but also increasingly in other parts of the world. While Beijing's attempts to pursue liberalised trade with the European Union have been hampered by political and economic differences, a Sino-Icelandic PTA is currently under negotiation which addresses both goods and services trade. The Iceland negotiations are an example of Beijing's preference for bilateral PTAs in non-Pacific Rim markets as well as its still-conservative approach to liberalised trade. This PTA, if successful, will further underscore both China's and Iceland's growing cross-regional trade capabilities as well as Beijing's rising commercial power. A completed agreement will prompt other members of the European Free Trade Association (EFTA), and possibly the EU, to examine their own policies on free trade with China.

*Introduction: China, Trade and Small States*

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## ***Introduction***

Much political analysis concerning the “rise of China” has centred on the country’s development into an increasingly formidable political power in the international arena. However, less study has been devoted to China’s developing market power and increased confidence and ability to shape policies relating to liberalised trade, both in the Asia-Pacific and increasingly across other regions. In the space of a decade, China has transformed itself from a sceptic of liberalised and preferential trade to one of its strongest proponents. Moreover, it has been able to better match words with deeds by actively engaging in dialogues designed to create stronger bilateral and multilateral preferential trade ties well beyond the Asia-Pacific region, including with Europe. Moreover, Chinese diplomatic efforts have recently expanded to include enhanced economic engagement with small states, underlining Beijing’s determination to diversify its foreign interests as it continues to develop as a great and perhaps global power.

A major impetus for these developments was China’s admission to the World Trade Organisation (WTO) in December 2001 following many years of negotiations, giving Beijing a stronger platform from which to negotiate more select forms of liberalised trade and with a wider variety of states and economies.<sup>1</sup> As well, growing international concerns about the viability of the ongoing Doha Round of global trade negotiations has galvanised many countries into seeking alternative agreements and Beijing has taken advantage of this development in seeking bilateral and sub-regional preferential trade agreements (PTAs) with selected states, including smaller ones.

In addition to the short-term and sector-specific economic gains which can be realised through these negotiations, PTA talks have also become an important foreign policy tool for Beijing in its pursuit of what has been termed “commercial diplomacy”, (*shangwu weijiao* 外交商务). This refers to the strategic use of commercial power, including the offering of preferred market access, to influence decisions not only related to trade but also to diplomacy and strategy. All matter of international commerce issues, including tariffs, services, competition policies and privatisation may factor into the use of commercial diplomacy. As well, while much strategic-related diplomacy often involves zero-sum outcomes, commercial diplomacy demonstrates a preference both for multilateralism and for win-win, positive-sum results.<sup>2</sup> This fast-developing branch of China’s expanding foreign policy is well in keeping with post-cold war

Chinese diplomacy and has allowed Beijing to make many policy inroads in regions well beyond the Asia-Pacific, including increasingly in Europe.

However, China's interest in developing preferential trade deals with Europe has been hampered by its increasingly strained economic relationship with the European Union. While trade between the two sides continues to grow and trade strategies remain coordinated, European dedication to fair trade and concerns over China's market structure along with Beijing's concerns over increasing politicisation of Chinese trade in Europe have produced frictions and have hampered any movement toward a specialised trade deal between China and the EU. China's commercial diplomacy of PTAs in Europe has instead centred on non-EU economies, beginning with that of Iceland. Reykjavik became the first government to initiate formal preferential trade negotiations with China at the end of 2006 and should the talks reach a successful conclusion, Norway and the rest of the European Free Trade Association (EFTA) may enthusiastically follow suit.<sup>3</sup>

The PTA negotiations between Iceland and China represent significant changes in China's commercial diplomacy. These include a greater willingness on China's part to incorporate the services sectors into liberalisation talks, Beijing's commitment to cross-regional economic ties, including with small and medium states and its determination to increase its visibility in the European economy, albeit through a "side-door" approach. As for Iceland, the island has demonstrated a willingness, in light of many previous trade negotiations with larger entities, including the EU to seek out free trade with China despite the huge differences in trade volume between the two actors. Moreover, the successful completion of these talks and possibly others with the EFTA may act as a catalyst for the European Union to re-examine its views on liberalised trade with Beijing. Finally, these negotiations will act as a critical test of China's policy towards building "partnerships" with select countries based on mutual interests rather than solely strategic thinking. A successful deal with Iceland will accomplish much in opening the door to further Chinese engagement, financial and diplomatic, with small-state economies.

### ***Beijing's Changed Views on Free Trade***

China's increasing success in drawing its neighbours into potential free trade agreements is a strong indicator of China's growing economic power, and its self-assurance in channelling this power to improve its regional authority in matters related to interregional trade. China's support

for free trade following the turn of the century was enthusiastically welcomed by many states in the Asia-Pacific region. Beijing has been able to acknowledge shifts in regional preferences for free trade both as a result of regional wariness towards older, larger free trade regimes such as the regional Asia-Pacific Economic Cooperation Forum (APEC) and the World Trade Organisation,<sup>4</sup> as well as the need to create further economic “parachutes” to prevent or mitigate a region-wide economic downturn as occurred during the Asian Financial Crisis (AFC) in 1997-98. Thailand, Hong Kong and Macao were the first bilateral PTAs negotiated and completed by Beijing in 2003-4, a PTA with Chile was struck in 2005, and free trade talks with New Zealand were completed in January 2008.<sup>5</sup> As well, preferential trade talks have begun with other Asia-Pacific states (Japan, South Korea, and Singapore) and also with others outside of the region, including Australia, Brazil, the Gulf Cooperation Council, Iceland, India, Mexico and South Africa.<sup>6</sup> This pattern suggests a preference in China’s PTA diplomacy for talks both with smaller developed states and larger emerging markets.

In order to better understand the reasons behind Beijing’s newfound abilities in developing and influencing the proliferation of preferential trade agreements cross-regionally, it is necessary to first examine why China has reversed its traditional antipathy towards free trade commitments, and has openly called for increased trade liberalisation. These reasons lie both within China, taking into account growing domestic-level recognition of the country’s economic power and the attractiveness of the Chinese “big market” (*da shichang* 大市场) factor, and shifting economic power levels in the Pacific Rim which have placed Beijing in a much more favourable position to influence regional trade discourse, a situation which so far China has been very adept at turning to its advantage. At the same time, however, those who have expressed concerns about Chinese economic hegemony in the region may be comforted by Beijing’s attempts to link its push for increased regional and bilateral free trade with its determination to become a cooperative great power, acting within partnerships rather than creating a network of economic subaltern nations.

The after-effects of the AFC in 1997-8 included much reconsideration of the benefits of PTAs among Asian states, including Beijing. Moreover, Chinese policy during the Crisis, including the granting of emergency loans to afflicted states in the region, all but ensured the country would be able to assume a commanding role in the development of smaller-scale economic arrangements. This change in viewpoint on China’s part resulted from the increased

strengthening of regional political and economic ties in Asia and beyond, as well as responding to the torpid pace of global multilateral trade liberalisation.<sup>7</sup> These overlapping trade agreements have been viewed by some as a potential bolster for larger-scale trade agreements such as the WTO and APEC. However other analysts have expressed the concern that this “PTA proliferation” will wear away support for these larger regimes and fragment the Asia-Pacific trading system into overlapping and contradicting regimes, otherwise known as the “spaghetti-bowl effect”,<sup>8</sup> an increasingly complex tangle of PTAs on various levels. On the other hand, PTAs do have an advantage of being faster to negotiate and implement,<sup>9</sup> as well as providing an alternative layer of trade liberalisation should the Doha Talks end unsatisfactorily, which is increasingly being seen as a risk as the talks have worn on.

The WTO has also been especially open to criticism as a result of the perceived slowness of the organisation to respond to regional-specific grievances, a factor that was magnified after the sudden halt of member talks in Cancun in September 2003, largely due to deadlock between developed and developing area representatives.<sup>10</sup> At the same time, the WTO and other international-level financial regimes such as the International Monetary Fund and the Group of Seven have been magnets for anti-globalisation protests and critical scrutiny. PTAs, by contrast, are not only viewed as more congenial alternatives but the smaller number of actors involved has frequently resulted in faster and often more efficacious deal-making. A successful PTA can provide models for future deals and can also be modified to best suit the specific requirements of both partners. China’s approach to multilateralism has consistently demonstrated a preference for flexible engagement rather than formal treaties. As well, the search for safety nets against future regional or international economic downturns provided a powerful motivator, highly relevant to both China and Iceland’s preferences, for seeking alternative trade arrangements and by the beginning of the twenty-first century many new PTAs had either come into being or were under negotiation. Within the Asia-Pacific region alone, the number of PTAs completed or under negotiation rose dramatically after 2002.<sup>11</sup>

China was not absent from this process, as its economic power had become increasingly attractive to Asian and non-Asian economies as demonstrated by the number of Asian economic actors seeking preferential deals with the country. Beijing rapidly became the driving force in Asian PTA development. Thus far, China’s approach to PTAs has reflected a preference for selective inclusion of goods and services as well as the settlement of disputes via informal

consultation rather than formal mechanisms,<sup>12</sup> a stance reflected in the Iceland talks. From the beginning of the decade, Beijing began to turn its attention to developing PTAs outside of its immediate periphery, demonstrating a preference for bilateral talks with small and medium economies. The opening of the PTA talks with Reykjavik clearly illustrates China's conservative, graduated approach to cross-regional free trade policy development.

The increasingly pro-free trade stance of Chinese President Hu Jintao and his government has signalled that the Chinese state is advocating a form of international engagement which has been called "system maintaining", while at the same time developing a "system exploiting" approach,<sup>13</sup> taking advantage of the more congenial international stance towards PTAs while seeking to uphold the integrity of the global trading system. Although Beijing is certainly interested in continuing to develop PTAs, rather than seeking to maintain the status quo in regional regime development, the country is pushing forward, seeking new alternative structures for liberalised trade. This provides a strong demonstration that Chinese engagement with international economic regimes at several levels is considered crucial not only to China's continued economic prosperity, but also to its ongoing foreign policy of regional engagement.

Moreover, Beijing has recently attempted to portray itself as a developing great power through the doctrine of "peaceful rise" (*heping jueqi* 和平崛起) and "harmonious world" (*hexie shijie* 和谐世界). At the October 2007 Congress of the Chinese Communist Party, Hu spoke of the necessity for improved international economic relations as a means of further strengthening global harmony.<sup>14</sup> At the same time, Beijing has made use of its growing economic power to forge political and economic partnerships with states much further abroad to further emphasize its desire to be a responsible great power and make positive contributions to the development of the global economy. The engagement of small state economies including Iceland demonstrates Beijing's determination to diversify its trade interests and develop a stronger-cross-regional approach to commercial diplomacy. The Iceland negotiations are an important test case of Beijing's resolve.

### *The Course of the Sino-Icelandic Negotiations*

Although a proposed EU-China preferential trade agreement was briefly floated in 2004,<sup>15</sup> it was Iceland which became the first European state to formally enter into negotiations with China in December 2006 with the goal of finalising a free trade agreement.<sup>16</sup> The main impediment to China-EU trade of late has been Brussels' stringent anti-dumping laws. Beijing has run afoul of these in recent years and has complained that it is being singled out by the EU for alleged dumping practices. The country was incensed at being refused the designation of "market economy" by the Union in its report on the subject in June 2004, an omission interpreted by China as being both unfair and politically-motivated, especially in light of Russia, a non-WTO member, successfully being granted that status.<sup>17</sup> Iceland, by contrast, agreed to apply the designation to China in 2005, stating that Beijing had achieved the minimum WTO standards for that level of recognition.<sup>18</sup> More recently, the EU has been worried about the growing trade deficit, estimated to reach €170 billion by the end of 2007, between its membership and China, as well as concerns over the allegedly undervalued Chinese currency, the *yuan*, which both the US and EU would prefer to see raised to better reflect the increasingly powerful Chinese economy.<sup>19</sup>

The economic negotiations between the two states were in many ways a result of the growing bilateral trade relationship begun after Iceland recognised Beijing in 1971, eight years before the United States, and later when Iceland established its embassy in Beijing in 1995. The catalyst for the PTA talks came in May 2005 when China and Iceland signed a memorandum of understanding (MoU) which recommended the commencement of free trade negotiations. It was suggested by Iceland that talks should comprise of Beijing and the entire EFTA, but Beijing requested that the talks be solely between itself and Reykjavik, further reflecting a pro-bilateralism policy.<sup>20</sup> The advantages to China of an "Iceland first" approach were many for both sides, since the island is not an EU member and its comparatively small economy meant that fewer sectors would be under negotiation with both sides having more room to explore liberalising ideas beyond trade in goods.

Moreover, Iceland has been referred to as a "norm entrepreneur" state, (along with its neighbours in Scandinavia), meaning that Reykjavik is frequently able to exercise diplomatic power well in excess of its size.<sup>21</sup> China is well aware of this, and a successful deal would allow Iceland to further demonstrate its abilities to negotiate trade with much larger economies, while China would have its first PTA with the European economy. From a wider geo-strategic

viewpoint, an Iceland deal would result in China having a liberalised trade deal with a member of the North Atlantic Treaty Organisation (NATO), as well as an integral part of the northern Atlantic corridor linking North America with Europe.<sup>22</sup> Symbolism is very much present in these negotiations along with political-economic considerations.

The overall trade volume between Reykjavik and Beijing has grown from 1.7 billion ISK (US\$28.1 million) in 1995 to 23.2 billion ISK (US\$380 million) in 2006. There is however, an ongoing trade deficit, with Chinese exports to Iceland totalling US\$77.7 million in 2006 versus US\$40 million for Icelandic exports to China. China's major exports to Iceland include textiles, clothing, coke and ships, while Iceland's main exports to China include fish and related products, machinery and electronic goods.<sup>23</sup> Tourism is also an important selling point for China-Iceland ties, as in 2006 alone an estimated 10,000 Chinese tourists visited Iceland.<sup>24</sup> There has also been increasing talk of closer cooperation between Iceland's financial institutions and those of China, as demonstrated by two major Icelandic banks recently opening offices in China, Glitnir in Shanghai in December 2006 and Landsbanki in Hong Kong in November 2007.<sup>25</sup> As financial services and insurance supersede fishing in terms of percentage of Iceland's GDP,<sup>26</sup> and with China increasingly interested in internationalising its own banking sectors, this is another source of potential increased cooperation between the two countries.

As well, China has sought Iceland's assistance to fuel its rapidly growing economy by developing thermal energy capabilities in order to diversify its energy consumption away from coal, which is both inefficient and a major contributor to Chinese pollution. At present, about 70% of China's energy comes from coal, with alternative sources such as nuclear, hydroelectric and geothermal very much underdeveloped. At the same time, China's increasing dependence upon foreign oil and gas supplies has sparked initiatives to diversify sources and make better use of indigenous supplies.<sup>27</sup> A joint project in geothermal energy development, begun in 2005 and completed in December 2006, has been supported by the Shaanxi Green Energy Geothermal Development Corp., co-administered by Iceland's Enx Kina and the Shaanxi Geothermal Energy Corporation and supported by China's Sinopec energy company and Glitnir Bank.<sup>28</sup> Construction of a thermal heating infrastructure was begun in the city of Xianyang in Shaanxi province in central China and is expected to be at full capacity by 2015. It is likely this pilot project will be duplicated elsewhere in China. Other Chinese provinces have shown interest and approximately ninety Chinese students have participated in training programmes at the United

Nations University Geothermal Training Program in Reykjavik, more students than from any other country.<sup>29</sup> There are many other potential outlets for exchanges of technical expertise in this area as China continues to seek modernisation of its energy capabilities.

China's bilateral approach to cross-regional PTAs is very much in keeping with its diplomatic initiatives in the 1990s in developing strategic partnerships (*huoban* 伙伴) with select states based not on military ties but rather on the willingness of both sides to treat each other as equals, work towards mutual benefits, and tolerate differences between themselves. China began this process by approaching large states such as Russia, Britain, France, Egypt and Saudi Arabia in the 1990s, and also signed a partnership agreement with the European Union in April 1998. Medium-sized states such as Canada, Mexico and South Africa also penned agreements with Beijing during that decade.<sup>30</sup> More recently, China has shown willingness to sign more multifaceted agreements with small and medium states well outside of the Asia-Pacific region, creating an increasingly intricate hub-and-spoke partnership configuration for Beijing. Iceland entered the negotiations not only with much experience in dealing with larger economies but also with the model of the 2005 free trade agreement between the EFTA and South Korea as a reference.<sup>31</sup>

The formal Sino-Icelandic trade talks began in Beijing in April 2007 with a second and third round of negotiations completed in June and October of that year, and a fourth and perhaps final set of talks scheduled for March 2008 in Reykjavik. At present, both sides are hopeful of completion of the PTA by August 2008, before China turns its attention to the Beijing Olympics.<sup>32</sup> The first round examined the major issues while the second looked at more specific areas including agriculture, fishing and other foodstuffs. Between rounds, Reykjavik consulted with representatives of major industries, including fishing, aviation, shipping and banking, for their views. The talks so far have produced much optimism on the Chinese side. After a meeting with Icelandic President Ólafur Ragnar Grímsson in October 2007, Hu Jintao called for an acceleration of the negotiations as well as increased cooperation in areas relating to medicine, finance, engineering and food. As well, both leaders agreed to enhance dialogue on geo-thermal energy and clean energy development as well as cultural ties.<sup>33</sup>

Icelandic officials involved with the talks noted that Reykjavik has had much recent experience in negotiating free trade, including with much larger states and other organisations such as the EU, and that despite the different sizes of the Chinese and Icelandic economies there

is much compatibility. As well, Chinese officials have stressed that Beijing has approached the talks not with economic size differences in mind, but as negotiations between two equal partners.<sup>34</sup> More crucially, what makes this potential agreement distinct is that it covers not only the abolition of tariffs on trade in goods but also services, such as banking, for which Iceland is becoming increasingly known. The MoU which preceded the talks noted the compatibility of service sectors including education, tourism and financial services, and suggested that services should be added to the PTA negotiations, a situation aided by the fact that upon joining the WTO, China also accepted global baseline rules governing services trade as specified by the General Agreement on Trade in Services (GATS).<sup>35</sup>

The fact that both goods and services are under negotiation for this specific free trade agreement means that a successful Sino-Icelandic PTA deal would be a “sector expanding” bilateral trade agreement, a PTA designed to take advantage of having only two actors involved in the process and delving into areas, such as services, not normally covered by multilateral agreements because of their complexity.<sup>36</sup> This is new ground for both China, which has had limited experience with talks in liberalisation of services, and for Iceland, as the first European state to negotiate directly with Beijing in these areas. As well, this PTA has much potential strategic value for both actors, as its success would demonstrate to other European economies, and especially the EU, that Beijing is serious about liberalising trade with the continent and that it is prepared to negotiate preferential trade beyond merely goods. Iceland’s growing reputation as a small state which has developed the means to successfully engage much larger economies for mutual benefit will be further underscored.

Not surprisingly, the major sector under consideration on the Icelandic side has been fishing, as that comprises the majority of Icelandic exports. Thus far the response from fisheries industries to the talks has been positive, and there are no plans to have the final agreement affect quotas despite some concerns of a possible Chinese demand to do so. China is interested in maintaining trade in Icelandic seafood both for local consumption and processing for trade with other countries. Since over the past few years China has maintained a 10-12% tariff on imported seafood, and demand for seafood in China has grown considerably in keeping with the country’s developing consumer base since the beginning of the 1990s, free trade in this area would accomplish much in boosting Icelandic seafood exports to China.<sup>37</sup>

There are, however, some issues which will need to be addressed before the PTA can be completed. Some actors such as the Association of Icelandic Industry have expressed concerns about competition with China, while others, including labour unions, have expressed worries about the negative effects of free movement of persons under a deal. However, while open borders, it has been stressed, are not on the agenda, there has been talk of including recognition of professional credentials and qualifications by each state.<sup>38</sup> There have also been recent concerns expressed about labour rights in China and scandals over product quality of Chinese goods. To address the latter point, there has been talk of a mechanism to be established between the two states to examine these concerns. There is also the matter of the trade deficit between China and Iceland, but its exact nature is open to interpretation since many Icelandic products sold to China (such as fish) are processed and re-exported.<sup>39</sup>

Thus far, the European Union is paying only marginal attention to the Sino-Icelandic talks, at least officially, but other states in the EFTA are watching matters more closely. Switzerland announced in April 2007 that it too was interested in initiating free trade negotiations, and an agreement with Norway is also on Beijing's agenda. Switzerland was the third European state, after Iceland and Norway, to recognise Beijing as a market economy.<sup>40</sup> Therefore, China has not ruled out the possibility of an eventual round of trade negotiations between itself and the EFTA. Success with the Iceland talks, however, may dictate how and when China will initiate a dialogue with the entire EFTA, as for now China prefers to approach the North Atlantic region bilaterally. From a European viewpoint, a Sino-Icelandic PTA may be sufficient to begin a "domino effect"<sup>41</sup> of PTA proliferation with the other EFTA states which may ultimately result in the regional deal which was first proposed. Moreover, these successes may place much strain on the EU to avoid being left out of privileged access to the Chinese market enjoyed by non-EU states, prompting a rethinking of its own Chinese trade policies.

### ***Iceland's Role in Chinese Commercial Diplomacy***

China is in many ways trying to catch up with its own trade successes, since much of its attention over the past five years has been focussed on assuring that economic reform remains on track while preventing much backlash in terms of protests against restructuring which have also created significant gains and losses within the country. Furthermore, the Chinese government has only relatively recently acknowledged the phenomenon of globalisation in an official capacity and has

had less time to fully gauge how closer economic and technological linkages will affect Chinese state-society relations.<sup>42</sup> There remains the question of the degree of economic sovereignty Beijing is willing to transfer to free trade regimes, especially larger ones, in the name of participating in liberalised trade. Turning towards bilateral PTAs, especially when seeking economic partnerships outside of its immediate region, has reflected these concerns, and stressing a variety of different preferential trade partners has served not only to profit the country but also further educate it on the politics of global economic liberalisation.

The underlying goals of China's "partnership" approach with various economies have been to maintain a peaceful international environment in order to allow for ongoing stable domestic reform, to increase the number of diplomatic ties with large and small powers in recognition of China's status as an imminent great power, to promote multi-polarity and improve China's image in the international system, and more recently to develop Beijing's economic diplomacy in keeping with its 'big market' status. Although China is demonstrating greater confidence in engaging larger institutions such as the European Union and the EFTA, there remains a preference for seeking bilateral relations before multilateral ones, especially in regions where China has less of a diplomatic history. Moreover, being a latecomer to liberalised trade policies, it has had to learn very quickly about the trade preferences of many countries. A recent article in the *People's Daily* in Beijing noted the successes which China has logged in diversifying its trade partners, especially in terms of overall trade growth in the country over the past decade.<sup>43</sup> This has led to the question, one which would not have been asked five years ago, as to whether China is now developing "soft power" beyond Asia to other parts of the world, including Europe.

The development of preferential trade regimes will have the ability to place China in a comparatively stronger economic role in areas outside of Asia and the Sino-Icelandic free trade talks are a vital component of Beijing's emerging commercial diplomacy in Europe and elsewhere. A successful deal will likely ignite pressure leading to a domino scenario among other EFTA members and the possibility of a Sino-EFTA multilateral agreement with the European Union, likely resulting in the European Union having to revisit the possibility of a China PTA of its own. However, there is the question of whether Beijing might be going too far, too fast, in its race to join and develop PTAs, launching itself into the proliferation process so soon after joining the WTO and lacking the time to fully absorb the economic advantages and disadvantages of

membership. Several sectors, especially agriculture and manufacturing, have found themselves under strain as a result of WTO commitments and with both the WTO and increasing Chinese engagement with free trade regimes, the benefits to the state's economy will be spread very unevenly, at least during the short term according to both sector and location.

Nevertheless, the diversification of China's trade interests reflects a growing enthusiasm not only for engaging larger regimes but also bilateral agreements with smaller states, signalling increased confidence and adroitness from Beijing, a phenomenon which requires greater examination. At the same time, should the current WTO talks fail, economic agreements on regional and cross-regional levels will be seen by Beijing as necessary backup tools to ensure that the process of trade liberalisation continues to move forward. Concerns about the Doha Round were also very much on the minds of representatives in Iceland when the PTA talks were first considered.<sup>44</sup>

One analyst noted that the primary incentive for China to pursue a PTA with Iceland is to gain "a foothold in Europe".<sup>45</sup> In a sense, this thinking is correct as Beijing does desire stronger linkages to the growing European economy. However, the motivations for both sides are actually much more multifaceted, not only involving mutual economic benefits but also gains in political and persuasive power. For China, a deal would demonstrate to the European Union that it is determined to economically engage the continent and is willing to "start small" with Iceland and other EFTA states. For Iceland, not only is a large new market for goods and services opening up, but a China deal would greatly enhance the visibility of traditional Icelandic goods (fish, seafood) as well as the newer sectors which are rapidly becoming internationalised (banking, financial services, geo-thermal energy).

China has largely set aside its concerns about loss of sovereignty as a result of economic regime engagement, a factor which, as has been argued, affected China's cautious approach to liberalised trade regimes throughout much of the 1990s. Yet China's growing support for preferential trade agreements along with an increased acceptance of cross-regional bilateral talks may create for Beijing a more intricate network of trade cooperation reaching well beyond the Pacific Rim. With the Iceland negotiations and other potential European preferential trade negotiations to follow, a new area of study is being opened on the subject of the contributions of PTAs to Chinese foreign policy and the country's developing commercial diplomacy with small states.

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- <sup>1</sup> Christopher Edmonds, Sumner J. La Croix, and Yao Li, "China's Rise as a Trading Power," *China's Emergent Political Economy: Capitalism in the Dragon's Lair*, ed. Christopher A. McNally (Milton Park, UK and New York, NY: Routledge, 2008), 173-4.
- <sup>2</sup> Ellen L. Frost, "China's Commercial Diplomacy in Asia: Promise or Threat?" *China's Rise and the Balance of Influence in Asia*, ed. William W. Keller and Thomas G. Rawski (Pittsburgh: University of Pittsburgh Press, 2007), 96-7; Raviprasad Narayanan, "The Chinese Discourse on the 'Rise of China'," *Strategic Analysis* 31(4) (July 2007): 653.
- <sup>3</sup> The EFTA currently has four members: Iceland, Liechtenstein, Norway and Switzerland.
- <sup>4</sup> Marc Lanteigne, *China and International Institutions: Alternate Paths to Global Power* (Milton Park, UK: Routledge, 2005), 78.
- <sup>5</sup> "China Signs New FTA Agreement," *Industry Updates* 21 January 2008.
- <sup>6</sup> Yanying Zhang, Gaiyan Zhang and Hung-Gay Fung, "The Prospects for China's Free Trade Agreements," *The Chinese Economy* 40(2) (March-April 2007): 7.
- <sup>7</sup> Razeen Sally, "Free Trade Agreements and the Prospects for Regional Integration in East Asia," *Asian Economic Policy Review* 1 (2006): 307; Chia Siow Yue, "Economic Cooperation and Integration in East Asia," *Asia-Pacific Review* 11(1) (January 2004): 4.
- <sup>8</sup> Jagdish Bhagwati and Arvind Panagariya "Preferential Trading Areas and Multilateralism - Strangers, Friends, or Foes," *The Economics of Preferential Trade Agreements*, ed. Jagdish Bhagwati and Arvind Panagariya (Washington DC: The AEI Press and College Park, MD: University of Maryland, Center for International Economics, 1996), 53-4.
- <sup>9</sup> Shujiro Urata, "Globalisation and the Growth in Free Trade Agreements," *Asia-Pacific Review* 9(1) (May 2002): 26-7.
- <sup>10</sup> See Antoine Bouët, Jean-Christophe Bureau, Yvan Decreux & Sébastien Jean, "Multilateral Agricultural Trade Liberalization: The Contrasting Fortunes of Developing Countries in the Doha Round," *Centre d'Études Prospectives et d'Informations Internationales Working Paper* 2004-18.
- <sup>11</sup> Jayant Menon, "Bilateral Trade Agreements," *Asian-Pacific Economic Literature* 21(2) (November 2007): 31.
- <sup>12</sup> Claude Barfield, "The Dragon Stirs: China's Trade Policy for Asia- and the World," *Arizona Journal of International and Comparative Law* 24(1) (2007): 110-11.
- <sup>13</sup> These terms were first discussed in Samuel S. Kim, "Thinking Globally in Post-Mao China," *Journal of Peace Research* 27(2) (May 1990): 193.
- <sup>14</sup> "Hu Jintao Calls for Building Harmonious World," *Xinhua*, 15 October 2007; Bonnie S. Glaser and Evan S. Medieros, "The Changing Ecology of Foreign Policy-Making in China: Ascension and Demise of the Theory of 'Peaceful Rise'," *The China Quarterly* 190 (June 2007): 291-310.
- <sup>15</sup> Yanying Zhang *et al.*, 7.
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