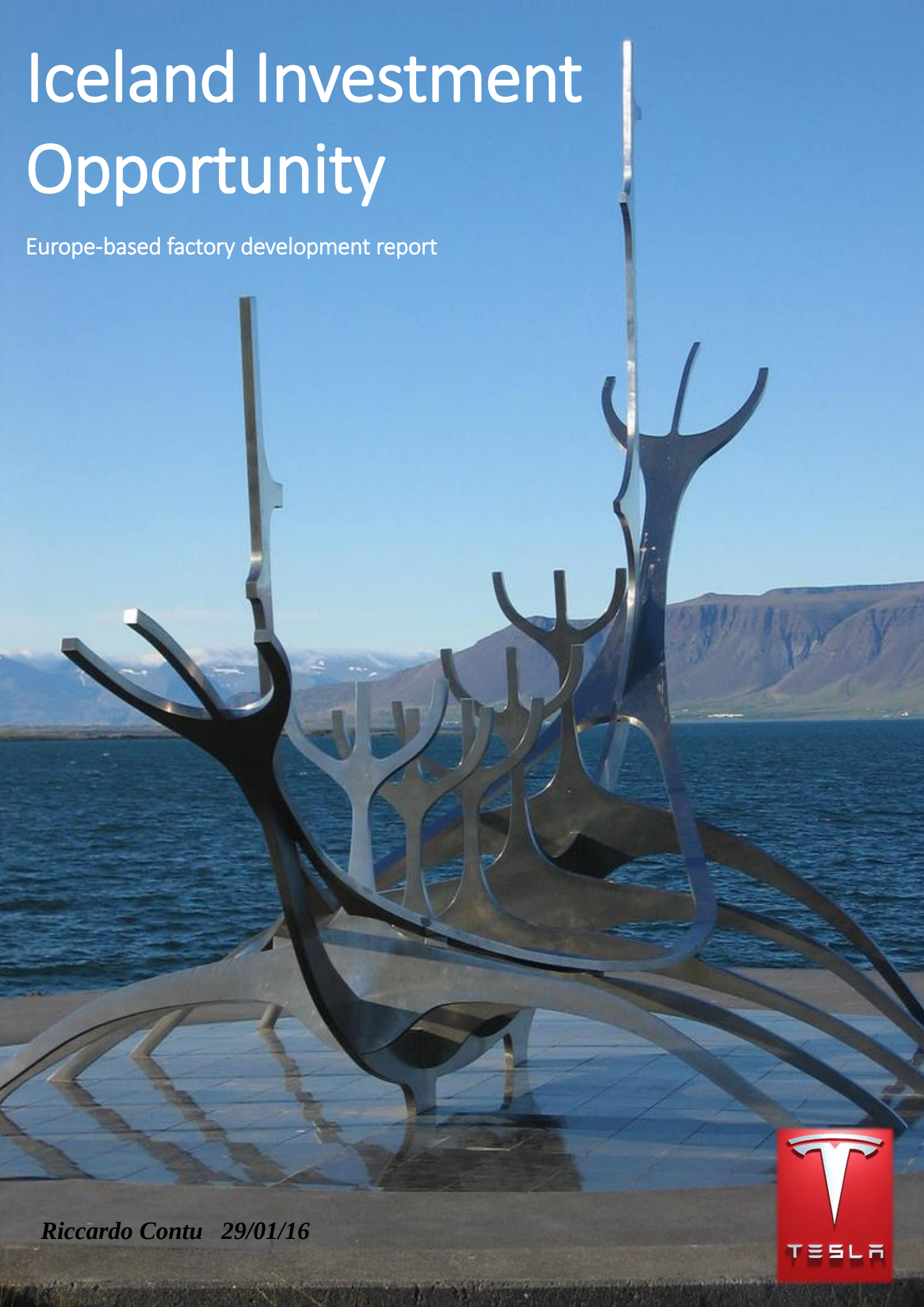
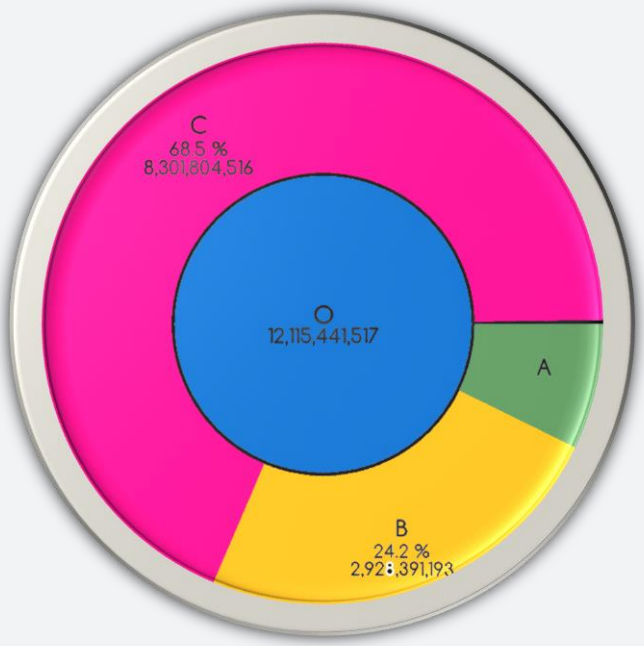
Iceland Investment Opportunity

Europe-based factory development report



Riccardo Contu 29/01/16



O : GDP (current US$)

A : Agriculture, value added : 7.3 % 885,245,808

B : Industry, value added

C : Services, etc., value added

GDP Composition

Total GDP: 16,818 mln US$ (1.87% growth rate)

O : GDP (current US$)

A : Gross national expenditure

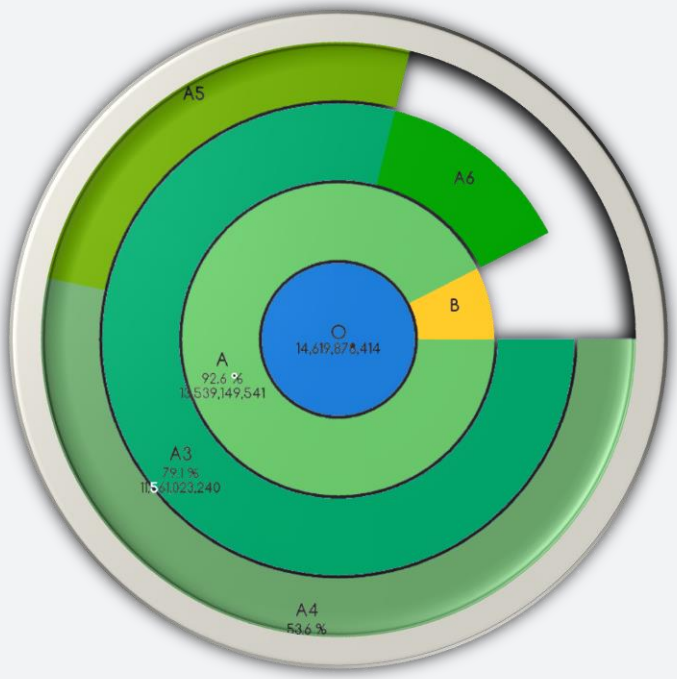
A3 : Final consumption expenditure, etc.

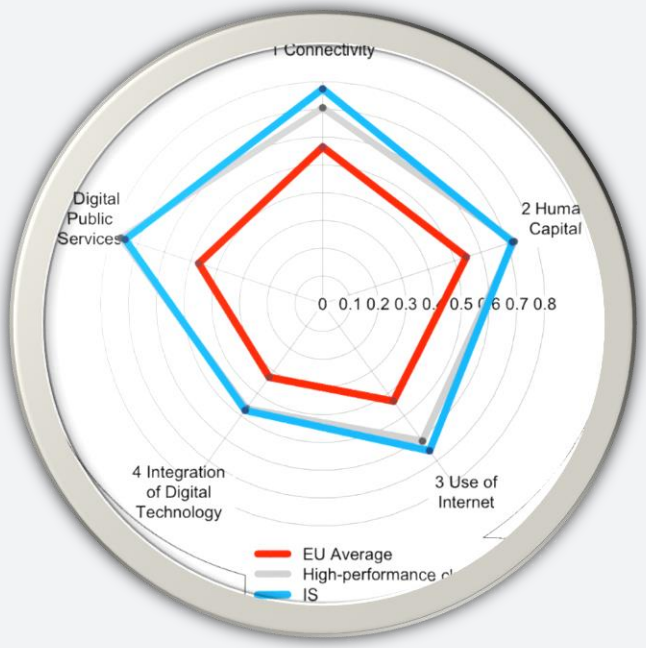
A4 : Household final consumption expenditure

A5 : General government final consumption expenditure : 25.5 % 3,725,053,040

A6 : Gross capital formation : 13.5 % 1,978,126,300

B : External balance on goods and services : 7.4 % 1,080,728,874





Population: 0.327 mln
Life expectancy: 83 yrs old
Land Area: 100,250 km^2
Capital: Reykjavik
Currency: Kròna
Exchange rate: 116.767 ISK/US$
Merchandise exports growth rate: 1.1%
FDI inflows: 436.08 mln US$
FDI outflows: -247.31 mln US$
ICT value added: 4.3%
Internet access: 94.6% of all households
Employment rate: 84.8% of w.a. population
Average wage: 25.3 US$ (EU avg 26.2 US$)

source: UNCTAD and Statistics Iceland

Iceland Overview

Iceland is a Nordic island located between the North Atlantic and the Arctic Ocean. It is the most sparsely populated country in Europe. Settled by Norwegian and Celtic (Scottish and Irish) immigrants during the late 9th and 10th centuries and having been independent for over 300 years, was subsequently ruled by Norway and Denmark. The country gained complete independence from Denmark in 1944 and is now a constitutional republic with a multi-party system.

The second half of the 20th century saw substantial economic growth driven primarily by the fishing industry. The economy diversified greatly after it joined the European Economic Area in 1994, but **Iceland was especially hard hit by the global financial crisis in the years following 2008.**

Iceland's Scandinavian-type social-market economy combines a capitalist structure and free-market principles with an extensive welfare system. Before the 2008 crisis, Iceland had achieved high growth, low unemployment, and a remarkably income equality.

Iceland's economy has been diversifying into manufacturing and service industries in the last decade, particularly within the fields of software production, biotechnology, and tourism. **The country has entered in 2016 its 6th year of economic recovery and forecasts are for continuing growth.** Progress has been made on many fronts: inflation has come down, external imbalances have narrowed, public debt is falling, almost-full employment has been restored and less families are facing financial distress.

Iceland has considerably improved its fiscal position. A budget surplus is close to be achieved and public debt has been lowered. Long-term projections made by the OECD suggest that fiscal policy had been on track to achieve sustainability before subsequent changes were made to secure wage settlements.

The number of new registered firms in Iceland has dropped significantly from the peaks just before the financial crisis, although those rates were unlikely sustainable.

Despite that, however, the government has supported the creation of small firms through innovation incubators, which are often clustered by sector to promote knowledge spillovers. Experience so far seems to have been positive with the existing eight incubators attracting several promising startups and links with universities are being established.

Why invest in Iceland

Natural resources

Iceland's energy infrastructure ranked number 1 in Europe according to IMD's World competitiveness yearbook 2014 for reliability, efficiency and cost.
Iceland has rich resources of hydroelectric and geothermal energy, which appear to be responsibly and renewably harnessed to provide electrical power, space heating, hot water and steam for industrial use. Thanks to its sustainable hydro and geothermal power, Iceland is one of the top five countries able to provide competitively priced renewable energy, a peculiarity that perfectly aligns with Tesla's mission to accelerate the world transition to sustainable transport by bringing mass-market electric cars to the market.
Iceland's resources have provided excellent results for the aluminum industry, from the first smelter in the 1960s to more recent developments by companies such as Alcoa and RioTinto Alcan. **Using electricity generated by hydropower has enabled producers to cut their CO2 emissions by up to 90% per ton compared with coal-fired power stations.**
One of the world's most advanced silicon metal production plants is being built in Northeast Iceland by international PCC group. The plant will be powered exclusively by energy from renewable resources, mainly geothermal, and utilizing energy-efficient technologies. Silicon metal is used in a wide range of different fields, from aluminum production, electrical engineering and electronics sectors to solar energy. Choosing to build the facility in this Country would therefor drastically improve the Model-S and Model-X all-aluminum-made bodies' production processes.

Environment and labor force

Iceland focuses on a favorable business environment, including low corporate tax, availability of land and green energy at competitive prices and efficiency within European legislative framework.

New direct investment projects can apply for an investment agreement, ensuring good regional incentives. EU regulation does also allow general incentives for SMEs, R&D and environmental protection.
The Regional Incentives, according to Act 41/2015, apply to the whole of Iceland outside the capital area**. The incentives include the authorization to fix an income tax rate ceiling of only 15% for 10 years**, depreciate real estate, equipment and moveable assets fully, reduce the rate of property tax and the general social security charge by 50%, grant exemption from customs and duties for construction materials, machinery and equipment, and other capital goods and the state and municipalities are allowed to lease a site for the project at reduced rates.
Iceland reach remarkable results in the high-skilled labor force comparisons between countries. In the Global Competitiveness Rankings index (made by the World Economic Forum) it is 14th in labor market efficiency, 8th in technological readiness, 11th in overall quality of education and 5th in ICT use and averaging the top 10 positions in general.

Strategic connections

Other than the local opportunities, it is also critical to stress the importance of the Iceland island positioning. Due to the crucial role of connector between Europe, Canada and the US, building a small-to-medium size factory that close to the continental massively reduce Tesla's costs.
Moreover, Iceland provide a special extensive free trade agreement with China, that added to the ideal location between Europe and North America gives to the Country an advantage on other European Countries in order to be chosen. In particular, the FDA allows exploiting the fast growing Chinese internal market to investors whose goods are wholly obtained or produced entirely in Iceland or produced from Icelandic materials.

Liabilities

Even if Iceland appears to be a welcoming environment, several potential liabilities have been spotted during the analysis.
First of all, a note has to be taken about the institutional constraints, still limiting the productivity despite the fact that the government is working in order to solve major problems in this field, in particular easing entrepreneurship and R&D investments. The path to fully recover from the 2008 crisis' downside has not been completed. To help and attract investment, though, also Public spending has been raised during the 2015 budget.
Iceland imposed capital controls in the wake of the banking collapse in 2008. Lifting these controls would be necessary for long-term prospects, but the risks of going in that direction (capital outflows in the short run) limit government operations. OECD 2015 report states that resolving the uncertainty surrounding capital controls would further improve the

investment climate, which would temper inflationary pressures and support stronger growth in the medium term. Sustained current account surpluses would create favorable conditions for lifting capital controls. However, the large overhang of króna debt, which may flood out of the country when capital controls are eased, remains a vulnerability.
Another threat to the recovery is represented by the outcome of the recent wage bargaining round. Private-sector wages are expected to raise on average by over 20% between the present and mid-2018 (even more rapidly for low-income workers) and this of course could affect negatively Tesla's productivity. The wage agreements were facilitated by fiscal measures, including tax cuts, at an estimated net cost of 0.5% of GDP. The central bank has raised interest rates in response to these developments and has signaled further increases. If deep reforms to the collective bargaining would not take place, such wage pressures could reoccur. Morevoer, while Iceland has many of the same labour market institutions as other Nordic countries, these counties have tended to avoid such sharp disputes.

Conclusions

Considering the overall context of analysis, Iceland can be considered a good potential location for the development of the first European Tesla factory. The major potential is represented by the strategic positioning of the island, providing a primary role in connecting North America, Europe and in addition China through special agreements. Not to take an aside is the importance of aluminium production facilities *in locus*, essential for the manufacturing of Tesla's electric cars.
Investment in this Country is therefore suggested by this introductory analysis, but only if the plans promoted by the government to boost productivity by reducing institutional constraints would be carried forward and fully exploited.
For now, then, are advised patience and further researches in other sustainable, innovative and less centralized countries.