

Response to the Commission of the European Communities Communication on ‘The Future of the Textiles and Clothing Sector in the Enlarged European Union’ (COM(2003) 649 final).

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1. Introduction

1.1. Our response to the Commission’s Communication is derived largely from on-going research conducted under the auspices of a US National Science Foundation project entitled ‘Reconfiguring Economies, Communities, and Regions in Post-Socialist Europe: A Study of the Apparel Industry’ (award no. BCS/SBE 0225088). In this project we have been pursuing in-depth research with key stakeholders in the clothing sector in the accession and candidate countries and in the European Union. This project is on-going but thus far we have completed a large 300 firm survey of clothing firms operating in Bulgaria and Slovakia, and a range of detailed interviews with key informants in the industry (company managers), trade unions and governments, as well as with officials at the European level. The project involves research collaboration with the Economics University, Bratislava, Slovakia and the Bulgarian Academy of Sciences, Sofia, Bulgaria.¹

1.2. There are five key issues that have emerged from this project relevant to the Commission’s Communication on ‘The Future of the Textiles and Clothing Sector in an Enlarged European Union’. Our response largely considers the experiences of, and challenges felt by, clothing manufacturers in the accession and candidate countries, with a specific focus on those in Bulgaria and Slovakia – two contrasting examples of restructuring in the clothing sector, as the Communication makes clear. We point to the importance of better understanding these experiences and the kinds of policy implications they might suggest that extend and elaborate those of the Commission’s Communication. In particular, we emphasise the importance of recognising the diversity of the clothing industry in the accession and candidate countries and its different organisational structure and forms of regional and sectoral specialisation to those found in the current EU Member States. This diversity has, we argue, important implications for industrial policy after enlargement, not least the need to construct appropriate policy responses sensitive to locally specific circumstances.

¹ Outputs from this project, and other related projects are listed at the end of this response.

2. The Limits of Outward Processing and EU15-Oriented Contracting

2.1. Producers in the accession and candidate countries are clearly facing extreme competitive pressure, largely based on cost, which continues to undermine their position in the system of outward processing and contract production for EU15 firms, which has tended to dominate the experience of most export-oriented firms since the collapse of state socialism. This competitive pressure is increasing quickly, as the Communication correctly demonstrates. Nothing we say in what follows seeks to minimize the sense of impending threat, especially that felt by manufacturers in the accession and candidate countries.

2.2. However, from our interviews and surveys it is clear that the dynamic nature of international sourcing and trade, and the attendant increase in competitive pressure now being felt by producers in accession and candidate countries, is generating a wide diversity of responses. In our interviews and survey work many firms point to three response strategies.

2.3. First, the typical experience for many firms is that, once locked into dependent relations on EU15-based contractors, these asymmetrical relations tend to persist until cost pressures create the possibility of the loss of orders and the relocation of production to other contractors in other, often cheaper, locations. However, for some manufacturers outward processing arrangements established since the 1980s have enabled upgrading into own-brand and higher value production.

2.4. Second, there has been a relocation of outward processing type contracting and C-M (cut-make) production away from the accession countries that have typically been at the forefront of these arrangements – notably Poland, Hungary and the Czech Republic. As costs have increased in the clothing sector in these countries, firms have found themselves ‘out-priced’ by lower cost producers elsewhere in the region, particularly in Romania and Bulgaria, and beyond.

2.5. Third, as the Commission’s Communication makes clear, there is an emerging trend towards what we might call more ‘triangular’ production and contracting relations with non-accession and non-candidate countries notably in the former Soviet Union. This process is resulting from cost pressures experienced by many of the more traditional producers in the region and the relocation of lower value mass production of garments to countries such as Ukraine. Our research suggests, however, that there are limits to the ability of domestically owned companies in the accession countries to co-ordinate this process (although there are examples of such production networks emerging). Rather, there is evidence that points to the central role played by EU-based inward investors some of whom have relocated mass production to the Ukraine from Slovakia, for example, while at the same time retaining logistical and finishing stages of the production process in Slovakia.

2.6. As continued waves of relocation work their way through the industry, the impacts for producers in the accession countries are clear. Their ability to take part in and effectively manage and organise cross-border production relations are quite constrained by all kinds of factors. Assistance in this area should, in our view, be one part of enterprise policy related to the clothing industry in the accession countries.

3. Clothing Design Capacity in the Accession and Candidate Countries

3.1. The Commission's Communication refers to the need for the sector in the accession and candidate countries to upgrade into higher value and more design-intensive areas of textiles and clothing activity. In our research we have examined the role of design in the clothing sectors of Bulgaria and Slovakia. It is clear from this research that there is an emerging though still small-scale design industry in both new and former state owned firms.

3.2. In some countries such as Slovakia the former state owned sector has tended to continue to dominate the clothing industry. In these cases, long-standing relationships with EU based companies and design houses have been maintained, in-house design capacities have been built, and – though still small-scale – these producers are beginning to supplement export, outward processing type contract production with cut-make-and-trim and own-design production for both local and international markets.

3.3. In other countries, such as Bulgaria, where the former state sector collapsed more thoroughly and from it emerged many more small producers and entrepreneurs, building design activity into production processes that are so dependent on outward processing sub-contacting is much more difficult. But, even here there is evidence on a small-scale of re-capitalization and upgrading in firms aimed at both export and internal markets, often based on marketing to local boutiques supplying the new social elites of the region.

3.4. There is some concern that this part of the clothing market in the accession and candidate countries may face similar competitive pressures from the increase of imports after 2005, as will the lower-value clothing sector, as the Communication highlights.

3.5. In addition, the design-intensive clothing sector is currently limited by relatively low domestic demand in the accession and candidate countries and the difficulty of establishing export markets for own-brand production. But this level of demand is not necessarily the result of imports of designer clothing from the EU15. Limited domestic demand is largely related to low per capita average incomes. But, from the perspective of producers already experiencing increasing difficulties of finding and profiting from assembly contracts for EU markets, more diversified strategies involving assembly contracting, parallel product development, design, and own-brand production are essential for survival. It remains unclear whether these strategies of diversification can sustain the industry as the broader changes in trade and competitive pressure occur, but we think it important for industrial policy to take into account these emergent industrial forms and their diversity of production process.

3.6. The constraints on the clothing design capacity of the accession and candidate countries might be enhanced through ensuring the development of strategic alliances between the emergent design sector in the region and design houses in the current EU Member States. Such forms of collaboration might be enhanced through the innovative use of information and communication technologies (ICTs) to enable geographically distant collaboration in the design sector.

3.7. Indeed, some firms are already restructuring and upgrading their production process. Some EU buyers and manufacturers who have longstanding relations with large former state-owned firms are devolving logistical and contracting functions to their Central European affiliates who are then responsible for outsourcing, pressing and packing, warehousing, and shipping to markets in EU countries on as short as 1-3 day orders.

4. The Importance of Regional Clusters of Clothing Production in the Accession and Candidate Countries

4.1. To a very large degree the clothing sector in the accession and candidate countries is geographically clustered in particular regions (as the Commission's Communication notes). These regional concentrations have historically played an important role in clothing and textile production. However, it is clear that such clusters differ in important ways from those in the current Member States.

4.2. First, these clusters are often centred on large, former state owned enterprises resulting in an industrial structure quite distinct to that found in the Member States. One implication of this industrial structure is the concentration of employment in larger enterprises, as opposed to the dominance of the medium and small firm sector in the EU15 clothing industry. Slovakia is a good example of this form of clustering. In Bulgaria the clothing industry was structured in the state owned sector through a few large producers and many small-scale subsidiary workshops, themselves part of a regional employment creation strategy, especially in rural areas and smaller towns. The globalisation of the Bulgarian clothing industry has created significant shifts in regional employment, with some areas experiencing rapid de-industrialization in clothing (as well as in other branches of manufacture) and in other regions employment growth has occurred so quickly and to such an extent that labour markets are now tightening (with signs of some upward pressure on wages and other labour costs). Community-level industrial and regional policy will have to take into account this growing dependence of some regions on the clothing industry and the regional diversity of forms of industrial organisation across an enlarged Union.

4.3. Second, where employment is still concentrated in larger former state owned industries, our research has indicated that employment conditions in many such firms are relatively good. While wages are often low (invariably the lowest manufacturing wages are paid) and the workforce is very feminised (not atypical for the clothing sector), conditions of work, the existence of employment contracts and other aspects of workplace relations are generally found to be adequate. In these settings, labour inspectorates and trade unions maintain quite strong, albeit diminishing, levels of oversight and intervention. Where problems do exist these are normally found in production units and workshops that dominate some of the most peripheral economic regions of countries such as Bulgaria. Clearly, then recognition of the diversity of the industrial structure of the industry in the accession and candidate countries is very important in the formulation of appropriate Community-level policy measures.

4.4. Third, the central role played by larger firms in the clothing sector means that activity is often concentrated in mass production for export markets under previously established outward processing arrangements. The removal of quota barriers, as the Communication recognises, will have a potentially detrimental effect on the

competitiveness of the sector. One way in which many larger firms have been able to manage the threat of competitive pressure thus far is through domestic outsourcing to smaller workshops and firms. Whether this response can continue to enable larger firms to remain competitive is an open question. Cross-border out-sourcing, as mentioned above, might be one increasingly utilised strategic response to these heightened pressures. But in those cases where cross-border linkages are emerging there are important differences in likely scenarios. These different scenarios depend on the extent to which producers are dependent on EU markets, whether they have emerged using a double strategy of producing for the EU and the US, or whether such strategies are centred, as we have already noted, on inward investors as opposed to domestically owned firms. In the case of dual strategies focused on EU and US markets, especially in Bulgaria, where Turkish firms have established such triangular production relationships, the decline in the value of the dollar has had enormously negative consequences on profitability for those firms locked into dollar-priced contracts. In similar triangular arrangements involving Greek producers in Bulgaria, the preponderance of contracts with EU retailers and manufacturers has shielded the firms in the past two years.

5. Export Specialisation in the Clothing Sector in the Accession and Candidate Countries

5.1. The Commission's Communication (in addition to the accompanying reports) notes the diversity of products within the clothing industry and discusses the effects of delocalisation on product mix, but it does not address the policy implications of the resulting export specialisation. Our research suggests that earlier outward processing customs arrangements and the expansion of outsourcing from EU15 to the Pan-Euro-Mediterranean zone have fundamentally re-shaped the product mix of exports from each country. Competitive contracting seems to have increased export specialisation, creating a 'sharper' geography of sourcing and increased specialisation and dependence by export producers on a narrower range of products.

5.2. In some cases, such as in Slovakia and for reasons indicated above, the product mix has concentrated increasingly on relatively higher value clothes, such as men's and women's trousers, suits, shirts, and jackets.² In other cases, such as in Bulgaria, competitive pressure from Asian producers of lower cost goods are creating enormous difficulties for producers unable to shift to alternative and higher-value items. Where that shift has been possible, manufacturers are also changing their relationships with EU15 buyers, reducing their dependence on C-M production, investing in new technologies, and beginning to establish deeper forward and backward linkages. The likelihood of long-term success in these endeavours is uncertain and many manufacturers now operate on very short-term planning horizons, while many more are on the verge of bankruptcy. However, the existence of these diversifying forms of production has important implications for industrial and regional policy.

² One estimate suggests that an average of 35% of clothing exports from the accession and candidate countries to the EU is comprised relatively high value garments, and that this concentration increases to nearer 50% in countries such as Slovakia (Smith, A., Buček, M., Pickles, J. and Begg, B. (2003) 'Global trade, European integration and the restructuring of Slovak clothing exports', *Ekonomický časopis*, 51: 731-748.)

6. How are we to Understand De-Localisation? From ‘Trade Liberalisation’ to ‘Industrial Process’ Perspectives

6.1. Finally, a critical area often neglected by considerations of restructuring centred on the impacts of continued trade liberalisation, concerns the multiple determinants of change within the European clothing industry. Throughout the Communication and its supporting working papers, the Commission places emphasis on the need for “measures aimed at strengthening the competitiveness of the EU textile and clothing sector in anticipation of the elimination, after almost of [sic] four decades, of WTO import quotas in January 2005” (IP/03/1463). January 2005 is undoubtedly an important horizon to which all eyes in the industry are now directed, as they have been for some time. However, as the Communication and reports point out, the community adopted an earlier round of measures to promote industry competitiveness among EU manufacturers, known as outward processing trade (OPT). A customs regime that allowed manufacturers and retailers in EU countries to outsource cut-and-make assembly operations to ECE countries without incurring customs duties on the re-imported clothing, outward processing trade stripped out from EU countries a large proportion of labour-intensive assembly operations, especially in clothing. As the reports show, one consequence of this process of de-localisation was that productivity increases were achieved in the EU textile and clothing industry throughout the 1990s.

6.2. It would be a mistake, however, to interpret such productivity increases in terms of the liberalisation of trade policies without also taking into account the forms and timing of the restructuring of the apparel industry in the EU. In practice, industrial outsourcing and de-localisation had begun in the 1980s and were driven primarily by manufacturers and retailers seeking to protect and increase their competitive position in EU and world markets and supported by EU customs-relief policies such as outward processing trade. These resulted in the extension and elaboration of production systems geographically to encompass low-wage producing regions in the accession and candidate countries, and beyond. Design, marketing, logistics and communications were retained in the main firms in the EU while assembly was outsourced. In the economic crisis that followed 1989, the majority of Central and East European clothing firms were forced to turn to C-M export production for EU buyers. Much of this outsourcing was ‘regional’ rather than ‘global’ in that it resulted in a cross-border production system centred on Europe producing for EU markets.

6.3. It is clear from interview after interview that we have conducted that retailers and manufacturers pressed for customs relief to enable this geographical shift in production relations. However, retailers saw this de-localisation not as a process that made the industry ‘footloose’, but one which enabled firms to develop more nuanced sourcing and production strategies based on their specific market and product needs. The Commission’s Staff Working Paper on the Evolution of Trade recognises this on page 6: “However, for countries to be able to reap these benefits they need to fully understand that changes that occurred in the global context, mainly the new organization of production based on short delivery time and regional strategies.” But the issue is not further elaborated. Instead, the report continues to locate the clothing industry as crucial for developing countries in their ‘stages of development’, focusing attention on the inevitability of competitive and price pressure as liberalisation of trade regimes continues.

6.4. In contracting in the accession and candidate countries of Central and Eastern Europe some retailers and buyers do locate Eastern Europe in a fully global strategy in which cost pressures are paramount. Some are able to develop this global sourcing strategy in a situation in which high quality inputs and production are also achieved. But for many EU-based firms and retailers adopting a strategy of ‘de-localisation’ issues of proximity, production schedule, delivery-time, established infrastructure and skills, and cultural familiarity for managers and technical staff are crucial elements of a sourcing and industrial location strategy centred on the Euro-Med region. In these cases, de-localisation means not just ‘price pressure’ or searching for low-wage production. It also means effective control over production processes in ways that enhance, not restrict, flexibilities in sourcing and marketing. Understood in this way, outsourcing and de-localisation may not be the same footloose processes that emerge through the single lens of ‘trade liberalisation’.

7. Outputs from the ‘Reconfiguring Economies, Communities, and Regions in Post-Socialist Europe: A Study of the Apparel Industry’ research project

Begg, R., Pickles, J. and Smith, A. (2003) ‘Cutting it: European integration, trade regimes and the reconfiguration of East-Central European apparel production’, *Environment and Planning A*, 35: 2191-2207.

Smith, A. (2003) ‘Power relations, industrial clusters and regional transformations: pan-European integration and outward processing in the Slovak clothing industry’, *Economic Geography*, 79: 17-40.

Smith, A., Buček, M., Pickles, J. and Begg, B. (2003) ‘Global trade, European integration and the restructuring of Slovak apparel exports’, *Ekonomický časopis*, 51: 731-748.

Pickles, J. (2002) ‘Gulag Europe? Mass unemployment, new firm creation, and tight labour markets in the Bulgarian apparel industry’ in A. Rainnie, A. Smith, and A. Swain, (eds), *Work, Employment and Transition: Restructuring livelihoods in post-communism*. London: Routledge, pp. 246-272

Begg, R., Pickles, J., and Roukova, P. (1999/2000) ‘A new participant in the global apparel industry: the case of southern Bulgaria’, *Problemi na Geografiata*, Volume #3/4, Sofia: 121-152.