From Gangnam to Brussels

There's a wish for liberalisation between Asia and Europe. Removal of customs tariffs? A desirable solution for the majority. But there may even be technological solutions that can surpass traditional economic recipes.

by Francesco Guarascio

"I only come to Seoul for the shopping. Everything is cheaper here and I can even buy quality European brands like Gucci or Louis Vuitton for much less than I would pay in Japan", explains Rie Ichimura, a Japanese tourist in Seoul.

Hundreds of thousands of Japanese like her roam the streets of the South Korean capital. More and more European brands are being displayed in luxury shops in Gangnam, the rich Seoul neighbourhood that symbolises the country's recent boom, also made famous by the 2012 worldwide smash hit song, 'Gangnam Style'.

This trend has spiked considerably after the Free Trade Agreement (FTA) between the European Union and South Korea came into force in July 2011. Since then, the price of European products has dropped significantly in the Asian country, with positive results for producers in Europe and for South Korean traders.

The South Korea deal, the first the EU has signed with an Asian country, has encouraged Japan and Taiwan to move in the same direction. For Tokyo, the stream of consumers heading to nearby Korea is just one of the reasons to push for an agreement with Europe.

However, perhaps even more significant is that large Japanese companies like Sony and Toyota are losing market share in Europe to Korean rivals such as Samsung and Hyundai. This wave of liberalisation is not only affecting South Korea's competitors. At the end of 2012, the European Commission completed negotiations for an FTA with Singapore too, while there is now serious talk of starting negotiations on the mother of all FTAs, between the EU and the USA. So what impact do these deals have on signatories' economies and employment? It is hard to say, partly because the only wide-ranging FTA that has actually become fully operational is the one between Europe and South Korea (*see inset*). But at a time when the world economy is so sluggish, more and more people are now in favour of such deals.

Many areas of Italian industry could take advantage of free trade agreements with Japan or North America. "This would certainly benefit the luxury sector", explains an Italian diplomat in Brussels. If customs tariffs were reduced or abolished, the price of coveted Italian brands could drop considerably in other countries, mirroring the situation in South Korea. The agri-food business is another potential beneficiary, even if larger countries – particularly the USA and Japan – are still strongly against possible new openings for Italian specialities.

This positive interpretation of free trade agreements clashes with the view that has prevailed in Italy up until now. The waves of trade liberalisations that have taken place globally over the last 20 years have actually coincided with Italy losing market share in several industrial sectors, resulting in economic stagnation and Italian job losses.

The textile industry is a key example. In just two decades, Italy went from being European leader in this business sector to witnessing the gradual dismantling of many production districts, from wool in Prato to silk in Como, that were unable to stand up to competition from cheap Asian products.

Italian textile companies had time to adapt to these widely foreseen changes, but they failed to do so. Responsibility for the decline of the Italian model based on small and

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medium-sized enterprises goes way beyond our entrepreneurs' lack of farsightedness.

Contrary to what the entrenched fallacy would have us believe, Chinese and Vietnamese competition is hardly to blame for the demise of the Italian textile industry. It was actually large western companies, like H&M and Adidas, that put the spanner in the Italian works. Having moved their production to Asia, they pressed for customs duties to be cut so they could re-import their branded skirts and shoes to Europe and sell them at unbeatable prices.

As a result of these humiliations, and backed by a public opinion that still values the rights of workers above those of consumers, it stands to reason that Italy should hold a dim view of these free trade initiatives. Which is why Italy was the scene of one of the biggest demonstrations in the western world by the now-defunct Anti-Globalisation Movement. And also why even crude forms of protectionism, like those championed by the Northern League political party, still have a lot of supporters in Italy today.

Nevertheless, the huge changes underway in industry worldwide could do away with many of these prejudices, making the relocation trend obsolete. In fact, the discovery of new materials with a variety of innovative applications – like graphene and rare-earth elements – make it possible to produce an increasing number of made-to-measure products, even complex items, at a distance using 3D printers. The gradual improvement of these tools, almost individual factories, will lead to significant changes in production methods.

It could be the dawn of a new industrial revolution. Manufacturing costs will drop and moving factories to remote countries to take advantage of low cost labour will become less attractive. The European Commission has announced it intends to boost investments to encourage the development of intelligent production methods, which would push the market further in this direction.

After all, relocation is already raising eyebrows due to the rising cost of fuel and the re-emergence of piracy, making shipping containers across the ocean increasingly expensive. The so-called 'Zara production model' had been operating well before 3D printers came along. In fact, this Spanish clothing chain made a name for itself particularly in Europe by using a very different kind of business model to its competitors engaged in outsourcing to other countries. Zara tends to manufacture its wares in Spain or nearby Morocco and limits its Asian production to what it sells on local markets. As a result, Zara's clothes cost slightly more than H&M or GAP, but they reach the European market first. This was a winning ploy. Since Zara was closer to its market outlets it managed to outsmart its cheaper competitors by beating them to the punch.

The predominantly local production model is also gaining ground among European politicians who had tended to view outsourcing and relocation as an inevitable consequence of progress. Alongside its free trade actions, Europe is also taking more care of industry on the continent. Last autumn, the Commission proposed returning manufacturing to at least 20% of the EU GDP by 2020, compared to its current level of around 16%. A detailed plan for the re-industrialisation of Europe clearly indicates that manufacturing creates jobs and is thus the backbone of economic recovery.

However, doubts remain about how to reconcile new liberalisation and keeping production in Europe. On this point, the crucial sector to watch is the car industry, still a key sector for the European economy given the millions who work in the industry directly or in its supporting sectors, from steel to rubber. In spite of strong criticisms about the agreement with South Korea, the industry is not against new deals in principle, "as long as there is complete reciprocity in the removal of tariffs and non-tariff barriers to trade" with the partners selected so far, according to a note released by the European Automobile Manufacturers' Association (ACEA). In some cases this industry even views free trade agreements as a chance to create new work opportunities, not merely unwelcome competition. The CEO of Fiat-Chrysler, Sergio Marchionne, who is also the president of ACEA, believes an agreement with the United States "would be very useful", even though he seems to have his doubts about a possible deal with Japan or India. "Removing customs duty on car parts would make the production of Fiat and Chrysler models in Italian factories much more competitive," noted a car industry expert. After having frequently blamed Asian competition as the source of its troubles, might further openings in global trade actually convince Fiat to review its production strategies in Italy?

The deal is done, but does it really work?

The Free Trade Agreement (FTA) with South Korea is the most important commercial deal ever signed by the European Union and the first to have been clinched with an Asian partner. This could be a model for a potential new wave of bilateral agreements based on a virtually complete liberalisation of trade and the elimination of non-tariff barriers and obstacles to competing for public procurement contracts. After two years of negotiations, South Korea and the European Union agreed to remove 99% of customs duties, making the Asian country a de facto member of the European free trade area.

The agreement came into force in July 2011. Eighteen months on, its effects are still under scrutiny by both Brussels and Seoul. Trade between the two blocks has not risen as forecast, in part because of the economic crisis in the euro zone.

Nevertheless, according to EU calculations, there was a 19% increase in European exports to South Korea in the first six months of 2012, compared with the same period in 2011. While exports from the Asian country to Europe were up by 6% over the same timeframe. The South Koreans, however, cite other figures; they complain of a 3.6% drop in their exports to Europe in the first nine months after the agreement went into effect.

Much-heralded positive effects on employment and growth have also failed to materialise. The car industry in Europe loses no opportunity to denounce the repercussions of increased competition. The two leading South Korean car manufacturers, Hyundai and Kia, are constantly increasing their share of the European market, to the detriment of competitors in the city runabouts sector, especially Fiat, Renault and Peugeot.

South Korean critics of the agreement with the EU are also making their voices heard, particularly in the agri-food industry, among producers of dairy products, spirits and meat.

But it's not all negative. If one only considers the trade involving goods for which the customs duties have been lifted following the agreement, then the South Korean and European figures match. The trading volumes in these goods have doubled compared to products whose duties have remained the same. EU Trade Commissioner Karel De Gucht has calculated that, for these goods, Europe has seen exports to South Korea grow by one billion euros.

Even the figures for the car industry are not all bad. The growing share held by South Korean groups in the European market has been matched by an equally significant rise in the European car manufacturers' share of the Asian market. In addition, many South Korean cars sold in Europe are actually made here, where the South Koreans employ tens of thousands of workers.


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