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MOVE

**‘The Moving Frontier: The Changing Geography of Production in Labour
Intensive Industries’**

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Preface

The Report at hand is the outcome of a research project that was financed by the European Commission (EC) in the context of the Specific Targeted Research Project (STREP) of the Sixth EU Framework Programme for Research and Technological Development (FP6) (<http://afroditi.uom.gr/move/index.html>). Therefore, at this point, I would like to take the opportunity to thank the EC for providing us the opportunity to materialise this project.

Furthermore, I would like to thank my colleagues from the different national teams, as well as the individuals that have participated in this project and whose contribution is acknowledged in the appropriate chapters. In a sense, this Report is a collaborative work throughout. That is, though individual teams were responsible for specific chapters, it constitutes a collective authorship in the sense that there were extensive discussions for more than three years over every minor detail. Needless to say, this is particularly true for the introductory, as well as the concluding chapters.

Most of all, I would like to thank all those who contributed their valuable time in replying to our questionnaires (i.e. 756 enterprises involved in some form of delocalisation), or whose long conversations with us gave us valuable insights (i.e. more than 100 key informants) and whose names were impossible to be mentioned.

The whole endeavour was quite an experience for all of us, since we had to work collectively to reach this outcome. This partnership has by now quite a long history; interaction in its present form began in 2002, when a proposal was drafted and submitted to the EC. However, most of us already knew each other and had already collaborated on a bi-lateral basis for several years before. At times it brought us up against the limits of our potential for agreement as individuals and as national teams which however led to some quite productive debates. I believe that we all learned not only through the actual research, but also by working with other research teams from different countries as well as scientific disciplines. I must admit that this was a very interesting and rewarding experience, though at times it proved to be quite difficult for all of us and particularly for the coordinating team.

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I would also like to thank our colleagues that participated in the Conference that we organised in Krakow on 12-14 April 2007 and helped us with their most valuable constructive suggestions. That is, *Robert Begg*, Prof. Geography and Regional Planning, Indiana University of Pennsylvania, Indiana, USA; *Mick Dunford* Prof. Economic Geography, University of Sussex, UK; *Gary Gereffi* Prof. Comparative and Historical Sociology Organizations, Markets, and Work Duke University, Durham, NC, USA; *Costis Hadjimichalis*, Prof. Dept of Geography, Harokopio University Greece; *Antigone Lyberaki*, Prof. Economics, Dept. Economics and Regional Development, Panteion University, Greece; *John Pickles*, Prof. Globalization, Modernity, Geographies of Social Change, Dept. Geography, University of North Carolina, Chapel Hill, Chapel Hill, NC USA and *Adrian Smith* Prof., Dept of Geography Queen Mary University of London – UK.

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Lois Labrianidis

Thessaloniki, July 2007

List of Abbreviations

CEEC	Central and Eastern European Country
DC	Developed Country
EC	European Commission
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
GCC	Global Commodity Chain
GDP	Gross Domestic Product
GPN	Global Production Networks
GVA	Gross Value Added
GVC	Global Value Chain
ICT	Information and Communications Technologies
ILO	International Labour Organization
IT	Information Technology
KWNS	Keynesian Welfare National State
LDC	Less Developed Country
LII	Labour Intensive Industries
NACE	Nomenclature of Economic Activities (Classification of Economic Activities in the European Community)
NAFTA	North American Free Trade Agreement

NGO	Non Governmental Organisation
OECD	Organisation for Economic Co-operation and Development
R&D	Research and Development
SEZ	Special Economic Zones
SMEs	Small and Medium Enterprises
SWPR	Schumpeterian Workfare Post-National Regime
TNC	Transnational Company
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation
WWII	World War II

1 INTRODUCTION

Lois Labrianidis

1.1 What is delocalisation?

Delocalisation is a term referring to the spatial restructuring of industry at a national, regional or global scale. According to Feenstra (1998), delocalisation was originally conceived as another variant of the long list of terms referring to the splitting of a production process, including but not limited to disintegration, internationalisation, intra-mediate trade, intra-product specialisation, kaleidoscope comparative advantage, multistage production, outsourcing, slicing up the value chain, splintering, subcontracting and vertical specialisation.

We adopted a wide definition of delocalisation so as to include: FDI; outsourcing; subcontracting; firms that traditionally bought the intermediate product (i.e. never produced it in-house and therefore never stopped producing it) and are now outsourcing it; horizontal FDI, which is very often not considered a component of delocalisation, since it involves the movement of production abroad. Moreover, while in the literature the emphasis is on Secondary data, Big TNCs, Chains or networks viewed from the perspective of the respective lead firm. We tried to include in the analysis even small firms that are not usually included and might be very important for development.

•*Foreign Direct Investment (FDI): is an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate) (UNCTAD 2004: 345).*

•*Subcontracting*: is defined as the manufacture of goods by one firm (the subcontractor) for another (the lead firm) based on the specifications of the latter. Often there can be several layers of firms or intermediaries mediating the relationship between the actual production workers and the end product market. The lead firms normally exercise considerable control over their subcontractors in terms of price, quality and timing of the products they supply.

•*Outsourcing*: is the delegation of tasks or jobs from internal production to an external entity (such as a subcontractor). Most recently, it has come to mean the elimination of native staff to staff overseas (offshore outsourcing), where salaries are markedly lower. This is despite the fact that the majority of outsourcing that occurs today still occurs within country boundaries.

•*Offshoring*: can be defined as relocation of business processes (including production/manufacturing) to an overseas lower cost location.

• *Offshore outsourcing*: is the practice of hiring an external organization to perform some or all business functions in a country other than the one where the product will be sold or consumed.

Before analysing delocalisation, let us first try to find our way through the ‘forest’ of terms and attempt to produce taxonomy of a firm organisation (Table 1). Let us suppose that we have a domestic firm producing a single product by using two intermediate goods (1 and 2 respectively, the former being labour and the latter knowledge intensive), domestic capital and domestic labour.

Let us start with a vertically integrated domestic firm. In this case, both intermediate goods are produced in-house, using domestic capital and labour. Under this

configuration, the firm can only be linked with the world market through its final good exports or raw materials imports.

The first possible deviation occurs when the firm realises that, for a number of reasons, a foreign market can be better served by producing the product there rather than exporting it. This implies a duplication of the production process, as additional plants are established to supply different locations: a horizontal FDI.

Table 1 A summary of definitions of IB organisation types

Location of production	Internalized or externalized production	
	Internalized	Externalized
Home country	Production kept in-house at home (Vertically integrated domestic firm)	Outsourcing (production outsourced to third-party firm e.g. a subcontractor)
Foreign country	Vertical or horizontal FDI	International outsourcing
For service industries <i>Offshoring</i>	Intra-firm (captive) offshoring	Outsourced offshoring

Note: Categories in gray cells comprise the delocalisation group

On the other hand, when the firm realises that, for example intermediate good 1 can be produced more efficiently in a less developed (and lower labour cost) country (LDC), it may decide to set up a plant there to produce it. Although such movements have traditionally been described as vertical FDI, quite recently the alternative term intra-firm or ‘captive’ offshoring has entered the International Business (IB) vocabulary. The differences between the two terms are almost inexistent, although the latter tends to apply more to service industries, while the former to manufacturing ones.

Alternatively, the firm may decide that it is in its best interest to focus on its core competences, which we may assume are better employed in the production of intermediate good 2. This could imply that the firm wishes to stop producing

intermediate good 1. Assuming that the latter is still essential to the firm, it would probably outsource it either to a local firm in a foreign country, or to an affiliate of another TNC.

The inherent difficulties in defining the terms are now more or less evident. One question that arises is whether firms that traditionally bought the intermediate product (i.e. never produced it in-house and therefore never stopped producing it) are outsourcing¹. Another issue is related with subcontracting: is it merely a special case of outsourcing or a completely distinct category? Finally, one last issue ignored by this relatively simple taxonomy – however very important in our context - has to do with governance; are relationships based on formal, contractual agreements, the outcome of specific social environments, trust and embeddedness?

Delocalisation is, therefore, a term referring to the spatial restructuring of industry at a national, regional or global scale. Its primary elements are FDI and outsourcing, although it also refers to all other types of cross-border business interactions. Traditionally, the direction of the movement was from the more developed to the less developed countries, although this is rapidly changing. In other words, delocalisation is a term that is ‘wider’ than other terms, which, at least in mainstream international economics, are identified with and limited to trade of intermediate products (e.g. Görg

¹ Gilley and Rasheed (2000) argue that abstention of producing a good in-house should also be considered outsourcing if the internalization of the good or service outsourced was within the acquiring firm’s managerial and/or financial capabilities.

and Hanley, 2003; Egger and Egger, 2003)². One last question that remains is how to treat horizontal FDI, which is very often not considered a component of delocalisation. We feel that it should be included inasmuch as it involves the movement of production abroad. Nonetheless, it will not occupy a prominent position in our analysis, since with the exception of the electronics sector is of minor importance to our sample.

In the literature so far there are estimations primarily of FDI and to a certain extent of outsourcing.

1.2 The changing geography of production in a globalised world

Economic activity is primarily focused in the DCs.

During the 60 years between the end of the WW II and today, the global map of production of goods and services has changed significantly. However, although three fourths of the global manufacturing still takes place in the developed countries, the share of the LDCs has risen considerably; from 5per cent in 1953 (Dicken, 1998), to almost 24 per cent in 2001 (UNCTAD Globstat).

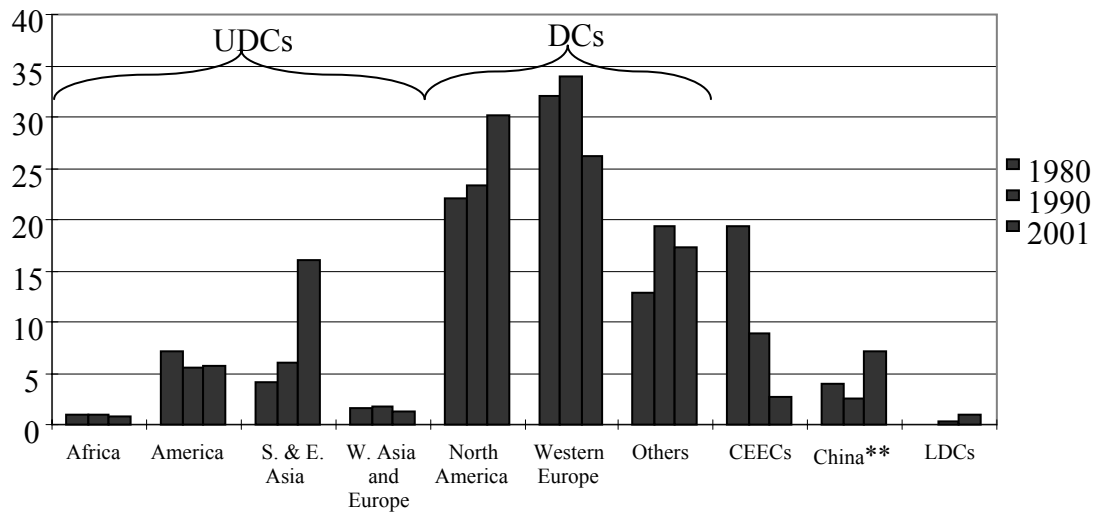
The situation within the various groups of countries has also changed significantly. Concerning the LDCs, almost all the change of the region's performance was due to the rapid increases in a relatively small number of countries in S.E. Asia. Led by the four Asian 'tiger' economies of S. Korea, Taiwan, Singapore and Hong-Kong, which were later followed by a number of other countries, the share of the region in world

² We should note that there have been efforts to analyse the two phenomena in a unifying way. For example in his analysis the implications of 'international fragmentation' Kohler (2004) treats vertical FDI and subcontracting as the two components of fragmentation.

manufacturing value added more than tripled during the last two decades. Among the countries of the region, it was China that displayed the most spectacular performance, recently overtaking Germany as the third most significant manufacturing producer in the world. In contrast, the LDCs of America lost ground, while Africa and the LDCs of W. Asia and Europe have been marginal in the global map of production.

Within the developed countries, there have also been considerable changes. North America emerged as the dominant region, with more than 30 per cent of the world manufacturing value added in 2001, outperforming Western Europe during the last decade. The performance of the 'other' developed countries seems to depict the slump of the Japanese economy during the 1990s.

However, the regions where the most impressive (although very different in direction) changes took place are the Central Eastern European Countries (CEECs) and China. The former appear to have experienced a dramatic crisis, currently accounting for less than 3 per cent of the world manufacturing value added (down from almost 20 per cent in 1980), while China is emerging as the fastest growing economy.



** The data shown for the year 1980 corresponds to 1981 data at constant 1980 prices

Figure 1 Distribution of world manufacturing value added, at current prices, by region

Source: UNCTAD Globstat (<http://globstat.unctad.org/html/index.html>)

A very small number of countries produce a significant part of the global output.

This goes for the LDCs as well as for the DCs.

Another significant feature of the world production map is that a very small number of countries produce a significant part of the global output. In 2000, the 15 most significant producers contributed 81.8 per cent of the global manufacturing value added. As Dicken (1998: 27) noted, *the 'manufacturing tail' of the world economy is very long indeed*, even though concentration at the top has slightly been reduced during the last few years (according to Dicken (1998: 27), the share of the 15 most important producers in 1994 was 85.8 per cent).

Table 2 The 15 most significant producer countries, 2003

Country	Industry Value added (in US\$ m.)	Percentage of world total (%)
United States	2,192	26.8
Japan	1,540	16.3
China	738	8.4
Germany	504	5.0
UK	357	3.7
France	281	3.7
Italy	278	3.0
Canada	226	2.2
Korea, Rep.	216	2.4
Spain	168	2.4
Mexico	142	1.6
Brazil	133	1.7
India	131	1.9
Saudi Arabia	109	0.5
Russian Federation	105	0.8
Subtotal	7,122	80.3
World	9,135	

Source: World Bank, WDI database

Concerning the LDCs, almost all the change of the region's performance was due to the rapid increases in a relatively small number of countries in S.E. Asia. (Led by the four Asian 'tiger' economies of S. Korea, Taiwan, Singapore and Hong-Kong).

The regions where the most impressive (although very different in direction) changes took place are: the CEECs have experienced a dramatic crisis, currently accounting for less than 3 per cent of the world manufacturing value added (down from almost 20 per cent in 1980); and China, that is emerging as the fastest growing economy.

A simple illustration of the extent of the inequalities is the fact that the manufacturing value added of Russia (the last country in our top-15 list) is more than the sum of the 80 countries found at the bottom of the table!

1.3 FDI

Although with significant fluctuations, FDI has grown enormously during the last 35 years and especially since 1985. More specifically, during the period 1970-2003, the

average rate of change of FDI inflows was 14.7 per cent, growing significantly faster than exports (11.2 per cent), and even faster than output (9.3 per cent - Figure 2). In fact, FDI growth was so spectacular that after three decades of growth, in 2000 (its peak year), it was more than 100 times higher³ than its 1970 level, with more than 80 per cent of that growth occurring during the last decade.

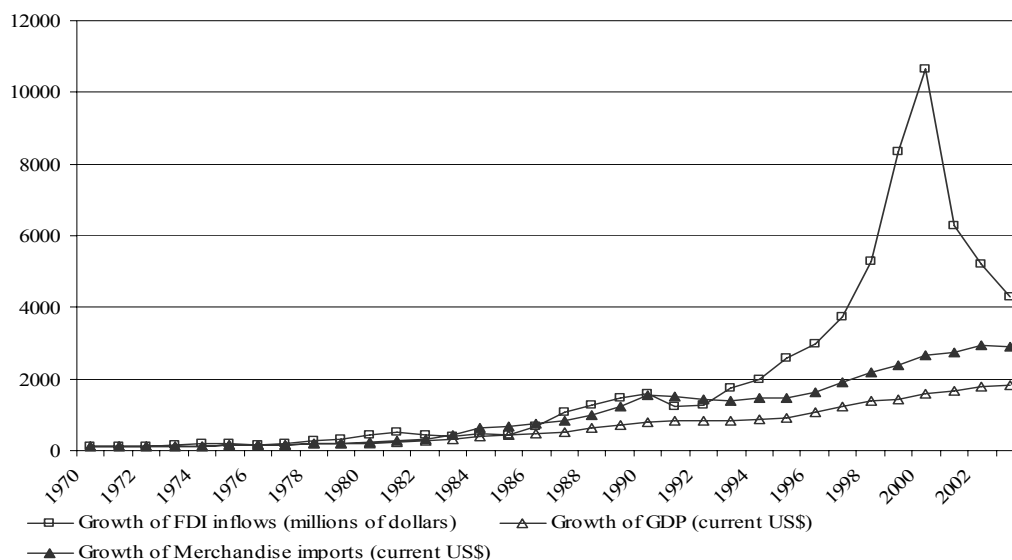


Figure 2 Growth and output (GDP) and merchandise imports and FDI inflows (1970=100)

Sources: World Bank WDI database (<http://devdata.worldbank.org/dataonline/>) for imports and output, and UNCTAD FDI Database (<http://stats.unctad.org>) for FDI inflows.

With regards to the distribution of FDI, the main feature of the participation of LDCs in both inward and outward stocks appears to have been the considerable fluctuations within the last quarter of the century. Furthermore, although not easily visible, both

³ The respective figure for trade and output was 29 and 18 respectively.

figures are displaying a long term upwards trend, implying a strengthening of the position of LDCs in the overall distribution of FDI (Figure 3).

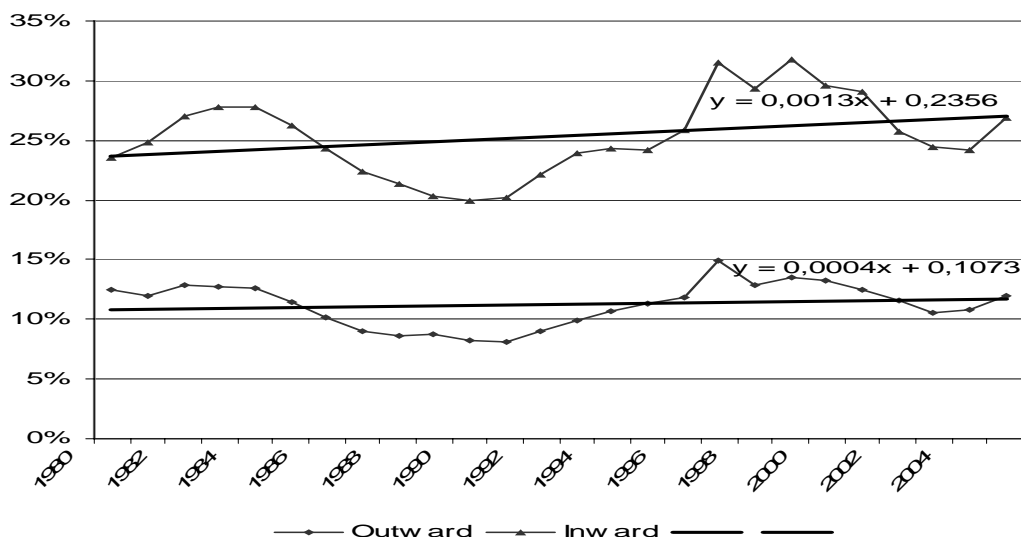


Figure 3 Inward and Outward FDI stocks of LDCs as a percentage of the total

Source: UNCTAD FDI Database (<http://stats.unctad.org>)

In spite of this, TNCs are still concentrated in the developed countries. Low labour costs alone are not sufficient for a country to attract FDI. There are other more important factors, including for example physical and non-material infrastructure, socio-economic stability and human capital. In 2001, the inward FDI stock of the developed countries amounted to \$4,545 per capita, while the respective figure for LDCs was only \$436. Furthermore, the stock of outward FDI of the developed countries was \$5,951 per capita, while the equivalent figure for LDCs was only \$168. For the last 30 years, ten countries have accounted for around 85 per cent of the outward investment stocks; during this period, there were of course major changes in the importance of individual countries, the most prominent being the decline of the importance of USA (Table 3).

Table 3 Outward investment cumulative stocks by country: main players (%)

		1967	1973	1980	1990	2000	2003
1	USA	50.4	48.0	41.3	25.0	21.3	25.2
2	UK	14.1	7.5	15.4	13.3	14.8	13.8
3	France	5.3	4.2	4.7	7.0	7.1	7.8
4	Germany	2.7	5.6	8.3	8.6	7.7	7.6
5	Netherlands	9.8	7.5	8.1	6.2	5.1	4.7
6	Belgium/Luxemburg			1.2	2.4	6.3	4.1
7	Switzerland	2.2	3.4	4.1	3.8	3.7	4.2
8	Japan	1.3	4.9	3.8	11.7	4.6	4.1
9	Canada	3.3	3.7	4.6	4.9	3.7	3.8
10	Italy	1.9	1.5	1.4	3.3	3.0	2.9
	Subtotal	91.0	86.3	92.9	86.4	78.7	78.2
	Others	9.0	13.7	7.1	13.6	21.3	21.8
	Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Dunning (1993c: 17) years 1967, 1973 and UNCTAD FDI database years 1980 - 2003

Sectoral and industry issues

The most important fact regarding the sectoral distribution of FDI is the growing importance of services. Both outward (Figure 4) and inward (Figure 5) FDI in developed, as well as LDCs are dominated by services. This represents a significant shift, particularly for developing economies, away from manufacturing, which during 1989-1991 accounted for 58 per cent of outward and 53 per cent of inward FDI. Both figures have since then been reduced to 21 per cent and 40 per cent.

Regarding the industry composition of sectors, the importance of labour intensive FDI in manufacturing has significantly declined. According to UNCTAD (2004), this can be attributed to two main factors, that is first, a general decline in labour intensive manufacturing, followed by a decline of traditional manufacturing employment. Labour appears to be increasingly replaced by capital and knowledge, both in developed and LDCs. Second, that firms in developing (although not exclusively) countries are increasingly developing their own ownership specific advantages vis-à-vis developed

countries, based on different factor endowments, particularly low cost labour. This allows certain labour rich LDCs to attract capital and knowledge intensive investments.

1989-1991 (average)

2001-2002 (average)

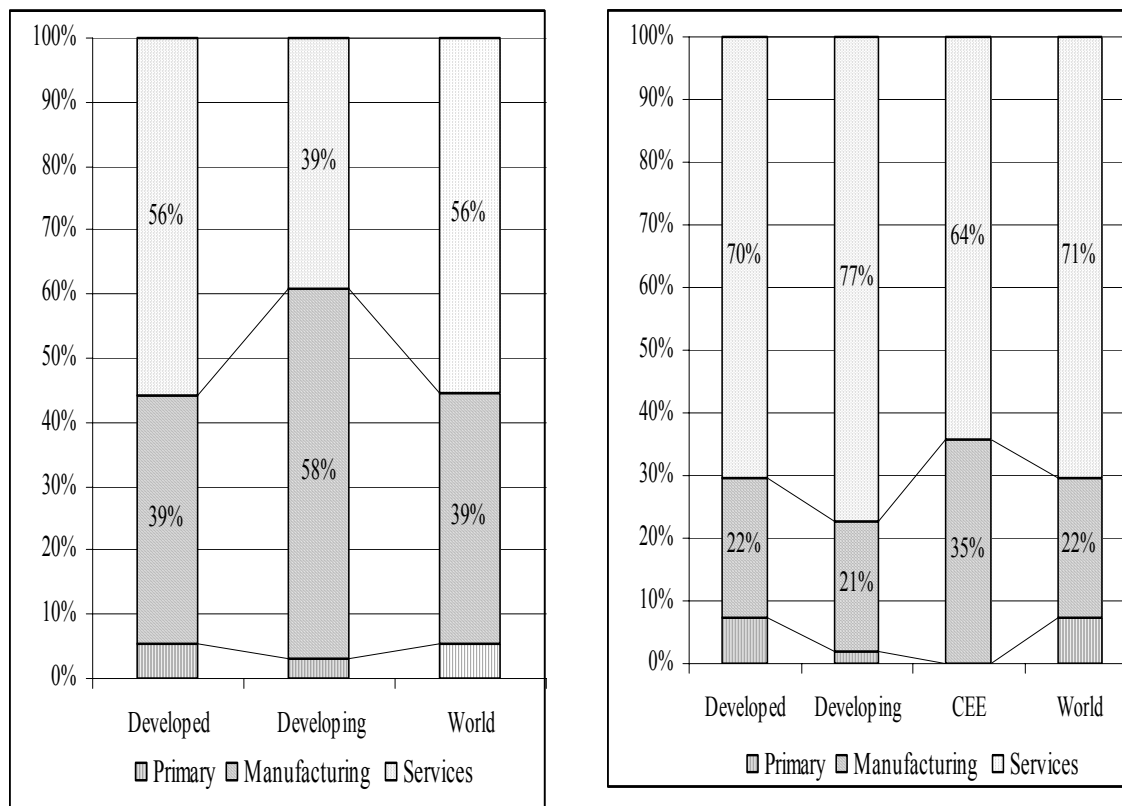


Figure 4 Sectoral distribution of outward FDI, average annual flows

Source: UNCTAD (2004: 319)

1989-1991 (average)

2001-2002 (average)

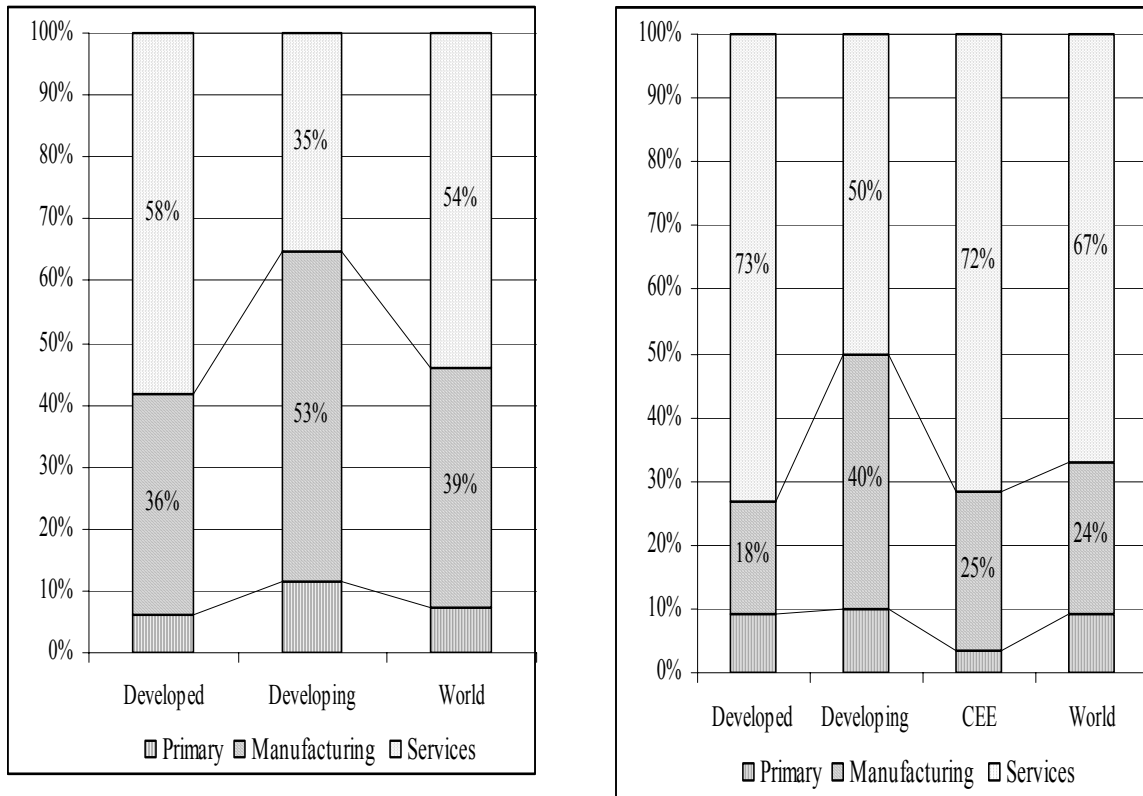


Figure 5 Sectoral distribution of inward FDI, average annual flows

Source: UNCTAD (2004: 319)

1.4 Outsourcing

The problems related to the definition of outsourcing, briefly analysed above, are reflected in the difficulties to measure it. In all types of efforts, outsourcing is measured in terms of trade flows or as a share of total trade flows. Intra-firm trade (trade between parents and affiliates in a TNC network) is one of the measures often used to capture outsourcing. As in the case of FDI, most of the empirical evidence comes from the USA, Japan and Sweden (Bonturi and Fukasaku, 1993; Slaughter, 2000; Andersson and

Fredriksson, 2000). In these three countries, intra-firm trade accounts for 38 per cent-45 per cent (in the case of the USA), 30 per cent (Japan) and 50 per cent (Sweden) of the total trade of the parent companies.

The second, and much more popular, measure is the various approaches of intermediate inputs. One such approach is that of Feenstra and Hanson (1999) and Hummels et al (2001), who tried to estimate the level of 'Vertical Specialisation' as a measure of the imported inputs in products that are then exported. Their measure is a subset of all intermediate inputs, as some of these are not embodied into export products. Studying ten OECD and three LDCs (Korea, Taiwan and Mexico), they observed increasing shares of vertical specialisation trade in the majority of countries. Furthermore, they argue that about 30 per cent of the growth of exports of these countries is attributed to vertical specialisation.

1.5 Low technology industry is not confined to LDCs

One of the features of the globalising economy of today is the emergence of many different kinds of low-technology, labour intensive industries (LII) as engines of growth; development and trade, both in high and low wage countries. While in the decades following the WWII sectors like these were often seen as being rather archaic hangovers from an earlier era of capitalism These low-technology, LII are often marked by low wages, unskilled work and sweatshop employment conditions though in more fashion-oriented segments they also provide many lucrative employment opportunities (Scott 2006: 1517-8)

Labour intensive firms come in many different shapes and sizes and in many different forms of interrelationship with one another. They range from networks of many small firms forming dense locational agglomerations to large establishments in relative organizational and spatial isolation. In all cases though there are dense networks of interrelated producers. Small and medium sized firms (SMEs) tend to agglomerate while large firms, that tend to have well developed internal economies of scale and scope, prefer places with cheap land, suitable pools of low wage labour (e.g. special economic zones (SEZ), export processing zones and maquiladoras). (Scott 2006: 1518-9).

In the late '70s it was apparent already that there was on the one hand a shift of low-skill, low-wage work in industries like clothing and electronics assembly to the world periphery and on the other hand an intensification of advanced design and production activities in core countries which has been coined by Froebel et al (1980) the "new international division of labor" (Scott 2006: 1520). This term though is useful as Scott (2006: 1520) argues "tends to impose an unduly schematic rigidity on the ways in which we think about the economic geography of contemporary globalisation" and he suggests the notion "of a worldwide mosaic of regional economies at various levels of development and economic dynamism and with various forms of economic interaction linking them together". Hence we can acknowledge a) that there is much more than core- periphery b) there are many counter examples such as: low-wage sweatshop industries in DCs; significant number of industrial agglomerations undergoing upgrading in LDCs; dynamic new technology poles in countries like Brazil, China and India.

As Scott (2006: 1528, 1532) argues, rising levels of production in low technology, labour intensive sectors in the less developed parts of the world are the cause of much employment loss in more DCs. There is mounting evidence that some low-wage countries, too, are beginning to feel the pinch as production expands in even poorer countries. Low-technology, labor-intensive industrial agglomerations at the bottom end of the global production scale are more often than not marked by inferior working conditions and grinningly meager wages. In these circumstances the prospect of “immiserizing growth” is very real (Kaplinsky et al 2002). Yet some of these agglomerations do sometimes manage to upgrade and to move on to higher levels of commercial achievement.

Simultaneously there agglomeration tendencies too which are boosted by localized learning effects, and, in high-quality, high – fashion production centres, by the place specific peculiarities that often characterize local skills, traditions, and design know-how. These peculiarities in turn become embodied in the outputs of given agglomerations, and endow them with an aura of authenticity (e.g. Paris fashions, Italian shoes, Scandinavian furniture) that enables them to “command premium prices on world markets” (Scott 2006: 1529).

In last ten years there was a significant relocation of clothing production away from the main producing regions in Europe and N. America. Such a geographical shift is intensification of what Frobel et al called the “new international division of labour” and the result of increasing pressure from lower cost producers. This relocation has been enhanced by the gradual removal of the quota-constrained trade in the industry. The result has been a long term loss of production jobs in the industry particularly in some of

the higher cost “global city” locations such as London, L. Angeles, Sydney and N. York. Two contracting trajectories have been identified there. On the one hand a “high-road” trajectory” in which employment activity shifts away from low-end, low-paid sewing jobs to the coordination of international production and a concentration on the “creative” aspects of the industry (i.e. in design and innovation). On the other hand there is the “low-road” model of growing informalisation in the industry with firms attempting to cut costs through the implementation of poor working conditions and home-working (Evans and Smith 2006: 2253-4).

1.6 The Survey

The issues raised in this report are based on an empirical research about the delocalisation in four industries in five European countries nonetheless they are not confined to them only. The issues raised have a global audience because people everywhere are trying to understand these issues. Many of the same things that are look at in this report (in the four industries in the provided countries) are also big things in North America, Canada, US, Mexico, Central America and Asia and they have global repercussions as well.

The report is based on the EU FP6 project ‘MOVE’ As with the vast majority of EU projects MOVE was a multinational effort by six partners from 5 countries; two ‘older’ EU members, i.e. the UK and Greece, two recent ones, i.e. Poland and Estonia and one from the very last ‘wave’ of accession, i.e. Bulgaria. The focus of the project was on four sectors, i.e. clothing, footwear, electronics and software.

Clothing and footwear are clearly among the most labour intensive sectors of European manufacturing. In fact, this is true for all of the industries' sub sectors⁴. What was very surprising was the fact that the textile industry displayed a similar labour intensity, disproving our fears about its higher capital intensity (at least compared to the clothing sector). It is true that, on average, textile sectors or subsectors are less labour intensive than the clothing ones, however the differences are miniscule.

Our initial third manufacturing sector was 'electronics'. The lack of a more specific definition (according to NACE) could turn out to be quite problematic. More specifically, following the description of 'electronics' of the proposal could lead us to the inclusion of the whole subsection DL (manufacture of electrical and optical equipment), except sector 31 (manufacture of electrical machinery and apparatus n.e.c.). The other sectors are: sector 30 (manufacture of office machinery and computers), 32 (manufacture of radio, television and communication equipment and apparatus) and 33 (manufacture of medical, precision and optical instruments, watches and clocks). Unfortunately, sector 30 does not appear to be a labour intensive sector (at least compared to the other sectors included in electronics – see Table 4), something that is also true for the EU25 data.

In relation to the problems outlined above, we would have two suggestions regarding electronics. The first is to include sector 31, which appears to be the most labour intensive one, while the second is to consider the possibility to exclude sector 30. Before

⁴ The only possible exception could be the sector 'Manufacture of non-wovens and articles made from non-wovens, except apparel', which was only present at the EU15 list. Scoring 61,1 clearly sets it apart from the other subsectors, however, it is questionable whether it should be excluded.

a final decision can be reached (especially regarding the latter), we need to estimate the possibly adverse impact of such a decision on the quality of our fieldwork, since computers could turn out to be a very interesting sector. On the other hand, we could also consider retaining the sector, in case we decide we need something like a control group sector.

Table 4 GVA per person employed (apparent labour productivity) for EU15

	Sector	2001
245071	Manufacture of textiles and textile products	30,3
245072	Manufacture of textiles	34,4
245073	Preparation and spinning of textile fibres	33,9
245081	Textile weaving	38
245087	Finishing of textiles	36,8
245088	Manufacture of made-up textile articles,except apparel	28,9
245089	Manufacture of other textiles	40,4
245090	Manufacture of carpets and rugs	43,7
245091	Manufacture of cordage, rope, twine and netting	29,4
245092	Manufacture of non-wovens and articles made from non-wovens, except apparel	61,1
245093	Manufacture of other textiles n.e.c.	37,3
245094	Manufacture of knitted and crocheted fabrics	30
245095	Manufacture of knitted and crocheted articles	27,2
245096	Manufacture of knitted and crocheted hosiery	29,2
245097	Manufacture of knitted and crocheted pullovers, cardigans and similar articles	25,9
245098	Manufacture of wearing apparel; dressing; dyeing of fur	25,6
245099	Manufacture of leather clothes	27,3
245100	Manufacture of other wearing apparel and accessories	25,6
245101	Manufacture of workwear	27,5
245102	Manufacture of other outerwear	25,1
245103	Manufacture of underwear	27,2
245104	Manufacture of other wearing apparel and accessories n.e.c.	25,5
245105	Dressing and dyeing of fur; manufacture of articles of fur	22,8
245106	Manufacture of leather and leather products	28,1
245107	Tanning, dressing of leather; manufacture of luggage	28,1
245108	Tanning and dressing of leather	35,8
245109	Manufacture of luggage, handbags and the like, saddler	30,1
245110	Manufacture of footwear	26,1
245294	Manufacture of electrical and optical equipment	52,7
245295	Manufacture of office machinery and computers	71,5
245296	Manufacture of office machinery	52,1
245297	Manufacture of computers and other information processing equipment	75,7
245298	Manufacture of electrical machinery and apparatus n.e.c.	49,1
245299	Manufacture of electric motors, generators and transformers	51,8
245300	Manufacture of electricity distribution and control apparatus	52,8

245301	Manufacture of insulated wire and cable	49,6
245302	Manufacture of accumulators, primary cells and primary batteries	44,3
245303	Manufacture of lighting equipment and electric lamps	44,3
245304	Manufacture of electrical equipment n.e.c.	44,1
245305	Manufacture of electrical equipment for engines and vehicles n.e.c.	42,9
245306	Manufacture of other electrical equipment n.e.c.	45
245307	Manufacture of radio, television and communication equipment and apparatus	54,1
245308	Manufacture of electronic valves and tubes and other electronic components	57,8
245309	Manufacture of television and radio transmitters and apparatus for line telephony and line telegraphy	54,2
245310	Manufacture of television and radio receivers, sound or video recording or reproducing apparatus and associated goods	46,4
245311	Manufacture of medical, precision and optical instruments, watches and clocks	52,7
245312	Manufacture of medical and surgical equipment and orthopaedic appliances	45,9
245313	Manufacture of instruments and appliances for measuring, checking, testing, navigating and other purposes, except industrial process control equi.	60,2
245314	Manufacture of industrial process control equipment	50,8
245315	Manufacture of optical instruments, photographic equipment	55,4
245316	Manufacture of watches and clocks	41,1

The situation appears to be slightly more complicated in our service sector (i.e. software), which is sector 72 (computer and related activities) according to the NACE classification and includes six sub sectors, namely, 72.1 ‘hardware consultancy’, 72.2 ‘software consultancy and supply’, 72.3 ‘Data processing’, 72.4 ‘database activities’, 72,5 ‘Maintenance and repair of office, accounting and computing machinery’, and 72.6 ‘other computer related activities’. Once again, in the discussions that were held in Krakow, we failed to exactly specify the sector to be investigated, however, it is quite clear that the whole sector 72 would be less than ideal. In fact, 72.2 appears to be the only suitable option. Furthermore, sectors 72.3 and 72.4 could also turn out to be interesting (although it remains to be seen whether any firms will be found in some of the participating countries) due to the quite different requirements in human resources.

Furthermore, there is no data available for the subsector level, while the score of the sector (sector 72) is rather high, at 60,1 (EU15), standing slightly higher than the

services' average (55). We can only conjecture about the labour intensity of the various sub sectors, however, it is quite clear that differences should be expected.

The sample: Since, the project is looking at an international movement of production from one country to another. It is useful to focus on companies that are actually involved in this process, because otherwise you can waste resources and of course EU officials would want us to be wasting resources.

A total of 756 extensive interviews were conducted, whose distribution by country and sector can be seen in Table 5. Although our initial intent was to conduct a stratified sampling based jointly on the sector (i.e. each national survey would contain equal numbers of randomly chosen firms by sector) and on whether the firm was in any way involved in delocalisation, it was quickly realised that our aim could not be achieved. The main reason was that in some cases (e.g. footwear in Greece, Estonia and Poland, and clothing in the UK), not only were we unable to randomly select from within our strata, no matter which source of information we used, we realised that these specific strata had been exhausted. As is evident in Table 5, all partners had trouble satisfying the quotas in all sectors. This is particularly evident in clothing and footwear, with the former being over represented and the latter underrepresented. Apart of the general picture, each country faced its own problems (with Bulgaria facing the least).

The instrument used in the survey was an extensive semi-structured questionnaire consisting of eight sections, four of which probed into delocalisation (addressed to TNCs and other firms involved in outsourcing and insourcing, while examining at the same time the implications of delocalisation).

There were also 120 Key informant interviews (Bulgaria 29, Estonia 18, Greece 26 Poland 30 and UK 17) with Business Associations, Experts (academics, researchers in Trade Associations and Trade Unions, consultants etc), Confederation of Employers in all four industries, politicians, Trade Union Leaders in all four industries, etc.

Table 5 Country – sector cross tabulation

			Bulgaria	Estonia	Greece	Poland	UK	Total
Branch (V1b)	Software	Count	52	51	20	50	17	190
		R%	26	25,5	25	24,9	22,7	25,1
		C%	27,4	26,8	10,5	26,3	8,9	100
	Electronics	Count	44	78	21	25	24	192
		R%	22	39	26,3	12,4	32	25,4
		C%	22,9	40,6	10,9	13	12,5	100
	Clothing	Count	60	60	31	92	12	255
		R%	30	30	38,8	45,8	16	33,7
		C%	23,5	23,5	12,2	36,1	4,7	100
	Footware	Count	44	11	8	34	22	119
		R%	22	5,5	10	16,9	29,3	15,7
		C%	37	9,2	6,7	28,6	18,5	100
Total	Count		200	200	80	201	75	756
	R%		100	100	100	100	100	100
	C%		26,5	26,5	10,6	26,6	9,9	100

On an empirical level, even a casual look at the literature reveals a clear preference to analyses which are either based on secondary data (exclusively concerned with the issue of FDI or outsourcing, especially when the latter is identified with flows of intermediate products) or case studies about large firms which are, for example, creating their own GPNs (e.g. see Coe et al., 2004 about BMW's GPN) or organising extensive GCCs (e.g. Gereffi and Mayer's, 2004: 22, work on the Gap). In turn, our empirical analysis will be based on an extensive survey database, which, although not suitable for inferences, may give valuable insights about the usually taken-for-granted 'small' players (i.e. second or third tier subcontractors or small affiliates) who may be less fascinating than the 'big players' such as the central or lead firms, or the large TNCs, but are, however, central to both the creation and capturing of value and therefore to development.

The report is divided into two parts. The first part is concerned with the more theoretical aspects and it consists of four chapters. Chapter 2 on "Geographies of delocalisation in Europe" analyses two questions: why and how do labour intensive firms delocalise. It argues that explanations based on production or consumption only are partial. It is true that a significant part of the explanation concerning the variables affecting the decision to delocalise is inherently microeconomic and, therefore, production based; however, to complete the picture and also analyse the organisation of international production, one must look beyond production. On a conceptual level, there appears to have been surprisingly little cross-fertilisation between the production side theories (mainly the theories of the TNC) and those theories that claim to capture the whole array of

activities, from production to consumption. On the one hand, the former seem to fall surprisingly short of grasping the complex realities of internationalisation caused by the fixation with the hierarchy-market dilemma (therefore failing to deal with the incredible variety of the in-between types of organisation), as well as the minor role accorded to geography. On the other hand, the chain or network approaches – in spite of their stated intentions – largely ignore the firm as perhaps the single most important actor in all variations of modern capitalism (there is a “black-box” attitude towards the firm). The chapter explores some possible linkages between the two schools of thought, whose intellectual foundations may be completely different, however, could both benefit.

The conceptual framework proposed for analysing the delocalisation of labour intensive firms has four main analytical dimensions that are intersected by wider categories i.e. The firm, with its own unique set of resources and competitive advantages; The sector, with its given technologies and markets; The “environment” (local/ regional/national) with its unique institutions, civil society, history and policies; and the global “environment” with its unique institutions, governance and power relations.

Chapter 3 on “*Patterns of enterprise strategies in LII: the case of five EU countries*” enhances our understanding of the enterprise strategies in labour intensive sectors. In the sense that conceptually strategies are viewed as multidimensional, influenced by a number of factors at work while methodologically strategies are viewed through a move beyond the “ideal type” models. The emerging picture is one of considerable diversity in the enterprise strategies. Enterprises may opt for different strategies when not only when they operate in different segment of the market and in different national context; or in

the same segment of the market but in different national context, but even when they operate in the same segment of the market and in the same national context.

Chapter 4 on “*Social consequences of delocalisation in labour-intensive industries: the experience of old and new members of the EU*”. Argues that the social effects of delocalisation are more limited than is often maintained. They are mainly observed on a local scale, to a lesser extent on the regional and are almost negligible on a national scale. There are intermediating factors (e.g. social and economic features of the locality/region/national labour regulations which influence whether the impact is strong or weak). The net employment effects of delocalisation within the EU are rather positive, at least in the mid-term, in the sense that: more jobs remain within Europe rather than moving to other parts of the world and that it lowers unemployment to the new member states far more than it increase unemployment in the DCs. The social characteristics of delocalisation can hardly be interpreted as “a race to the bottom” in terms of wages and employment conditions in the labour-intensive activities in the EU. This may be the effect of the regulated environment of the EU.

The public debate on the social consequences of delocalisation of labour-intensive industries is clouded by common misinterpretations. The analysis conducted in five countries shows that these effects are mainly observed on a local scale and to a lesser extent on the regional level. Widespread emphasis on job losses ignores the fact that this decline usually has no direct impact on unemployment levels. The balance of negative versus positive effects is place-dependent and determined by the role of the sector/employer on the labour market and the overall performance of the regional/local economy. The main problem is not delocalisation itself, but the ‘weaknesses’ of certain

regions and localities. The net employment effects of delocalisation within the European Union (EU) are rather positive. Delocalisation facilitates lower unemployment in the new member states to a greater extent than it contributes to higher joblessness in the developed areas, where more alternative employment opportunities exist. A substantial part of manufacturing jobs and related improvements in skills and capabilities go to peripheral regions of Central and Eastern Europe and to underprivileged social groups. There is also little evidence for the ‘race to the bottom’ in terms of wages and employment conditions. This may primarily be interpreted as an effect of the stable, regulated environment of the EU.

Chapter 5 on “*Governance of delocalisation*” argues that the notion of governance has come into prominence in the context of global economic, social and political restructuring where one of the key changes is that co-ordination is not anymore the exclusive domain of states. Indeed broad social processes are becoming increasingly embedded into much more complex institutional arrangements that are organised around diverse spatial scales (sub-national, national, supra-national) and different networks. These changes raise both substantive and theoretical questions some of which are central to understanding the process of delocalisation of LII. Thus, from the perspective of industrial organisation there are new challenges of co-ordination of production across spatially and institutionally distant sites; from the perspective of the state the challenge is to establish, within its territory, relatively stable couplings of the increasingly globally mobile capital flows and the largely immobile labour; these changes also raise conceptual, analytical and methodological questions about the appropriate units of analysis, levels of abstraction, and their relevance to policy.

Rather than juxtaposing different perspectives and trying to establish, as if it were, the 'best scale' the aim in this chapter is to discuss governance as a dynamic and multi-level process, where actors, with their motivations and time horizons, as well as objects of governance are constantly being created and re-shaped. Thus it argues that while de-localisation constitutes a key economic conundrum as well as a political and social concern, de-localisation as such is not an appropriate object of governance given the reduced powers of the state to influence processes within their own territories. Importantly however states are also acquiring new powers of coordinating, or steering, and thus have the ability to influence other levels of governance. In this sense, issues related to delocalisation and its consequences need to be addressed within a broader social and economic agenda where the role of an active, though not necessarily only and always directly intervening, state is crucial.

Drawing on a broad set of literatures that study the interrelationships of a state-centred (territorialised) and industry-centred (networked/de-territorialised) perspectives on governance, and focusing on the same set of key players (states, global and local governing bodies, TNCs, NGOs, business associations, trade unions) it argues that the two perspectives offer different insights into the significance of these players for the coordination of the relations in the four industries under study. More specifically some of the key questions that this chapter addresses are related to the ways in which different players respond to existing governance structures, who is responsible for setting, monitoring and enforcement of rules, how are they related to trade, production, consumption, the environment and labour relations, on what levels do they operate.

The second part of the report is concerned with the analysis of the delocalisation phenomenon in the four industries and, thus it is consisted of four theoretically informed empirical chapters. In fact, Chapter 7 is on “*The impact of internationalization on the clothing industry*”, and examines the impact of processes of global integration upon inter-organisational relationships and enterprise strategy in the clothing industry, drawing on the results of extensive fieldwork in the five European countries. The findings reported in the chapter suggest that international opportunities can be best exploited initially by early engagement, with low commitment strategies, followed later by significant foreign investment and joint venture creation, and finally by an emphasis on buyer/supplier relationships. A gradual shift appears to be occurring from public- to privately-driven forms of governance, reinforcing the importance of such relationships. Chapter 8 on the “*Impact of delocalisation on the European Electronics Industry*”, describes major patterns of delocalisation of European and world electronics industries. This is a hot topic since every week in Central and Eastern Europe two new factories are established and 500 new jobs are created while at the same time 1-2 factories in Western Europe are closed. The chapter investigates supply chains of electronics industry and geographical patterns of electronics industry in Europe. Major forms of delocalisation in electronics industry are foreign trade, subcontracting and acquisition/ mergers of firms. Electronics industry location and establishment of new factories is influenced both by public sector policies and private sector demand. Public sector policies influencing electronics industry are tariff rules, direct support of governments, intellectual property protection rules, environmental legislation, national education and science policy and general economic policy. Private sector influences electronics sector via growing

purchasing power in Eastern Europe and search of new clients in Eastern Europe by multi-national companies. Investments of TNCs acts also like initiators for the creation of local supply networks. Biggest influences of electronics production are cost of input factors and ability to create new products. Ability to create new product is determined by education level and entrepreneurship of engineers and managers. The chapter also investigates social consequences of delocalisation and possible public policies.

Chapter 9 (part A) on the “*Impact of delocalisation on the European software industry*” analyses the internationalisation of the European software industry in the context of subcontracting and FDI. Forms of delocalisation and their extent in the European software industry, the reasons behind delocalisation from both perspectives of host and home countries are examined. Prospects of further delocalisation to locations outside Europe are investigated. Software sector is among the most rapidly growing in OECD countries, with strong increases in value added, employment and R&D investment. Rapid growth, especially in CE Europe and some non-OECD countries like India, deserves announcement as a new wave of globalisation in global ICT. Despite of dynamic development of offshoring activities there is no job loss in developed countries. Global expansion of IT firms is driven by the need for market access and growth at first place, economies of scale and costs savings at the second and finally by access to skills and technology. Success of many Central and Eastern Europe IT companies is accounted for by quality of human capital, flexibility, level of expertise rather than to its low cost. Further delocalisation of IT sector activities to India or to other low cost country is not perceived as a danger to European software industry.

Chapter 9 (part B) on the “*Impact of delocalisation on the European Footwear Industry*”, argues that the recent decade was marked by enlargement of EU and further international trade liberalization. The dynamic process of relocation of the European footwear industry creates significant diversification of delocalisation forms and networks connecting firms and regions, and being embedded in different local historical, political, economic and social environment. This chapter aims at contributing to a better understanding of the recent delocalisation trends in the European footwear industry. The main research objectives are the identification of industry-specific and country-specific factors and effects of delocalisation. The focus is placed on the question of how the national production networks are integrated in the European ones, on outlining the causes and the effects of this process, and what opportunities and constraints does the existing relationships create in terms of international competitiveness of footwear firms. It ends up with a concluding chapter (Chapter 11).

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**2 GEOGRAPHIES OF DELOCALISATION AND
DEVELOPMENT IN EUROPE: CONCEPTUAL ISSUES AND
EMPIRICAL FINDINGS**

Thanasis Kalogeresis, Lois Labrianidis

2.1 Introduction

The beginning of the 21st century could easily be considered as one of the most exciting times for the social scientist. Consumers, firms – ranging from micro enterprises to transnational behemoths – localities, regions and countries, to mention only a few of the actors involved, are increasingly being affected by forces that are inherently global in nature, while, on the other hand, the role of geography is increasingly becoming more pronounced.

At the same time, the global map of production of goods and services has been changing, with LDCs currently producing almost a quarter of the global value added, compared to only 5 per cent in 1953. This change is mostly due to a small minority of LDCs, which are joining the ranks of the world's significant producers.

The main aim of this chapter is to look into the inner working of the organization of production and its implications on development. On a conceptual level, there appears to have been surprisingly little cross-fertilisation between the production side theories (mainly the theories of the Transnational Corporation – TNC) and those theories that claim to capture the whole array of activities, from production to consumption. On the one hand, the former seem to fall surprisingly short of grasping the complex realities of internationalisation caused by the fixation with the hierarchy-market dilemma (therefore failing to deal with the incredible variety of the in-between types of organisation), as well as the minor role accorded to geography. On the other hand, the chain or network approaches – in spite of their stated intentions – largely ignore the firm as perhaps the

single most important actor in all variations of modern capitalism. It is our intention, therefore, to explore some possible linkages between the two schools of thought.

On an empirical level, even a casual look at the literature reveals a clear preference to analyses which are either based on secondary data (exclusively concerned with the issue of FDI or outsourcing, especially when the latter is identified with flows of intermediate products) or case studies about large firms which are, for example, creating their own Global Production Networks (GPNs – e.g. see Coe et al., 2004 about BMW's GPN) or organising extensive Global Commodity Chains (GCCs – as in Gereffi and Mayer's, 2004: 22, work on the Gap). In turn, our empirical analysis will be based on an extensive survey database, which, although not really suitable for inferences, may give valuable insights about the usually taken-for-granted 'small' players (i.e. second or third tier subcontractors or small affiliates) who may be less fascinating than the 'big players' such as the central or lead firms, or the large TNCs, but are, however, central to both the creation and capturing of value and therefore to development.

In fact, our analysis is based on the otherwise 'black box' of the firm, since we are interested on the impacts of its ownership and therefore decision making structure (including how the firm interacts with other agents, i.e. market, hierarchy or network⁵ and why it decides to become involved in international production); its strategic orientation and embeddedness on how it creates, enhances and captures value; lastly, its power within the chain or network (seen not only as the control exerted on others, but

⁵ Even if we assumed that the market was of minor importance (which by the way, we do not), still it is a mode of managing transactions that cannot be ignored, as has been the case in the majority of the relevant literature. In a sense, GCC and GPN theorists have gone to the extreme of providing oversocialised accounts of the organisation of economic life.

also the freedom to operate independently, which is usually essential in functional upgrading).

The structure of this Chapter is the following: the first section contains an exposition of our understanding of how firm delocalise, a framework which is taken forward in the second section, where our conceptual framework of the impacts of delocalisation on development is discussed. The third section is an empirical assessment. Lastly, in the fourth section, the concluding points of the Chapter are drawn.

2.2 Conceptual issues

The organisation of international business

The constantly changing new geography of production, particularly (although by no means exclusively) in LII is characterised by a multiplicity of ways of integrating firms and regions into global networks of production and distribution.

What emerges as a key question in this context is how formerly localised enterprises globalise. This first key question (the second will be discussed further down) has two distinct, although closely inter-related dimensions, which have to be addressed in conjunction in order to get a clear picture. The first dimension is that of the individual firm, which we consider the basic building block of the economy (the ‘why’ of the main object). It is interesting to note that, although both the GCC and the GPN approaches for explaining international production (on which our analysis will also be based) claim to consider the firm very important (according to Henderson et al., 2002, firms constitute one of the conceptual dimensions of the GPN), not only has this variability been consistently treated as exogenous, the empirical evidence appears to be surprisingly

scant⁶. This may be due to the fact that, as Hess and Yeung (2006) argue, most of the empirical studies are interview-based qualitative ones, trying to follow mechanisms and processes. In fact, in the majority of network or chain approaches, there seems to be a ‘black-box’ attitude towards the firm that is enhanced by the reluctance to pose the most basic questions (which have been the central question of the International Business literature) revolving around the decision to delocalise. Specifically, questions such as ‘why do some firms decide to invest abroad while others prefer not to’, or ‘why is FDI more preferable to subcontracting’ necessitate the use of tools or theories that are usually considered alien – at best – to the network or chain approaches (the theory of the firm, internalisation, Dunning’s (1993) eclectic approach, etc.).

The second dimension concerns the wider picture of how the economy is organised from production to consumption. Before going on into any assumptions or theorisations, we should note that our main analytical instruments will be theories falling into the wider group of chain or network theories, mainly the GCC and the GPN. The former has been the most successful paradigm in a number of –perhaps contradictory- ways: firstly, it was the culmination and therefore the most elaborate of a number of chain conceptualisations of the economy; secondly, it was the most successful effort to link production and consumption in a coherent framework; thirdly, in an era of globalisation, or at least excitement about it, the approach provided an insight into truly global phenomena (such as the GCCs). The final proof of the theory’s success is that it has

⁶ The absence of the firm in the wider economic geography literature was the object of two articles by Maskell (2001) and Taylor and Asheim (2001).

received significant criticism, mainly from the GPN proponents, who surprisingly acknowledge GCC as perhaps the most significant precursor.

GCCs, according to Gereffi and Korzeniewicz (1994: 2), are sets of inter-organisational networks, clustered around one commodity or product, linking households, enterprises, and states to one another within the world economy. A 'commodity chain' traces the entire trajectory of a product from its conception and design, through production, retailing and final consumption. GCCs are the network of labour and production processes whose end result is a finished commodity. These networks are situationally specific, socially constructed and locally integrated, underscoring the social embeddedness of economic organisation. Initially, Gereffi (1994: 45) distinguished two types of GCCs governance: a) *Producer-driven commodity chains*, where TNCs or other large industrial enterprises play the central role in controlling the production system, mainly in capital and technology intensive industries (e.g. automobiles, computers, aircraft and electrical machinery); b) *Buyer-driven commodity chains*, where large retailers, brand-name merchandisers and trading companies play a central role, predominantly in labour intensive and consumer-good orientated industries (e.g. clothing, footwear, toys, consumer electronics, house-wares and hand-crafted items). Recently (Gereffi et al., 2005), it was acknowledged that the governance of value chains depends on three factors (the complexity of transactions, the degree to which knowledge can be codified and the capabilities of suppliers vis-à-vis the requirements of the transaction), giving rise to five different governance structures. Not unexpectedly, the two extreme positions are occupied by market and hierarchy, while between these (moving from market towards hierarchy) we find the modular, the relational and the

captive types of governance, each one characterised by different combinations of the three factors and an increasing degree of explicit coordination and power asymmetry going from market to hierarchy.

Among the various criticisms the GCC theory has received (e.g. Leslie and Reimer, 1999; Henderson et al., 2002 Smith et al., 2002), the most relevant appears to be that the theory is overly preoccupied with flows and ‘systems’, while individual nodes more than often remain at the periphery of the analysis. In this context, the focus on specific sectors implies a neglect of the history and social context of the various nodes of the chain. The point here is that history and social relations impose a path dependency on the chains (e.g. the impact of the former state-communist regimes on the incorporation of CEE firms, regions and countries in chains – Henderson et al., 2002) . Therefore, it would appear that firms within the GCC framework appear as largely disembedded from their local or national social and institutional context. Hence, firms appear to have little or no autonomy to develop independent strategies (Henderson et al., 2002)⁷. In a similar context, Smith et al. (2002) argue that the region is remarkably underplayed, while, in contrast, the nation is the crucial barrier and divide.

GPN proponents argue that their approach deals successfully with the majority of criticisms. According to Henderson et al. (2002:445), a Production Network is a ‘nexus of interconnected functions and operations through which goods and services are produced, distributed and consumed’. These networks integrate firms and national or

⁷ Although Gereffi (1994) claims that GCCs have a territoriality in the sense that the various activities, nodes and flows are geographically situated

regional economies in ways that have enormous implications for their well being. The interaction of firm-centred networks with the socio-political contexts in which they are embedded is a very complex, often bi-directional process, also because the former can potentially be very mobile, while the latter are territorially-specific.

It would appear that our approach shares more features with the GPN rather than the GCC theory. Assuming that this is the case, and we will not argue for the opposite, this is to a great extent symptomatic of our data, which by being very diverse allows for the inclusion of more external factors, more akin to the GPN approach.

Our conceptual framework for analysing the delocalisation of labour intensive firms has four main analytical dimensions that are intersected by wider categories.

Analytical dimensions

Dimension 1: The firm with its own unique set of resources and competitive advantages

The main approaches in explaining why firms internationalise revolve around three main themes. The firm's ownership advantages, the internalisation decision and the role of resources (internal or external to the firm). The two first dimensions, along with location, are the three elements of Dunning's (1993) extremely influential Ownership-Location-Internalisation (OLI) or eclectic paradigm of the TNC. The third (i.e. the resource-based approach) is, in fact, not widely considered a mainstream explanation of why firms expand abroad. However, following Kay (2000) and Pitelis (2000), we believe that a treatment of resources as a separate factor is essential in understanding the growth of firms. On the other hand, the treatment of location as an analytical category

can be better implemented⁸. In turn, the framework presented here has the potential to bring into the analysis a much wider array of exogenous factors, central to the analysis of internationalisation.

Firms trying to operate in a foreign market are faced with a number of barriers (Hymer, 1974). Those firms that manage to compensate for these disadvantages of ‘foreignness’ need to possess certain competitive advantages, such as (Graham, 2002: 37): a) ‘preferential’ access to cheaper factors of production compared to competition, b) a production function of lower cost, c) access to better (cheaper or more extensive) networks of distribution and d) product differentiation.

However, the possession of such advantages can only interpret a firm’s competitive advantage vis-à-vis its competitors at home or abroad. Whether these will be exploited by the firm itself or leased to some foreign firm is an issue discussed by the internalisation theory. Hence, ownership advantages are a necessary, however, by no means sufficient condition.

The same is true for the firm’s resources. According to Penrose (1959), productive resources are not general and unspecified categories to which all firms have access. Therefore, certain resources, and especially the services that they can offer, are particularly important to each firm, since they constitute the base of firm differentiation. In fact, even if two firms have exactly the same resources, the way they combine their

⁸ This is not to say that Dunning missed something. Location advantages include a great variety of factors such as (Dunning, 1993 p. 81): the spatial distribution of natural resources and markets, the prices and the quality of inflows and the productivity, the investment incentives, or disincentives, the particular social characteristics of the receiving region, the economies of concentration of R&D etc.

services is almost impossible to be identical, so inevitably they will be led to producing different products. Therefore, the growth of firms depends on factors that are slightly or not at all predictable. On one hand, we have the resources of the firm that change constantly, while the accumulated experience determines novel ways of combining them, in a usually turbulent external environment. On the other hand, we have the very important role of entrepreneurship. Without the 'psychological predisposition' for discovering opportunities, which requires considerable effort, along with the engagement of certain resources of the firm, it is rather impossible to achieve change (with the characteristics of innovation).

We should note that the resource-based theory cannot constitute a complete theory of the TNC. According to Kay (2000), the resource-based theory is useful for the analysis of the direction of expansion (i.e. expansion at home or abroad). For the analysis of the mode (i.e. whether the firm will advance in the direction it has selected alone or with collaborators), the use of the internalisation theory is required.

In fact, what we are looking for here is an explanation about the decision to make or buy. Almost all answers to that question can be traced to Coase's seminal 1937 article on the boundaries of the firm. According to Coase, outside the firm, it is price movements that direct production, which is coordinated through a series of exchange transactions in the market. Within a firm, these market transactions are eliminated and the entrepreneur-coordinator who directs production substitutes the complicated market structure with exchange transactions. It is clear that these are alternative methods for coordinating production

In other words, the firm internalises the operations of the market to the extent that the cost of this internalisation is lower than the cost of using the market mechanisms. Therefore, the decision about whether to make or buy is a trade-off between the cost of running a large and less specialised organisation (similar to those described above) and the costs involved in finding partners and incomplete contracting (Grossman and Helpman, 2002).

There have been a few other efforts to explain how firms grow and how they internationalise, but none has been more influential than Dunning's (1993 – particularly regarding the internationalisation issue) eclectic approach. This was also the theory that paid more attention to the exogenous factors affecting (mainly) FDI.

Dimension 2: The sector with its given technologies and markets

Sectors are central in the determination of the possibilities to upgrade, because firms from the same sector will tend to share two characteristics that we consider central in the decision to delocalise, i.e. technology and market orientation. As Henderson et al (2002) further argue, firms in the same sectors will tend to create similar (in terms of organisation and governance and institutional framework) networks, and share common 'languages' and communication structures.

Dimension 3: The environment with its unique institutions, civil society, history and policies.

The environment (local, regional, national or beyond) has its own unique historically shaped institutions - including among others the local or national governments, labour unions and business associations - that constantly affect and are affected by the civil

society and the prevailing norms and attitudes. How do the characteristics of the environment influence the decisions to delocalise?

Somewhat paradoxically, in a period of increased globalisation there has been a strong revival of academic (and policy makers') interest on the role of regions as loci of innovation and economic activities. Undoubtedly, success stories of industrial districts and regions across the globe (e.g 'Third Italy' in Europe, Silicon Valley in the USA) in the late '80s-early '90s have contributed significantly in this direction. As Coenen et al (2004) mention, researchers in economic geography and innovation (Porter, 1990, Saxenian, 1994, Asheim, 1996) argued that processes of localised learning played a crucial role in fostering innovation within territorial agglomerations.

At about the same time, Soete and Freeman (1987) and Lundvall (1988, 1992) used the term "innovation system" in order to describe the complex nature of innovation process involving intense and multiple interactions between various actors (firms, employees, research organisations, universities) within a –usually nationally defined- institutional framework. The National Innovation Systems (NIS) approach emphasised the importance of interactive learning and the role of nation-based institutions in explaining the difference in innovation performance and economic growth across various countries (Coenen et al, 2004). Building on both these approaches, Cooke (1992) developed the concept of Regional Innovation Systems (RIS), stressing the fact that regions are in several cases geographical (and administrative) units that play an important coordinating, economic and institutional role. The same author later (1998) provides us with a more detailed definition of a RIS. As cited in Coenen et al (2004: 2), in order to have in place a regional innovation system, two subsystems must be systematically

engaged in interactive learning: **a)** the regional production structure (or knowledge exploitation subsystem) consisting primarily of firms, especially when there are cluster tendencies, and **b)** the regional supportive infrastructure (or knowledge generation subsystem), consisting of private and public research labs, universities, technology transfer agencies, etc. In addition, the role of informal institutions (trust, norms, routines) is emphasised as the main factor facilitating communication and interactive learning within a region. Much along the same lines, Lundvall et al (1997) also mention: ‘the region is increasingly the level at which innovation is produced through regional networks of innovators, local clusters and the cross-fertilising effects of research institutions’ (Lundvall et al, 1997: 39).

In an opposite direction (away from the regional and even national scale), one has to take into consideration the changing environments running parallel to the trend towards globalisation and trade liberalisation, in the formation of trading blocks and regional agreements, among which, *EU further integration and recent enlargement* holds a prominent position. During the 1980s and 1990s, the EU made unprecedented progress towards greater integration, making economies of scale and agglomeration more relevant, thus altering the geography of production. Moreover, the larger size of the market and the dynamic effects this may create (in terms of productivity growth) could strengthen the degree of integration of the EU – or parts of it – into the global economy (Baldwin, 1992). Indeed, there is empirical evidence suggesting that changes in governance structures have spurred the re-organisation of operations of TNCs located in the EU to a much greater extent than in the case of affiliates based outside the area (Dunning, 1996). The recent enlargement (completed in 2007 with Bulgaria and

Romania) introduced significant quantitative and qualitative changes, as well as new challenges and opportunities, both for the new members and for the EU as a whole. These two processes have already put in motion a potentially much more drastic series of changes in the structure and hierarchy of European economies. Based on rather different theoretical backgrounds and policy assumptions, two diverging scenarios seem to emerge, i.e. convergence of European countries and regions versus divergence. Nevertheless, the historical evolution of the EU has shown that both scenarios are possible and have in fact taken place (Fagerberg et al., 1997).

Dimension 4: The global environment with its unique institutions, governance and power relations.

Globalisation came to prominence over the past two decades, following changes in the ‘real world’, namely improvements in information and communication technologies (ICT) that facilitated global exchange, changes in the institutional framework governing world trade and production, as well as the pursuit of a liberal economic policy agenda fostering integration of product and capital markets. The opening-up of international markets resulted in intensified (and growing) international competition and forced enterprises to adopt an international perspective. Even businesses focusing primarily, or even exclusively, on their domestic markets must become internationally competitive to ensure long-term survival and growth (Karagozoglu and Lindell, 1996).

This need is not limited to individual firms, but encompasses also sectors, regions and countries. According to Dicken (2000: 287) like firms, states also engage in: *price competition* in their attempts to capture a share of the market for mobile investment; in *product differentiation* by creating particular images of themselves (i.e. the strategic

nature of their location, the attractiveness of the business environment, the quality of the labour force etc). Nevertheless, it must be pointed out that globalisation has so far been an uneven and asymmetric process with differentiated results, both across sectors of the economy as well as across regions (Soete, 1999; Lundvall et al., 1997).

On the other hand, individual strategies, which shape and are shaped by the decision to delocalise, the role and position of the firms within their networks, all greatly affect how much and in what ways value is created, enhanced and captured by the firm, its labour force, the region and the country it is located in.

Delocalisation and growth

The creation, enhancement and appropriation of value brings us to the second key question which is how delocalisation affects growth. In analysing how our framework may help us better understand the impacts of delocalisation on development we follow Coe et al. (2004), who claim that endogenous factors are inadequate to generate growth in an era when competition is increasingly global. According to them, development (which is identified with value creation, enhancement and capture) is a product of the interplay between three large groups of variables.

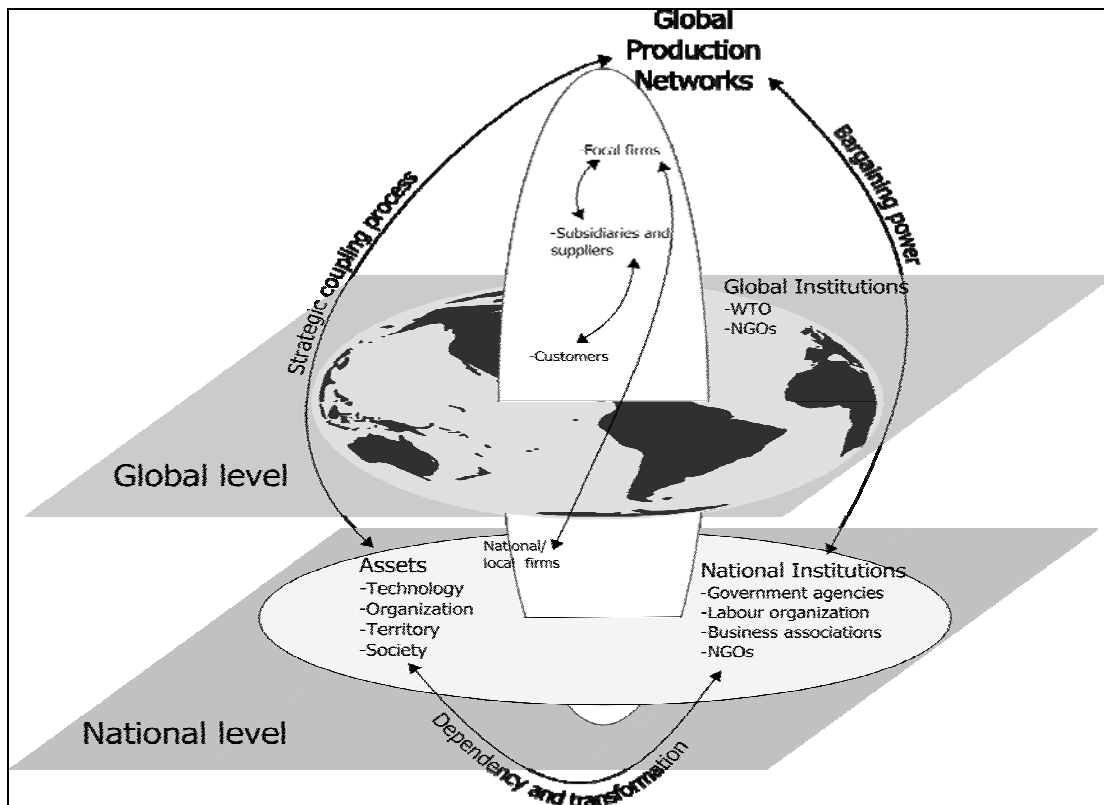


Figure 6 A conceptual framework for analysing the impacts of delocalisation

Source: Based on Coe et al. 2004

Each country or region is endowed with (or has created) a set of assets, some of which are ubiquitous, while others are more or less exclusive to the country. Although technology, organisation and territory appear in the framework since they are considered the ‘holy trinity’ of (regional) development (Storper, 1997:26), these three elements seem to imply the conditions of a whole range of resources including labour, capital, infrastructure etc.

Firms lie at the other apex of the triangle. These may be the focal firms, their subsidiaries or suppliers or their customers. For the needs of our analysis, this has to be expanded to firms that are not part of GPNs or GCCs. Firms operating within bi-national

or regional networks, which are most usually considered as quite irrelevant to not only the more mainstream IB or neoclassical approaches, but also to the more 'socialised' network approaches, need to be seriously considered, as they often support or outright substitute GPNs in their role of growth enhancement accorded to them by Coe et al. Specifically, they argue that a region's (and therefore a nation's) assets (in fact the economies of scale and/or scope implied by the specific assets) can bring growth inasmuch as they 'complement the strategic needs of trans-local actors situated within GPNs' (p.471). This strategic coupling (of the firms' of GPNs' strategic goals and the regions' economies) is therefore of primary importance to development.

Nevertheless, we should try not to ignore the possibilities of a de-coupling process that can be equivalently detrimental to development. This possibility points to the importance of embeddedness to the sustainability of development. Here we view embeddedness as defined and understood by Liu and Dicken (2006:1232) who 'use the term "embed" in a very precise way, in order to capture the extent to which an activity becomes fixed in a particular place and, as such, contributes to local/national economic development through both direct and indirect spinoffs (including backward linkages with local suppliers)'. It is clear then that even local firms can become disembedded.

Finally, we have the institutions at all levels of governance (national, regional or local). During the last decades, there has been a growing devolution of political and economic power from the central state to local and regional institutions. This has resulted to a multitude of configurations of institutions, affecting both the regional or national sets of assets and the bargaining power vis-à-vis the TNCs. In this context, the case of China is rather unique. Describing the Chinese automobile industry, Liu and Dicken (2006) show

the enormous bargaining power of a large and centralised country like China that is able to play off TNCs against each other. At the same time, automobile TNCs improvised quite a few ways to avoid bargaining with the central government and instead try to play off Chinese provinces (eager to attract FDI) against each other.

The result of this interplay between countries or regions with their assets and institutions and firms trying to take advantage of the assets is development, which is conceptualised as value that is created, enhanced and captured. Assuming that value is created in the country, the big question then is how to enhance this value and, more importantly, how to capture it.

What Coe et al. (2004) did not explicitly consider is the role of the global environment, with its ever more pervasive institutions, which are increasingly capable of influencing greatly national policies and, therefore, the immediate environment of firms and networks, at all territorial levels. However, the global environment is not only about the infamous Washington Consensus. Along with the institutionally induced collapse of trade barriers, the world is also getting smaller in more tangible ways, mainly through the increasing efficiency of transport and more importantly ICTs.

Finally, transcending the two levels of analysis (the global and the national/local), as well as the three tangible dimensions parallel to the two levels, i.e. the firms, the assets and the institutions, flows what is the central object of this Chapter, which is no other than the value created in the production and consumption of goods. The territorial embeddedness of the firms, as well as the power they possess within their respective networks, more or less defines how much of this value will be captured by the regions.

It is clear that these factors combine in a rather individualistic way, consequently rendering prescriptions extremely difficult. This, nevertheless, does not render the approach completely chaotic. In fact, there are very clear directions towards development in the intangible categories, which are always mediated by the pursuit of the firms' goals and the balance of bargaining power.

What are then, the possibilities for upgrading created by delocalisation? We will follow Kaplinsky (1998) in both the definition of upgrade (although in the following sections we will make use of the more systematic and widely used definition of Humphrey and Schmitz (2002), which is no other than the ability 'to appropriate a greater share of the returns accruing from the whole production cycle', as well as the types of economic rent, which in the Schumpeterian tradition stem mainly from innovation and to a significantly lesser extent from scarcity. In this context, apart of resource rents, i.e. those that are based on the availability of otherwise scarce resources (the only such resources found within European territories that spring to mind are the North Sea oil reserves), a country (or a sector or a firm) may benefit by the existence of policy rents that may be local, national, regional or global. An example of the last type was the Multi Fibre Agreement (MFA) that, as it will be displayed later, was central in the development of the Greek clothing sector. Closely related to the resource and policy rents are infrastructure, human resources and finance rents, since all of these are, to varying extents, exogenous to the firm. Of course, this does not mean that these resources are freely available to all firms. Each firm is constantly forced to operate within given production frontiers, with scarce resources. In this context, not all firms in a country that has heavily invested in education can employ post-docs for all the available positions.

Instead, in our times of trade liberalisation and integration, it would appear that the rents that are internal to the firm - such as technological, organisational, relational and product and marketing rents - are far more significant. Regarding technology, it appears that with the shortening of the life cycles of most current technologies, what is more important is the creation and appropriation of new technology and its rents. However, what is paramount in any analysis of economic rents is the realisation of the transient nature of economic rents, making the ability to constantly identify and pursue new sources of rents perhaps the most significant of economic rents.

Having more or less established value, what are the roles of power and embeddedness? In the context of our analysis, they both have considerable implications on whether value created in a country or region is actually captured locally (development **in** a region vs development **of** a region). The role of embeddedness is rather straightforward. In a sense, territorial embeddedness refers to implanting a firm into deeply rooted social and economic relations with which it becomes interwoven. In practical terms, a firm is territorially embedded if it draws resources (e.g. labour or intermediate products) from local sources, which possess qualities that are hard to replicate. The more embedded a firm is, the more value it creates will be captured by the region it operates in. In a similar manner, value creation and capture of a firm is also conditioned by the power it possesses within a network. An interesting, although not necessarily typical, and quite extreme representation of the role of power is provided by Sacchetti and Sugden (2003: 674). They define a network as a number of nodes and links amongst actors, where each one dynamically aims at improving its position within the network; as relating the distribution of resources amongst actors to the structure of actors' interdependencies.

Therefore, according to Sacchetti and Sugden (2003: 675), we can understand networks either as reciprocal dependence based on complementarity of resources, shared objectives and on the agreement not to act against the interests of others in the network, or **not** as a reciprocal, preferential and mutually supportive locus of production (e.g. relation of prime contractor to subcontractors).

Therefore, networks entail an idea of governance in production, where power becomes a crucial determinant of the nature of relationships between actors, with or without the presence of market relations. According to Sacchetti and Sugden (2003: 670), this is different from the “market model” (where all actors have equal power), as it does not confine the presence of power asymmetries to exceptional circumstances –i.e. a market failure – but embodies power as a constituent element of network relationships.

In this context, as Sacchetti and Sugden (2003: 671) argue, networks may be viewed as having a centre, the big firm (the star) managing the actors of its “constellation” (the planets), which are partially controlled and partially autonomous; without a centre, where – in order to obtain reciprocal advantages – relationships among participants are mutual. Hence, one of the most central characteristics of networks is the distribution of power, which may give rise to two quite distinct governance structures, i.e. networks of direction and networks of mutual dependence⁹, with very different implications on the roles of the various members of the network. In the TNC literature, the issue of the

⁹ Tracing the actual source of dependence is a very interesting and relevant issue. In this context, considering the embeddedness of the firms to be the source of dependence, instead of purely economic (i.e. transaction) reasons will have different implications for the network, as well as for the firms comprising it (Uzzi, 1997).

relationships between parents and affiliates has attracted considerable attention (e.g. Bartlett and Goshal, 1989 and 1990; Birkinshaw, 1998). Expanding this logic to encompass all other relations (contractual or not) could be particularly interesting in our context.

2.3 Empirical findings

The first aim of this section is to analyse how the basic dimensions of our analytical framework affect the decision to delocalise (specifically, ‘why’ and ‘how’ firms delocalise). The second is to examine the impacts of delocalisation on development, through the use of some stylised examples.

Explanatory power of the analytical dimensions

The sector

Not unexpectedly, the specificities of the sectors appear to influence significantly not only the reasons of delocalisation, but also the form it takes. In fact, it would appear that the different competences (or put in a different way, the technology) characterising each sector will lead to different types of delocalisation. In this context, the software and electronics sectors place considerably more value in knowledge than the clothing and footwear sectors, where the generic category of skills is more significant. This was evident in the huge differences of the mean share of workforce with tertiary education: 83.6 per cent of the personnel of the software sector had tertiary education, while the shares of the other sectors were considerably smaller (electronics: 34.2per cent, clothing: 11.5 per cent and footwear: 8.7 per cent).

Apart from the level of education, firms in the clothing and footwear (and some segments of the electronics) sectors express their concern about the fact that they actually face an ageing problem, since their employees keep getting older, while at the same time young people do not seem to be willing to work in these sectors.

‘People working in the shoe trade are getting older and older’, (British shoe firm).

‘Younger people don’t want to work in the shoe industry now’, (British shoe firm).

‘What is missing are young people willing to do this work. They rather seek employment in other spheres and not in the footwear industry’, (Bulgarian shoe firm).

‘There is scarcity of young qualified personnel willing to get employment in the footwear industry’, (Bulgarian shoe firm).

On the other hand, the software sector does not appear to be experiencing the same problem; on the contrary, there are many young people who wish to be employed in the sector after finishing their studies (sometimes there is some kind of cooperation between firms and local universities). To some extent, this is also the case for some firms in the electronics sector¹⁰.

‘We cooperate with universities such as The Silesian University of Technology, Warsaw University of Technology, Warsaw University. Thanks to that the company recruits workers from these universities’, (Polish software firm).

¹⁰ This is due to the great diversity of the electronics sector comprised by an extremely wide array of firms with different technology and knowledge intensities, from simple assembly to product development and R&D.

'We have young people with technological experience', (Polish software firm.).

'I am really happy to be looking for young graduates and PHDs. We have employed two new graduates and two new post-docs and two people from industry, so there is a balance', (British software firm).

This was further mirrored in the differences in the perceived sources of competitive advantage of the sectors. Hence, although R&D was important to both the software and electronics sectors, design & marketing was much more important to the former, as was inputs supply to the latter. Similarly, the ability to produce cheaply (labour intensive products) was most important to both the clothing and the footwear sectors. Nevertheless, the latter appear to place more emphasis on skills (one of the most illusive characteristics of our survey).

The reasons for delocalising reflect the different competences of the sectors. Hence, knowledge being the most significant strength of the software sectors, the lack of specific skilled labour becomes the most important reason to outsource. In a similar manner, the higher capital and R&D intensity of the electronics sector makes the lack of the appropriate technology or equipment the most significant reason to outsource. High labour costs in the home country was of paramount importance to the clothing sector and rather important to the footwear sector, where access to natural resources was the primary motive.

Regarding the motives of FDI, low cost unskilled labour was of primary importance only for the clothing sector, while market related factors (market size, growth and per capita income) dominated the other three sectors. Given the predominantly vertical

structure of FDI in clothing, the importance of low cost unskilled labour is not surprising. However, footwear in particular and to a lesser extent electronics seems to behave rather unexpectedly; we will try to understand why in the next section.

The country

Not unlike the sectors, the countries of our sample share some features while are completely different in others. Hence, although Greece¹¹ is (in terms of GDP per capita) conventionally considered a DC -as is the UK¹²- one could argue that this is the only similarity between the two countries. Their economic and socio-political history, their geography, and industry structure (to mention just a few parameters) clearly differentiate the two countries. The importance of national idiosyncrasies could, nevertheless, hardly be more pronounced than in the case of the former state-socialist countries. Despite a period of 45 years of more or less similar historical consequences, the three former socialist countries in our sample have followed very different pathways since the

¹¹ Greece is a Mediterranean country with a strong Eastern European orientation. Although its relative position within the EU was improved by the recent enlargement, it is still characterised by average levels of economic prosperity, reliance on agriculture, considerable degree of concentration of economic activity in Greater Athens and Thessaloniki, and the presence of some of the most peripheral locations - both at the national and European level. The degree of integration of the Greek economy to the European and global networks of production and distribution increased considerably during the post-1974 period. It became a member of the EC during the second wave of enlargement in the 1980s. Labour intensive industries account for a very large part of the total economic activity and display varying degrees of dynamism.

¹² UK is the first industrial nation and probably an early exemplifier of a global economy. It is also an advanced industrialised economy that maintained a global orientation for the past two hundred years or so. However, during the post-war era, it had to change the earlier patterns of international trade and production factor flows and acquire a stronger European orientation. It became a member of the EU during the first wave of expansion in 1977. Labour-intensive industries in the UK have been undergoing profound restructuring accompanied by significant employment decline for the best part of the twentieth century.

beginning of the transition process¹³. Features such as the size of the country, its progress in the transition process (despite the fact that all three countries are currently EU members), its geography, as well as its pre- WW II sociopolitical situation and therefore position in the international status quo all combine to create some very unique trajectories. Therefore, Poland, being the largest CEE country (save Ukraine), has been defined by rapid advances in the process of post-socialist transformation and below average levels of economic prosperity. Increasing integration had diverse effects on LII, offering a multitude of opportunities for clothing, textiles and electronics, but posing considerable threats on agriculture. Bulgaria, on the other hand, advanced more hesitantly towards reform and has only recently managed to join the EU. Bulgaria is characterised by very distinct historical trajectories defined by its position in the faultline between orthodox Russia and the Muslim Ottoman Empire. The prevalence of an idiosyncratic form of Socialism perpetuated the specific characteristics of the Bulgarian socio-economic structure and its marginal integration in the global economy. However, during the last decade, the country has gone a long way in reforming its socioeconomic structures and becoming an EU member. Finally, Estonia is a country with strong Nordic ties, which went through a rapid transition process in the 1990-s, accompanied by the restructuring of the economy and rapid growth of the service sector. Not unexpectedly, the three countries have developed quite distinct economic relations orientations, with the role of geography being very pronounced. Germany in the case of

¹³ This does not imply that the recent history is unimportant. In fact, of the five countries in our sample the ones which at some time in their recent history shared most characteristics would be Greece and Bulgaria before WWII. The 45 years that followed led the two countries to completely diverging pathways.

Poland, Finland and Sweden in the case of Estonia and Greece and Italy in the Bulgarian case have been the main trade and FDI partners.

Apparently, the common socialist history of the three CEE countries is evident in the similar competences of their firms. Specifically, skills are considered a very important aspect of human capital in all three countries, while experience and knowledge are important in Greece and the UK. The three CEE countries also seem to affect the competitive advantages of their firms in broadly similar ways, since the majority claimed that, prior to delocalisation, they were competitive in skill and labour intensive products. The backwardness of the Greek firms is evident in their contrast with their UK counterparts. In fact, the British firms were the only ones in our sample to define design as their most significant competitive advantage, while Greek firms admitted depending on the production of labour intensive products.

The differences in the attitude of the firms towards relations are slightly more complex to comprehend. Specifically, the UK and Estonian firms stand out as those operating in a more supportive environment, while Bulgaria and Poland are at the other end of the spectrum, with significantly more firms claiming to have no relations with other firms, institutions and the central or local government.

The impact of the country is perhaps best depicted at the geographical orientation of the delocalising firms. Although the findings are consistent in all types of delocalisation, for reasons of simplicity (and wealth of information, since the relative sample is considerable more sizeable) we will concentrate on outsourcing. Figure 7 summarises the geographical orientation of outsourcing from the UK and Greece. Three interesting and rather unique points characterise the geography of the British outsourcing. Firstly,

the fact that China and India were clearly the most important ‘host’ countries for the British firms, accounting for almost 20 per cent and 13 per cent respectively. Secondly, British firms were the ones with the greatest diversity in terms of the location of their subcontractors. In fact, they reported doing business with firms located in twice as many countries than the other four counties of our sample. Finally, there does not seem to be any geographical concentration of the countries receiving orders from British firms, which appear to be the only really ‘global’ in our sample. This ‘global’ argument is further reinforced by the fact that the vast majority of British firms outsourced to firms in more than one country (50 per cent to at least 3 countries and only 27.8 per cent to only one country).

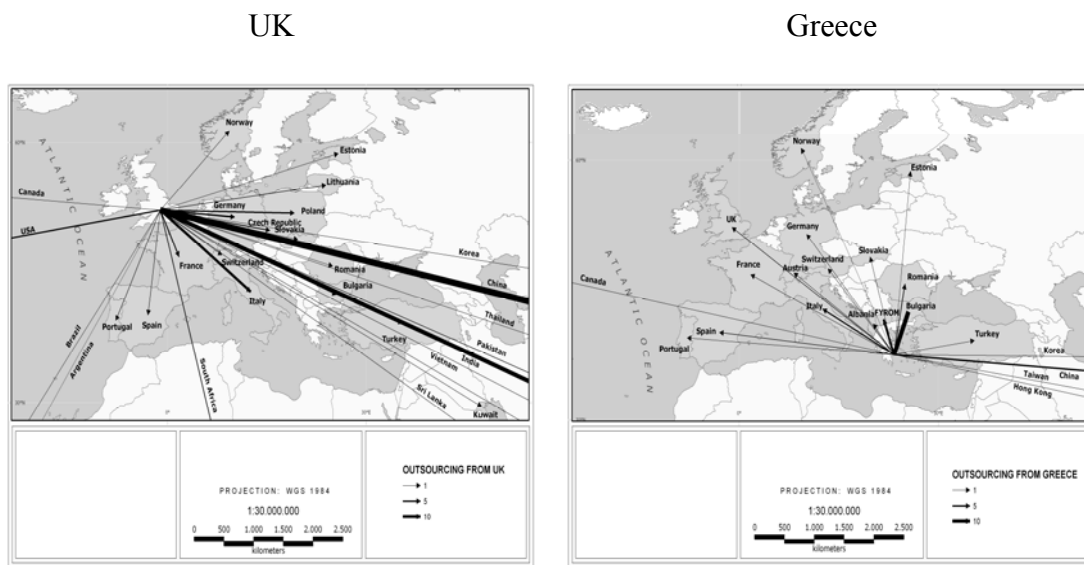


Figure 7 Geographical orientation of outsourcing from the UK and Greece

Source: Enterprise Survey

On the other hand, the most important feature of Greek outsourcing is the concentration in the Balkan region, with a single country – Bulgaria – accounting for almost a third of

the subcontractors. Adding the other Balkan countries, the figure easily exceeds 50 per cent. However, the most interesting feature of the Greek outsourcing is its relatively small depth, with most firms (56.8 per cent) outsourcing to only one country, thus implying a lock-in of Greek firms to a single country. Furthermore, there are cases where Greek companies outsource from companies located in the Balkans, which are however of Greek interests.

Polish firms are the ones resembling the British ones the most in many respects. Firstly, China is the most important recipient, while there is a spread of countries that is equally wide in terms of geography, although the number of countries is considerably smaller. Interestingly, Polish firms outsourced to firms located in both less (e.g. China, India and a few other SE Asian countries) and more (Italy, the UK, USA, Germany etc.) developed countries. The same is also true for the Estonian firms; however, this is where similarities end. Estonian firms were significantly less 'global' than their Polish counterparts -in fact among the 24 countries, Estonian firms assigned contracts to only four non-European ones (China, India, the USA and Taiwan), while there was an obvious regional focus. Finland alone is home to almost a quarter of the suppliers (mainly through outsourcing) of Estonian firms (many of which are owned by foreigners), while the Baltic and Nordic regions together account for more than 60 per cent of the total.

The firm

As we have argued in the previous sections, the firm is perhaps the single most significant source of variation in the decision to delocalise, as well as in the forms

delocalisation takes. What this implies is that firms that are in most (observable) ways identical are expected to behave in quite different ways. Given the variability in strategies among the firms of our sample (Kalantaridis and Vassilev 2007), the main aim of this section is to look into the importance of the competences (resources) of the firms and transaction costs involved when doing international business in explaining the different outcomes.

As it will become evident, the nature of our sample has some adverse implications on the expected outcomes. This small section will begin with a simple finding from our sample, which is counterintuitive to the basic argumentation of the resource-based theory that large firms are more likely to become TNC. The mean size of the firms in our sample owning at least one subsidiary abroad was 509 employees, while the respective figure for the firms involved in outsourcing was 154. So far, there is nothing counterintuitive. However, remove two outliers from the TNC group (Siemens UK and Logica CMS – two giants of 21,000 and 6,000 employees respectively) and the image changes to 229 and 154 employees. Even if we assume that these figures point to the direction of the resource-based view, explaining Figure 8 requires some departure from the conventional understanding of resources.

What is troubling about the figure is that an annoying 30 per cent of the 95 TNCs of our sample employ less than 50 people and also that 60 per cent of both groups is accounted for by firms with less than 100 employees.

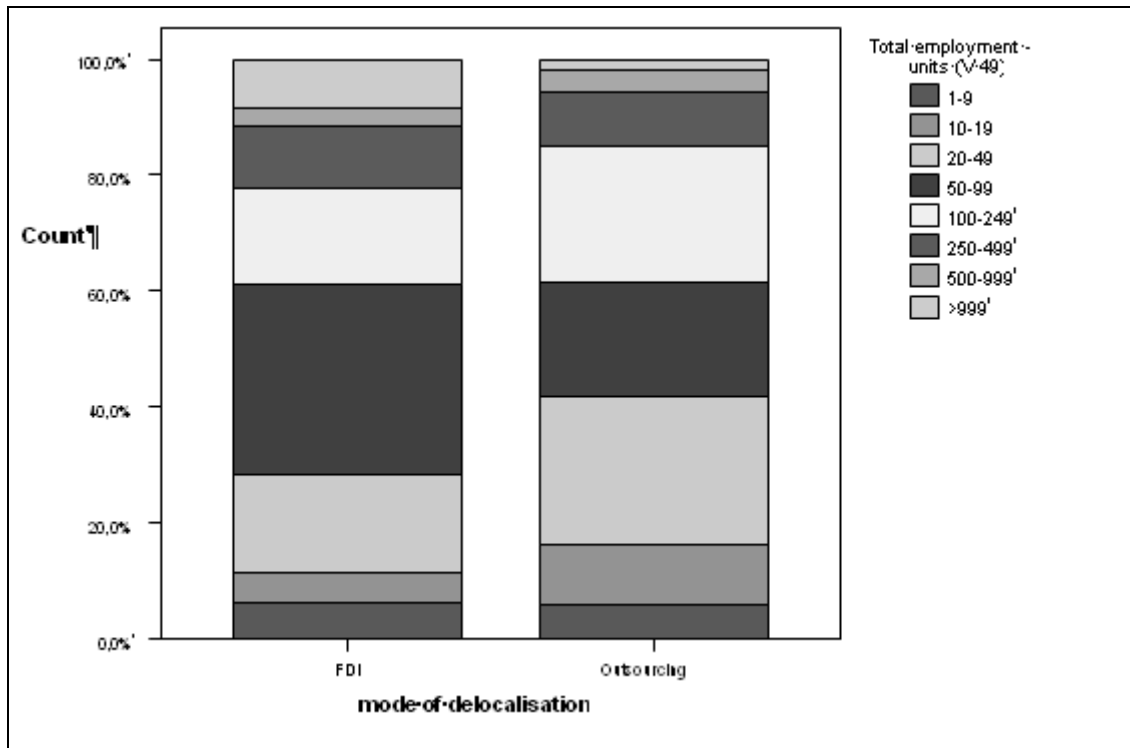


Figure 8 Size composition of the TNC (left) and outsourcing (right) groups

Source: Enterprise Survey

We believe that the answer could lie in the special nature of some resources available to some firms combined with the resource requirements of some forms of FDI. The former is exemplified by the commuting entrepreneurs of the Greek-Bulgarian borders. 19 out of the 22 (85 per cent) Greek clothing firms of our sample (only two of which had more than 100 employees) have invested in Southern Bulgaria, the vast majority being at commuting distance. Can these projects be called FDI? Apparently, according to the entrepreneurs, the penalty of foreignness is considerably smaller in those regions. Not only do they not have to employ expensive administrative staff, since it is usually the entrepreneur or a member of the family performing these tasks, perhaps more importantly there is an intangible resource available to all incumbent or potential Greek

ventures in the region, which is no other than the extensive community of Greek entrepreneurs and their support mechanisms.

The ethnic entrepreneurs in the UK clothing sector operate in a similar way. Although the distance is considerably longer (e.g. to Bangladesh or Pakistan), the most considerable barriers are outright demolished. With no (or very small) culture, language and religion barriers, these firms face practically no foreignness penalties.

On the other hand, for the majority of the Greek clothing firms, the establishment of a factory is very cheap as it is very often equivalent to the cost of transporting the existing equipment no more than 100 km away.

Therefore, the decision to delocalise is very much an issue of resources. The choice between the different types of delocalisation was more of a mixed bag. Not unexpectedly, market failures was the factor most often mentioned

Delocalisation and growth

Upgrading

The aim of this subsection is the individual firm and it is approached through the use of an extremely rich qualitative dataset, gathered during the semi-structured interviews. What we are interested in is to highlight the diversity of experiences of firms in the same sector and country regarding upgrading. This is not as straightforward as it may initially seem, as there appear to exist very different views on what constitutes upgrading. Unfortunately, the data from the UK and Estonian firms was scarce and is, therefore, not reported.

Looking for a unifying framework of upgrading we turned to Humphrey and Schmitz (2002) who identified four distinct types of upgrading, namely (a) *process*: transforming inputs into outputs more efficiently by reorganizing the production system or introducing superior technology, (b) *product*: moving into more sophisticated product lines (which can be defined in terms of increased unit values), (c) *functional*: acquiring new functions (or abandoning existing functions) to increase the overall skill content of activities and (d) *inter-sectoral*: involving the movement of firms into new productive activities.

Although not explicitly mentioned, these four types implicitly represent a procession from less to more desirable types of upgrade. However, as Martin Bell (quoted in Humphrey and Schmitz, 2002:13) noted while criticizing Gereffi's (1999) idea of a virtuous circle of upgrading of East Asian clothing manufacturers from assembly to undertaking the entire production process, to own design, to sale to domestic and foreign markets¹⁴, the movement towards the final stages of upgrading is by no means guaranteed.

Table 6 is a summary of the various responses we received regarding the changes in processes after the delocalisation of the firm interviewed. It is quite straightforward that all three countries present very different pictures. Even Bulgaria and Poland (the two CEE and overwhelmingly host countries) cannot be grouped together. The majority of Greek respondents (54.7 per cent) were unaffected by delocalisation, while 28 per cent

¹⁴ We should note that these 'stages' are not seen as equivalent to those described by Humphrey and Schmitz (2002). The possibility of discontinuity is, however, very similar.

percent of the respondents (a figure corresponding to more than 60 per cent of the firms that claimed to have upgraded) went through process upgrade. The vast majority of software firms was unaffected by delocalisation, while those that claimed to have upgraded, managed it mostly because of the experience they have acquired through the years, which enriched their know-how and rendered them capable of widening the range of the products offered.

While this is not the case with electronics, since those that were unaffected were fewer, while the upgrade paths were slightly more diverse, it was interesting to note that three companies attributed this upgrading in terms of technology either to the demands of their customers or to the competition they face. In both cases, this upgrading is a result of factors that are exogenous to the company itself.

Table 6 Changes in processes after delocalisation (percentage of firms that responded by sector and by country)

		Bulgaria					Greece				Poland				
		Software	Electronics	Clothing	Footwear	Total	Software	Electronics	Clothing	Total	Software	Electronics	Clothing	Footwear	Total
	N	36	30	45	37	148	17	13	23	53	31	22	84	23	160
Process	equipment-technologies	5.6	16.7	11.1		8.1		23.1	13	11.3		9.1	2.4		2.5
	greater capacity-higher turnover-employment	2.8				0.7			8.7	3.8					
	QMS	2.8			2.7	1.4									
	Quality	2.8	3.3			1.4			21.7	9.4					
	quick response-flexibility				2.7	0.7			8.7	3.8					
Product	more complex prod-more activities-whole products-more activities		13.3	40	43.2	25.7					16.1	13.6	3.6	13	8.8
	wider range	2.8	3.3			1.4					9.7				1.9
	R&D-design-innovativeness	5.6	6.7	11.1		6.1		15.4	8.7	7.5	6.5	18.2	10.7	17.4	11.9
	know how-experience-models from sketches	27.8	30	4.4	13.5	17.6	17.6			5.7	3.2	9.1	7.1	4.3	6.3
	own product relations										12.9		4.8		5
											3.2		2.4		1.9

Functional	distribution network-own brand-marketing-niche markets	5.6		6.7	2.7	4.1			4.3	1.9	6.5	4.5	7.1	17.4	8.1
	diversification from manufacturing to services										12.9		2.4		3.8
	diversification from subcontractor to lead firm										3.2		2.4		1.9
	move up subcontracting layer												2.4	13	3.1
	Other							7.7		1.9	3.2		2.4		1.9
Down Grading	Diversification from 1st to 2nd layer											4.5	1.2		1.3
	narrower range of activities												1.2	4.3	1.3
	Seize own production/only subcontracting											9.1	1.2		1.9
	Seize R&D			2.2		0.7							1.2	4.3	1.3
	unchanged	44.4	26.7	24.4	35.1	32.4	82.4	53.8	34.8	54.7	22.6	31.8	47.6	26.1	37.5
	Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Clothing was the most diverse (in terms of upgrade strategies) Greek sector, since for the 12 companies stating that they have been upgraded, there were no less than ten different upgrade strategies. Of particular interest here are the impacts on the successful domestic brand names, i.e. the firms organising their own national and lately international (although still by no means global) production networks. Only one firm in this ‘elite’ group attributed its upgrade not to delocalisation but to the general strategy it has

followed. On the contrary, other brand name companies explicitly attribute their upgrading to their decision to delocalise part of their production activities abroad. More specifically, these companies state that if it weren't for delocalisation, they wouldn't have achieved their objectives.

Finally it is quite surprising that no company expresses a downgrading of its position in the supply chain, especially given the general picture of the sector in Greece (and the quantitative findings from the field work).

On the contrary, considerably more Bulgarian and Polish firms appear to have benefited from delocalisation, although in quite different ways. Concerning the former, the vast majority of respondents went through some type of product upgrade. Bulgarian firms appear to more closely correspond to the virtuous circle described above. Specifically, clothing and footwear firms (the two sectors that became involved into the delocalisation processes earlier) were considerably underrepresented in process upgrading, which most of the respondents appear to have gone through. On the other hand, it is the more high-tech industries (electronics and software) that appear to be going through process upgrading, even though product upgrading is far more important. .

On the other hand, Polish firms clearly stand out, as a significant minority (almost 18 per cent) is undergoing functional upgrade, while at the other end of the spectrum, only four firms went through process upgrade.

This upgrading could be either proactive, in the cases where it is consciously pursued by the firm, or reactive, when it is imposed by a client. However, in both cases, it is evident that a learning process derives from the subcontracting activities, whose results are evident on the firm's functioning.

We consider upgrade to be proactive, when a firm involved in insourcing as subcontractor mentions that its relation with the foreign client sets off an evolutionary course for the firm itself. This is when the firm actually takes advantage of insourcing, in order to improve its own position in the value added chain, as part of a development strategy. On the other hand, we have reactive upgrading, when a firm involved in internationalization reports an improvement either of its production process or its products (quality), but purely as a result of the client's demands.

Polish companies appear to be involved more in proactive upgrading, in the sense that they express to a wider extent than Bulgaria that subcontracting resulted in:

- learning a particular know-how by the client, which is then embodied in their own production, either for the domestic or foreign markets (sometimes even under their own brand)
- developing their own brand / product for the domestic market. In some cases, this also means that they also start to assign subcontracting to third parties, while in others that they stop acting as subcontractors themselves
- undertaking a wider range of activities.

“We turned into a subcontractor mainly for German companies. Over the time we have tried to develop our own brand names through taking over design activity and development of distribution channels for our products. Now, we outsource part of our manufacturing activity to subcontractors in Poland, China, Indonesia and India”, (Polish clothing firm).

Bulgarian companies, on the other hand, seem to be more involved in reactive upgrading, since they mostly talk about: upgrading of the equipment and the technologies used for the production, complying with various health and safety regulations that improve the working conditions within the firm.

“We go up – the customer requires more, that lead to adding a value in the product. We use always the new technologies”, (Bulgarian software firm).

At this point, it should be made clear that this classification describe the general tendency of the companies in these two countries and does not mean that the opposite is ruled out (Bulgaria undergoing reactive upgrading and Poland proactive).

A further interesting point is that attitude of the Bulgarian firms towards upgrading appears similar to that reported by many Greek firms, which, however, never managed to create their own competences and remained locked-up in subcontracting arrangements.

Undoubtedly, it is very difficult to compare the relative success of upgrade strategies, when the whole sample is consisted of relatively successful firms. However, we feel that a general assessment is possible. The general rationale behind this was succinctly expressed by the manager of Bulgarian clothing firm in the following. *‘quality is standard (you cannot sell anything without it)’*. This simple phrase points directly to the transient nature of economic rent. If we assume that a few decades ago quality was scarce, then it is normal to expect that firms managing to produce high quality products would reap the benefits of producing a scarce product.

In other words, the value of any specific upgrade strategy lies, to a considerable extent, on its uniqueness. Hence, this is the first distinction of upgrade strategies, i.e. the common and the unique upgrade strategies. A second possible distinction could be between strategies that are more or less imposed on the firm, as opposed to strategies decided by the firms. In a sense, these two distinctions are the two sides of the same coin. For example, in the quotation of the Bulgarian manager, a subcontractor may not be directly forced to adopt a new technology by his lead firm. However the knowledge that this technology may become widespread, in which case the firm will be outpriced, is a substantial indirect pressure. So, technology rents, as they were discussed here, may be a suboptimal upgrade strategy. In fact, with many very different manifestations (e.g. purchase of new machinery, production of more complicated part of products or even whole products, increased automation and most often higher quality) simple technological upgrade was the only response for the majority of the firms. On the other hand, R&D (equivalent with the production of new technology or knowledge) or design was pursued by relatively fewer firms, which were again based in the three countries. However, it is the less frequent responses that are more interesting. Product or marketing rents were pursued by a small number of Greek and Polish firms and a couple of Bulgarian firms. Polish firm were the only ones to attribute their upgrade to organisational innovations, as well as a functional upgrade out of subcontracting. Equally interesting is the relatively poor performance of Greek firms, particularly with relation to the absence of all types of organisational or relational innovations. Perhaps one needs to look more carefully into the specific historical context of the Greek economy, something that, to some extent is accomplished in the next section..

A case study of the Greek – Bulgarian clothing sector ‘connection’: the role of proximity and the creation of transnational clusters

The main aim of this case study is the analysis of the northwards movement of a Greek clothing cluster, and its transformation into what appears to be an international cluster in northern Greece – southern Balkans. Similar phenomena have also been noticed in other countries (e.g. the clothing industry moved from Japan to China in the 1990s – Yamamura et al, 2003). During the last few years, clothing in Northern Greece has been developed in what could be called ‘triangular manufacturing’ (Labrianidis and Kalantaridis, 2004). Recently, one of the triangle’s apexes, namely the textile-clothing industry cluster in Northern Greece, is gradually shifting more to the North, crossing the borders of the country to include parts of Southern Bulgaria and, to some extent parts of Southern Albania and FYROM. Therefore, the central questions are the following: what are the characteristics of this ‘*transnational cluster*’ can it provide some competitive advantage to the companies involved and finally, what type of policies can support it?

As a result of the decentralising strategies pursued by the developed countries during the ‘60s and mainly from Germany, the textile-clothing industry developed in Greece because of the country’s relatively low labour cost, as well as of some privileges it enjoyed in its trade relationships with the EU (Simmons and Kalantaridis, 1995: 290). Consequently, the sector was developed on the basis of undertaking subcontracting by companies from the developed countries, something that continues to a considerable extent until today. This can largely explain the important role of clothing in Greek

exports (mainly towards the EU and especially Germany). In fact, in 2002, it was the most export-oriented sector (IES-SEV, 2005: 2).

The clothing industry has been one of the most important sectors of the Greek economy. Since the mid 80's, it underwent through crucial crises. However, despite the drastic reduction in the number of enterprises, clothing industry remains until today one of the predominant sectors of the Greek manufacturing; according to 2003 data, it contributes to a large extent to the country's manufacturing production (3.3 per cent), employment (7.2 per cent) and exports (15 per cent).

With the gradual abolition of all possible support measures available to the Greek clothing industry, it became apparent that the only alternative option the industry had in order to recover its waning international competitiveness was the relocation of part or the entire production to CEECs and mainly in the Balkans, which could lead to considerable reductions of average per unit production costs. Therefore, in many cases, Greek clothing manufacturing enterprises create a triangular manufacturing arrangement. Specifically, they reach Balkans assigning a (2nd level) subcontracting part of –or the whole of - their production, for which, in turn, they had already been assigned a (1st level) subcontracting from a company in a DC. In certain cases, the production is made in hired plants, using imported equipment from the Greek plants.

The ability of the lead firms to control the market renders them capable of maintaining their position at the top of the subcontracting chain. In this way, they achieve the lowest possible cost, while at the same time, by relying on the mediatory role of the subcontractors located in Greece (1st level subcontractors), reducing the risk factor. On the other hand, companies in Greece maintain an intense interest for assigning

subcontracting to the Balkan countries (2nd level subcontractors), since it constitutes a means for staying competitive.

Since the beginning of the 90's, when Greek companies started assigning third part subcontracting, a gradual transfer of more complex production parts to the Balkan countries is observed. Initially, the seaming process was mainly the one to be relocated - which is also the most common example of the labour intensive part of the production - but even more operational parts of these enterprises are now on this way.

Up until today, the experience of *triangular manufacturing* has been mixed. For example, in the case of Bulgaria, average wages in the Southern provinces have increased substantially, while unemployment rates are among the lowest in the country. On the other hand, most of the new jobs have been low-skilled, which could hamper the upgrading of the local human capital. Furthermore, the integration of the Balkans in the European and global production and distribution networks is characterised by a high degree of dependence and vulnerability. As the Greek experience points out, redefining the position of the Balkan countries in the international division of labour is a difficult and not necessarily guaranteed mission, since up until today, Greece has not managed to improve substantially its position in the international division of labour in the textile and clothing industry.

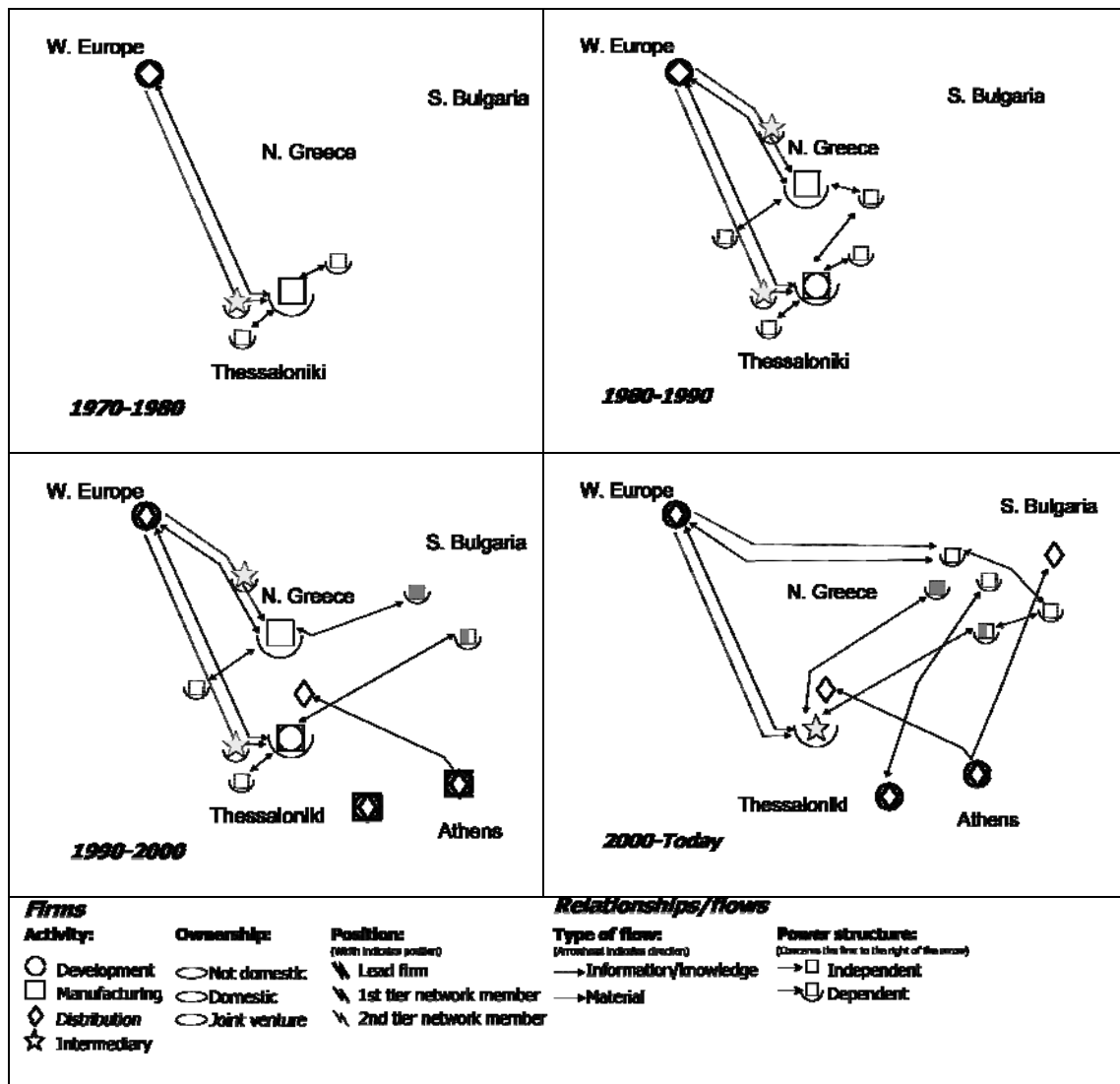


Figure 9 The evolution of the clothing sector in Greece (1970-today)

Source: Derived by the authors from the literature review

Developing a relationship with a new contractor usually takes long time, thus assignors may prefer to follow their established patterns wherever they decide to shift to a new country and keep on negotiating the conditions of their relations rather than looking for new suppliers. Moreover, dependence and asymmetrical power relations may co-exist with mutual confidence (Kalantaridis *et al.* 2007) These two factors can explain, at least in part, why Greek firms continue to form one of the apexes of the German-Greek – Bulgarian clothing manufacturing triangle.

Figure 9 describes the various stages in the transformation of the sector, viewed from the Greek perspective, while Figure 10 tells the story through the Bulgarian perspective. The former describes four quite distinct stages, which, although highly stylised, reflect the reality of the vast majority of the sector. During the first stage (1970- 1980) orders to Greek subcontractors started coming from W. European (mainly German) and to a lesser extent American lead firms. These were normally executed within the company, although in some cases, there were also 2nd layer subcontractors within the same city (e.g. Thessaloniki), so as to lower labour cost.

The change that takes place during the second stage (1980- 1990/91) comes from the Greek subcontractors, since they gradually develop quite extensive subcontracting networks of 2nd layer subcontractors within the same city (e.g. Thessaloniki) and mainly in the surrounding villages. Although a considerable part of the less labour intensive tasks are still performed in-house by the first level subcontractors, the simpler tasks are assigned to 2nd layer subcontractors, who, in their turn often develop their own – smaller – networks of 3rd level subcontractors, often homeworkers.

The third stage (1990/1 – 2000) is the ‘triangular’ manufacturing stage. Lead firms in e.g. Germany or the US, continue placing their orders to their established Greek partners. However, soon after the collapse of the state-socialist regimes, the latter are beginning to transfer parts of their activities to 2nd layer subcontractors in the Southern parts of the neighbouring countries, particularly Bulgaria, and FYROM. By the end of this period, most Greek clothing firms are mainly responsible for the organisation of the network. It is interesting to note that for variable periods (ranging from several months to few years) the lead firms were uninformed of this development. This gave first movers a considerable advantage, since they were paid Greek prices for Eastern European labour costs. The extent to which this behaviour gave rise to the fourth stage (2000-today), when more direct links between Germany and Bulgaria are being created, therefore circumventing one of the apexes (i.e. Greece), is discussed in the Bulgarian case, further down.

We feel that two are the central points of this story. The first is no other than the immensely important role of proximity in the creation of the cluster. In fact, the Greek-Bulgarian borders highlight the case that intense delocalisation in the border areas can provide a fertile ground for companies that otherwise would not be able to go international. On the other hand, the very fact that even very small companies can easily go international can create a shock, at least in the short term, to the local economy of the home country.

Geographic proximity in the sense of *commuting distance* was crucial for the delocalisation of the SMEs located mainly close to the borders areas. This allowed the entrepreneurs themselves to commute daily to their subsidiary in southern parts of

Bulgaria. There are businessmen and highly paid technicians that have been doing this cross-border commuting every single weekday for years, spending almost 5 hours/day on the road¹⁵.

Also historic ties, cultural affinity, common religion (Greeks and Bulgarians being Christian orthodox) mixed marriages and other kinship relationships, the existence of Greek students, as well as of political refugees from the civil war who lived in Bulgaria were very important in guiding those intending to invest, especially during the early '90s (Kamaras, 2001; Labrianidis, 1996).

Delocalisation 'comes' from Greece, but the lead firms and the main market are German. From the early '90s until today, it has been very important both for Greece and Bulgaria. For the Greek border areas, it meant opportunities, even for very small sized companies, to go international so as to take advantage of new markets and low cost labour. However, in the short term, it led to increasing bankruptcies and unemployment. For Bulgaria it was also important, since Greece is one of the most significant trade partners of Bulgaria, following Italy and Germany. For Bulgarian border regions, Greek delocalisation is crucial, because it contributed in solving the problem of unemployment, which was particularly high in first years of change. Nowadays, it is still important, because working at Greek clothing firms or Bulgarian firms undertaking subcontracting from Greece is the only job option for women in many settlements of the border areas.

¹⁵ A similar case might be US firms delocalizing to Mexico. All the American staff – engineers, technicians, managers etc- want to reside in the US and commute to work in Mexico every day.

This is not only a matter of physical proximity, since there are instances of Greek firms located in Athens and flying to Sofia. So, this difference might be attributed primarily to *cultural* reasons (Greeks do not want to leave their home, or perhaps they “look down” at the particular societies where they have delocalised their business).

The second point is related with the development implications of the evolution of the cluster in N. Greece and particularly Thessaloniki. In Figure 9 it becomes evident that the clothing sector is in a sharp recession phase. In addition to what was already mentioned about the role of the city as an apex of the triangle, it is interesting to note that, as if the increasing establishment of direct links of their original (foreign) buyers with Bulgaria was not enough, local producers never really managed to gain a foothold in the local, not to mention national market, which during the last few years is increasingly dominated by firms originating from Athens. In other words, functional upgrading for the cluster’s firms was a real rarity. How did this come to happen? This is certainly not a case of obstacles imposed by the buyers, as Schmitz and Knorringa (1999) argue is often the case in the footwear industry. What seems to be the answer to this question is the fact that Greek subcontractors became locked-in into what was, at least initially, a very rewarding arrangement. Almost overnight these firms broke into foreign markets, eschewing the considerable sunk cost mentioned by Roberts and Tybout (1995) as necessary in order to become exporters. In fact, most of these firms never even searched for new clients. In a sense, the obstacles to upgrading were imposed by the firms themselves and their unfortunate short-termist view of success. As one interviewee said:

'...it is often brought to us that in order to be a successful exporter one has to be good in design and marketing. Surprise, surprise; we are good exporters. Why then should we make all this risky investment in design and marketing?'

When it comes to the Bulgarian side, although, as will become evident further down the history of the sector was completely different from the Greek one, it seems to face very similar problems, since it is now entering its critical phase.

The manufacturing of clothing in Bulgaria began in the 1960s, while the following two decades (1970s and -80s) saw the establishment of large State enterprises. Each enterprise had many workshops located in areas where free female labour force was available. These areas specialised in mining and metallurgy industries and tobacco growing. Clothing industry had tight production linkages with domestic textile industry. Not surprisingly, the bulk of exports were directed to the CEECs, but also West Germany, the UK, some North African countries and Near East countries.

The early reform period (1990 – 1996/7) was dramatic in two ways. The first was – very – negative and was no other than the collapse of the CMEA markets, which resulted in a sharp decline of production volumes, closures of workshops, decrease of employment in large plants and wide-scale restructuring of ownership. The second development was positive and was linked with the establishment of new small clothing firms, working for the domestic market or/and under subcontracting for small Greek and Turkish entrepreneurs. FDI in SMEs was pursued by Greek firms in South Western Bulgaria.

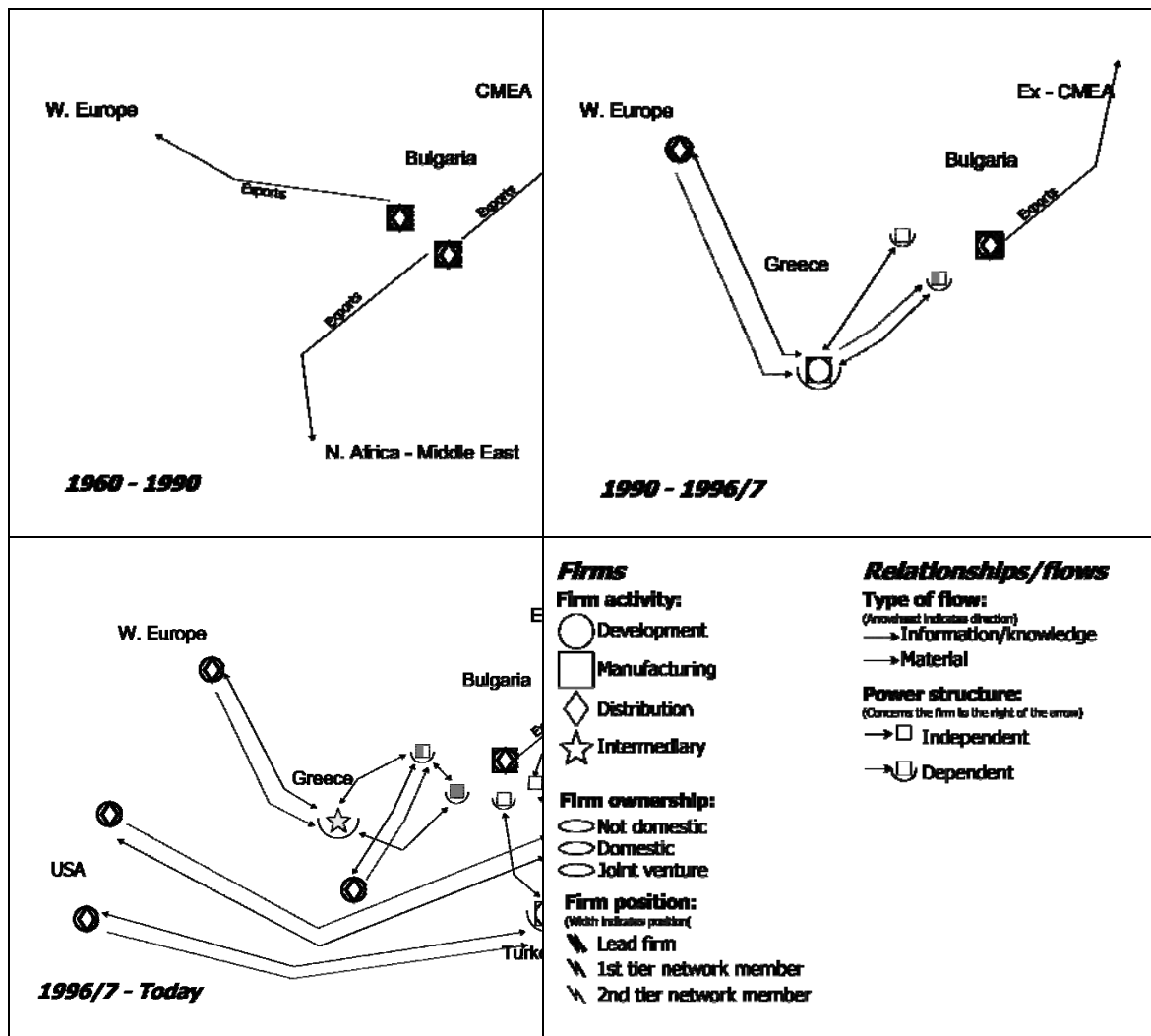


Figure 10 The evolution of the clothing sector in Bulgaria (1960-today)

Source: Derived by the authors from the literature review

During the last decade (depicted as the bottom frame of Figure 10), the situation appears to have changed dramatically. Specifically, the number of new medium and large firms has considerably increased, along with employment in the sector. production volume, most of which is being exported under subcontracting (more than 90 per cent), has also increased. This was not the case with FDI, which is mainly pursued by Greek firms, followed by other EU and Turkish firms. Germany is the most significant market, either through direct subcontracting, which is based on relations extant from '80s or indirectly through Greece. Other markets are the UK, Italy, France, and Spain. A small part of the export is directed to the American market, mainly through Turkey. No information for outsourcing by Bulgarian clothing firms is available, but if there are some cases these are a few firms. Between Bulgarian firms, subcontracting is the most wide-spread practice. Some large firms have their own brands and products, but they are sold in the domestic market.

2.4 Conclusions

Our effort is obviously prolusory in the sense that more has to be said about the role of the nature of networks, as well as the role of embeddedness, both of which were merely touched upon.

A brief reading of the findings presented could give a rather chaotic picture. The main reason for that, we believe, is that there are inherent difficulties in bringing together exclusively micro with relatively macro approaches in order to understand why and how firms delocalise. Our findings seem to be at odds with all conventional wisdom. At the level of the firm, globalisation and regionalisation seem to have blurred the distinctions

between FDI and outsourcing, creating circumstances and specific loci where the two are equivalent at least in terms of the organisational stress they impose on firms. This does not mean that resources (or competitive advantages) and market failures are becoming irrelevant in the decision to delocalise, but merely that changes in the external environment may affect the nature of resources.

At the level of the sector, there appears to be considerably more variation than what is assumed by the conventional understanding of the technological and market orientations of sectors. Sectors are definitely different in some respects, however, not so different in others, and while this will depend on the various definitions and understandings of sectors, it more or less prohibits the creation of any hierarchy of 'sector desirability'. Hence, there may be a higher technology content in the electronics sectors, than even the software sector, however, the crucial questions must always be related to the implications on value creation, enhancement and capture. According to Kaplinsky (1998) technological rents are one of no less than nine distinct types of rent, none of which is in any way superior to the others. In fact, since all of the rent types (as rent itself) are dynamic and transient in nature there are no easy recipes to development. Hence, it may be more important to be able to capture value than to simply create it, and perhaps the most significant determinant of value capture is functional upgrading, as it is always the focal or central firms that capture most of the value. Furthermore, it may in fact be easier for firms in sectors that are not technologically advanced to upgrade, often by creating local production networks and specialising to the internal market, as some clothing and footwear firms in our sample.

In one of the few efforts to study such turns of inward-looking-upgrade strategies, Schmitz (2006) was wondering whether upgrading depends on the choice between global vs national chains or captive vs even relationships. Our findings point to the importance of sector, however, more importantly country. In the context of our study the differences between Polish and Bulgarian subcontractors in the clothing sector were minimal. However, the former were considerably more active in the direction of upgrading than the latter. In fact, the behaviour of Bulgarian subcontractors in 2006 resembles the behaviour of their Greek counterparts ten years ago (Labrianidis 1996) who were forced to 'upgrade' in order to match the requirements of their customers. Are we, then, dealing with some kind of economic determinism¹⁶? Although we are not actually equipped to answer that, it would suffice to note that some Greek firms (contrary to national trend) managed to break out into creating their own branded product, although we have very little information about whether they are former subcontractors. In any case, and this is perhaps the main contribution of the Chapter, firm behaviours are codetermined by a vast array of factors, of which we have studied only a small fraction.

In conclusion, the decision to delocalise is obviously affected by the form delocalisation takes and vice versa, and is obviously considerably more complex than what the theory of the firm or economic geography usually assumes. Ours was a merely exploratory effort, and we feel that more work needs to be done in that direction.

¹⁶ To succumb to a deterministic claim that firms from a given country will not upgrade would be equivalent to arguing that the firm is unimportant, actually cancelling our own argument about the significance of the firm.

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3 PATTERNS OF ENTERPRISE STRATEGIES IN LABOUR- INTENSIVE INDUSTRIES: THE CASE OF FIVE EU COUNTRIES

Christos Kalantaridis, Ivaylo Vassilev, Grahame Fallon

3.1 Introduction

One of the noteworthy features of contemporary economic change involves the emergence of growth patterns resting squarely upon the global diffusion of production of labor-intensive industries (Scott, 2006). This is facilitated by i) advances in information and communication technologies; ii) the changing architecture of production through modularization, itself the result of the advent of digital technologies (Steinfeld, 2004); and iii) the opening-up of national markets through changes in the global governance framework and the advance of neo-liberal views (Levitt, 1995). This outward oriented pattern of growth is of particular importance in the case of formerly planned economies of Central and Eastern Europe and what was Soviet Union. This is partly because their semi-detached position from the global marketplace for the best part of the post-war era – or even longer in the case of the Commonwealth of Independent States – offers a multitude of opportunities for growth. More importantly, however, the collapse of the old system was linked with the disintegration of old distribution channels and significant decline in levels of domestic demand that could offer alternatives for growth. Thus, there is now a large body of empirical evidence suggesting that growth based upon the global diffusion of production in labor-intensive industries is increasingly evident in formerly planned economies (Smallbone et al, 1996; Smith, 2003; Kalantaridis et al, 2003; Scott, 2006; Pickles et al. 2006).

During the past twenty years or so, research in this area – in formerly planned economies and beyond – has been heavily influenced by the GCC approach. This

approach provided researchers with useful insights into the reconfiguration of industrial dynamics in increasingly integrated networks of production and distribution. These insights have been used to inform policy-making by transnational organisations such as the IMF (2004), UNCTAD (2003, 2004), World Bank (2004) and the OECD (2004). As is always the case with approaches that dominate the research and policy agenda, GCCs has been the focus of intense scrutiny (Raikes et al, 2000, Henderson et al, 2002, Coe et al, 2004, Palpaceur et al. 2005). Among the plethora of critiques, Smith et al (2002) advanced the thesis that there is ‘a tendency to neglect the dynamics and fluidity of organisational forms in GCC analysis ... [and] [t]here is consequently little detailed analysis of complexity in either intra- or inter-organisational relations’ (Smith et al, 2002). Advocates of the GCC approach acknowledged the importance of the difficulties created by the relatively high level of abstraction of early works, and provided a number of correctives (Gereffi and Meyer, 2004, Gereffi et al, 2005, Bair 2005, Neidik and Gereffi 2006). This constitutes the point of departure for this Chapter. We set out to explore the micro-dynamics of industrial change. The enterprise is the subject at the heart of our inquiry, whilst deciphering the strategies adopted by firms and their implications upon external linkages and performance constitute key areas of our work. The Chapter is organised in three large Sections. The first, and larger Section, reviews the accumulated body of empirical evidence around adjustment strategies in labour-intensive industries. This is followed by a discussion of the results of our fieldwork research in Bulgaria, Estonia, Poland, Greece and the UK. Lastly, we offer some concluding remarks.

3.2 A Review of the Literature

A Framework for Exploring the Literature

Previous empirical research into the successful adjustment strategies adopted by enterprises in LIIs has often adopted two, not mutually exclusive, viewpoints (see Figure 11): internal and external (Humphrey and Schmitz, 2001; Schmitz 2006). The former refers to the study of dimensions that can be controlled and directed as they lie within the organisational boundaries. Within this context, particular attention has been paid upon products, processes, and production. The second viewpoint explores the interrelationship between the firm (and its strategy) and its environment, focusing particularly upon relationships with other firms and organisation. Particular emphasis is placed here upon the organisation of different types of relationships over space and through time. A third dimension involves patterns of integration (ranging from market exchange to hierarchical linkages through the creation of subsidiaries). We would like to stress here that the boundaries between these two viewpoints are at best blurred. For example a decision to externalise part or the whole of the production process is closely interlinked with decisions about the nature of the relationships to be established as a result. Lastly, there is the nature of emerging relationships.

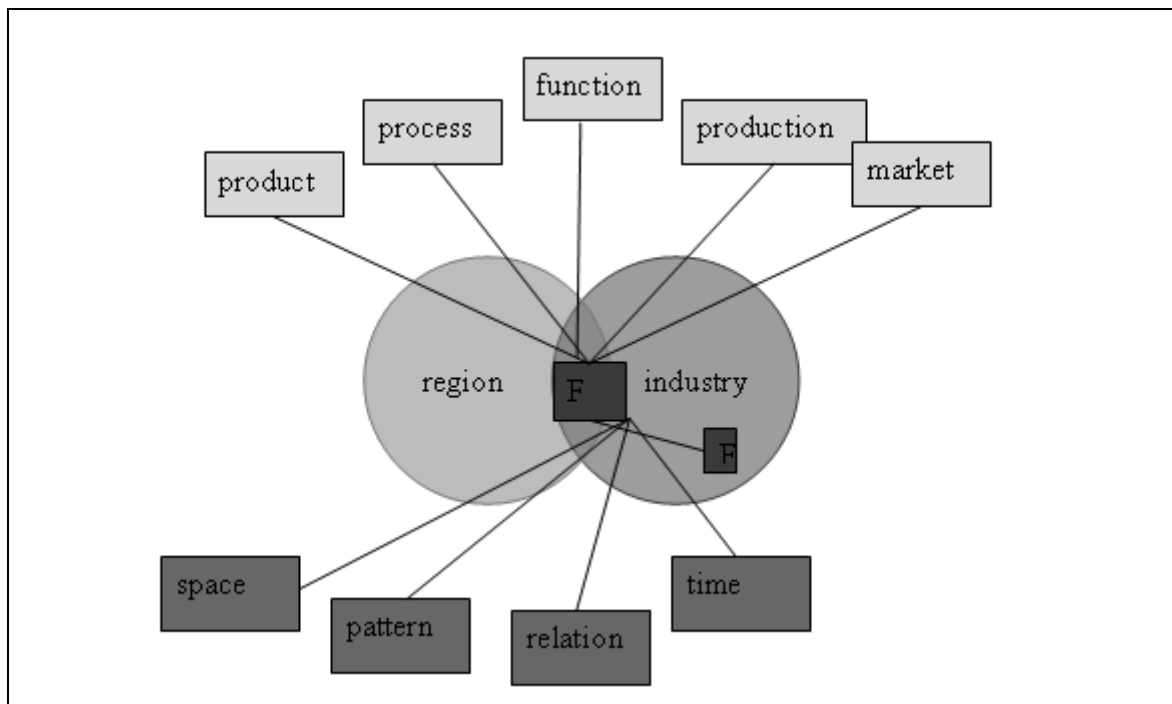


Figure 11 Analytical Framework

Enterprise Strategy

There is widespread agreement among researchers as well as policy-makers that product innovation is one of the main means of enhancing long-term enterprise competitiveness in LII (Dunford, 2002; Gereffi and Memedovic, 2003; Schmitz, 2003). It enables the enterprise to move away from cut-throat price competition towards market segments where price (and as a result production costs) is a secondary consideration. However, the manifestations of product innovation may vary considerably between LII. In the clothing and footwear industries one manifestation of product innovation is the introduction of new design. Although each ‘generation’ of new designs may have a relatively limited ‘self-life’ it may increase ‘brand-awareness’ (assuming off-course that new design is used in own-brand products). Another manifestation of product

innovation in the clothing industry is the use of new man-made fibres and technical textiles. Technical textiles are particularly significant in that they offer opportunities to develop new kinds of product and are suited to new uses in, for example, the transport sector, furniture and furnishings and construction (Dunford, 2002). Again however, product innovation has to be visible to the consumer as the advantage derived from each generation of changes may be short-lived. The development of brand awareness is therefore a key consideration. Another manifestation of product innovation is the development of incrementally different products (Run and Kuusela, 1996): something that is particularly the case in the electronics and software industries. These industries also offer scope to launch radical innovations, in the form of products that are totally different from what preceded them. In both incremental and radical product innovation each 'generation' of changes may be more sustainable – at least in the short to medium term – as they may involve difficulty in replicability, either on technological or intellectual property rights grounds.

It is useful to note here that product innovation matters not only because of the short or medium term competitive advantage gained. Probably more importantly, product innovation matters because of the competences (in a wide sense of the term) that it affords the enterprise (Corso and Pavesi, 2000; Chapman et al, 2001). These competences are both tangible (for example capital due to short term profit rises, technology, and skills) and intangible (in terms of knowledge, market recognition etc). These competences are the real source of competitive advantage, if they are used in a process of continuous product innovation.

We must stress here that product innovation is an activity that involves considerable difficulty, and therefore may often be unsuccessful (in the sense of failing to achieve the objectives originally envisaged, rather than necessarily leading to bankruptcy or downsizing). In fact, for every successful product innovation there may be literally tens of unsuccessful ones.

Process related strategies revolve around two key considerations. The first involves matching demand with production and storage capacity, whilst the second involves technological advancement. The key concept regarding the former consideration is ‘lean retailing’¹⁷ (Wrigley and Lowe, 2002). This aims at the optimisation not only of intra-organisational but also of inter-organisational processes. The underlined aim is to optimise the flow of products and information and information along the entire value chain, starting at the point of sale with the collection of highly detailed data on customer demand (Von der Heydt 1999). This results in faster reaction of supply to actual sales. Lean retailing is made possible through using more accurate sales forecasts and the adoption of electronic sales registers and bar-coding. The latter also providing valuable information about customer behaviour (i.e. who buys what, when and where) that can be used for the development of new marketing strategies (Wortman, 2003).

Technological change constitutes an element of process-focused strategy that has not often received sufficient attention in empirical literature on enterprise adjustment in labour-intensive industries. In some instances the implementation of new (either to the company or the industry) technology has been identified as a source of productivity

¹⁷ Another term often used in the literature is agile supply chain (for a review see Christopher, 2000).

gains, and increased production capabilities (i.e. better quality of production or enhanced capacities) (Kalantaridis, 2000). Within this context, accessing new technologies is viewed as a source of enhanced competitiveness for the enterprises involved. In many other instances technological change is viewed as an enabler in the processes of either product innovation or functional upgrading – which will be discussed in greater detail below. In this context, access to new technologies is a means of implementing enterprise strategies. In both instances however, we have to be aware of the distinction between accessing and exploiting new technologies. The latter requires strong assimilation capacity and ability to utilise spill-over technology, Japan in the 1980s being the best such example (Watanabe et al. 2001).

Functional upgrading, has emerged during the past ten years or so as a key element of enterprise adjustment in labour-intensive industries (IMF 2004; World Bank 2004). It is a strategy often identified with the GCC approach. The argument goes like this: European producers and distributors seek monopolistic rents through strategies centred on design, fashion and branding. Another strategy (deployed by producers both in Europe but also in Newly Industrialised Countries) is aiming to introduce changes in the distributive order. This is to be achieved through change the weight attached to different functional roles in the value added chain, by concentrating for example on knowledge intensive activities, marketing and logistics. Essentially producers seek to reposition themselves in the overall value added chain, with a specialisation on what are seen as core competencies (Gereffi and Memedovic, 2003).

In order to improve the position of an enterprise in the global networks of production and distribution involves organisation learning. Thus, participation in these networks

emerges (at least in the GCC literature) as an essential pre-condition that may initiate dynamic learning curves (Bair and Gereffi, 2003). However, there are other obstacles in the process of functional upgrading, as higher level roles are more demanding than lower ones. In order to overcome these obstacles enterprises require physical and human capital as well as access to effective networks (invariably identified in the literature as social capital). Within this context, building and managing networks, where power is complexly constituted rather than simply ‘possessed’ by one of the partners (Tokatli 2007), emerges as an issue of at least equal importance as accessing financial, design and marketing resources. Some forms of upgrading may meet obstacles of different kinds: access to resources, restriction from partners¹⁸, etc. addressing obstacles such as restriction may require ‘underground’ risk-diversification (Bazan and Navas-Aleman 2001).

In achieving functional upgrading there are differing views regarding the origin¹⁹ of resources. On the one side, local cluster theory emphasises that the knowledge needed for upgrading comes from within the cluster (Fujita, Krugman and Venables, 1999; Audretsch, 2003). On the other side, global value chain (GVC) theory emphasises that the know-how comes from outside the cluster, in particular from the global buyers (Schmitz 2003).

¹⁸ Schmitz et al. (1999) discuss a case of a footwear cluster in Brazil where few big local exporters, included in global chains, tried to prevent conflicts of interest with the lead firms in the value chains, and were instrumental in preventing a collective upgrading strategy.

¹⁹ This will be discussed in greater detail in the following Sub-Section.

Functional upgrading is invariably viewed in the literature as progressive change, whilst functional downgrading is viewed more or less by definition as inherently negative. In fact, there has been precious little research exploring particularly functional downgrading, even though we are aware that this is also a strategy that may be deployed by enterprises in labour-intensive industries. This is because the main approach adopted by the majority of scholars in the field focuses upon the long-term economic development of a spatial unit (locality, region or nation). This tension between enterprise on the one side, and wider economic development on the other, means that we currently possess precious few insights into the process of functional downgrading. This is despite the fact, that there is ample evidence to suggest that functional downgrading is often used as a short-to-medium term strategy by enterprises in labour-intensive industries. For example, a number of enterprises in post-socialist regimes opted for functional downgrading during the early stages of reform, in order to safeguard survival and link into the global network of production and distribution (Kalantaridis et al, 2003). An example of an Italian company which opted for functional downgrading is presented in Rabellotti (2001).

Production constitutes the final element of internal viewpoint. If product innovation revolves around the question: what to produce; and process about how to produce it; production focuses squarely upon how much to produce and where to produce. It is interesting that there is precious little discussion in the literature about production levels per se. Instead, discussion about production focuses more on where does it take place: an issue that will be discussed in greater detail in the following sub-Section.

Enterprise Strategies and External Linkages

The geography of production (identified as the 'space' dimension in Figure 11) constitutes the first aspect of the external viewpoint. A number of competing explanations have emerged regarding **spatial enterprise strategies**. These could be broadly clustered in two groupings: the first stresses the importance of locality, and enterprise embeddedness as a source of competitive advantage. In sharp contrast, the second approach focuses upon industrial dynamics, and thus views enterprise strategy emerging in a global but structured space. However, an issue common to both approaches is the importance of environmental influences in the process of enterprise strategy formation.

The 'locality' view falls within a broader shift in paradigm, supported by a voluminous body of empirical research, regarding the role of spatial externalities on economic activity (Fujita, Krugman and Venables, 1999; Dunford 2006; Yeung, Liu and Dicken 2006). This 'new learning' perceives individual ventures as structural elements of territorially defined networks, whereby emphasis is placed on the interaction between firms and the local milieu (Audretsch, 2003). Within this context, geographical, industrial, organisational and institutional proximities are perceived to be instrumental in facilitating the emergence of shared patterns of behaviour and cognitive rules, which in turn underpin collective learning processes (Kirat and Lung, 1999; Malberg and Maskell, 2002). This shift in emphasis towards localised interacting agents rather than their behaviour in isolation, long accepted in regional science, has become more common in 'mainstream' economics (Anselin, 2003; Karlsson and Dahlberg, 2003). As a result, concepts such as location, spatial interaction and spatial externalities are

increasingly common in theoretical formulations in a growing number of fields of study with economics. The empirical evidence that lends support to the new paradigm draws upon a growing number of celebrated cases of localised systems the world over (see Castells and Hall, 1994; Cooke, 1996; Ottati, 1996). The 'new learning' advances the idea of local enterprise co-operation as a key element of economic development initiatives (DTI 2005). Such strategies build upon notions of participation and endogenous development and involve the exploitation of human, natural, and economic resources that are specific to a geographically defined locality (Laschewski et al, 2002). Within this context, both policy-makers and academics have become concerned with the role that public agencies can play in enabling or even stimulating in promoting inter-organisational co-operation and networking (Huggins, 2000). Two central assumptions underlie these local development initiatives. The first is the assumed existence, or the good possibility of creating, relationships between local actors which themselves may engender mutual trust and shared learning (Curran et al, 2000). The second assumption is that economic activity is typically socially embedded, which is generally taken to imply local embeddedness (Jack and Anderson, 2002).

The importance of the locality as a source of competitive advantage has been emphasised by authors coming from different traditions. There are however different views on how exactly is the locality important. Thus, some authors emphasise the linkages between local enterprises and institutions (Scott 2002) and those who stress on the importance of extending those links to the meso level and the global level (Messner 2002, Bair 2006). The importance of the region has prompted further distinctions

between types of regions beyond the 'flexibly specialised' region as discussed mainly in relation to Italian cases (Rama et al. 2003).

However, there is also a growing appreciation of the disadvantages associated with 'over-embeddedness in a regional or local setting. These arguments are inspired by the work of economic sociologists who suggest that local embeddedness can also act as a constraint. Uzzi (1997) identifies three conditions that may turn embeddedness into liability: the unforeseeable exit of a key player, the prevalence of institutional forces that rationalise markets, and overembeddedness, which is of greater importance in a rural context. Burt (1992) argues that overembeddedness can reduce the inflow of information into the local setting if there are few or no links to outside members who can contribute innovative ideas. He takes the argument further, suggesting that people who stand near structural holes 'are more familiar with alternative ways of thinking and behaving, which gives them more options to select and synthesize from alternative' (Burt 2003). Whilst people connected across groups may be able to generate good ideas, locally embedded entrepreneurs may become 'ossified and out of step with the demands of its environment, ultimately leading to decline' (Uzzi 1997:59).

One important issue discussed in the external view of enterprise strategy revolves around the choice of **patterns** (or modes) of integration. The literature on transaction costs provides us with an understanding of the full complement of options confronting the firm: ranging from spontaneous contracting in the marketplace to hierarchical control through internalisation. Each pattern of integration possesses a number of advantages and disadvantages that are discussed in considerable length in an earlier Workpackage. Moreover, the accumulated empirical evidence suggests that whilst there are a multitude

of patterns of integration no obvious regularities to emerge. It is impossible to sustain arguments of the type that in industry A, sub-contracting out constitutes the main pattern of integration. Such arguments are not sustainable even within the same country, as a multitude of patterns of integration exist comfortably next to each other. The specific characteristics of the enterprises involved and often the attributes of the entrepreneurs (e.g. their attitudes to risk) are instrumental in defining this diversity.

Of course, it is worth pointing out some suggestive contribution to the exploration of this issue. Schiavone (2003) distinguishes between two types of enterprise strategies regarding patterns of integration. The first revolves around the creation of new business ventures in lower-wage countries, and is termed entrepreneurial delocalisation. The second involve simply changes in the supply chain without necessarily the externalisation of part of the production process. This involves the creation of subsidiaries of the very same firm in foreign countries and is termed as productive delocalisation). This distinction has significant implications upon the nature and characteristics of the enterprise strategies adopted. In the latter case there is a much greater degree of alignment of interests that may prevent independent action in lower-wage countries – though there are profound resource advantages concerned. Andersen (2005) adopts a similar – but by no mean identical approach – when he explores the difference between offshoring and outsourcing. In both cases what is essentially argued is that there is a significant trade-off between risk and flexibility on the one side and control and standards on the other.

Relying extensively on interorganisational **relationships** raises questions of first, migration of responsibility and ways of controlling standards and second, managing the

diversity of contexts, locations and relationships. Thus, for example, the migration of bureaucracy leads to changes in negotiating, administrating and monitoring contracts²⁰ (Mackenzie 2002), as well as putting in place mechanisms for assessing the quality and the work of a subcontractor before they are contracted and before they deliver the product (Assmann and Punter 2004). Further, the problem of co-ordination becomes a central strategic task (Abernathy et al. 2006) and it becomes necessary for companies to develop distributed management execution systems (Huang 2002). Humphrey and Schmitz (2001) address the question of governance by asking how are parameters set and then enforced, is it firms within the chain (e.g. the lead firm) or external entities that are enforcing them. The empirical evidence, however, does not offer a single and straight forward answer to the question about what types of relationships and governance mechanisms employed within the process of restructuring work best, as they are always socially embedded, and are simultaneously positioned within different, and often contradictory, discourses, structures of interests and priorities. For example, developing close relations or arms-length relations can both have advantages and disadvantages and can be useful in some cases, yet harmful in others. The ability to manage the inbound logistics and to cooperate with other companies appears to be essential for the success of subcontractors, and one of the positive consequences of such relations is that they can lead to knowledge transfer (Deardorff and Djankov 2000). Thus, looking at Finnish manufacturing companies Lehtinen (1999) argues that there is

²⁰ Contrary to what is often believed this process does not necessarily lead to the dismantling of hierarchies but on the contrary to their reproduction.

an increased significance of long-term and commitment based supplier-customer relationships, while Lazzeretti et al. (2004) emphasise the importance of trust and informal credit for the industrial development of the Italian district of Prato.

Because developing a relationship with a new supplier usually takes a long time companies may prefer to follow their established partners wherever they decide to move and keep on negotiating the conditions of their relations rather than looking for new suppliers. Discussing the clothing sector in the UK Gibbon (2001) argues that there is a tendency to reduce the number of suppliers, while also increasing the expectations of the range of services and functions expected to be carried out. In contrast, long-term relations can also be harmful and partnerships between manufacturers and retailers may create binding on both sides, where buyers may be forced to buy things just because the producer has got the capacity to produce it (Gibbon 2001) and/or at non competitive prices. Further, the positive effects are never guaranteed, indeed, there are structural constraints to the inter-organisational learning process, while buyers would also be concerned with future competition and thus would be cautious in transferring knowledge and technology to their partners (Lee and Chen 1998).

The variety of the observed relationships can further be extended into studying and conceptualising different forms of networks. Ponte (2005) distinguishes between four forms of co-ordination²¹: hierarchy, relational contracting (tighter forms, not easy to standardise, repeated interaction, understanding the mindset, ‘captive’ contractors),

²¹ Gereffi, Humphrey, and Sturgeon (2003) link the shape of the network to the degree of complexity of transactions, the possibility to codify transactions, and the capabilities in the supply-base and come up with similar categories. Thus, they distinguish between markets, modular value chains, relational value chains, captive value chains, and hierarchies.

relational contracting (looser forms, standardisation is possible but needs some degree of customisation, ‘modular’ contractors, contract manufacturing), market (homogeneous product, universally understood quality, etc.).

The diversity of possible outcomes from similar types of relationships²² given different contexts leaves the question of what is a ‘good’ choice open²³. However, being unable to predict and to firmly establish relationships of the cause-effect type does not mean that strategic choices are made totally in the dark. On the contrary, here we argue that it is possible to identify significant mechanisms, analyse the wide diversity of ways in which processes can work, and refine the existing distinctions, and that this is what practitioners often do in deciding on their strategies.

Time is the last fundamental element of enterprise strategies in labour-intensive industries, in that each firm has a history comprised of significant events that occurred at specific points in time (Jones et al 2002). Acknowledgement of the time dimension is implicit in a number of studies emanating from different disciplinary settings (GCC, Actor Network Theory, incremental models etc). Based on insights gained from these approaches we would like to distinguish here between chronological time and time sequences. Chronological time is the same for all firms. That is, all firms in a given area operating in the 1990s experienced the same macro-environmental influences, and

²² Buckley and Ghauri (2004) offer a comprehensive literature review on the links between ownership and location strategies.

²³ Sacchetti and Sugden (2003) contrast the externalisation activities of large TNC, which are concerned with flexibility, but also more control over governments, labour and subcontractors and argue that different networks would have different effects on socio—economic development.

passed through the same periods of economic growth and recession. Thus, chronological time patterns may emerge. Moreover, it is likely that the same enterprise may differ in its strategic decision-making over chronological time. Therefore, it is important to peg the firms' strategies against a relevant historical backdrop. Whilst chronological time is shared, time sequences are specific to each enterprise. They refer to the stages in the evolution of the firm and their implications upon the resources, skills and attributes of the enterprise.

3.3 Enterprise Strategies

Patterns of Enterprise Strategy in the Clothing Industry

Drawing primarily upon the literature a number of prototype strategies were identified (in a manner similar to the GCC). The prototype strategies for the clothing industry are presented in Table 7 below. We used this matrix as a means of clustering enterprise strategies: the variables used were those in the vertical axis of Table 7 (product, process, function, production, market) and the coding for each company reflected the horizontal axis (lock-in, hybrid, break-out). In order to process the data we used hierarchical cluster analysis: and particularly the Ward method, a common clustering algorithm, which had also been used effectively in previous studies. This technique was performed separately for each country, so as to allow for context specificity. The only exception was the cases of Greece and the UK, where cases were processed together due to the relative small number of cases (31 and 12 respectively). The determination of the appropriate number of groups or types is a key but arbitrary decision in hierarchical cluster analysis. In our case, guidance was provided by the increase in within-cluster

distances as groups were merged. Relatively large increases, that signify the merging of less similar cases (Harrigan, 1985; Carlyle, 2001), were apparent at different solutions for each. Overall, 16 groupings were derived (described in more detail in Appendix 1).

Table 7 Overview of Strategies

	Competence lock-in	Hybrid	Break out Competences
Product/service	Not own product range so limited scope for action	New product or product design for some of the product range	New product design & brand development
Process	Technological change (invariably in production) in line with needs of parent enterprise	Technological change in order to gain manufacturing competences (often knowledge transfer from one dimension (OPT) to the other)	All encompassing technological change including manufacturing and/or lean retailing
Function	Moving up or moving down the production chain but remaining within manufacturing	Moving up and/or moving down the production chain – often simultaneously in two different production dimensions.	Moving up the production chain – often away from manufacturing towards distribution. Proximity to the consumer a key source of competitive edge.
Production	Production competences remain at the heart of enterprise strategy.		The importance of production competences and volume production decline.
Market	Serving in the main price sensitive and to a lesser degree flexibility focused segments of the market	Serving flexible response focus plus one more of the other two (flexibility focus or design sensitive) segments of the market.	Serving in the main design focus segments of the market

Source: Enterprise Survey

The analysis of the enterprise strategy demonstrates how enterprises operating in the same segment of the market but different national context, may opt for different strategies (for example Poland-2, Estonia-3, and Bulgaria-3). This point can be taken further, as the analysis of strategy illustrates that even companies in the same country

and same market segment may adopt significantly different strategies (for example Poland 1 and 4, Poland 2 and 3, Estonia 1 and 2, Bulgaria 2, 3, and 4). Interestingly, the analysis suggests that companies that operate in different segments of the market, in different countries may actually adopt the same strategy (for example Poland-2 and Estonia-1, Greece-1 and Poland-1). Off course, there are also some similarities. Companies both in Greece and the UK fall in clusters 2 and 3, clusters Poland-2 and Bulgaria-4 are identical, as are clusters Poland-1 and Bulgaria-1.

The cluster analysis of the enterprise strategies allows us to identify a number of interesting patterns (see Figure 12 below). Competence lock-in strategies do not link exclusively to the price sensitive segment of the market. This type of strategy also appears to be of importance in market segments where success is conditional upon flexible response. This is apparent in the case of Estonia-1 and Bulgaria-1, clusters. Interestingly, both clusters maintain a strong export orientation, and enjoy to a considerable degree foreign investment. However, in both instances there is little evidence of function up-grading, with most companies reporting no change. Competence lock-in strategies are, of-course, apparent in the price sensitive segment of the market: for example Poland-2 and Bulgaria 4 as well as Greece 1 fall within this grouping. Another grouping (Estonia-3) appears to adopt a very similar strategy, but for the development of some design competences for some of the product range. A strong export orientation and significant foreign involvement (but for the Poland-2 grouping) are also apparent. Among these groupings functional up-grading is commonplace only in one grouping (namely Bulgaria -4).

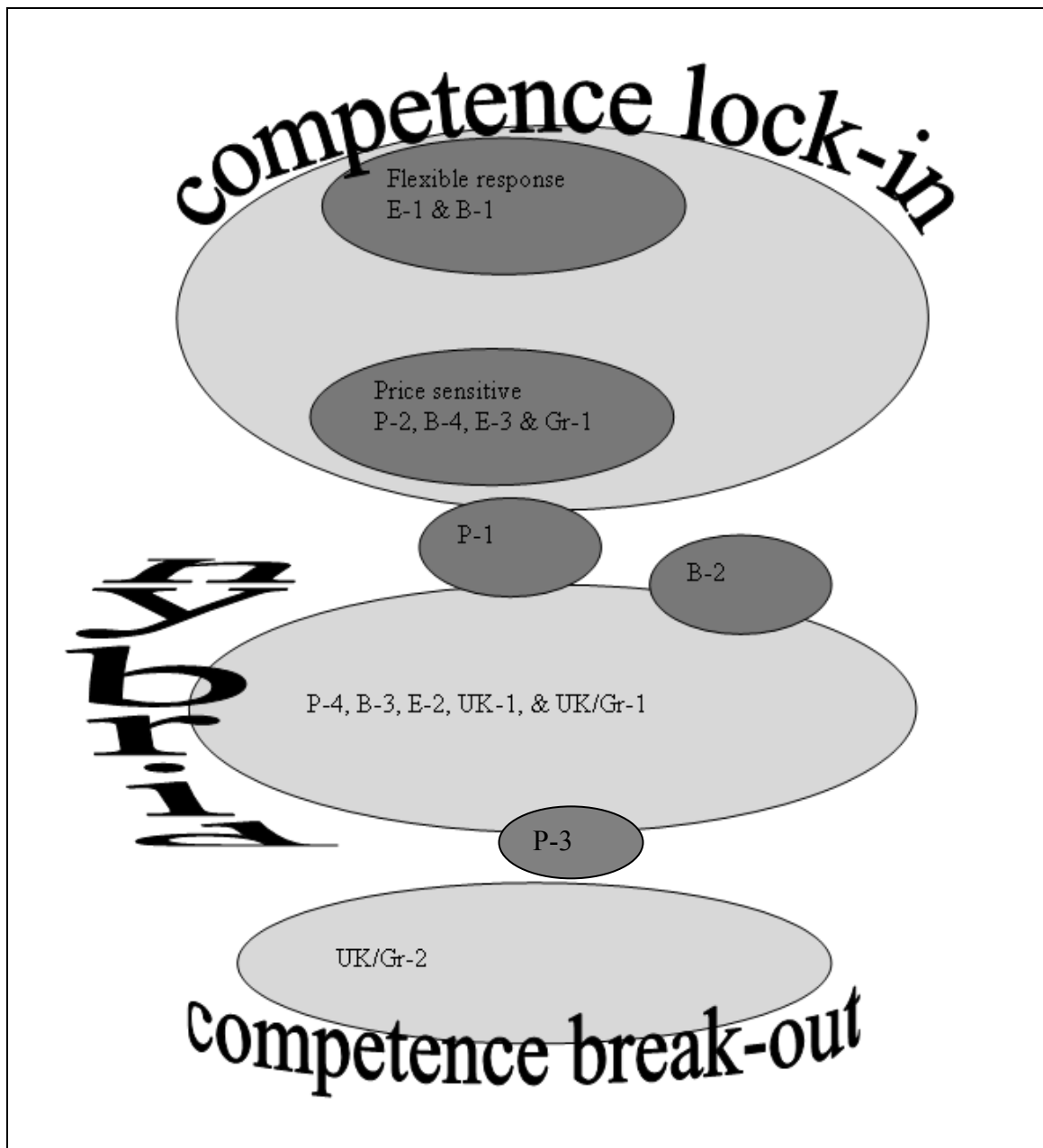


Figure 12 Patterns of Enterprise Strategies

Another interesting pattern emerges around those hybrid strategies, aiming to use competences used through engagement in global networks of production and distribution in order to enhance the enterprise's position in the domestic market. However, none of the emerging clusters reflect the ideal-type developed in Table 7. There are five groupings that appear to broadly fall within this pattern. Those in Poland (-4) and Estonia (-2) appear to have developed greater design competences and own brand products than originally envisaged. Functional up-grading among these groupings is widespread. The Bulgarian one (-3) has failed to introduce functional change. The remaining two – which differs somewhat because of the declining importance of production – are UK-1, and UK/Greece-1. Moving-upwards in the production chain is common in the former grouping but less so in the latter. Interestingly, the evidence suggests that those groupings which developed a strong interest in the domestic market were – overall – more successful in moving-up the production chain. In many instances this was often achieved at the same time as downgrading – or at best no change – in the position of companies in GCCs.

There is only one grouping (UK/Greece-2) that resembles to a considerable degree the Break-out competences category, comprising of only nine companies that maintain a strong domestic focus.

Lastly, there are three outlier groupings. The first (Poland-3) is located in between hybrid and break away strategies. These firms have developed their own brand and are increasingly moving away from production, linked with a move further up in the chain, but they still have not completed the implementation of advanced technologies in all aspects of production and distribution and their focus remains on the price sensitive

segment of the market. The remaining two groupings provide us with useful illustrations of two processes of transition between competence lock-in and hybrid strategies (as can be seen in Figure 12).

Patterns of Enterprise Strategy in the Footwear Industry

In analysing footwear strategies we followed the same general approach as we did with clothing. However, the categories that were used to represent competence lock-in, hybrid and breakout competencies were adapted to the specificities of the footwear sector. Thus, the prototype strategies for the footwear industry are presented in Table 8 below.

In order to process the data hierarchical cluster analysis was performed separately for two groups of companies in our sample: those located in new member states (Bulgaria, Poland and Estonia) and those located in old member states (UK and Greece). The cases were combined into only two groups due to the small number of cases for Estonia and Greece. While this broader groupings restricts our ability to derive country specific conclusions we can nevertheless distinguish between strategies in countries that are differently positioned in the value chain.

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conclusions we can nevertheless distinguish between strategies in countries that are differently positioned in the value chain.

Table 8 Overview of Strategies

	Competence lock-in	Hybrid	Break out Competences
Product/service	Not own product range so virtually no action	New product or product design for some of the product range or movement to niche markets	New product design & brand development
Process	Technological change (invariably in production) in line with needs of parent enterprise	Technological change in order to gain manufacturing competences; this may include sharing of technological production secrets from parent company as well as knowledge transfer from one dimension (OPT) to the other	All encompassing technological change including manufacturing and/or lean retailing
Function	No movement within production chain remaining firmly within manufacturing	Moving up and/or moving down the production chain – often simultaneously in two different production dimensions. Often targeting simultaneously specific markets both at home and abroad.	Moving up the production chain – often away from manufacturing towards distribution. Proximity to the consumer a key source of competitive edge.
Production	Production competences remain at the heart of enterprise strategy.	Moving away from volume production and/or the production of parts for footwear.	The importance of production competences decline. Fully develop own retail network in the home and/or international markets.
Markets	Competition occurs primarily on the basis of price and to a lesser degree quality	Competition occurs primarily on the basis of design mainly for the domestic market	Competition occurs mainly on the basis of design and quality, mainly for international markets.

Source : Enterprise Survey

Similar to our analysis for clothing, in footwear we also observe that companies operating in the same market segment may adopt different strategies (e.g. 1 and 3; 2 and 4; 12 and 13; 11 and 14). Only companies that are located in new member states are targeting the price sensitive segment of the market (1 and 3). Companies that are competing on design are present in both old and new member states (2, 4, 12, 13). Only two groups (1 and 2), both located in the new member states, demonstrated lock-in competences. Cluster 4 was closest to the ideal type of hybrid strategy, while strategy groups 3, 12, 13 and 14 adopted different versions of hybrid strategies also addressing different market segments. Interestingly companies located in different market segments adopted the same strategies (3 and 12). Only cluster 11 coincided with our ideal type of break out competencies.

Country of origin is a significant factor for the type of strategies adopted in the footwear sector, although less so than in the case of the clothing sector (Table 9). Thus companies in cluster 1 are almost exclusively located in Bulgaria, while the presence of Bulgarian companies in cluster 4 is very weak. In the grouping of old member states Greek companies are almost exclusively located in cluster 12, with UK companies present in all four clusters. Bulgarian companies are the largest in the sample with also the highest dependence on export markets.

Table 9 Country and Strategy

Ward Method			* Country Crosstabulation					
			Country					Total
			1	2	3	4	5	
Ward Method	1	Count	13	1	0	0	0	14
		% within Country	31.0%	11.1%	.0%	.0%	.0%	12.5%
	2	Count	15	3	11	0	0	29
		% within Country	35.7%	33.3%	34.4%	.0%	.0%	25.9%
	3	Count	12	0	11	0	0	23
		% within Country	28.6%	.0%	34.4%	.0%	.0%	20.5%
	4	Count	2	5	10	0	0	17
		% within Country	4.8%	55.6%	31.3%	.0%	.0%	15.2%
	11	Count	0	0	0	1	4	5
		% within Country	.0%	.0%	.0%	14.3%	18.2%	4.5%
	12	Count	0	0	0	6	4	10
		% within Country	.0%	.0%	.0%	85.7%	18.2%	8.9%
	13	Count	0	0	0	0	5	5
		% within Country	.0%	.0%	.0%	.0%	22.7%	4.5%
	14	Count	0	0	0	0	9	9
		% within Country	.0%	.0%	.0%	.0%	40.9%	8.0%
Total		Count	42	9	32	7	22	112
		% within Country	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Enterprise Survey

The cluster analysis of the enterprise strategies allows us to identify a number of interesting patterns (Figure 13 below). There are only four clusters that fall into one of our ideal types, these are clusters 1 and 2 for lock-in, cluster 4 for hybrid, and cluster 11 for breakout competencies. Interestingly competence lock-in strategies (1 and 2) are linked to both the price sensitive and the design focussed segments of the market.

At the other end of the spectrum is cluster 11 which stands for companies that have break out competencies and compete mostly on international markets.

There is only one cluster (4) that represents companies oriented towards the domestic market and is likely to incorporate both companies that are aspiring to develop their own

brand as well as companies that are focusing on narrow niche markets. Significantly here they are all employing very similar strategies, which is in contrast to their counterparts in old member states. The remaining three clusters from new member states are oriented to the price segment of the market and for them selling on the national market is supplementing their export focus.

There remaining four clusters (3, 12, 13, and 14) developed different forms of hybrid strategies. Cluster 12, 13 and 14 are at different stages in terms of product development with cluster 13 being the least advanced of the three. Cluster 3, located in the new member states is the only cluster with a hybrid strategy that is targeting the price sensitive segment of the market.

Similar to the situation in clothing the evidence for footwear suggests that those groupings which developed a strong interest in the domestic market were – overall – more successful in moving-up the production chain. In many instances moving upwards this was often achieved at the same time as downgrading – or at best no change – in the position of companies in GCCs. Thus, advance in the main market is linked to functional retreat in the secondary market.

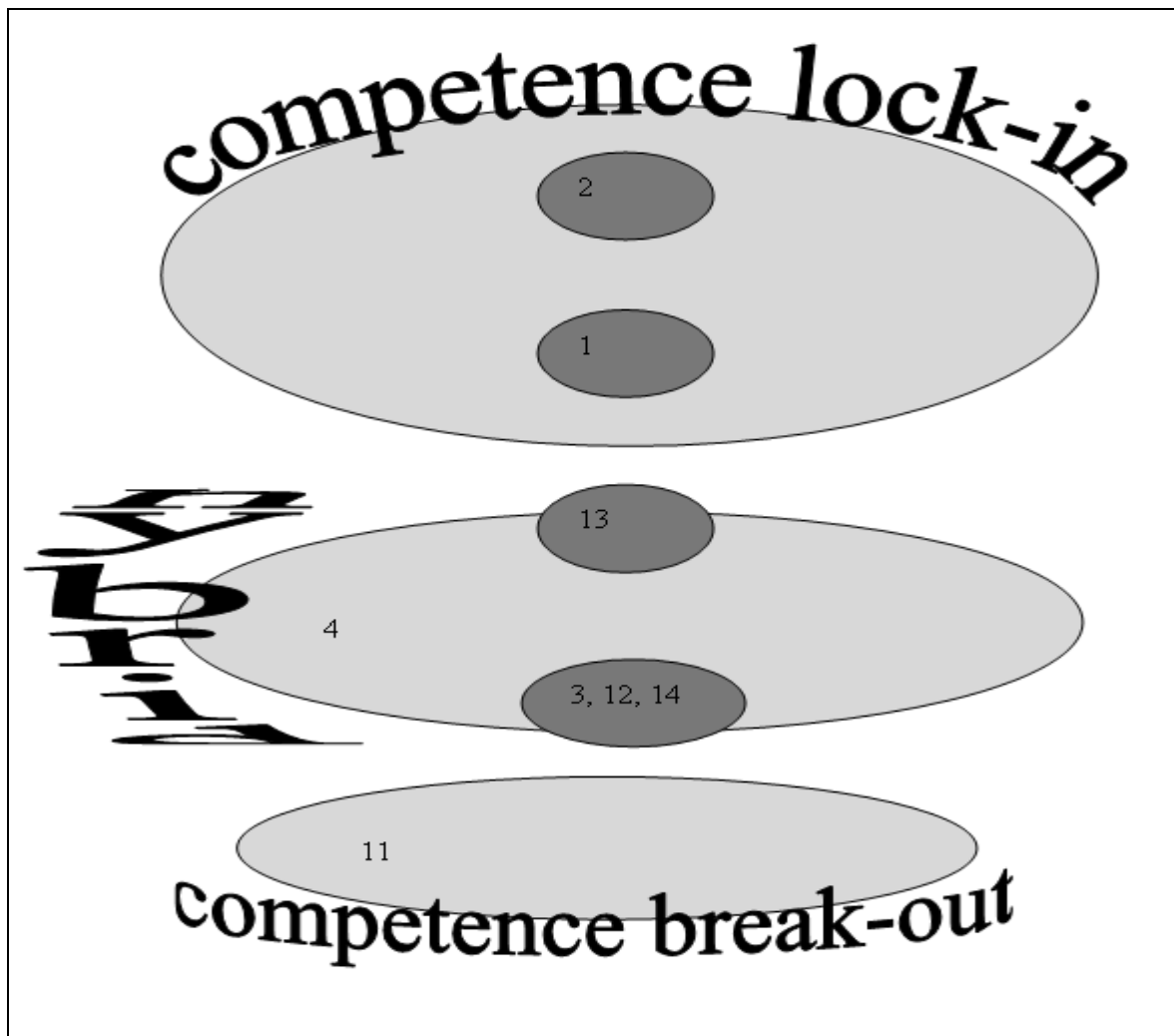


Figure 13 Patterns of Enterprise Strategies: Footwear

Patterns of Enterprise Strategy in the Software Industry

Drawing primarily on the literature a number of prototype strategies were identified (see Table 10 below). Not unexpectedly these strategies differed significantly from those in the clothing and footwear industries. The specificities of the sector mean that there is a much greater emphasis on innovation – both in terms of products and processes – as well as intellectual property (hereafter IP). Moreover, the characteristics of the supply chain

mean that low value added stages are concentrated in the middle, with higher value added in the two ends (design and distribution).

Table 10 Overview of Prototype Strategies

	Competence lock-in	Hybrid	Break out Competences
Product/ service	Not own product range, mainly servicing products development (sometimes maintenance) and support of other organisations	Some product design capabilities and/or capabilities for integration and support in unique environments	Own product design (IP-very important) & brand development and/or unique products for highly complex environments
Process	Technological change and specialisation/competence in line with the requirements of external software producer(s)	Some technological innovations and specialised competencies	Unique own technology (but also technological innovations here)
Function	No significant movement between stages, though maybe some movement within	Moving up and/or moving down the value chain – often simultaneously in two different production dimensions	Moving closer to final markets/consumers and/or to product development
Production	Services mainly testing and/or code writing under order (or very often implementation of solutions of other companies with no substantial own intellectual property)	Some project management capabilities and/or some increasingly complicated code writing	Reduced internal production capacity, and developing chain management competences Often in consulting services or design of own systems
Market	Price competition and aspects of quality are of paramount importance in serving few non-major customers	Innovation is a key element of competitive advantage, maybe alongside secondary considerations such as design, quality or even price	Niche products/ solutions for major international players, where design capabilities and quick response are of paramount importance

Source: Enterprise Survey

The evidence regarding the software industry shows a relatively lower degree of diversity, than in the case of footwear and clothing (see Figure 14). Enterprises in the same segment of the market tend to adopt to a greater degree than in the other two sectors, broadly similar strategies. Thus, we have a number of groupings across

different countries falling within our prototype categories. This relatively lower impact of the national context is an interesting feature of the industry and may be attributed to the ease of flows across space.

Another interesting characteristic of the industry is the concentration of competence lock-in strategies exclusively in Eastern European countries, where they account for a significant percentage of the total. However, all of the enterprises surveyed do not remain focused exclusively on price sensitive segments of the markets. Indeed, price competitiveness in the markets they operate is combined with innovativeness. Overall, forty three enterprises fall in this grouping – making up around 30 per cent of the total enterprises in the sector.

Interestingly, there is a considerable concentration of strategy groupings around the hybrid prototype strategy. However, there are some interesting differences between enterprises adopting hybrid strategies. A number of these enterprises fall squarely within the prototype strategy developed here: thus focusing on markets where competition occurs in terms of competition, and to a lesser degree price and quality. Some fifty-four enterprises – 38 per cent of the total fall in this grouping – and can be found in all the countries surveyed. However, hybrid strategies are also adopted by enterprises which try to focus on niche markets, and provide solution for major (often international) players. Groupings from Estonia and Poland fall in this broad category – accounting for some 40 enterprises. Lastly, there appears to be grouping (UK/Greece-2) which is moving away from competence lock-in towards hybrid strategies. Altogether, 73 per cent of the enterprises surveyed adopt hybrid strategies.

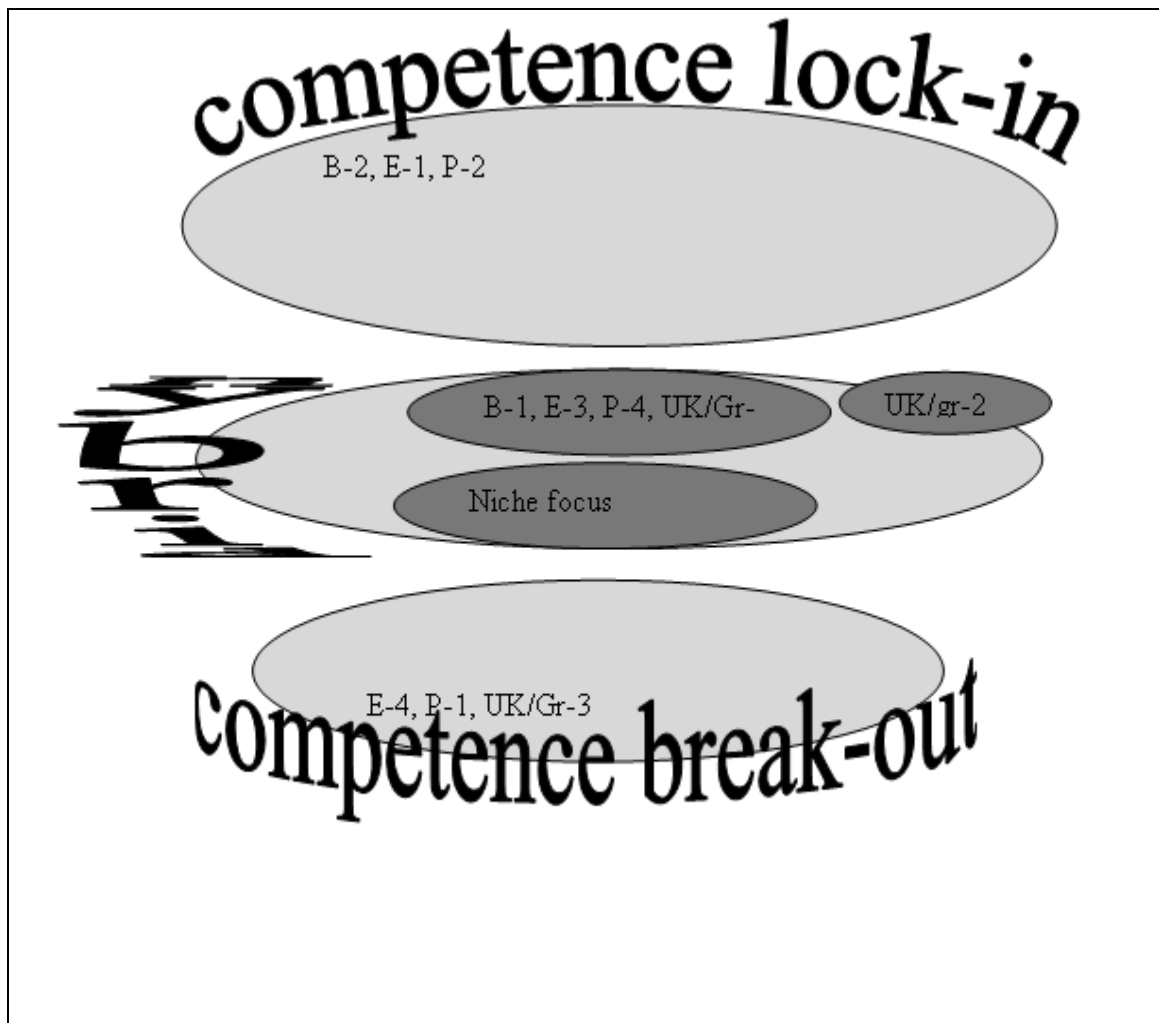


Figure 14 Patterns of Enterprise Strategies: Software

Pattern of Enterprise Strategy in Electronics

In analysing the electronics sector we followed the same approach as in the analysis of clothing, footwear and software. Building on the literature we developed a matrix with three ideal type strategies (Table 11).

Table 11 Overview of Prototype Strategies

	Competence lock-in	Hybrid	Break out Competences
Product/ service	Not recognisable products, integration into network product architectures	A combination of not recognisable and recognisable products. Design capabilities are present. IP does not play a substantial role	Own recognisable product (design & brand development) and/or unique products for highly complex environments where IP is very significant
Process	Narrow technological specialisation/competence that may be cutting edge but is an integral part of a wider process	Some technological innovations and competences, often developed in co-operation with major customers	Unique own technology, and/or ability to combine and apply different technologies in a new and unique way
Function	No significant movement between stages, though maybe some movement within	Moving up and/or moving down the value chain – often simultaneously in two different production dimensions	Moving closer to knowledge intensive parts of the supply chain often simultaneously with a move towards final markets/consumers
Production	Production remains at the heart of the company	Production remains importance, but often combined with new services.	Reduced internal production capacity, and developing chain management competences and/or services

In contrast to the other three industries the strategies in electronics reflect much closer the three ideal types (Figure 15). Companies in three of the five countries, Bulgaria, Estonia, and Greece developed lock-in strategies with Greek companies focusing exclusively on the flexible response segment of the market (Gr-2), while there were Estonian companies focusing on the flexible (E-2) and the price sensitive segments (E-3).

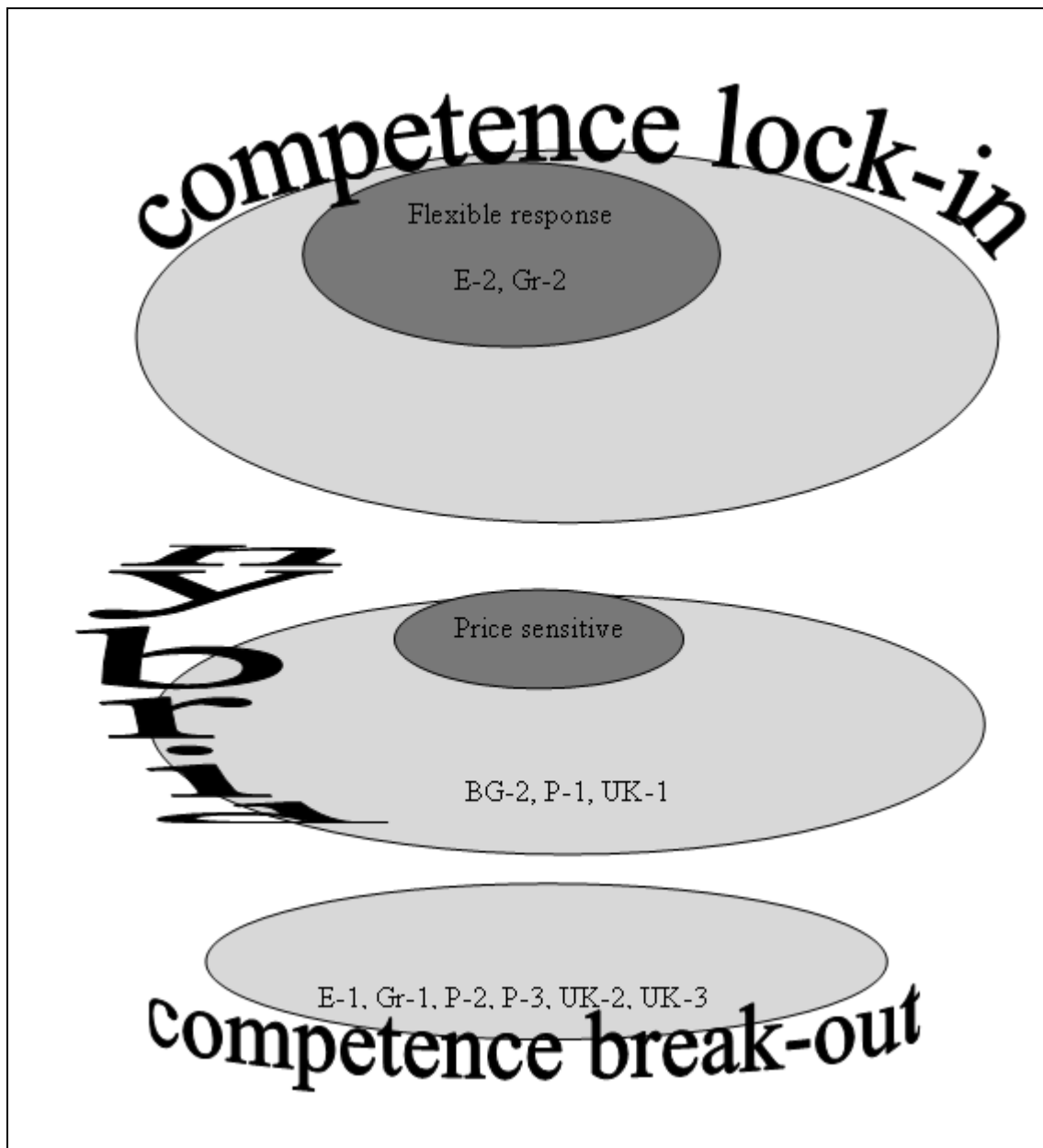


Figure 15 Patterns of Enterprise Strategies: Electronics

There were no Bulgarian companies that adopted break-out strategies. Bulgarian companies developed either lock-in or hybrid strategies with no Bulgarian company developing break-out strategy. Bulgarian companies that developed hybrid competencies

were located in either the price sensitive (BG-1) or the flexible response (BG-2) segments of the market.

The strategies adopted by Greek and Estonian companies were polarised and were either lock-in (E-2, E-3, Gr-2) or break-out (E-2, Gr-1). However, the Greek companies that developed lock-in strategies were only located in the flexible response segment of the market (Gr-2). Interestingly it was UK and Polish (rather than Greek) companies that demonstrated similar behaviour and adopted either hybrid (P-1, UK-1) or break-out competencies (P-2, P-3, UK-2, UK-3).

3.4 A Kaleidoscope of Strategies

The analysis of the primary data on a sector by sector and country by country basis provided us with a total of 55 groupings. Whilst, there was profound diversity – especially in clothing and electronics – there were also similarities. Some of these similarities are found around our prototype strategies, but not only. These similarities enable us to identify six main strategy patterns, presented below in kages as well as performance. Thus, we derive the following groupings: i) competence lock-in, ii) competence lock-in for markets that require flexibility, iii) hybrid focusing on price sensitive segments of the market, iv) hybrid, v) competence break-out and vi) outliers. The groupings are presented in a centripetal manner (with those adopting competence lock-in strategies in the periphery, and those adopting break-out strategies in the core). Each industry occupies a different colour and side of the rectangle, whilst those groupings that fall in the same pattern are linked or overlap.



The incidence of these groupings varies significantly from country to country, and from sector to sector. Thus, there is a considerable concentration of enterprises that adopt a competence lock-in strategy in Bulgaria, whilst no firm in the UK falls in this grouping (Figure 16). In contrast, nearly half of the enterprises in the latter country adopt a competence break-out strategy (none of the firms in Bulgaria fall in this grouping). Interestingly, in Estonia competence lock-in strategies are invariably linked with flexible markets. As far as sector is concerned, there is a greater incidence of enterprises that

adopt competence lock-in strategies in clothing, whilst this is much less the case in software (Figure 17). In the latter sector hybrid strategies are more commonly present, and, to some degree, break-out. However, it is in electronics, where competence break-out is most commonly apparent. Lastly, in footwear, hybrid for price sensitive markets, and competence lock for other (than price sensitive) markets are of considerable importance. These disparities in the national and sectoral composition of each strategy pattern may assist in interpreting variation in external linkages as well as performance.

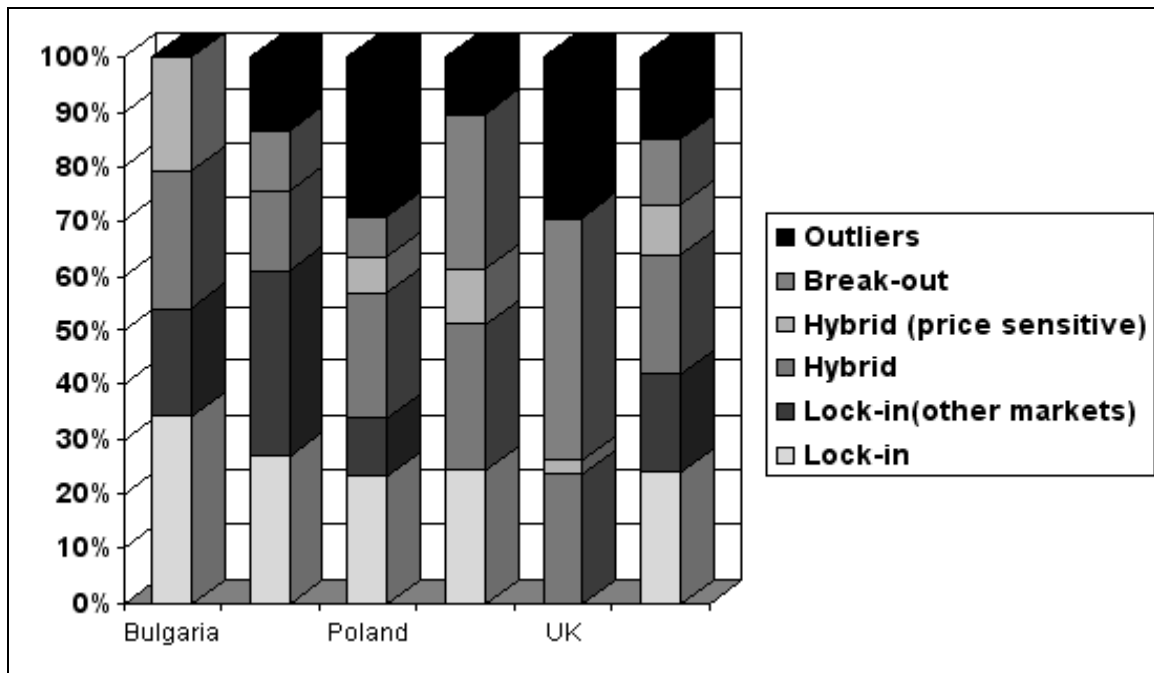


Figure 16 Strategy Patterns by Country

Source: Enterprise Survey

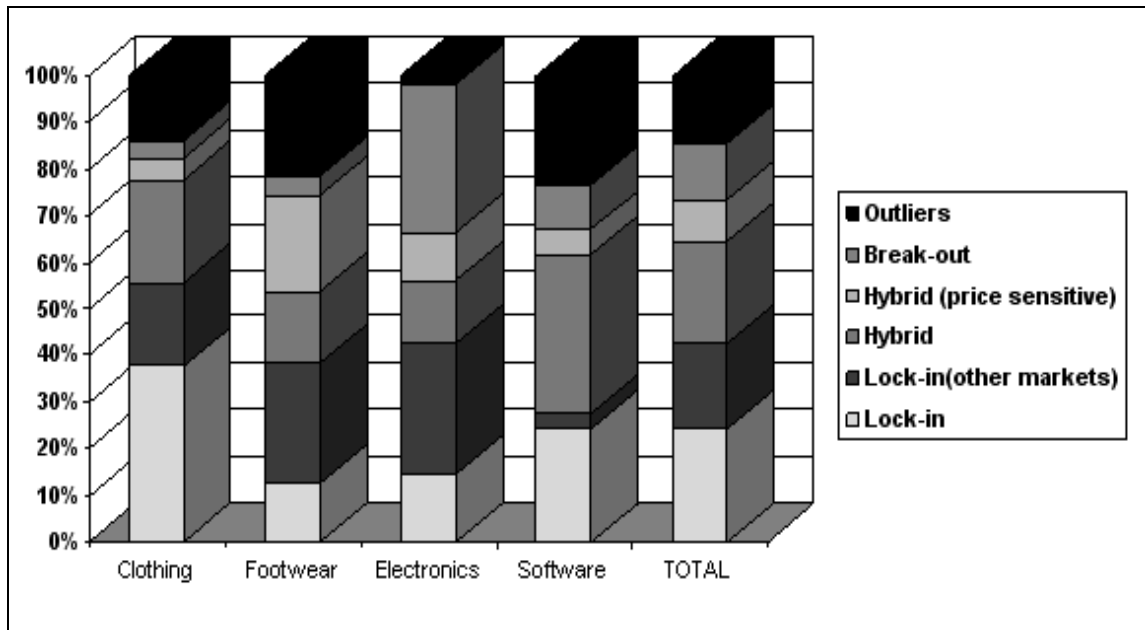


Figure 17 Strategy Patterns by Sector

Source: Enterprise Survey

There are some disparities in the characteristics of the enterprises adopting different patterns of strategy. As can be seen from Table 12, enterprises that adopt competence break-out strategies tend to be larger and well established units, which do not rely heavily on international markets (less than half of their sales). Outliers are also established firms with lower export orientation – interestingly these are most common in the two largest markets (UK and Poland), but they tend to be somewhat smaller units. Export orientation and relatively recent establishment is invariably linked with enterprises that adopt competence lock-in strategies, and are most commonly found in the two smaller Eastern European countries (namely Bulgaria and Estonia). These characteristics raise an interesting question for future research: i.e. to what extent there is a progression (through time) from one strategy pattern to another (as the age and size

evidence indicates), or to what extent do firms do not alter radically their patterns of strategy. The latter argument would mean that the lifespan of firms that adopt competence lock-in strategies may be shorter than those aiming to break-out.

Table 12 Enterprise Characteristics by Strategy Pattern

Report

strategygroup		Total employment - units (V 49)	Exports as % of total sales in 2004 (V 95)	ageoffirm
outliers	Mean	103.0303	45.0440	27.5960
	N	99	91	99
	Std. Deviation	181.45216	37.75268	31.71555
competence lock-in	Mean	110.5549	60.8500	14.1220
	N	164	160	164
	Std. Deviation	214.07424	37.57947	12.36896
competence lock-in(other markets)	Mean	194.6393	73.7723	13.8033
	N	122	119	122
	Std. Deviation	324.42040	35.07494	13.87943
hybrid(price sensitive markets)	Mean	183.7333	60.2200	19.8500
	N	60	50	60
	Std. Deviation	259.78954	35.63780	16.90635
hybrid	Mean	126.1233	50.1115	16.7103
	N	146	139	145
	Std. Deviation	244.73496	34.59282	15.52772
competence break-out	Mean	948.6750	46.9531	28.3951
	N	80	64	81
	Std. Deviation	4091.67853	35.79990	29.01408
Total	Mean	234.5887	57.1355	18.8465
	N	671	623	671
	Std. Deviation	1448.51998	37.36754	20.74008

3.5 Enterprise Strategies and External Linkages

In order to explore the impact of space upon enterprise strategies we developed three new measures that capture proximity/distance – influenced heavily from the literature. The first concerns physical proximity, and is a three category variable. So in instances

where the main international market of the enterprise is in a country that borders with the country of origin the measure is low (1=high proximity), a market elsewhere in EU is moderate (=2), and elsewhere in the world high (3=low proximity). The findings are presented in Table 13 below. This indicates some interesting disparities by strategy pattern. Overall, European markets are of paramount importance for nearly 90 per cent of enterprises. Interestingly, it is enterprises that opted for competence break-out strategies, outliers, and those adopting hybrid strategies that appear able to work in markets outside their immediate vicinity. In the case of the last pattern, this may be linked to the importance of the US dominance in the software sector. Interestingly, immediate physical proximity appears to be more important for enterprises that used a competence lock-in strategy for markets where competition occurs primarily in terms others than price – although this is linked with the over-representation of Estonian firms (which rely heavily on the Finish market) in this pattern. This also appears to be the case – though to somewhat a lesser degree among enterprises which adopted competence lock-in strategies for price sensitive segments of the market.

The second measure of proximity/distance used for our purposes includes institutional proximity (Table 14). This captures the ease of transacting internationally on account of national and international institutions. The EU market is viewed as the one with the highest institutional proximity (=1), other advanced market economies follow (2=moderate), whilst countries in the former Soviet Union are viewed as institutionally distant (=3). Disparities on this measure are modest, by strategy grouping, primarily on account of the overwhelming importance of the EU markets. Again, however,

enterprises that adopt hybrid strategy patterns (including those for price sensitive markets) opt more frequently for institutional distance.

Table 13 Geographical proximity by Strategy Group

			geoproximity			Total
			1.00	2.00	3.00	
strategygroup	outliers	Count	32	33	19	84
		% within strategygroup	38.1%	39.3%	22.6%	100.0%
	competence lock-in	Count	60	76	14	150
		% within strategygroup	40.0%	50.7%	9.3%	100.0%
	competence lock-in(other markets)	Count	57	50	2	109
		% within strategygroup	52.3%	45.9%	1.8%	100.0%
	hybrid(price sensitive markets)	Count	16	29	7	52
		% within strategygroup	30.8%	55.8%	13.5%	100.0%
	hybrid	Count	58	50	24	132
		% within strategygroup	43.9%	37.9%	18.2%	100.0%
	competence break-out	Count	19	17	9	45
		% within strategygroup	42.2%	37.8%	20.0%	100.0%
Total		Count	242	255	75	572
		% within strategygroup	42.3%	44.6%	13.1%	100.0%

Source: Enterprise Survey

Table 14 Institutional Proximity by Strategy Group

			instproximity			Total
			1.00	2.00	3.00	
strategygroup	outliers	Count	60	17	7	84
		% within strategygroup	71.4%	20.2%	8.3%	100.0%
	competence lock-in	Count	129	14	7	150
		% within strategygroup	86.0%	9.3%	4.7%	100.0%
	competence lock-in(other markets)	Count	99	3	8	110
		% within strategygroup	90.0%	2.7%	7.3%	100.0%
	hybrid(price sensitive markets)	Count	43	1	8	52
		% within strategygroup	82.7%	1.9%	15.4%	100.0%
	hybrid	Count	100	17	14	131
		% within strategygroup	76.3%	13.0%	10.7%	100.0%
	competence break-out	Count	36	9	0	45
		% within strategygroup	80.0%	20.0%	.0%	100.0%
Total		Count	467	61	44	572
		% within strategygroup	81.6%	10.7%	7.7%	100.0%

Source: Enterprise Survey

The third measure captures organisational proximity, which can also be viewed as a proxy for patterns of integration (Table 15). We view as the highest level of organisational proximity instances where there is a direct ownership link, i.e. FDI or joint venture. Moderate level of organisational proximity is perceived in cases where there are at least five years of continuous relationship with a single buyer, and this buyer accounts for at least 40 per cent of sales. Low level of organisational proximity is in all other instances. Enterprises that adopted a hybrid strategy (both patterns) did not opt for high organisational proximity approach. This is not particularly surprising, as these are – often local businesses – that engage in international markets as a means of strengthening their position in the domestic market. The reverse is the case regarding enterprises which adopted a competence lock-in strategy, especially for other (than price sensitive) markets. This may be influenced by sector, as there is a considerable incidence of clothing firms within this strategy pattern.

Table 15 Organisational Proximity by Strategy Group

			orgproximity			Total
			1.00	2.00	3.00	
strategygroup	outliers	Count	24	10	30	64
		% within strategygroup	37.5%	15.6%	46.9%	100.0%
	competence lock-in	Count	36	30	70	136
		% within strategygroup	26.5%	22.1%	51.5%	100.0%
	competence lock-in(other markets)	Count	52	13	46	111
		% within strategygroup	46.8%	11.7%	41.4%	100.0%
	hybrid(price sensitive markets)	Count	13	6	31	50
		% within strategygroup	26.0%	12.0%	62.0%	100.0%
	hybrid	Count	20	22	64	106
		% within strategygroup	18.9%	20.8%	60.4%	100.0%
	competence break-out	Count	22	6	28	56
		% within strategygroup	39.3%	10.7%	50.0%	100.0%
Total		Count	167	87	269	523
		% within strategygroup	31.9%	16.6%	51.4%	100.0%

Source: Enterprise Survey

In exploring the nature of the relationships between strategy patterns we deployed five indicators (Table 16). The first and the second, are viewed as measures of dependence: the number of foreign companies serviced, and the percentage of sales going to the main international customer. The third and fourth are viewed as measures of strength of the relationship: the number of years of continuous transaction, and their view of the degree of mutual confidence. The final one is a Lickert-type measure of the balance of power in the relationship (the lowest the index the more power resides with the enterprise surveyed).

Table 16 Nature of Relationships

Report						
strategygroup		How many foreign companies did you service on a subcontracting basis last year (V125)	Main customer1 - % of total (V 135)	Average number of years of continuous relationship (V 144)	Balance of power (V148)	Mutual dependence (V 149)
outliers	Mean	4.8542	43.9219	7.0000	1.91	1.42
	N	48	32	45	93	92
	Std. Deviation	4.51470	33.75149	5.88527	1.960	1.626
competence lock-in	Mean	5.4857	55.6327	6.8154	3.40	3.19
	N	140	113	130	148	148
	Std. Deviation	9.63692	33.11681	3.80897	1.354	1.347
competence lock-in(other markets)	Mean	6.6881	58.1818	6.5182	3.69	3.30
	N	109	88	110	121	120
	Std. Deviation	8.59446	35.24318	3.29228	1.489	1.515
hybrid(price sensitive markets)	Mean	5.4182	54.9048	6.5364	3.55	3.00
	N	55	42	55	60	60
	Std. Deviation	5.82361	32.20499	3.88117	1.241	1.340
hybrid	Mean	6.9135	45.3596	6.3552	3.28	2.85
	N	104	89	116	137	137
	Std. Deviation	11.82979	29.66297	4.00435	1.670	1.570
competence break-out	Mean	15.7097	59.4231	8.2326	2.54	1.95
	N	31	26	43	76	76
	Std. Deviation	37.53860	35.84765	5.25917	1.963	1.664
Total	Mean	6.6407	53.0769	6.7509	3.12	2.71
	N	487	390	499	635	633
	Std. Deviation	13.09542	33.26648	4.13636	1.719	1.645

Source: Enterprise Survey

Enterprises that adopted a competence break-out strategy depend heavily upon their main buyer, who accounts for more than half of their sales turnover (the highest of all). However, they also possess greater customer base, which, in turn, diminishes their vulnerability. This is an interesting finding that indicates that developing competences that may enable a firm to break-out does not necessarily mean that the company operates in isolation from other businesses in the sector. In fact, the relationships developed by enterprises falling in this grouping are both long lasting (mean duration of 8.2 years – the longest of all groupings). Moreover, these relationships rely less upon mutual confidence, but are more symmetrical in terms of power is also profound.

However, the most profound dependence upon a small number of international buyers, and the main buyer among them is apparent in the case of companies that adopt competence lock-in strategies (both for price sensitive and flexible response markets). Overall, the durability of relations is considerable (more than six years), and there is recognition of the mutual confidence that this creates, as well as the asymmetry of power.

Those enterprises that adopted a hybrid strategy appear to rely to a much lesser degree upon a single international buyer: a trend re-inforced by the fact that in most instances a significant percentage of sales is directed in the domestic market. However, this does not impact upon the durability of relationships, but somewhat diminishes the sense of mutual confidence and power asymmetries.

Lastly, the strategy pattern that reports the lowest level of dependence on buyers involves the outliers. They rely less on the main customer, have a wider customer base,

and a lower sense of mutual dependence and asymmetrical power than firms in any other strategy pattern.

These findings are influenced to a considerable degree by sector and country. This is because of the considerable disparities in the incidence of strategy patterns by sector and country.

Statistical analysis, regarding the variables that capture the nature of emerging relationships, provide some interesting results, presented in Table 17. Not unexpectedly, there is a statistically significant (at $p < .01$) relationships between the number of international buyers and the importance of the main buyer. This relationship is negative (the more the buyers the lower the importance of the main buyer), and moderately strong. A positive relationship appears to exist between the significance of the main buyer and the degree of mutual confidence. More interestingly, there appears to be a strong and statistically significant ($p < .01$) between the balance of power and mutual confidence.

Data regarding the timing of the processes at work are weak. Table 18 (below) captures the timing of FDI and joint venture creation. This process peaked in 1997 – and appears to be subsequent of the creation of sub-contracting linkages. Following a modest decline, the pace of integration accelerated again in 2004 and 2004.

Table 17 The Nature of Relationships

Correlations

		Main customer1 - % of total (V 135)	How many foreign companies did you service on a subcontracting basis last year (V125)	Average number of years of continuous relationship (V 144)	Balance of power (V148)	Mutual dependence (V 149)
Main customer1 - % of total (V 135)	Pearson Correlation	1	-.229**	.039	.091	.281**
	Sig. (2-tailed)		.000	.430	.057	.000
	N	437	416	412	435	433
How many foreign companies did you service on a subcontracting basis last year (V125)	Pearson Correlation	-.229**	1	.057	-.001	-.044
	Sig. (2-tailed)	.000		.195	.982	.301
	N	416	549	510	546	544
Average number of years of continuous relationship (V 144)	Pearson Correlation	.039	.057	1	.125**	.180**
	Sig. (2-tailed)	.430	.195		.003	.000
	N	412	510	563	561	559
Balance of power (V148)	Pearson Correlation	.091	-.001	.125**	1	.665**
	Sig. (2-tailed)	.057	.982	.003		.000
	N	435	546	561	714	712
Mutual dependence (V 149)	Pearson Correlation	.281**	-.044	.180**	.665**	1
	Sig. (2-tailed)	.000	.301	.000	.000	
	N	433	544	559	712	712

**Correlation is significant at the 0.01 level (2-tailed).

Table 18 Year of foreign involvement by strategy group

		strategygroup						Total	
		outliers	competence lock-in	competence lock-in(other markets)	hybrid(price sensitive markets)	hybrid	competence break-out		
Year of involvement: (V 75)	pre70	Count	0	0	0	0	0	2	2
		% within strategygroup	.0%	.0%	.0%	.0%	.0%	10.0%	1.2%
	71/88	Count	0	1	1	0	2	1	5
		% within strategygroup	.0%	3.0%	1.9%	.0%	6.9%	5.0%	2.9%
	1989	Count	1	0	1	0	0	1	3
		% within strategygroup	4.0%	.0%	1.9%	.0%	.0%	5.0%	1.7%
	1990	Count	0	2	0	0	4	1	7
		% within strategygroup	.0%	6.1%	.0%	.0%	13.8%	5.0%	4.1%
	1991	Count	1	0	3	0	0	2	6
		% within strategygroup	4.0%	.0%	5.7%	.0%	.0%	10.0%	3.5%
	1992	Count	1	1	3	0	2	3	10
		% within strategygroup	4.0%	3.0%	5.7%	.0%	6.9%	15.0%	5.8%
	1993	Count	0	3	4	1	1	0	9
		% within strategygroup	.0%	9.1%	7.5%	8.3%	3.4%	.0%	5.2%
	1994	Count	1	1	4	0	0	1	7
		% within strategygroup	4.0%	3.0%	7.5%	.0%	.0%	5.0%	4.1%
	1995	Count	2	2	1	2	3	0	10
		% within strategygroup	8.0%	6.1%	1.9%	16.7%	10.3%	.0%	5.8%
	1996	Count	3	2	8	2	1	1	17
		% within strategygroup	12.0%	6.1%	15.1%	16.7%	3.4%	5.0%	9.9%
	1997	Count	0	3	6	2	3	4	18
		% within strategygroup	.0%	9.1%	11.3%	16.7%	10.3%	20.0%	10.5%
	1998	Count	1	2	4	1	5	1	14
		% within strategygroup	4.0%	6.1%	7.5%	8.3%	17.2%	5.0%	8.1%
	1999	Count	2	4	1	1	2	0	10
		% within strategygroup	8.0%	12.1%	1.9%	8.3%	6.9%	.0%	5.8%
	2000	Count	6	0	2	0	3	0	11
		% within strategygroup	24.0%	.0%	3.8%	.0%	10.3%	.0%	6.4%
	2001	Count	3	4	2	0	0	0	9
		% within strategygroup	12.0%	12.1%	3.8%	.0%	.0%	.0%	5.2%
	2002	Count	0	1	5	1	1	1	9
		% within strategygroup	.0%	3.0%	9.4%	8.3%	3.4%	5.0%	5.2%
	2003	Count	4	4	2	0	1	1	12
		% within strategygroup	16.0%	12.1%	3.8%	.0%	3.4%	5.0%	7.0%
	2004	Count	0	3	6	2	1	1	13
		% within strategygroup	.0%	9.1%	11.3%	16.7%	3.4%	5.0%	7.6%
Total		Count	25	33	53	12	29	20	172
		% within strategygroup	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Enterprise Survey

Figure 18 below attempts to explore the combined effects of performance change (for employment, sales and profits) by strategy pattern. A number of interesting patterns emerge. The evidence suggests that enterprises that adopt competence lock-in strategies record the highest incidence of relatively poor performance (decline or profitless expansion), and weak organic growth. This is despite the fact, that these enterprises are

often concentrated in the lowest labour-cost countries (Bulgaria and Estonia), among the five surveyed here. It is the outliers and hybrid strategies that record robust performance. The case of enterprises adopting competence break-out strategies is interesting. Nearly two thirds of such firms report jobless growth, itself linked with the fact that they are located in the UK and Greece.

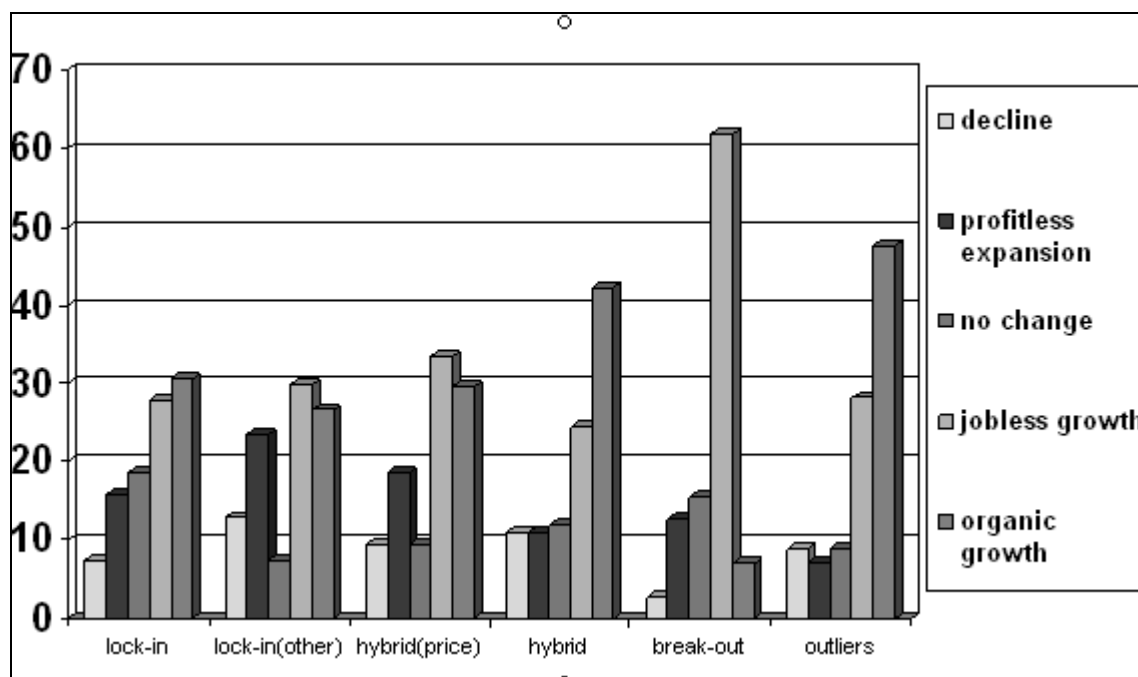


Figure 18 Combined Performance by Strategy Group

Source: Enterprise Survey

3.6 Concluding Remarks

The approach adopted in this Chapter enhances our understanding of enterprise strategies in labour-intensive industries in two ways. Firstly, conceptually: enterprise strategy is viewed as multidimensional, influenced by a number of factors at work (industrial context, local context, enterprise characteristics and competences). Therefore,

there is greater complexity of outcomes – that capture more accurately diversity in the real world – than is the case in the literature – especially the GCC approach. Secondly, methodologically: through a move beyond ideal-type strategies, again increasing our ability to capture diversity. However, this is done in a structured manner that allows for the identification of dimensions of similarity and diversity. By exploring the micro-dynamics of industrial change this Chapter is seeking to open up the discussion around the notion of upgrading. We argue that while upgrading is very useful in describing tendencies on a high level of abstraction it fails to capture the complexity of actual strategies and the diversity of choices and possible paths that companies face.

Drawing on the lock-in/hybrid/break out conceptualisation we demonstrated that competence lock-in strategies are not linked exclusively with the price sensitive segment of the market. In fact, this strategy is often important in markets that require flexible response (especially in sectors such as clothing and footwear). This means that a shift to markets for complementary orders – often viewed as an intermediate position between cut-throat mass-produced items and the design, own-label segment of the market – does not involve a fundamental change in strategy. This means that this is attainable, but does not fundamentally alter the competences of the firm. Further, competence break-out strategies revolve around the development of competences that are not relationship specific, and thus, can facilitate multiple of changing relationships. However, this does not mean that enterprises that adopt such strategies engage in weak relationships or rely to a lesser degree than other firms upon their main buyer. Instead, what appears to be the case is that the advantages gained by developing competences that are not

relationship specific are not readily exercised by firms, but are a means of diminishing vulnerability.

This brings us to one of the main findings of the present Chapter: dependence and asymmetrical power endowments may co-exist with mutual confidence. This can be explained using a ‘voice, exit, loyalty’ argument. Indeed, Hirschman (1972) argues that voice can be deployed in circumstances when one participant in a relationship believes that the other party will seriously consider his or her voice. In the context of labour-intensive industries this may be the case when there are profound power inequalities: with the most powerful agent feeling confident that the less powerful one will consider the former’s voice. Interestingly, this Chapter captures the view of the less powerful agent in the relationship.

Our findings re-introduce the importance of the domestic market in this field of scholarly inquiry. Whilst national and local market may also be influenced by global dynamics, they remain a distinct and more accessible market for local enterprises. As such these markets may be used as a key element in the emergence of hybrid strategies that use global integration as a way of strengthening the competences, and, consequently, the position of individual firms. This is particularly important in countries with large domestic markets – such as the UK and Poland. Evidence regarding performance indicates that this pattern may be effective in specific settings. Companies combined these from different positions: in order to develop production competencies and/or a recognisable brand name, but also as short-term tactics in order to address fluctuation in demand for example. In making these choices companies are also faced with a constantly evolving set of available paths which are only open for a limited period

of time (and differ between contexts), these paths are not equally accessible for all firms, and commitment to any one of them often carries strong ‘weight of legacies’ that makes it difficult to move back onto a different path of development. Time therefore is a key dimension for understanding both the evolving structure of opportunities that companies face within a specific context as well as the path-dependent nature of these choices given the choices that companies have already made in the past.

Therefore the implications of strong relationships for future performance merits further investigation. In the literature, and implicitly in this Chapter, we adopt a positive view. But whether strong relationships increase the vulnerability of firms, especially when buyers are faced with competitive pressures or even default remains an open question.

In terms of performance: the evidence presented here lends support to two complementary arguments. Firstly, there are disparities in performance between enterprises adopting diverse strategies. Thus, the performance of enterprises that adopt competence lock-in strategies compares unfavourably with that of firms that adopt hybrid strategies or with outliers. However, the disparities are not conclusive. Moreover, there are cases of success among competence lock-in strategies and instances of decline among enterprises adopting hybrid strategies. This brings us to the second argument: i.e that there is no single recipe for success. Success is not only conditional on strategy, but also upon its appropriateness in the industrial and regional context, the competences of the firm, and – off course – how effectively it is implemented.

Lastly, as far as policy implications are concerned the findings of this Chapter lend support to the view that state policies can only have a limited impact on the direction of change in the LII and thus debates about the benefits of market versus strong state

intervention do not capture well the real choices that states have available. The increasing complexity of the economic, political and social environment that states face with both supra-national and sub-national players becoming ever more prominent makes a strong case for an active and enabling, though not necessarily only and always directly intervening, state.

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**4 SOCIAL CONSEQUENCES OF DELOCALISATION
IN LABOUR-INTENSIVE INDUSTRIES: THE EXPERIENCE OF
OLD AND NEW MEMBERS OF THE EU**

Krzysztof Gwosdz, Bolesław Domański

4.1 Introduction

The notion of delocalisation commonly refers to downsizing or closure of plants and/or companies, which is related to a transfer of activities to a foreign country (outward relocation). At the same time, it implies that some countries gain new activities that were formerly located abroad, by expansion of existing establishments or greenfield investment (inward relocation).

Delocalisation has become a hot topic, primarily due to its social consequences in developed countries where jobs are lost through outward relocation. Whereas a huge section of the debate focuses on the number of jobs, it also raises important issues of the effects of increasing mobility of capital on wages, skills, and concerns about a 'race to the bottom' in labour standards and 'social dumping'.

The issue is not entirely new and is closely linked to the extensive debate on the relationship between globalisation, deindustrialisation and the labour markets. Studies of social consequences of delocalisation are conducted within two broad contrasting frameworks:

- Contestation of globalisation as a process detrimental especially to countries/regions where jobs are lost.
- Belief in an inevitable process of industrial restructuring, where the decreasing number of industrial jobs in advanced economies is seen as a natural stage of economic change, which enhances long-term national/regional competitiveness.

The multidimensional and uneven nature of the processes under discussion in various sectors and areas, and difficulties in separating the social consequences of delocalisation from the effects of other processes such as technological change, make it impossible to reduce these consequences to simple general statements. Three types of questions can be addressed here: what (types of consequences), who (social groups affected) and where (places). Popular perceptions tend to focus on the short-term direct effects of jobs lost or gained as a result of downsizing or expansion of plants, their closure or opening. There may be positive and negative social consequences of both outward relocation and inward relocation. We need insights into both direct and indirect effects. A long-term perspective is necessary to fully assess the real nature of processes and consequences. As delocalisation may take different forms, i.e. FDI or subcontracting, social consequences will vary accordingly. The fundamental issue is that the same process produces different effects depending on the industrial and spatial contexts within which it operates (Figure 19).

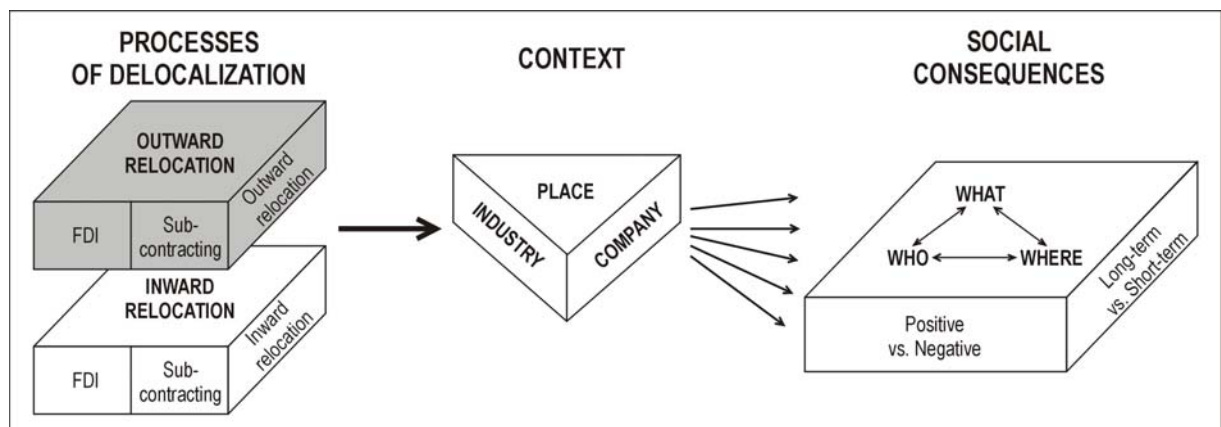


Figure 19 The complex nature of the social consequences of delocalisation

Source: Authors' elaboration

The debate on the social consequences of delocalisation

Not surprisingly, the role of delocalisation in job losses in advanced industrialized countries gained most attention. The serious difficulty here lies in isolating changes resulting from delocalisation from the effects of other factors, including technological advancements.

Many studies argue that the effect of trade flows linked to delocalisation is too small to account for significant labour market changes in developed countries. Fluctuations in domestic demand and increases in labour productivity related to technological changes are considered to be much more important (Krugman & Lawrence, 1994; Morcos, 2003). Rowthorn and Ramaswamy (1997) claim that about two-thirds of the decline in the share of manufacturing between 1970 and 1994 in the USA can be explained by higher productivity in manufacturing than in services. This is questioned by Feenstra (1998), who argues that if we take into consideration trade in both final and intermediate inputs, the impact of globalisation on employment is equivalent to changes induced by technological innovation. This debate is sometimes framed as one of 'trade' versus 'technology' explanations. Helg and Tajoli (2004, 8) maintain that this distinction is artificial, and that it is better to see delocalisation as another 'distinct cause of shift in labour demand'.

Estimates based on the data of the European Foundation for the Improvement of Living and Working Conditions indicate that delocalisation is responsible for 9 per cent of the annual job losses in the EU (Restructuring and employment, 2006). The report Relocation, an element of industrial dynamics (2000), based on a survey of 3,000

Belgian companies, attributes 28 per cent of employment loss through collective layoffs in industry 1990-1995 to relocation. The majority of transfers of activities took place towards and from other developed countries.

The pressure of potential relocation may pose a threat and contribute to less favourable employment conditions. People still working in the industry may have to accept worse pay, more involuntary part-time work and temporary jobs (Waddington & Paddy 2001; Hadjimichalis, 2006). The role of large industrial companies, which tend to pay higher wages, becomes more limited vis-à-vis smaller companies (Glasmeier & Jensen, 2001). Mingione (1997, 1) argues that although numerous job opportunities are created in the tertiary sector, they 'do not reflect the traditional standards of social regulation and therefore entail a weakening of the mechanisms of social integration and a growing risk of exclusion'.

Eliason and Storrie (2003) found that the workers displaced due to plant closures in Sweden from the mid-1980s suffered substantial losses in earnings. Hijzen et al. (2003) claim that outsourcing accounts for about half of the increase in domestic wage inequality in the UK. Feenstra and Hanson (2001) maintain that the activities that are outsourced use a large amount of unskilled labour and consequently cause growing inequality between high-skilled and low-skilled workers in developed countries. Opponents argue that the shift from unskilled to skilled workers in developed countries is a natural market-driven phenomenon underpinned by the competitiveness of nations and the resources in which they are better endowed.

It is often suggested that the main threats of job losses and worsened employment conditions concern low-skilled blue-collar workers, poorly educated people, women and

ethnic minorities. The EU study *Employment in Europe* (2004) reports that if a woman is unemployed one year, her transition probability towards employment is half that of a man.

Negative social consequences go beyond the workplace. Decline in income may result in impoverishment, loss of identity, disrupted family and social life and worsening life prospects for children. Further indirect consequences attributed to delocalisation include increasing tax competition, which may lead to reduction in government expenditures vital to the poor (*A Fair Globalisation*, 2004).

On the other hand, delocalisation in West European countries also has positive employment effects. Several studies show a positive correlation between outward foreign investment and exports in delocalizing industries and other related sectors. The foreign site may allow the firm to continue a low-end activity that would no longer be profitable in the home country (Crestanello & Dalla Libera 2003). Many scholars argue that relocation is often the least bad solution (Relocation, 2000).

So far, we have discussed the issue from the point of view of places of outward relocation. Location of labour-intensive activities in countries of periphery brings about various positive effects, the most obvious being new jobs. According to Ghose (2003), net employment created in manufacturing industries in LDCs has been larger than the net employment loss in developed countries.

In addition, we can find growth in productivity, knowledge spill-overs, training programmes and upgraded skills. Outward relocation may also produce multiplier effects in the region, including creation of new indigenous companies (Morcos, 2003).

Many studies suggest that relocation of production has affected working conditions and wages in a positive direction (Gradev, 2001). This has been shown for Bulgaria by Begg, Pickles and Roukova (2000). According to Lorentowicz et al. (2005), in Poland outsourcing contributes roughly 35 per cent to the change in the relative wage for skilled manufacturing workers. The winners may include women in less developed countries, who gain access to wage employment and improved social status.

On the other hand, there is concern about the inferior quality and possibly temporary character of new jobs created in low-cost countries as a result of delocalisation. The low-paid, low-skill jobs may represent a sort of ‘social dumping’.

Main aims and research questions

Despite the growing body of literature, understanding of various aspects of the social consequences of delocalisation is far from satisfactory. There is an especially limited number of studies approaching the issue from the broader perspective of both the countries of outward relocation and those of inward relocation.

This Chapter attempts to make a contribution to the current debate on the social consequences of delocalisation on the basis of an empirical study of four labour-intensive industries in five countries – both old and new members of the EU: the UK, Greece, Estonia, Poland and Bulgaria. These include three sectors that are very sensitive to labour costs – clothing, footwear and electronics – and one that is particularly sensitive to labour skills – software. The UK represents the traditional core of European manufacturing. Greece could provide a relatively cheap location for labour-intensive activities in the EU, which might be threatened by its recent enlargement. The three

post-communist countries differ in size and in level of economic development. The social consequences are explored in the context of the ongoing process of European integration.

The focus is on three main groups of issues:

- Impact on the number of jobs and unemployment levels.
- Effects in the quality of jobs.
- Long-term consequences for local, regional and national social wellbeing.

They are explored both for areas which are experiencing decline and for countries and regions which report growth in labour-intensive activities from the point of view of three major types of determinants: industry-specific, company-specific and place-specific.

Social consequences may be studied using two approaches – tracing the careers of people who lost their jobs due to delocalisation (which requires long-term data on individuals) or analysing quantitative and qualitative changes in the labour markets and social wellbeing on different geographical scales. The latter approach is applied in this Chapter.

The vital problem concerning the quantitative effects on the labour market is not simply the number of jobs lost or gained, but the impact of delocalisation on employment and unemployment levels. This reflects the capability of the labour market to absorb job-losers and new entrants. There is also the question of the role of labour shortages in delocalisation processes.

The analysis of the quality of jobs has to take into account issues of feasible alternatives, of winners and losers and the possible segmentation of the labour market.

Finally, the salient question is the long-term impact of delocalisation on the social wellbeing on various geographical scales. Does the decline in labour-intensive industries contribute to the erosion of the economic strength and social wellbeing of countries and regions? Is the growth of labour-intensive activities a raising path to sustainable, competitive economy and thus enhanced quality of life? The concepts of path dependence, embeddedness and localized capabilities created in territories, on the basis of which a company's competencies are built, may also be useful here.

4.2 The quantitative impact on the labour market

Impact of delocalisation on the number of jobs and unemployment trends

The study provides some insight into the creation/destruction of jobs under the influence of delocalisation in four industries and five countries. The trends revealed reflect the varied position of countries in delocalisation.

In Bulgaria, which may be a benchmark for inward relocation, 62 per cent of the companies investigated increased employment compared to the situation when they were first involved in delocalisation within the last 15 years. In Poland and Estonia the increase occurred in 57 per cent of enterprises; however, 23 per cent of Polish companies showed diminishing employment. A similar share of Greek companies experienced decline, with 32 per cent of enterprises growing and a large number unchanged. In the UK the proportion of companies reducing and expanding their workforce was 53 to 25 per cent respectively (Table 19).

Table 19 Changes in the level of employment of the surveyed companies involved in delocalisation

Country	Number of surveyed companies	Decrease in employment	No change	Increase in employment
		per cent of companies		
UK	75	53.4	21.9	24.7
Greece	80	23.8	43.8	32.5
Estonia	200	9.8	33.5	56.7
Poland	200	23.4	19.8	56.9
Bulgaria	200	20.0	18.0	62.0

Source: company survey

There is no direct link between delocalisation and rise in regional unemployment. This can be illustrated by the lack of correlation between changes in industrial employment and changes in unemployment rate in 198 NUTS-2 regions of the EU-15, 1999-2004 (Figure 20). There are regions where a decline in industrial employment leads to higher unemployment, but a vast number of regions have experienced falling unemployment despite the job losses. This shows that industrial jobs are replaced by workplaces in other sectors.

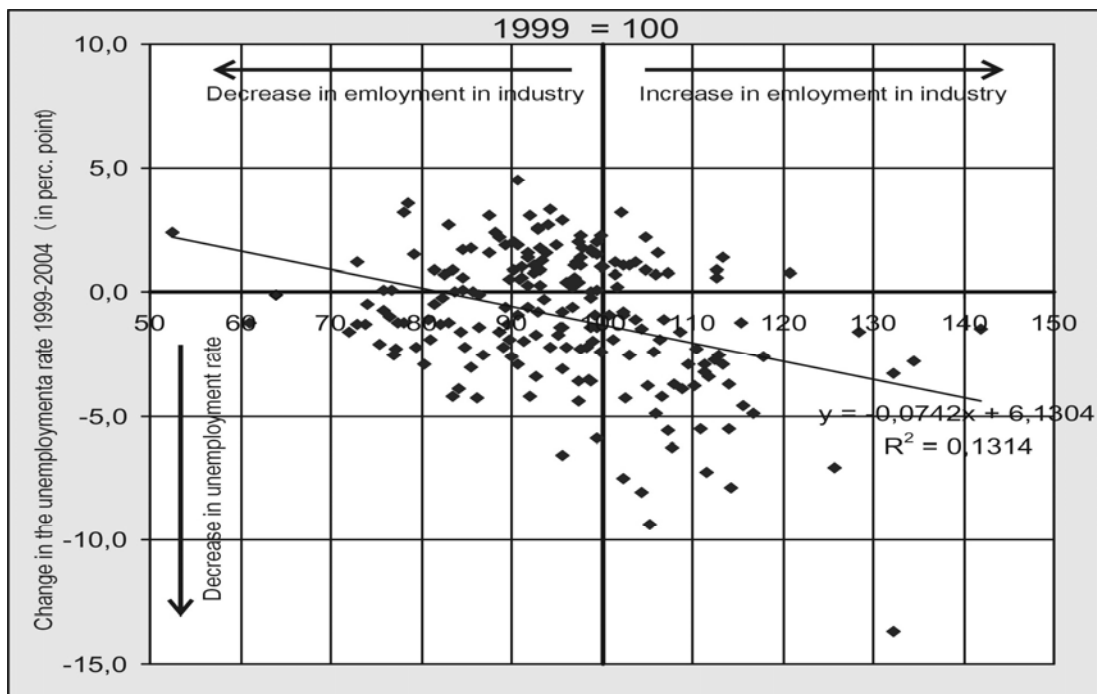


Figure 20 The relationship between changes in industrial employment and unemployment rate in NUTS-2 regions of the 15 countries of the EU, 1999-2004

Source: Authors' calculations based on Eurostat data

The relationship between a decreasing number of industrial jobs and regional employment/unemployment rates can be analyzed in greater detail for the UK. Between 1995 and 2006, the country experienced another wave of deindustrialisation and 1.24 million manufacturing jobs were lost (25.7 per cent). At the same time the unemployment rate fell from 9.0 to 5.0 and the total number of jobs increased by 2.5 million. The employment rate also increased from 71.3 to 74.3 per cent.

The analysis of the 330 UK districts shows an interesting picture. In the areas where manufacturing employment stayed relatively unchanged, the rate of male employment²⁴ grew significantly more than in the areas that lost 25 per cent of manufacturing jobs or more (Table 20). The female employment rate grew faster than that of males and was less related to the decrease of jobs in manufacturing. This is even more striking if we take into account the fact that more female jobs disappeared in manufacturing after 1990 (women accounted for 40 per cent of the workforce in 1990 and 34 per cent in 2004²⁵). Women proved to be more successful in finding new jobs in services.

The impact of delocalisation varies among sectors. The employment shifts are most evident in clothing. Between 1995 and 2004 they were most dramatic in Bulgaria (77.7 per cent increase), on the one hand, and in the UK and Greece (70.3 and 43.5 per cent decrease respectively), on the other. The changes in Estonia and Poland were relatively moderate.

The growth in the Bulgarian clothing industry is a conspicuous example of delocalisation. The sector has revived significantly since the crisis of the early 1990s. The principal growth in clothing took place in peripheral districts of the country, especially those adjacent to Greece: Blagoevgrad, Kurdzhali, and Smolyan.

²⁴ The employment rate is a good indicator of the strength of the labour market reflecting the inflow to and withdrawal from this market (Danson, 2001).

²⁵ This can partly be explained by outsourcing of non-production activities.

Table 20 Deindustrialisation and the change in the employment rate in the UK by districts 1995-2006

Change in the manufacturing employment	Number of districts	Unemployment rate in 2006 UK=100	Relative change in employment rate (in perc. points)		
			All workers	Male	Female
Decrease by 50% and more	24	106.7	2.30	1.00	3.90
Decrease by 25-50%	177	103.4	2.46	1.26	3.73
Decrease by 5-25%	88	101.0	2.92	1.92	4.02
No major change (+- 5%)	22	95.5	4.43	3.48	5.50
Increase by 5% and more	19	95.8	2.36	1.68	3.34

78 districts were not included in the analysis due to lack of data

Source: Authors' calculations based on Nomis official labour market statistics

On the other hand, clothing was at the forefront of manufacturing decline in Greece. In the heyday of the late 1980s the industry employed 81,000 people²⁶; the number had sunk to 60,000 by 1995 and to 15,000 in 2002. On the whole, Greece lost 41,000 manufacturing jobs between 1993 and 2003 (7 per cent). Clothing was heavily concentrated in Central Macedonia, where total employment increased by 6.3 per cent 1999-2005. In terms of its unemployment rate Central Macedonia performed similarly to the national economy. Thus delocalisation of clothing did not affect the regional labour market (1 per cent of all jobs now). Still, some small towns in Central and Eastern Macedonia could have been affected.

In the UK, the current decline in clothing and footwear represents only the tail-end of a process that began several decades ago. According to the key informants interviewed, if

²⁶ Data for 1988 and 1995 cover all companies, while data for 2002 refers only to entities with more than 10 people (smaller companies represented half of employment in clothing in 1988).

companies had not relocated their production to cheaper sites, they would have gone bankrupt and their workplaces been lost anyway. The labour market effects are fairly limited, because the process occurred over a long period of time and was accompanied by growth in other sectors.

The impact of a universal decline in employment in footwear in the countries studied is limited due to the small size of this industry and its geography. In Greece it represents 0.5 per cent of all employment in manufacturing and is concentrated in and around the two largest Greek cities of Athens and Thessaloniki, meaning that the impact on the labour market is negligible. In the UK, the footwear industry employed 6,400 people in 2003, i.e. 0.2 per cent of total manufacturing. In Poland roughly 10-15 per cent of 40,000 footwear jobs are linked with subcontracting and foreign subsidiaries. About half of Polish companies involved in internationalization and 70 per cent of their Bulgarian counterparts show an increase in employment.

In electronics the main carriers of internationalization are TNCs, and plants are often large. In the UK the sector declined rapidly after a period of growth induced by public subsidies. This mainly affected the North-East of England, Scotland and South Wales. Almost 55 per cent of the UK companies surveyed had reduced their employment in recent years, with one-fifth showing an increase. However, plant closures in electronics are closely connected with fast technological change and do not always represent outward relocation.

Despite the lack of growth in employment in electronics in post-communist countries in general, more than half of the companies increased the number of jobs. The spectacular growth of some parts of the electronics industry in Poland is fuelled by the expansion of

Asian and American companies, which enter the European market in this way. The location of new large plants and expansion of older ones have a significant impact on some medium-sized towns, e.g. Mława and Kwidzyn. There is also some shift from Nordic countries to Estonia. Bulgaria and Greece are not important players in this industry.

The picture in software is radically different. The dominant process is expansion rather than relocation. Employment is growing significantly in all the countries. The share of companies that reduced their workforce in recent years is below 10 per cent, except for the UK, where it is 23 per cent (but half the British companies increased employment). According to key informants, the impact of delocalisation on British software is visible in simple code writing, which makes some people redundant. The spatial concentration of software companies in national capitals and other major cities in Poland, Bulgaria and Estonia reinforces their economic position in the country.

Table 21 The extent of delocalisation and effects on the labour market in different industries

a) (clothing)

Country	Change in the number of jobs (1995-2004) 1995=100	The role of delocalisation in job creation/destruction	Impact on regional unemployment
UK	29.7	Significant	Insignificant
Greece	56.5	Significant	Modest
Estonia	100.8	Significant	Moderate
Poland	83.5	Significant	Moderate
Bulgaria	177.7	Significant	Significant

scale: insignificant, modest, moderate, significant

b) (footwear)

Country	Change in the number of jobs (1995-2004) 1995=100	The role of delocalisation in job creation/destruction	Impact on regional unemployment
UK	28.2	Significant	Insignificant
Greece	49.2	Moderate	Insignificant
Estonia	86.0	Modest	Insignificant
Poland	54.4	Modest	Insignificant
Bulgaria	74.4	Insignificant	Insignificant

c) (electronics NACE 30-33)

Country	Change in the number of jobs (1995-2004) 1995=100	The role of delocalisation in job creation/destruction	Impact on regional unemployment
UK	68.3	Significant	Moderate
Greece	122.5*	Insignificant	Insignificant
Estonia	n.d.	Significant	Moderate
Poland	97.5	Significant	Moderate
Bulgaria	57.8	Insignificant	Insignificant

*1995-2002

d) (software)

Country	Change in the number of jobs (1995-2004) 1995=100	The role of delocalisation in job creation/destruction	Impact on regional unemployment
UK	252.8	Modest	Insignificant
Greece	311.7*	Insignificant	Insignificant
Estonia	153.6**	Modest	Insignificant
Poland	258.8	Modest	Insignificant
Bulgaria	182.1	Modest	Insignificant

*1995-2001

**2001-2004

Labour scarcity and its effects

One of the challenges for labour-intensive industries is difficulties faced by companies in labour recruitment. They may stem from limited labour supply in general, scarcity of people with specific skills, or alternative employment opportunities.

Many of the managers interviewed and key informants in the UK raise the issue of the poor image of factory work in general, especially among young people. 'Kids see factories as dark, noisy and smelly' says a footwear industry manager. Young people are less willing to take mundane factory jobs and follow work routines than older workers. This is related to competition from less demanding job opportunities elsewhere and/or rising aspirations. Uncertainty caused by delocalisation discourages the entry of young workers and entrepreneurs even further.

A negative feedback mechanism is at work, which accelerates the shrinking of the traditional labour-intensive industries. The companies are sensitive to cost, pay low wages and offer a limited number of new jobs. Accordingly, new entrants to the industry are few and the pool of 'within the industry' candidates is contracting due to factory closure in the past and an ageing workforce. Labour skills in clothing and footwear are increasingly lacking from the local market and existing companies face mounting problems in recruitment. The important point is that once skills are lost they are hard to replace and technical competencies of towns and regions wither away. Therefore the delocalisation of activities requiring specific industrial skills may be an irreversible phenomenon.

In 'transition economies' the supply of skilled labour for clothing and footwear is also becoming insufficient in certain places as more alternative job opportunities emerge and aspirations grow. Low pay, a stricter working regime than in many services and seasonal fluctuations make factories relatively less attractive. This is accompanied by a diminishing supply of vocational school-leavers. Labour migration to Western Europe makes matters worse in Poland, Estonia and Bulgaria.

Companies use different strategies to tackle labour recruitment problems. A quite obvious action would be to raise wages and offer extra-wage benefits and better employment conditions. However, for companies engaged in delocalisation in labour-intensive activities, often competing on price, this may be difficult and has to be part of a broader restructuring towards higher value-added products. Another option is to train people without the required qualifications, which is costly, takes time and may adversely affect product quality. The recruitment of foreign migrants as factory employees is yet to take place in Central and Eastern Europe (CEE) on a large scale, in contrast to the UK.

Last but not least, producers may choose location in areas with more ample labour supply and/or lower wages. This probably underlies the increased share of peripheral regions of Bulgaria in the apparel industry. In Estonia the clothing industry is growing in Ida-Varruna, where salaries are 25 per cent lower than in Tallinn. The ultimate solution may be to subcontract production abroad or invest in a foreign country endowed with a cheaper labour force – that is to delocalize. Several successful Polish clothing companies have already moved their production to Ukraine or China.

All these strategies except the last may bring about positive effects for workers, providing jobs to more peripheral areas as well as training and/or higher wages.

4.3 What kinds of jobs are lost and gained?

Quality of jobs

Western and Southern Europe

There is little doubt that a vast number of jobs lost in outward relocation countries were poor jobs in terms of wages. In British clothing and footwear, earnings range from 47 per cent in clothing to 73 per cent in footwear in relation to the manufacturing average, with the respective figures for Greece being 64 and 69 per cent.

Wages and salaries in British clothing, footwear and electronics increased 1996-2004 in parallel with the decreasing number of employees. The typical pattern is that 'better' jobs stay at home longer. For example, many large electronics companies have relocated their manufacturing abroad, but training and R&D facilities remained in the UK.

The survey reveals that 37 per cent of the UK companies involved in delocalisation and more than 43 per cent of the Greek enterprises offered wages higher than the average in the industry, with 47-49 per cent paying about the average, and only 14 and 9 per cent respectively below the average. This may confirm the generally positive impact of delocalisation on the efficiency of companies²⁷ and/or the fact that higher paid jobs are maintained at home.

This finds further support in the fact that half of British companies have increased the proportion of white-collar employees compared to the situation when they were first involved in delocalisation within the last 15 years; no company reports a decrease in this

²⁷ We must bear in mind that the survey was conducted among existing enterprises, so those that went out of business were not represented.

respect. White-collar workers now represent nearly 50 per cent of the total workforce in the electronics companies surveyed, and roughly 40 per cent in clothing and footwear. The percentage of white-collar workers and of those with tertiary education has risen especially in traditional industries.

There is a striking contrast between Greece and the UK here. The vast majority of Greek companies (85 per cent) report no change in their employment structure; only 12.5 per cent have increased the share of people with tertiary education and of white-collar staff. The latter comprise just 14-17 per cent of the workforce in electronics and clothing. This may reflect a stronger market position, larger size (in electronics) and higher competitiveness of British companies in comparison to their Greek counterparts. The latter may use delocalisation more as a survival rather than an expansion strategy. In all four sectors from 80 to 90 per cent of British enterprises moved to a competitive advantage based on design and product development, while 85 per cent of Greek clothing companies and all footwear companies declare that their competitive advantage rests on labour-intensive products.

There is little support for concerns about deterioration of employment standards of people who remain in labour-intensive activities in the developed economies. An increase in temporary employment is found in 15 per cent of surveyed British companies, mostly in software and electronics. In addition, only 9 per cent of enterprises have extended part-time employment; the figure is twice as high among clothing companies. The share of Greek companies that have experienced a rise in temporary and part-time employment is 5-7 per cent. About 10 per cent of British electronics enterprises increased their use of rented employment.

However, there are two possible negative consequences. First, the jobs that were lost provided employment to people who were generally in a weak position in the labour market. Second, the quality of jobs undertaken by the former employees of labour-intensive industries is not necessarily good, though this has not been studied here.

Central and Eastern Europe

Jobs that appear in labour-intensive industries in post-communist countries are generally inferior to those in other sectors, but their evaluation is more positive if we take the perspective of the industries themselves or the local labour market situation.

About one third of the companies surveyed in Estonia and Poland involved in delocalisation show higher wages than the sector average; the share is 40 per cent in Bulgaria. Relatively high wages are particularly characteristic of Estonian and Polish software business and of Estonian electronics. Clothing companies in Estonia more frequently offer wages below the average than above it. In Poland a similar situation is characteristic of electronics, while the share of clothing companies with higher and lower wages is the same. By contrast, clothing and footwear in Bulgaria show the highest share of enterprises with above-average earnings. In all countries large clothing and footwear companies (250 employees and more) tend to pay more than SMEs, whereas big Polish and Estonian electronics companies offer wages above the average less often.

The differences revealed can probably be attributed to the fact that the economic performance of Polish and Estonian clothing companies dependent on their foreign partners for inputs and markets compares unfavourably with that of successful

companies developing their own brands and targeting the domestic market. The widespread positive impact of subcontracting on wages in Bulgaria may reflect its generally greater role in local clothing and the smaller share of successful domestic companies. The assembly-type operations of foreign affiliates and location of factories in peripheral areas may lie behind lower wages in electronics in Poland, whereas electronics producers in Estonia represent more advanced establishments vis-à-vis other local businesses.

The proportion of the workforce with tertiary education and of white-collar employees has increased in 25 per cent of clothing companies in Poland and Estonia, and slightly less in Bulgaria. Such a rise has occurred in half of all electronics enterprises in Poland. White-collar workers constitute 31 per cent of total employment in electronics in Poland, 25 per cent in Estonia and 13 per cent in Bulgaria (similar results to Greece). The figure is considerably lower in clothing: 11-12 per cent in Poland and just 5 per cent in Bulgaria.

There is a widespread increase in the role of skill-intensive products in the three countries, which is accompanied by the manufacturing of higher value-added goods. In addition, a greater number of enterprises in Poland and Estonia declare a competitive advantage based on design and product development. Estonian companies are showing a clear move towards services such as design and marketing.

Growing permanent employment is accompanied by an increase in temporary employment in 30 per cent of Estonian and Polish companies. In both countries this is most common in electronics and software, in Estonia also in clothing, while in Poland clothing companies more often reduce temporary employment. It plays a marginal role

in Bulgaria (4 per cent of companies). The growth in part-time employment is taking place primarily in Estonia (27 per cent of companies), rarely in Poland (12 per cent) and Bulgaria (2 per cent). In addition, rented employment is used by 38 per cent of Estonian clothing enterprises and 15 per cent of Polish electronics companies; in other sectors and countries it is almost non-existent. All in all, worse types of jobs are more typical of labour-intensive activities in more developed post-communist economies, which may reflect companies' attempts to maintain lower costs and flexibility.

FDI usually creates better employment conditions than subcontracting undertaken by domestic enterprises. Foreign-owned companies offer higher wages and salaries than their domestic competitors in the same industry and on the local labour market. Both the survey and the key informant interviews show that foreign companies provide more training and hence contribute to improved skills. Former employees of foreign-owned clothing companies in Bulgaria or of Italian footwear subsidiaries in Poland enjoy a good reputation and are sought-after on the labour market.

On the whole, this indicates some progress in the standard of employment and skills at the low end of industrial jobs and hardly supports the 'social dumping' argument. The new CEE members of the EU are not the flexible labour markets characterized by inferior labour standards compared to those in Western Europe. This is related to their implementation of EU legislation prior to accession.

The winners and the losers. The segmentation of the labour markets

The losers of delocalisation in the developed countries have to be primarily sought among older redundant employees with particular industrial skills. They are often

middle-aged or older women, who move to low-skill jobs in services or retire and hence have limited impact on unemployment rates. A high proportion of migrants and minority groups among the employees of the UK clothing industry means that women from these groups may be among the people most affected. Also in Greece the outward relocation of this industry has mostly harmed women. Many of them were close to retirement age, as since the mid-1980s there was little young blood injection in this occupation. Paradoxically, male workers losing their jobs in electronics in towns in the North of England and Scotland may be the least successful in finding alternative employment.

In CEECs, many companies prefer to recruit young people without professional experience, because they are more flexible and do not have 'bad' habits acquired in a previous career. The better-educated youth benefit from increased demand for white-collar staff. At the same time, the limited number of young people willing to undertake manual work in the footwear and clothing industries may become a barrier to their development in the future. Women are preferred in footwear, clothing and parts of electronics business. They are believed to be more accurate in manual work and more likely to accept low wages. It is also women above middle age who profit from internationalization in clothing and footwear sectors. In Bulgaria, women who previously worked in agriculture and food processing find new full-time manufacturing jobs and training.

The expansion of traditional labour-intensive industries largely takes place outside the developed areas of CEECs. There are also big electronics factories located in medium-sized peripheral towns in Estonia and Poland. Jobs are created or maintained in communities that live in peripheral areas and are often plagued by high unemployment

and weak alternative employment opportunities. They include areas inhabited by ethnic minorities, especially Turks in Bulgaria (Pickles, 2001). Companies hire and train relatively less-skilled people, contributing to a progress in local skills and capabilities. This sometimes leads public authorities to invest in education, e.g. on the Estonian island of Saaremaa, where three international electronics companies are situated.

Delocalisation may contribute to the segmentation of the labour markets. This segmentation may take different forms:

- the sectoral segmentation of the entire labour market with cleavages between industries providing high quality jobs and low quality jobs;
- divisions within the particular industry based on the different position of companies in the value chain and related labour conditions;
- internal segmentation within the company.

Clothing and footwear are usually regarded as inferior segments of the labour market; the same is true of assembly operations or simple production in electronics. From this perspective, the growth of these sectors may not be a favourable change. At the same time, the manufacturing of advanced electronics products may belong to a superior submarket, which is also typically true of software activities.

The processes of upgrading towards higher value-added products and non-production services (R&D, design, marketing) described earlier in the case of British electronics and clothing indicate an increasing share of the superior segment of the labour market in these industries. The tendency to move up the value chain with parallel changes in the employment structure and improvement of labour conditions is to some extent observed

in all labour-intensive activities in CEE, meaning that the lower segments of the labour market get better.

The quantitative analysis of employment structures and trends in delocalizing companies in labour-intensive industries in the UK and Greece does not indicate a significant increase in the level of segmentation of the job market in terms of temporary, part-time and agency workers.

The explicit internal segmentation of the company labour market can be identified in large foreign-owned consumer electronics factories in Poland. There are three distinct segments that differ in employment stability: 'core' staff employed on permanent contracts, part-time workers employed on more flexible conditions, and rented employees. These submarkets are associated with performance of certain functions and production of particular final or intermediate goods, where 'good' employment is related to activities regarded as core to the company. Access to the privileged submarket is constrained.

4.4 The long-term impact on national, regional and local social wellbeing

The fundamental question concerns the overall long-term effects of delocalisation on social wellbeing. In the long run social wellbeing is determined by economic development on various geographical scales, thus it is necessary to consider how delocalisation affects competitiveness of local, regional and national economies. This means that the diversification of the economy, the role of viable economic activities, local embeddedness of large companies, and the development of localized capabilities may be important intermediating factors here. The significance of structural features for

the sustainable development of the economy is obvious. The embeddedness of large companies, especially TNCs, in economies where they carry out their activities is a popular concept in studying the relationship between the global and the local (Ettlinger, 1999; Phelps, 2000). The concept implies that the company is planted in local networks, which affects its impact on the host economy. The notion of localized capabilities was introduced in the evolutionary, competence theory of the company. Maskell (2001) argues that companies' competences are built on 'created localized capabilities'. They are a dynamic product of interaction between the company and the territory (Domański, 2005) and may be helpful in interpreting spatial differences in the effects of delocalisation. These concepts can be used to discuss how the long-term development trajectory of localities, regions and countries changes under the influence of delocalisation of the labour-intensive industries being studied and hence affects broader social wellbeing.

The comparison of the old industrial districts of Durham and Northampton is very telling. The former, where a policy of attracting inward investment by subsidies was employed to tackle the declining economic base, has experienced a serious decline in electronics since the mid-1990s. The current unemployment level is 7.3 per cent, i.e. 2.3 percentage points above the national average, and the male employment rate has fallen by 3.9 pp as compared to 1995. Northampton, a traditional centre of the footwear industry in the UK, lost a quarter of its manufacturing workplaces, but the effects were very modest. The unemployment rate is equal to the national average and the female employment rate has increased by 9.3 pp (as compared to 3.9 pp in the whole country). Durham's sensitivity to industrial decline is even better reflected in GDP indicators. In

1995 GDP per capita in the area represented 75 per cent of the UK average; ten years later it had diminished to 62 per cent. By contrast, the GDP of Northamptonshire grew from 96 to 107 per cent of the UK average 1995-2005. Thus the standard of living in the Durham area has been negatively affected by delocalisation. The difference can be attributed to lower diversification of the local economy, poorer development of various alternative activities, especially services, and the disembodied nature of large electronics factories attracted by public subsidies (Hudson, 1989, 2005).

In Greece, the negative impact of the contraction of the clothing industry was rather modest on the regional level. However, in some peripheral prefectures of Central Macedonia, e.g. Imathia, Pella, Serres, and even in Thessaloniki, GDP per capita dropped by more than 10 pp as compared to the national average 1995-2005. The growth of clothing in Greece represented a relatively short-term phenomenon based on the advantages of a cheap location for subcontracting within the EU. These advantages have been eroded with the advent of new low-cost competitors in post-communist countries, so the long-term development trajectory of places with inherent structural weakness has not been altered.

A simple typology of regions/localities can be based on two criteria: internal features of a place and the strength and type of delocalising activities. In the case of outward relocation and strong regions/localities, delocalisation is a form of 'creative destruction', where old industries are replaced by new viable activities. Thus social consequences for the community are negligible even in the short term, and in the long run the overall effects are clearly positive. However, in weak regions (North-East England, Northern Greece) delocalisation brings about negative consequences, if alternative dynamic

sectors do not emerge or represent temporary solutions only, triggering a need for cyclical restructuring without reinforcing the position of a region vis-à-vis strong communities. Thus low-road strategies may contribute to the deepening of structural weaknesses, if they do not facilitate the development of generic local capabilities. Still, the main reason is not delocalisation, but the economic weaknesses of the region/community.

For the new EU member states, which are gaining or maintaining new jobs in labour-intensive industries, the vital problem is the long-term viability of these activities and their impact on broader competitiveness and sustainable economic development.

The overall effects of delocalisation may be different in areas where a given industry is already concentrated and in peripheral places where it creates a new economic base. It seems that the established areas of labour-intensive industry have better opportunities for success, as their enhanced industry-specific and localized capabilities may stimulate upgrading towards higher value-added and/or niche products and hence they escape from a lock-in in low-value added activities. There are stronger local linkages (embeddedness) and non-production competencies. The overall economic development of other sectors matters too. A good example is Słupsk in northern Poland, where an Italian-Polish joint venture company established in the early 1990s triggered positive changes in many locally-owned companies, strengthening the position of the area in footwear production in Poland.

In peripheral areas which are at least temporary winners of delocalisation of labour-intensive industries, e.g. southern Bulgaria and some medium-sized towns in Poland and Estonia, they often contribute to the diversification of the local/regional economy, but

may also lead to excessive dependence on new activities. The long-term success of such economies depends on several factors. Low-value added character of activities developed here, inferior position in the value chain, lack of strategic-decision and other non-production capabilities and weak local linkages may undermine upgrading of the industry and lead to a lock-in situation. Nevertheless, some regions and communities may succeed in enhancing their position, if the current growth of labour-intensive industries creates generic localized capabilities conducive to further development of other economic activities.

All things considered, different scenarios will emerge of the future evolution of regions and localities dependent on labour-intensive industries, probably reflecting the ‘strong’ and ‘weak’ nature of their economies.

4.5 Conclusions

The public debate on the social consequences of delocalisation of labour-intensive industries is clouded by common misinterpretations.

First, the social effects of delocalisation are generally more limited than is sometimes maintained. There seems to be a geographical fallacy whereby phenomena that are significant locally become generalized on the national level. Analysis shows that the social consequences of delocalisation of labour-intensive industries are mainly observed on a local scale, to a lesser extent on the regional level, and are almost negligible in entire national economies, with the notable exception of Bulgarian clothing. Moreover, widespread emphasis on job losses ignores the fact that this decline usually has no direct impact on unemployment levels. There are intermediating factors, such as social and

economic features of the region/locality and national labour regulations, which decide whether the impact is strong or weak. Neither clothing nor footwear contributed to higher unemployment in the UK; adverse effects of the closure of electronics plants can be found in some towns. The collapse of the Greek clothing industry dating back to the late 1980s is an evident case of relocation of production to neighbouring low-cost countries, but its negative effects also manifest themselves on the local scale alone.

There is little doubt that the social consequences of delocalisation are not only connected with industry and enterprise characteristics, but are largely place-dependent. The balance of negative versus positive effects is to a large measure determined by the role of the sector/employer on the labour market and the structure and overall performance of the regional/local economy. The main problem is not delocalisation itself, but how to overcome the 'weaknesses' of certain regions and localities.

A frequently neglected element in the mechanisms of delocalisation is labour shortages. Something of a vicious circle exists in shrinking labour-intensive industries, such as clothing and footwear. The downsizing of production entails a continuous contraction of the pool of skilled labour, workforce ageing and limited number of new entrants. This is underpinned by low attractiveness of jobs and negative perceptions of them, particularly by young people. As labour skills become scarce, the existing companies find themselves under further pressure to move out. The erosion of local capabilities and the decline of production capacities are inseparably linked with one another, and may lead to the demise of a particular economic activity in certain places.

The net employment effects of delocalisation within the EU are rather positive, at least in the mid-term. First, thanks to the Europeanisation of labour-intensive industries more

jobs remain within Europe, instead of moving to other parts of the world. Second, delocalisation facilitates lower unemployment in the new member states to a far greater extent than it contributes to higher joblessness in the developed areas, where more alternative employment opportunities exist. Finally, a substantial part of manufacturing jobs and related improvements in skills and capabilities stemming from relocation from Western to Central and Eastern Europe go to peripheral regions of the latter and to underprivileged social groups, especially women.

On the whole, the social characteristics of delocalisation processes can hardly be interpreted as the 'race to the bottom' in terms of wages and employment conditions in the labour-intensive activities in the EU which are the subject of this research. There is also little evidence for the 'social dumping' hypothesis concerning CEE countries. Earnings in the industry are generally on the rise, temporary and part-time employment has little significance, although slightly more in electronics than elsewhere. This may primarily be interpreted as an effect of the regulated environment of the EU, which prevents a 'race to the bottom'. EU and national regulations create a stable environment, which entails additional costs for companies, but provides them with the favourable conditions that allow them to avoid costs of uncertainty and instability. In addition, this may be supported by the high level of economic development of the EU-15 and overall improvement in the new EU member states since the 1990s, which leads to greater social expectations and pressure on companies and public authorities. Finally, the enterprises may also tend to 'behave' better in Europe/the EU ('at home') than in LDCs in other parts of the world. The low-road approach of suppressing wages and employment standards would not stop delocalisation in the situation of low attractiveness of work in

labour-intensive activities and increasing competition of cheaper producers from outside the EU.

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5 GOVERNANCE AND DELOCALISATION

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5.1 Introduction

The main aim of this report is to address questions related to the governance of the processes of delocalisation of labour intensive industries, with a specific emphasis on the mechanisms of public governance and especially the changing role of states, as well as the growing significance of the EU and other non-state actors. The notion of governance could broadly be defined as a set of mechanisms and practices that shape collective decision-making roles, procedures, and relationships, as well as social and economic agents, within the framework of multiple and often complexly inter-related, nested and/or tangled, domains. The latter could be highly formalised, as in the case of national jurisdictions, but could also be informal, as in the case of inter-organisational agreements, codes of practice, etc.

The notion of governance has come into prominence in the context of global economic, social and political restructuring where one of the key changes is that co-ordination is not anymore the exclusive domain of states. In this sense the notion of government, which implies a mainly top-down policy process centred on the state, was substituted by the broader notion of governance that was better able to address the growing number and diversity of important players, and the complexity of their relationships. Indeed social and economic processes are becoming increasingly embedded into much more complex institutional arrangements that are organised around diverse spatial scales (sub-national, national, supra-national) and different networks. In this context questions related to labour market regulations, FDI related issues, innovation, taxation and state aid schemes

cannot be discussed as the exclusive domain of the state but are also dependent on a multiplicity of other players, including TNCs.

In the first part of this report we will address some of the key contributions in the literature on governance, and in the second part we will offer a discussion based on original empirical research in five EU countries: the U.K, Greece, Poland, Bulgaria and Estonia. The study is based on a survey and in-depth interviews with managers of enterprises in four labour intensive industries: clothing, footwear, electronics and software. The different public governance layers have been investigated using primary and secondary data. The latter included data on economic regulations in the countries covered by the study. Secondary data was supported by primary information gathered during companies' interviews and interviews with key representatives of business, politics and science in the countries and industries under consideration. The findings are derived from a qualitative analysis of the enterprise survey. NVivo software was used to search for interesting quotations. The statistical analysis conducted in order to identify significant differences between means for different types of companies included the use of two procedures. T-tests were used for independent samples (in combination with Levene test on homogeneity of variation) and the post-hoc Tamhane test was used when there was a heterogeneity of variation.

The main questions addressed in the report relate to: employment conditions, the role and impact of trade unions and business associations, product quality, health and safety standards, taxation and tariff barriers, state aid schemes, and their impact on the decision of firms to delocalise. More specifically we ask what are the ways in which different players respond to existing governance structures, which actors are responsible for

setting, monitoring and enforcement of rules, how are they related to trade, production, consumption, labour relations and the environment, and at what levels do they operate.

PART I. LITERATURE REVIEW

5.2 Relevant aspects of Governance

Defining governance

There are several definitions of governance across different academic disciplines, while main concerns also vary between the fields of policy-building and business practice. For example, Michalski, Miller and Stevens of the OECD Secretariat define governance rather narrowly as “the general exercise of authority” (Michalski et al, 2001), while Kauffman of the World Bank offers a somewhat broader definition and describes governance as “the exercise of authority through formal and informal traditions and institutions for the common good” (Kaufmann, 2003). Further, the UNCTAD discusses governance as “the way in which the main players in society, governments, business and civil society work together to make the society better” (UNCTAD, 2003), while Jessop (2002) refers to governance as “any form of coordination of interdependent social relations that could include three general forms: anarchy of exchange (markets), hierarchy of command (e.g. state) and heterarchy of self-organisation (e.g. horizontal networks)”. The European Commission (EC) gives the following definition: “The term governance, in corporate and State contexts, embraces executive bodies, assemblies (e.g. national parliaments) and judicial bodies (e.g. national courts and tribunals). The term

governance corresponds to the so-called post-modern form of economic and political organisation (European Commission, 2005a)".

In the 1990s, the notion of multi-level governance became prominent reflecting broad processes of political and economic restructuring where authority and policy-making are decentralised and operate across multiple social domains, subnational, national and supranational, the EU being a prime example of such developments (Marks et al, 1996). In this sense questions of governance and delocalisation need to be discussed in relation to the growing significance of both supranational players such as the EU, as well as private governance mechanisms particularly the regulatory arrangements, norms and practices within the networks of TNC. While this report makes an attempt to demonstrate different aspects of the complex interaction between value chain governance and global, national and local governance mechanisms, our main focus remains on the implications at the national and, to a lesser extent, the EU level.

Internationalisation and governance at global level

It has often been argued that processes of globalisation are increasingly making diverse and distant places, processes and people more interdependent. As far as economic globalisation is concerned it is the increasing mobility of goods, services and capital, and the widespread diffusion of technology, as well as the relative immobility of labour that constitute the major new developments. Within this context the role of TNCs is becoming increasingly important. For example, transfers of technology within large TNCs is not a mechanical process but requires adaptation to different legal frameworks and cultural practices, which in turn are important factors for the success of their

internationalisation (Johansson and Vahlne, 1977, 1990; La Porta et al., 1998 and 1999, Djankov et al., 2002; Glaeser and Shleifer, 2002).

The growing significance of TNCs as well as the emerging new global risks has firmly put questions of global governance on the political agenda. There is however a wide diversity of opinions as to the preferred nature and powers of such mechanisms. Taylor (2004) usefully distinguishes between global government and global governance. Global government is defined as a group of supranational institutions, autonomous from nation states, with the legitimate right to the use of force to impose laws, rules and regulations. Global governance is an institutional framework by which global issues are addressed and hopefully resolved. It is not implemented through the use of force but rather through the agency of contract. Global governance includes a bewildering array of bilateral and multilateral treaties among nations, as well as rules and regulations of multinational corporations, numerous non-governmental organisations (NGO-s) etc. In the following section we will briefly discuss the role of some international organisations that are particularly significant for processes of delocalisation and for the changing structure of the four industries that are under consideration in this report.

The World Trade Organisation (WTO) plays a central role in governing global institutional trade order. The WTO system consists of the General Agreement of Tariffs and Trade (GATT) together with 12 other agreements. The international trading order is supported by a powerful dispute settlement procedure.²⁸ This dispute settlement

²⁸ The WTO functions are related to administration of trade agreements, acting as forum of trade negotiations, settling trade disputes, assisting LDCs in trade policy issues, through technical assistance and

mechanism by which a member can be authorised to impose economic sanctions against a member in violation of a WTO agreement gives it teeth and enables the WTO to play a unique role in governance of the international trade system. At the same time it should be mentioned that the WTO system is one of many other agreements that deal with the governance of international trading system, some of which is in cooperation with, while with others in disagreement or even conflict.

More importantly, certain WTO agreements penetrate deeply into the realm of jurisdiction and influence directly domestic rules and regulations. This often creates tension between the WTO system and national sovereignty (Matsushita, 2004). For example, the WTO does not accept export subsidies, or nationally imposed restrictions on imports. In addition, concerns have been expressed that, despite the principle of “one-country-one-vote” and, whenever possible, the reaching of consensus by which WTO operates, there are “greenroom effects” and behind-the scene attempts by rich countries to set the agenda in advance (Basu, 2004). The risk of trade sanctions being used for protectionist purposes cannot be ruled out, nor can the risk of international labour standards being used as an instrument for Northern protection against LDCs (Bhagwati, 1995). The impact of abolishment of import restrictions on textile and clothing, which

training programmes, cooperating with other international organizations. The WTO is essentially not concerned with the behaviour of private businesses. It deals only with actions of governments. Thus the WTO is a regulator of the regulatory actions of governments that affect trade. A specific recommendation by the UNDP is (1999, p. 114): “The mandate of the WTO needs to be expanded to give it “antimonopoly” functions of the activities of multinational corporations including production, working in close collaboration with national and antitrust agencies”.

boosted exports from China, Bangladesh and other poor countries to the USA and the EU and political reactions against those developments on country, EU level and on international scene is one very acute example.²⁹

Labour standards used to be a purely national matter. The globalisation of distribution of work brought also labour issues on international scene. The International Labour Organisation (ILO) uses labour standards to protect interests of weakest social groups.³⁰

³¹ The main method used by the ILO is to draft a convention and then to encourage countries to sign it – in this case signing means a commitment on the part of a government to enforce the terms of the convention.

²⁹ See for example debate about the influence of outsourcing on US economy, see, Bhagwati et al. (2004).

³⁰ This agency seeks the promotion of social justice and internationally recognized human and labour rights. The ILO formulates international labour standards in the form of Conventions and Recommendations setting minimum standards of basic labour rights and provides technical assistance primarily in the fields of vocational training and vocational rehabilitation, employment policy, labour administration, labour law and industrial relations, working conditions, management development, cooperatives, social security, labour statistics and occupational safety of health. It promotes the development of independent employers' and workers' organizations and provides training and advisory services to those organizations. Within the UN system, the ILO has a unique tripartite structure with workers and employers participating as equal partners with governments in the work of its governing organs (ILO 2004, 2005).

³¹ The international community, acting through the ILO, has identified four core labour standards as the minimum for all countries, whatever their stage of development: eliminating all forms of forced or compulsory labour, abolishing child labour, providing equal opportunity and non-discrimination in employment and ensuring the freedom of association and the right to collective bargaining (ILO, 2004).

The UN “Global Compact” is a rather similar voluntary agreement to uphold minimum labour standards, but unlike the ILO’s conventions, the signatories are not countries but corporations and TNCs. The ILO and the UN work on the basis of self-enforcement by the signatories and rely on the power of publicity and social disapproval. In this sense, the enforcement mechanisms are much weaker in comparison with the WTO, which, if it were to introduce a social cause in its agreements, would use trade sanctions and other forms of punishment as retribution for countries that violated the specific standards (Basu, 2004).

The International Monetary Fund (IMF) and the World Bank are more narrowly focused on economic issues’ approach. The conditionality of the IMF’s stabilisation and structural adjustments programs and economic policy conditions of loans of the World Bank have been criticised, especially after getting ambiguous results in solving financial crises in East Asia at end of 1990s, dealing with poverty problems in Africa etc.³² There have been several proposals to reform international, financial and economic structures from inside and outside those organisations. According to the revised consensus, liberalisation, privatisation and global integration are still important but they need to be supplemented with and supported by reforms in the area of governance.³³

³² One of the best-known and most referenced lists of reform components labelled as the “Washington Consensus on Reform” made by Williamson consists of fiscal discipline, reorientation of public expenditure towards the building of human capital and infrastructure, tax reform, financial liberalisation, unified and competitive exchange rates, trade liberalisation, support of FDIs, privatisation, deregulation and secure property rights (Williamson, 1994).

³³ See, Fischer (1998), Rodrik (2000 and 2004), Stiglitz (2002).

The Organisation for Economic Cooperation and Development (OECD) comprises developed countries of the world and plays an indirect but significant role, functioning as the forum of discussion, and expressing views and guidelines that influence policy making. OECD covers economic and social issues from macroeconomics to trade, education, development, science and innovation, and seeks to play a prominent role in fostering good governance in the public service and corporate activity, help governments to ensure the responsiveness of key economic areas with sector monitoring, help policy-makers adopt strategic orientations, and produce internationally agreed instruments, decisions and recommendations to promote rules of the game in areas where multilateral agreement is necessary for individual countries to make progress in global economy (OECD, 2001a, 2004).

The European Union (EU) level

Fifty years after its foundation the EU has evolved into a complex economic, political and social entity, although its future development is still open to occasionally heated debates among researchers and policy makers. Different definitions and visions of European integration have direct implications on EU governance interpretations, given that policy formulation and implementation at the European level is greatly shaped by the course of European integration.

In recent years the governance debate has focused on the relation of the EU with its constituent member-states. The intergovernmental or “state-centric” governance is based on the presumption that European integration does not challenge the autonomy of nation-states and that state sovereignty is preserved through EU membership. It is

argued that bargains among member states are the main governance process, and that no country has to integrate more than it wishes because Council decisions are based on the lowest common denominator. Thus, policy outcomes reflect the interests and relative powers of member states (Marks and Hooghe, 1996). The multi-level governance approach (Marks, 1993, Hooghe 1996) argues that as the European integration proceeds, authority and policy-making influence, are shared across different levels (subnational, national and supranational) of government.

The rather complex nature of EU governance is reflected among others, in the different implementations of multi-level governance in the various policy areas. Thus, while in certain areas (such as competition, trade or agriculture) the EC is the responsible body for the implementation of the respective policies, in others (like for example, education) member states still retain their independence in formulating and implementing national policies³⁴. Given the strong reluctance of certain member states to yield more powers to supra-national institutions, the Commission adopted a new form of governance, *the open coordination mechanism*. Starting with the policy area of Employment, at the Luxembourg Summit of 1997, this method was quickly extended to other areas that remained by and large under national sovereignty. This method can be described briefly as follows: The EC provides a detailed analysis of the situation in the areas concerned, and sets specific, quantified targets for the member states to meet them. It is then left to the member states to formulate and implement the policy measures that they deem

³⁴ These are obviously not the only possible cases. For example, Monetary policy for the Euro-zone, is left exclusively at the hands of the European Central Bank, while in a number of areas there is shared responsibility between the member states and the EU institutions (environment, employment, structural policies, etc).

appropriate in order to achieve these targets, while the Commission ensures proper monitoring and facilitates benchmarking between the various national policies.

In the case of delocalisation of firms, a number of policy areas are important. *Competition*, a European common policy, sets the rules for mergers, acquisitions, public grants and sectoral or regional state aid schemes, and can thus considerably influence the efforts of member states to attract foreign investment. *Structural policies* based mainly on Community Support Frameworks agreed in accordance with the member states, provide significant budgetary resources for the upgrading of national (and regional) infrastructure, as well as support for industrial restructuring, R&D and innovation. In the field of *social protection and labour market issues*, the overlapping jurisdictions and regulations concern the impact of regulations at the EU level and the division of responsibilities between the EU institutions and national governments.³⁵

In other areas, the *open coordination mechanism* is the main instrument of governance at the European level. The role of the Commission is therefore rather limited, while policy formulation and implementation lies primarily with the member states. This is the case, for example, with *industrial policy*. Despite the efforts of the EC over a long number of years³⁶, industrial policies are still under the competence of the member states. The open method of co-ordination, offers now the framework in which national policy

³⁵ For example, there is documented a large increase of EU legislation in areas such as welfare and citizen protection that are quite far from the original mandate of EU institutions. See, Berglöf, et al. (2003).

³⁶ See, for example, the EC Communications on: “Industrial Policy for an open and competitive environment: guidelines for a community approach” (European Commission, 1990), “Industrial Policy in an enlarged Europe” (European Commission 2002), and on “Fostering Structural Change: An Industrial Policy for an Enlarged Europe” (European Commission, 2004).

performance can be discussed, developed and improved. In this context, and with a view to supporting the process of structural change in the EU, the Commission has outlined a set of specific measures, which cover regulatory framework, community policy and combine sector level policies³⁷.

Similarly, *employment policy* remains primarily in the hands of national governments and the EU intervenes under the open coordination mechanism. The Commission has proposed a European employment strategy around three priorities: 1) boosting the labour market participation; 2) improving the adaptability of workers and companies; 3) investing more in human capital (European Commission, 2005g). In the context of delocalisation, the critical issue is the creation of new activities and jobs, and the shifting of resources from declining sectors to sectors where the EU can sustain a comparative advantage.

Given that differences in tax systems can influence the decision of firms to delocalise, *taxation policy* presents a particular interest. At the EU level, there is not an explicit taxation policy, but measures have been taken aiming at the co-ordination and

³⁷ Regulatory framework arguments support an idea that burdens on industry must be reduced to the bare minimum of what is strictly necessary to achieve objectives of regulation and a balance must be struck between industrial competitiveness and the need for regulation. Community policies arguments stress that synergies must be better exploited to improve the policies' impact on industrial competitiveness. The focus should be on developing a knowledge-based economy and strengthening cohesion in an enlarged EU. Combination of policies at sector level means that the EU must continue to develop the sectoral dimension of industrial policy while ensuring that its sector policies are strengthening industrial competitiveness (European Commission, 2004).

harmonisation (or approximation) of national tax policies in order to facilitate the functioning of the internal market. The fiscal harmonisation began in the field of indirect taxes. Discriminatory customs duties and other taxes imposed on goods and services are considered the most important impediments to the free movement of goods and services in the EU market. To date, the major steps toward harmonisation have been achieved in the field of indirect taxation, notably, the abolition of customs duties, the introduction of the Community Customs Code and common VAT system as well as the harmonisation of the most important excise duties. The harmonisation of indirect taxes has been far more advanced than the harmonisation of direct taxes, in which large differences are still observed. The 12 new EU members have an average corporate tax rate of about two-thirds of the old 15 EU members. These relatively low levels are contributing to the delocalisation of industries and jobs from Western to Eastern Europe (CEE). The governments of the new member states seem to believe that low taxes are necessary for their economic convergence with the rest of the EU. Their model is Ireland, which for decades has aggressively employed tax incentives (Forbes, 2004). The governance of delocalisation of labour intensive industries through tax policy is still an instrument applied at national level. The discussion between supporters of tax harmonisation and tax competition approaches is one important factor which will determine future development of taxation level and structure³⁸.

³⁸ See, Cnossen (2002, Cnossen and Bovenberg (1997), Mitra and Stern (2004), OECD (2000), Purju (2004).

National level

The dominance of the nation state over the past two centuries, has equipped it with an impressive array of governance structures in practically all areas of economic and social life, and with powerful enforcement mechanisms. National institutions (governments, parliaments, courts) intervene and regulate economic activities, labour markets, welfare systems, shape the institutional environment, and draw and implement specific policies for their economic and social development. In the area of the labour market, for example, governments are actively involved in the wage-setting process and regulate working conditions. The government commonly regulates work hours and the cost of overtime; mandates vacations, holidays and sick leave; sets minimum wages; restricts child and forced labour; ensures non-discrimination; provides unemployment, disability and retirement income insurance, and in many countries health insurance, and sets the conditions for hiring and firing, unionisation and collective bargaining (European Commission, 2005b; OECD 2003; World Bank, 2004).

The state's role in governing structural industrial problems has also been central in previous decades. In the 1950s and 1960s, aid programmes and academic advisors propagated the idea of state bureaucracy as the lead agent for the transition to what was then known as modernisation (Stone, 1965). Aid agencies favoured large-scale projects of industrial development, which, in their turn, required the guarantee of government involvement (Esman, 1988). The state-led development was not only imitative but also built on a response to local circumstances. The case was made in re-structuring the economy towards "inward directed" industrial development on the basis of import

substitution (Todaro, 1994). Until the 1980s, the role of the state expanded, in advanced countries faster than among developing countries.

Following the oil crises of the 1970s, the 'statist' model became the subject of strong criticisms that gradually led to the rise of the neo-liberal approaches and to a subsequent (significant) reduction of the role of the state in almost all areas. The prevalence of neo-liberal approaches in international organisations (IMF, World Bank, OECD) seem to have played an essential role in that direction, given that many countries that had to resort to them for financial assistance, were forced to change their economic policies, and reduce the role and scale of the public sector³⁹.

A similar approach was followed in the CEECs during their transition to market economies in the beginning of 1990s.⁴⁰ Partly in response to the experience of liberalisation during the 1990s, partly due to the Association Agreements with the EU, the institutional side of reforms became very important. The goals of reforms were extended from freeing market forces and making economies efficient, to addressing problems related to institutions like clear property rights, the rule of law, financial

³⁹ Batley and Larbi mention, that the UK experienced the first structural adjustment programme when in 1976 it negotiated a loan from the IMF. In return it had to accept public expenditure cuts, divestiture of public enterprises, a floating exchange rate and restraints on money supply. These became the principal elements of the structural adjustment programmes that were later applied globally (Batley and Larbi, 2004 p. 5).

⁴⁰ In transition economies like Estonia, there was a very limited expertise in market economics for a number of spheres of economic policy in beginning of 1990s. The role of international organisations was for that reason extremely important in formulating principles of legislation, regulations and in guidance general economic policy choices. Their representatives often preferred solutions that were not influenced by local lobbies but based on market solutions.

systems, accountability of government, effective and efficient public administration (Kohsaka, 2004; Rodrik, 2004).

As internationalisation and deregulation advance at a global level, the centrality of the nation-state is destabilised and governance issues are 'spilling over' its boundaries. Thus economic, political, cultural and broader social relations become increasingly embedded into much more complex spatial scales (sub-national, national, supra-national) where hierarchies are not necessarily simply nested but could also be tangled, while scales are not just reordered but rather new ones are constantly being developed (Jessop, 2000).

Jessop conceptualises these changes at the level of the state as a move from a Keynesian Welfare National State (KWNS) towards a Schumpeterian Workfare Post-National Regime (SWPR). Thus, he argues that the restructuring of the state can be discussed in relation to: 1) the objectives of state regulation (from a state focused on intervention (Keynesian) to a state focused on creating conditions for competitiveness (Schumpeterian); 2) the move from being the main provider of welfare towards shifting responsibility to individuals, -for example linking benefits to work and/or actively looking for work- (workfare); 3) the move from centrality of regulation within national (state) boundaries towards the growing significance of different levels of governance that can be sub-national (such as regions or cities for example) and supra-national (such as the EU, IMF, WTO etc.).

Within this context the state is becoming one among many other centres of governance (although still probably the most important one). Jessop suggests conceptualising this change as a move from 'national' (space) to 'post-national' (space), where the centrality (sovereignty, etc.) of the state is destabilised and therefore states are increasingly

moving towards what he calls ‘regimes’ of governance where the powers of the states to influence processes within their own territories are reduced (thus a move from *government* towards *governance*); however, the latter process is paralleled by another one, where states gain significance and acquire new powers of coordinating, or steering the new levels of governance (both sub-national and supra-national) (he calls this *meta-governance*).

Thus, there are increasingly complex dependencies between different scales (Jessop, 1998) as well as a variety of actors operating at different levels that establish and shape the rules of the game. The dominance of the nation-state for a long period of time, has led to a situation in which governance at both sub-national and supra-national levels is less regularised, which in turn means that private actors (mostly, but not solely, enterprises) are dominant. Thus, governance concerns first the establishment and shaping of local and global mechanisms in addition to national ones, as well as the interrelation between local, national and global institutions.

Depending on how conflicts are negotiated Jessop offers a typology of four types of state restructuring: neo-liberal, neo-statist, neo-communitarian, and neo-corporatist (Jessop 2002, see Table 22).

Table 22 Governance types in SWPR

<i>Neoliberal</i>	<i>Neocorporatist</i>	<i>Neostatist</i>	<i>Neo-communitarian</i>
Promote free competition	Rebalance competition and cooperation	From state control to regulated competition	Limit free competition
Deregulation: reduce role of law and state	Decentralised 'regulated self-regulation'	Guide national strategy rather than plan top-down	Empowerment: enhance role of third sector
Privatisation: sell off public sector	Widen range of private, public and other 'stakeholders'	Auditing performance of public and private sectors	Socialisation: expand the social economy
Market proxies in residual public sector	Expand role of public-private partnerships	Public-private partnerships under state guidance	Emphasis on social use-value and social cohesion
Internationalisation: free inward and outward flows	Protect core-economic sectors in an open economy	Neo-mercantilist protection of core economy	Fair trade not free trade; think Global, act Local
Lower direct taxes: increase consumer choice	High taxation to finance social investment	Expanding role for new collective resources	Redirect taxes: citizens' wage, carers; allowances

Source: Jessop (2002).

Drawing on Jessop's distinction between KWNS and SWPR as well as the different types of SWPRs we will discuss different aspects of state strategies in relation to labour markets and industrial structure of the five countries in our study.

Regional (local) level

In many countries there is an explicit national policy for the development of their less developed regions, aiming to improve infrastructure and create the conditions that could encourage investment. These policies usually include infrastructure works, state-aid schemes and investment incentives, and the provision of tax and social insurance benefits to potential investors.

In addition, the role of regions has substantially increased in almost all EU member states over the last two decades. As a consequence, regional (but in certain cases also local) authorities have become more active in shaping and implementing their own policies, particularly with a view to attracting investment and promoting innovation in their regions. As competition between regions (or local areas) gradually increases, local actors adopt more ambitious approaches to improve their competitiveness, which include at least one of the following elements: 1) the creation of roundtables, partnerships (including public-private partnerships) or alliances for local economic development in order to formulate and implement a strategy to improve the location advantage or revitalise old locations; 2) the implementation of cluster initiatives; 3) the creation of dedicated local economic development agencies to co-ordinate and organise local level efforts (OECD, 2001b; Wallis, 1996).

More recent approaches (see for example, Cooke, 1996) stress the role of knowledge and innovation in the new “knowledge economy” and the need for regions to become internationally competitive in a globalised economy (Lundvall, 1997). These approaches focus on improving the R&D capabilities of firms and their link with the (regional) technological infrastructure of higher education and R&D institutions through which knowledge irrigates the regional economy. Regional policies following these approaches aim primarily to strengthen the innovative capabilities of existing firms, attract innovative firms to the region and enhance the regional innovation capacity.

Governance and Global Commodity Chain

The GCC⁴¹ literature offers a wealth of empirical material and useful theoretical insights on the operation of labour intensive industries and the governance mechanisms along the global commodity chains. The GCC approach has been criticised in the past on a number of levels (see also ch. 2). It has been argued that the approach tends to exclude labour and focus on industry (i.e. capital), that it does not address legacies and path-dependence. It tends to emphasise global, i.e. trans-border links and does not cover local relations and complex institutional arrangements. Issues of governance concentrate almost exclusively on firms and power relations tend to be reduced to two overly generalised models (buyer or producer-driven chains). More specifically, Smith et al (2002) argue that the GCC literature does not consider the spatial aspect and focuses on the chains as linear forms of economic practice. The role of the state is under-theorised and labour relations are not discussed as a part of the governance of economic practices.

⁴¹ Also referred to as “global value chains” approach.

Generally, they argue, there is little concern with governance action outside the production chain (e.g. national and/or regional processes).

Some of these issues have been addressed more recently in Gereffi et al (2003) who define five forms of governance limited at both ends by market and hierarchy. Depending on the degree of complexity of transactions, the possibility to codify transactions, and the capabilities in the supply-base, they distinguish between markets, modular value chains, relational value chains, captive value chains, and hierarchies⁴². Humphrey and Schmitz (2001) address the question of governance by asking how are parameters set and then enforced; is it firms within the chain (e.g. the lead firm) or external entities that are enforcing them? Further, a contribution by Messner (2002) has brought together a) global value chains, b) global policy networks (or ‘world of standards’), and c) localities in what he called a ‘world triangle’. Messner argues that these networks constitute separate governance regimes that are characterised by different rationality, modes of operation, organisational capacity, etc. These differences lead to tensions between global value chains, the ‘world of standards, and local networks⁴³. Thus he argues that local (and firm) strategies need to be considered within global standards and global value chains.

⁴² These criteria however are quite rigid and dwell on a distinction between ‘arm’s length markets’ and ‘large vertically integrated corporations’. Given this definition it becomes impossible to discuss different forms of formal/informal hybrids that occur on different levels of governance.

⁴³ One such example is discussed in Schmitz et al. (1999) about a footwear cluster in Brazil where few big local exporters prevented a collective upgrading strategy.

Globalisation of trade and production on the one hand and their integration across distant locations across the globe, on the other, raises the question of co-ordination of activities across space (Feenstra 1998, Gereffi et al 2005). Gereffi et al (2005) offer an analysis of different modes of relationships along the value chain (market, modular, relations, hierarchy), where the focus is on TNCs and their suppliers. However, the governance of the value chain is not restricted to the role of companies and involves a broader set of actors that are operating on global, national and sub-national levels (see Table 23) and include local and national firms, TNCs, trade associations, certification firms, NGOs, consumer groups, trade unions, local and national governments and standards organisations, international and regional organisations (see Table 24).

Table 23 Categories of private-public and local, national and global governance of economic activity

	Local (National and EU) level	Global level
Private Governance	Local business associations Hub-and-spoke cluster	Global buyer-driven chain Global producer-driven chain
Public Governance	Local and regional government agencies	WTO rules National and supranational rules with global standing
Public-Private Governance	Local and regional policy networks	International standards International NGO campaigns

Source: adapted from Humphrey and Schmitz (2000).

Table 24 Type of actors

Types of actors		Local/National	Global
Private	Business	Local and National Firms, Trade Associations and Certification Firms	TNCs, Global Trade Associations, Global Certification Firms
	Civil Society	Local and National NGOs, Consumer Groups and Trade Unions	Global NGOs, International Trade Union Federations
Public		Local and National Government and Standards Organisation	International and Regional Organisations

Source: Nadvi and Walding (2002).

Gereffi and Mayer (2004) suggest that governance of GCCs can be usefully discussed in relation to the main domain within which they operate, private or public, and the main functions that they serve within the organisation of GCCs, facilitative, regulatory, compensatory (see Table 25). Here the facilitative function is associated with the establishment of property rights, enforcing contracts, establishing rules of fair competition, providing information, etc. The regulatory function is concerned with controlling the negative externalities of markets such as environmental pollution, exploitation of workers, etc. Finally, compensation refers to mitigation of the tendency of markets to produce highly unequal distribution of outcomes and will include social insurance, health care, education and retraining, progressive tax system and other welfare policies. Nevertheless, we would like to point out that the boundaries between these functions are not always clear. For example, competition policy, classified under the “facilitative” function, could also be part of the “regulatory” function, given that it

provides the overall legislative framework for both private actions (e.g. mergers and acquisitions) as well as public policies (e.g. state-aid schemes, investment incentives laws, etc).

Table 25 Modes and realms of governance

	Realms of governance	
Modes of governance	Public	Private
Facilitative	Property rights Banking and commercial law Competition policy	Market ideology Professional codes and norms
Regulatory	Labour law Environmental regulation Health and Safety regulations	Voluntary codes of conduct Corporate social responsibility Pressure and consumer boycotts
Compensatory	Social insurance Education/retraining programmes Public health policies	Collective bargaining Philanthropy

Source: Gereffi and Mayer (2004).

More specifically, Gereffi and Mayer (2004) argue that economic globalisation is associated with a growing governance deficit. The “thinness” of institutions becomes evident by observing the strengthening of facilitative institutions both internationally (e.g. GATT, IMF) and at the national level (including in developing countries), compared to the weakness of regulatory and compensatory institutions globally, and their gradual erosion in developed countries. Furthermore, facilitative institutions are mostly associated with the regulation of capital flows and are not applicable to labour

where migration flows are generally governed at the level of the state. The tendency however, they argue, is for an extension of the functions of global governance mechanisms, or what they call *thick* (as opposed to mainly facilitative functions in *thin*) governance.

Our study seems to confirm Gereffi and Mayer (2004) analysis but adds further depth into the ways in which these tendencies vary across industries and countries. Drawing on interviews with key informants and businesses we are able to discuss in more detail the role that different actors play (Humphrey and Schmitz 2000, Nadvi and Walding 2002) in the governance of GCCs.

PART II. EVIDENCE FROM THE STUDY

5.3 Delocalisation: Key factors and players

State policies, especially those related to tax levels, seem to have a strong influence on company decisions to delocalise although there are other factors that companies also quoted as important. Such factors include for example: a combination of change in technology and existing capacity, looking for a strategic global footprint, increasing output, reporting tax and profit/loss as a global strategy, level of market growth. Further, internationalisation as such is not necessarily the most significant development as far as companies are concerned and some of the key changes could include mergers and acquisitions, restructuring of main markets (e.g. the collapse of the telecommunications sector), political events such as 9/11 and the drive towards security, the wars in Iraq and Afghanistan, etc. As will be shown below, according to our survey, trade unions and

business associations have a negligible role in company decisions to delocalise, in all five countries.

Figure 21 presents trade union membership in most EU countries. Union membership in Poland and Estonia is around 10-19 per cent and in UK, Greece, and Bulgaria it is around 20-29 per cent. This does not necessarily reflect the general tendency in the EU where trade union membership varies significantly across countries and the unionisation in the five countries in our sample is among the lowest in the EU. It should also be mentioned that the industries examined in this study (even the more traditional ones) have much lower rates of trade unionism than other industries like e.g. machine industry.

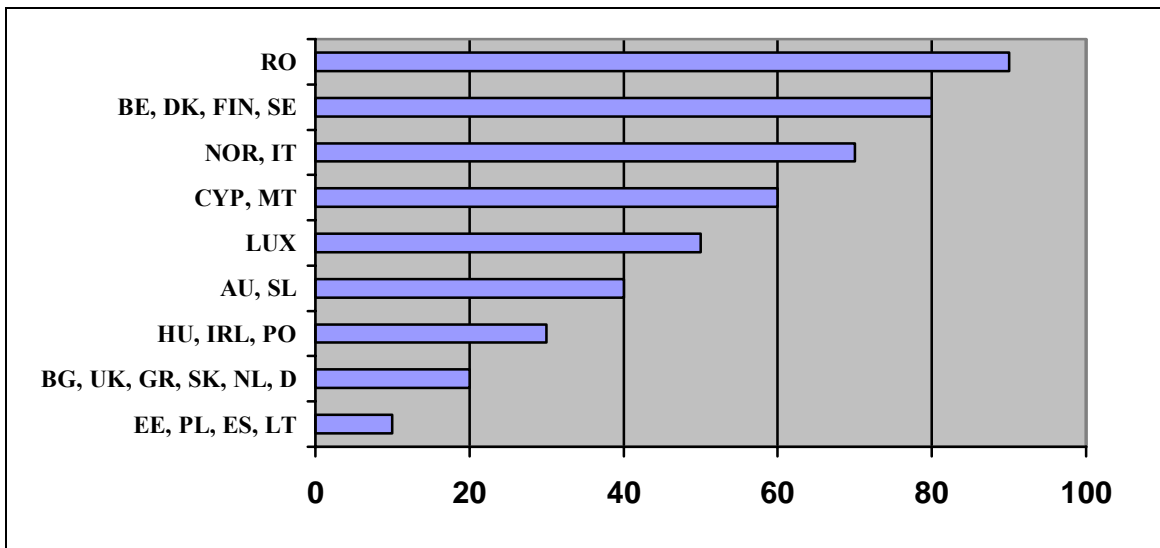


Figure 21 Trade Union Membership (percentage)

Source: adapted from Carley (2004).

As already mentioned above, according to the results of the survey, there has been practically no influence of trade unions and business associations on firms' decision to delocalise in Poland, Bulgaria and the UK. In Estonia and Greece, the influence of trade

unions was somewhat more apparent but still very limited. As can be expected, the influence of trade unions is more common in traditional industries like footwear and clothing while business associations had a somewhat stronger role in new industries like software and electronics. Companies for which delocalisation decisions were influenced by trade unions and business associations, are more often in clusters or industrial networks than other companies in the sample involved (Table 26). This may suggest that they have relocated their activities in order to take advantage of agglomeration economies that can be obtained due to geographical concentration. These groups of companies often feel they have succeeded in getting orders from abroad due to geographical proximity. They also seem to develop value added products significantly more often than other companies.

The trend towards the marginalisation of trade unions is observable in all countries studied and is reflected in the comments of both companies and key informants. The deficiency of state protection and weakness of organised labour leads to the growing significance of private arrangements. Negotiations take place at the level of the company where the “philanthropy” or the moral judgement of individual businesses seems to be the key governance mechanism.

Table 26 Selected statistically significant (t-test for independent samples) difference between means for companies, which delocalisation decisions were/were not influenced by trade union and business associations

	Are trade unions and business associations, influencing your company's decision to delocalise ?	N	Mean	Standard deviation
Company which gives subcontracting / outsourcing to a company abroad	Yes	46	1,54	,504
	No	628	1,25	,439
Production of more complicated goods (higher value added)	Yes	46	,67	,474
	No	628	,40	,490
Company as a part of a cluster / industrial district	Yes	46	,35	,482
	No	628	,15	,355
Succeeded in getting orders because of geographical proximity	Yes	46	,57	,501
	No	628	,34	,473

Source: enterprise survey.

'As I've already explained, our relationships with our employees are very good, so we don't have any problems of this nature. In the past, when we had 200 employees, things were different; they caused trouble on a daily basis. Today and given the high rates of unemployment, nobody dares to talk.' (Clothing, Greece)

'No we manage employee relations to voluntary work in the committee and we always have done and that works very well, so trade unions have never been able to make any success here although they have tried from time to time but there is no place for them.' (Electronics, UK)

Nevertheless, trade unions continue to play a certain role in all countries, though the actual functions that they have and the form that their actions take vary. Further, there is also a tendency for social dialogue to become much more significant at the EU level as compared to negotiations at the national level. Thus, in the case of the UK the role of trade unions has become one of implementing directives and providing a range of services to their members rather than collective bargaining. In Poland collective bargaining is weak or absent in the private sector in analysed industries. Although there is a representation of employees at the national level bargaining mainly takes place at the local level and is absent from the industry level. In Bulgaria the situation is similar to Poland and there is also preference for informal arrangements between employers and employees (Wallace et al 2005, HWF).

As regards business associations and chambers, the evidence suggests that they are perceived as useful supporting mechanisms but not vital to companies:

'They're chambers that help us in issues like that. And I should note that their help has been essential. The chambers organise some meetings for the businessmen. They also organise fairs and send informative brochures and other documents that concern fairs and other activities of the company.' (Electronics, Greece).

There appears to be a variety of relationships between TNCs, local subsidiaries, employees, trade unions, business associations and government. Thus in some cases local management and employees develop close interests as opposed to TNCs (e.g. TRW, and national trade unions, see the 'cornflakes redundancies, UK), while in other cases TNCs and employees as opposed to owners of local subcontractors or subsidiaries as for example in the cases of improvement of labour conditions (most cases in the sample).

'Trade unions we have here, primarily Amicus. But it has to be said they are very weak.... But also because of the way the business is gone we had the real hard time in 1990-2000. But Margaret Thatcher just made it easier for UK companies. And we can see this now. Whenever there is a push for a headcount reduction they always look in the UK because it is hard everywhere else. It is expensive, the unions are strong elsewhere, it's hard to close plants in those places and easier in the UK. And when I was an ambitious young man I thought 'great': no trade unions to worry about, but now as a manager when I have to protect the plant from head office I wish there was more protection.' (Electronics, UK)

Further, trade unions in some cases need to take decisions to protect one group of employees as opposed to another and to align with different capital and government

configurations. This analysis confirms the wide ranging de-coupling between interests of capital and labour on the one hand and between financial and production capital, and the wide variety of alignments and confrontations that vary across contexts. It is not always the state, but it could also be the locality, the specific organisation, the network, etc. the level at which negotiations take place, while the key players and their alliances could be constantly changing.

As far as governments are concerned this situation requires the development of a variety of mechanisms that would make flexible negotiations possible (for example the case of UK trade union negotiations on the local level and the obstacles created by the need to co-ordinate decisions with the central office of the union). Nevertheless flexibility cannot substitute the need for political and normative choices that have to be made.

5.4 State Policies and Governance

Labour markets and state policies

Wages and labour cost

Table 27 shows the average labour cost and the minimum wage per month in each of the countries covered by the study, for selected years in the period 1996-2006. As expected, the old member states have a significantly higher labour cost than the new ones, with the UK average labour cost being 5-6 times higher than that of Poland and Estonia and up to 18 times higher than Bulgaria. Greece has an average labour cost of slightly less than 2000€ per month, which is roughly 3 times higher than in Poland and Estonia and 9 times higher than in Bulgaria. The observed large discrepancies in the average labour cost between old and new member states have undoubtedly played a significant role in

the decision of firms to delocalize. In traditional industries of the UK and Greece, high labour costs were the most important factor to delocalise into lower labour cost countries (mentioned by 67.8 per cent companies in clothing and 66.7 per cent in footwear industry). Those reasons were less imminent in software and electronics. However, in electronics, the sensitivity to labour costs depends very much on where the company is situated in the value chain. The producers from the lower part of value chain (foreign consumer electronic companies) behave similarly to companies in traditional sectors.

An interesting observation concerns also the relative weight of minimum wage to average labour cost in each of the 5 countries. In our survey the share of minimum wage to average labour costs was highest in Bulgaria (38.4 per cent), in other states except Estonia between 33 and 34 per cent and in Estonia 29.5 per cent⁴⁴. The relatively high level of minimum wage could be a problem for peripheral regions with lower than average wages, although one should also take into consideration the absolute figures and not only percentages. In the case of Bulgaria, for example, with the highest proportion between minimum wage and average labour cost, the absolute figures are significantly lower than those of Poland and Estonia, let alone the ones in Greece and the U.K. Statutory minimum wages vary significantly (Table 28) and the gap between CEECs and the old EU states can not be quickly minimised.

Many Polish clothing companies were forced to get involved in outward processing trade due to high costs of labour and costs of mandatory social security in particular. Polish and Greek footwear managers argue that ‘a lesser burden from social security

⁴⁴ The comparison between labour costs in 2004 and minimum wages in 2006.

could stimulate companies to employ new people, such as designers, sales representatives which would enable them to escape from the vicious circle of OPT dependency’.

Table 27 Monthly labour cost and minimum wage, 1996-2004 and 2003-2006

	Labour costs, EUR						Minimum wage, EUR	
	1996	2000	2001	2002	2003	2004	2003	2006
EU-25	2254.7	2732.3	2768.7	2864.2	2892.6	2979.1	-	-
EU-15	·	3154.4	3149.8	3252.7	3330.2	·	-	-
Bulgaria	·	179.0	189.8	193.6	202.2	213.5	56	82
Estonia	275.9	429.1	496.3	562.4	608.4	650.3	138	192
Greece	1446.3	1658.1	1739.9	1849.4	1984.3	...	605	668
Poland	447.1	672.4	791.8	783.1	698.2	699.2	201	234
UK	2168.8	3676.9	3793.4	3891.3	3642.4	3848.6	1106	1269

Source: Eurostat (2006a).

Table 28 Statutory minimum wages (at 1st January 2006)

	Bulgaria	Estonia	Greece	Poland	UK
Year of introduction	1990	1991	1991	1990	1999
Coverage	All employees	All employees	All employees aged 19 or over (non-manual) or 18 or over (manual workers)	All employees	All employees aged 16 or over
Method of setting	Set by government based on recommendations of social partners and taking account of State budgetary restrictions	Set by government	Annual negotiation by social partners	Set by government based on negotiation by social partners	Set by government based on recommendations of social partners
Method of updating	Set by government based on recommendations of social partners and taking account of State budgetary restrictions	Set by government based on negotiation by social partners	Annually, based on government forecasts of inflation	Once or twice per year, based on government forecasts of inflation	Set by government based on recommendations of social partners
Type of rate	Monthly and hourly	Monthly	Weekly	Monthly	Hourly
Statutory level or monthly estimate, EUR, except USA	82	192	668	234	1269
In force since	01.01.2006	01.01.2006	01.01.2006	0.01.2006	01.10.2005

Source: Eurostat (2006b).

Flexibility

The following table (Table 29) presents the main trends towards flexibility in the labour markets of the five countries under consideration.

Table 29 Trends in labour market policies

State	1980s	1990s and 2000s
United Kingdom	Deregulated flexibility	Partially deregulated flexibility
Greece	Deregulated flexibility	Partially deregulated flexibility
Estonia	Strongly regulated anti-flexibility	Partially regulated flexibility
Poland	Strongly regulated anti-flexibility	Partially regulated flexibility
Bulgaria	Strongly regulated anti-flexibility	Mainly unregulated flexibility

Source: adapted from Wallace 2005, HWF.

In the UK the flexibility regime is deregulated or partially regulated and working time and employment conditions are negotiated on the workplace (Wallace 2003). There are very few restrictions to employing people on part-time and on short hours (OECD 2002, 2005, Boje and Andreas 2007). Much of the new regulations introduced by the New Labour in UK are minimal and originate from EU directives. New member states followed a rather different path and moved from a high degree of state control where the policy was one of deliberate rigidity towards different degrees of regulated flexibility. The so far achieved regulated flexibility is low in the cases of both Poland and Estonia,

while in Bulgaria due to the deeper economic crisis there is still lack of coherent policies and flexibilisation is largely unregulated (Wallace 2005, HWF).

In the Bulgarian case, the positive role of employment conditions has been most important in clothing (for 30.0 per cent enterprises) and footwear industry (29.5 per cent positively). For Bulgaria's electronics and especially software industry, those conditions were not important for delocalisation.

Estonia and Poland belong to a different group of countries: traditional industries have been more sensitive to employment conditions, but their impact was divided to positive and negative influence. This means that labour costs started to be a reason also for outward delocalisation from these countries, more in Estonia, less in Poland. Labour conditions were less important in software and electronics industry:

'I think, I feared it much more than the reality but in that the force of having a minimum wage imposed, being forced to accept flexible working, I would have seen as being limiting our ability to do this up here, before they arrived but in fact they are quite consistent with the changes that globalisation has demanded on the business anyway, and because of this and the way the business has changed we did abort the minimum wage and we are inclined to allow the flexibility because that's good for the business, the way that it is today. It would have been bad for business the way that it was five years ago but by the time it had become reality. So I think that is probably less of a negative than we would have perceived it was going to be. But I think the Government could do a lot less with this.' (Electronics, UK)

Perceptions of businesses seem in certain cases to be explicitly in contrast to the overall framework set by the EU.:

'Well it's quite a big issue but in the UK as a whole, is not only local based. Yeah, the working hours directive, number of hours you can work especially in our industry. You can be expected to work a hundred hours a week. But then you have the rules ... and they say you can't do that. All of our staff sign out from that particular directive. (...) So, just generally it just seems kind of more restrictive what you can do, what you can't do. You know you have a person in staff who is particularly crap. You can't get rid of them because he'll sue you or he'll be off six months on stress leave. It's very, very hard and very restrictive but that's just employment law.' (UK, software)

A main dividing line between North Western EU countries and new member states (including Greece in this case) is the high degree of informal flexibility that applies in the latter group. This tendency is especially strong in countries, such as Bulgaria, where labour markets are less regulated and additional contracts, casual work, and other types of 'atypical' employment are not unusual (Wallace 2005, HWF). In particular, the situation in certain peripheral areas can be quite different than what appears in the formal regulatory framework of the country.

Three of the industries that we study (clothing, footwear, and to a lesser degree electronics) are not core for the countries in our sample and are located mainly in peripheral areas. The lack of alternative work opportunities in peripheral locations pushes wage levels down but also makes weaker the implementation of existing regulation. In

such cases the role of external buyers for the improvement of working conditions can be very important (private governance mechanisms).

Private governance seems to play an essential role in forming a governance structure. Asian consumer electronic companies base their strategy on the reduction of labour costs, what is clearly expressed by them. For Asian companies investing in Poland is a way to enter EU market through avoiding paying import duties and get access to cheap labour (in reality finding appropriate people is difficult). Some Chinese companies have gone there to learn. Large Asian (Korean, Indian and Chinese) consumer electronic companies were attracted to many sites in Poland. However, it occurred that these are companies, which dictate labour conditions and do not follow some labour regulations⁴⁵.

Among the most crucial issues, there are:

- when workers try to fight to protect their rights they are moved to Asian subcontractors of TNC which followed their main customers. There are lower salaries, mobbing cases are more often.
- in practice the hour-work day lasts on average 10-12 hours, but they are cases of 16-18 hours workday.
- lack of places to rest, lack of benches and wardrobes.
- during unplanned production breaks, which take several hours, the worker must stand up, can not sit or talk.

⁴⁵ We have managed to establish a balanced and objective point of view through interviewing trade unions representatives, company managers and local labour inspectors.

- temporary job is characterized by no followed regulations in relation to time requirements and no selection in relation to qualifications,.
- some companies broadcast on their facilities noisy slogans in Asian languages what could have been harmful for employees
- common blackmails by medium-level Polish management. Trade unionists were promised to be promoted when they resign from the union; cases of not prolonging job contracts for trade unionists

The above mentioned facts clearly point at the strong private governance in this sector, where neither labour inspectors nor trade union representatives can influence the company's behaviour. TNCs shape the delocalisation processes entering CEECs coming with their Asian subcontractors, which usually offer worse labour conditions.

The degree to which private arrangements are significant also depends on the size of the informal economy where regulation is not enforced and conditions are negotiated at the company level. The degree of significance of the informal economy varies between sectors (more important in clothing and footwear) and countries (more significant for new member states). In the new member states, for example, there is a clearly identifiable two-tier structure between companies that are working in the formal and the informal economy, with significant differences in terms of opportunities, degree and process of enforcement of regulation. Thus, while state regulation of labour conditions is quite strong in new member states and even positively comparable to other EU countries the presence of a large grey sector means that these regulations are often not implemented.

In this context it is standards imposed by buyers that can play a role of a regulator (valid for all industries and countries), although operating in the grey economy is usually associated with work for international buyers that are barely surviving and only competing on price. In this sense poorer standards (as much as they guarantee lower labour cost) is one of the reasons that pushes them to operate in new member states

‘An increasing number of companies are making efforts to introduce improvements, since these conditions form part of the order assignment contracts.’

(Key informant, clothing Bulgaria) ‘The contractors were seriously interested in the employment conditions and working hours.’ (footwear, Bulgaria)

‘US customers delegate here their representatives to check the employment conditions and only then place their orders to us.’ (footwear, Bulgaria)

‘The Greek owners of clothing factories in Bulgaria do not adhere to the requirements of labour conditions as stipulated by law. They have come to Bulgaria to avoid the EU requirements related to labour conditions.’ (Key informant, clothing, Bulgaria)

‘The most important thing is the low cost of labour as well the existence of obedient labour (they do not complain for overtime, etc).’ (Key informant, clothing, Greece)

International labour mobility

Increased economic integration and free movement of labour has a strong impact on domestic labour markets, especially in small countries like Estonia or Bulgaria but recently also in Poland. In the case of Estonia, highly skilled and reasonably priced labour has been one of the cornerstones of rapid economic growth.

There are different channels of labour migration: some of them are negotiated at the state level (the case of LG in Poland, see next paragraphs), others are regulated by the state (e.g. EU migration and special quotas, German green cards, UK permanent residency) and some of them are illegal (unregulated) (e.g. home workers and illegal migrants). After joining the EU in May 2004, labour migration became a significant economic and social policy issue in Estonia and Poland (with estimations of up to 1.5 million of Poles, who emigrated to the UK). One of the main incentives for migration is the existence of an income gap between the home country and destination countries (the UK and Ireland, Scandinavian states). The first two are the EU countries that haven't applied for a transition period in the opening of their labour market for the other EU members. After two years transition period, several other EU countries opened their labour market: for Estonia, the opening of the Finnish labour market on 1 May 2006, was very important.

In Poland, the emigration of young, usually highly skilled labour force enhances a chain reaction on the labour market. The jobs of those who left abroad are filled with workers lured over from other enterprises or with unemployed. When skilled people leave, it is

necessary to train new people to replace them. This leads to a rise in qualification of employees and reduction in unemployment. However, alternative substantial danger emerges: high expectations of potential workers do not fit in to relatively low salaries offered by employers. This recent phenomenon is especially important for Polish consumer electronics, where low-paying large TNCs can not find suitable employees and do not want to raise salaries. A different situation has emerged in the Bulgarian footwear industry, where even foreign companies that offer relatively high wages cannot find employees, because it is not popular to work in a 'dirty industry'. A German employer in Bulgaria with excellent working conditions and salaries said: 'young people do not like to work in such an industry. It is not attractive for them. They prefer to earn less money, but to work in services'.

Companies are no longer able to find appropriate employees, which leads to a reduction in delocalisation due to the lack of the availability of labour. There exist relatively large labour shortages in the analysed industries. Scarcities on the labour market are reported by 83.1 per cent of interviewed companies and this doesn't depend on the industry, but on the country. The respective percentages were 97.5 per cent in the case of Bulgarian companies and only 57.3 per cent in the case of British firms. The most remarkable shortages were the following: the lack of sewing ladies (in Bulgaria and other CEECs) and the scarcity of workers for large Asian TNCs investing in Poland. TNCs requested regional and national authorities to obtain a permit for employing Korean workers. The lack of appropriate software developers in Poland and the need for some companies to import labour from Ukraine is a similar emerging phenomenon. Polish secondary school graduates do not like to study engineering, as mathematics is perceived as the

‘obligatory evil’. In the absence of appropriate policy measures, this situation may result in the complete lack of software developers.

The question of labour scarcity is important in all four sectors. Sometimes it can be attributed to the level of wages, especially when there are alternative opportunities (emigration from Poland), sometimes it is an issue of fast-rising aspirations and expectations. Additionally, there seems to be a decreasing number of people that would like to work in traditional industries. Against these trends, there seem to be four solutions for companies:

- increase wages (a limited if not impossible option in industries that compete on prices),
- relocate within the country (lot of traditional industries have developed in more peripheral areas with lower expectations and fewer opportunities);
- import labour (apply to regional authorities to import Asian labour, the cases of: LG Philips in Wroclaw, Samsung in Czech Republic);
- delocalise outside the country/EU.

The international competition from low wage countries makes it impossible to substantially increase wages, which in turn creates difficulties in finding workers. In Estonia, it has been possible to find low skilled (or unskilled) labour force from peripheral regions and attract them to industrial towns. However, the recent Polish experience of high emigration to the UK and Ireland shows that the scarcity of labour emerges also for the low-skilled parts of the electronic sector. A different option is immigration from third countries that would make possible to keep the economic structure and prevent a socio-economic deterioration. Such an option depends to a large

extent on national policies that until now have been restrictive as far as inflow of foreign labour is concerned.

The case of Germany is an example of how a relaxed -and targeted- immigration policy did not produce the expected results. The decision of the German government to open the market for specialists (through the system of 'green cards') had been cautiously taken, following an often heated debate. At the time, Polish software companies complained that emigration of the most talented people to Germany could ruin their businesses. However, this has not been the case at all, as salaries of Polish software developers had been drastically increasing at the same time. According to various Polish industrial associations and experts the scale of emigration from Poland has been very limited, not exceeding 300 software developers in the first two years.

Some investors in Estonia and Poland are still interested in the maintenance of low technology, cheap labour requiring activities and even in the creation of new ones. At the same time, many low-paid workers emigrate from Estonia to earn much higher wages for similar work in other EU states with better working conditions. That has a substantial impact on wage level in Estonia and Poland and creates increasing problems for labour-intensive industries in Estonia. The hardest hit are subcontracting enterprises like garment industry, where the share of labour spending is up to 80 per cent of the total cost.

5.5 Industrial restructuring and state policies

The gradual reduction of market barriers has considerably increased the mobility of factors, particularly of capital. Portfolios have become more international and the

number of cross-border mergers as well as the volume of FDI has increased. As a result of liberalisation, globalisation and integration of the markets, the international spill-over effects of national tax policies have increased. Because capital can easily move from one jurisdiction to another, differences in tax policies can have an important impact on investment flows.

Taxation and tariff barriers

The tax burden is an important determinant in cost-related strategies of firms. All countries in our sample have lower than the EU-25 or Euro area average tax burden. There was a tendency towards a decrease of tax revenues in GDP in new EU members, but in Greece and the UK taxes as a share of the GDP increased. Estonia is a very clear example of a country with emphasis on taxation of consumption. The tax burden of labour is high due to high social tax. Taxation in the UK is biased towards taxation of capital remarkably more than in the rest of the EU countries (Table 30), while taxation of labour is relatively low in comparison with the other EU countries. The level of corporate income tax and of labour taxes has been considered an important factor supporting FDI and delocalisation into Bulgaria, Estonia and Poland. The position of companies of these countries in the value chain of particular products depends also on the education level and R&D expenditure, a large part of which is financed through public expenditure (hence through tax revenues). Such a rationale leads to the conclusion that a low tax policy aimed at improving a country's competitiveness may create short-term advantages, but may lead to potential negative consequences in the

long run. The following table summarises the tax revenues (as a percentage of GDP) of the countries under consideration.

Table 30 Tax revenue and implicit tax rates by type of economic activity

	Tax revenue, % of GDP		Implicit tax rate on:					
			Consumption		Labour		Capital	
	1995	2004	1995	2004	1995	2004	1995	2004
EU-25*	39.7	39.3	21.1	21.9	35.7	35.9	23.1	25.8**
Euro area*	39.9	39.7	20.3	21.5	35.7	36.6	23.6	29.2**
Bulgaria
Estonia	37.9	32.6	20.3	20.8	39.2	37.6	17.9	10.3**
Greece	32.6	35.1	17.3	17.5	34.1	37.9	12.1	17.0
Poland	38.5	32.9	21.8	19.3	37.9	34.6**	...	19.4
UK	35.4	36.0	19.6	18.7	25.7	24.8	33.3	34.9

*EU 25 and Euro area overall tax rates are computed on the basis of a GDP-weighted average.

** Figures for 2003.

Source: Eurostat (2006a).

Duties are also important in creating a competitive environment. Although many Polish and Bulgarian companies cry for higher duties for Chinese products, others claim that exports and imports should become cheaper, mainly by decreasing social charges. Managers state that such interventions (e.g. introduction of higher duties on the Chinese goods), in the absence of additional, more necessary measures related especially to the social burden on labour, will not resolve the problem of closure of Polish footwear companies.

The Trade Barriers Regulation helps to develop trade with third country markets. However, this tool is not very well known: some entrepreneurs from electronic companies complaining about too low taxes for Chinese and Thai goods and problems to export Polish products to South America were not aware of the existence of such a tool.

Regulation at the EU level, is largely necessary in the case of textile products. Even relatively expensive countries like Hong Kong (China), Republic of Korea and Taiwan play a major role in apparel exports, because they still have access to large apparel quotas primarily issued by the USA and Western Europe (Gerreffi 2005). The role of the EC is to initiate safeguard investigations, when imports rise above quotas. Additionally, punitive tariff duties should be imposed on goods after concluding that export countries had been paying hidden subsidies to their industries, thereby allowing them to send goods to Europe at markedly lower prices than those in Asia. Such a procedure was successfully implemented in the case of imports of leather shoes from China and Vietnam.

After introduction of limits to the inflow of cheap Chinese textile products, managers claim that their companies should need at least two more years to prepare themselves to the new situation and focus on short-series production. Some Polish and Bulgarian clothing enterprises are unable to withstand the competition from Chinese firms, which get huge subsidies (up to 50 per cent) from their government to buy fixed assets.

Non -tariff barriers

An important role in public policy is played by non-tariff barriers, such as the establishment of different standards, including those regulating product quality, but also health and safety conditions at work. As expected, the number of standards is highest in industries characterized by network externalities, such as those related to electronic equipment and communication technology (World Trade Report 2006).

The regulations related to product quality, health and safety influenced company's decisions to delocalise in 23.5 per cent of cases, in favour in 17.6 per cent cases and against in 5.7 per cent cases. The highest share of companies answering positively to this question was located in Bulgaria and Estonia. In Bulgaria's case, 26.7 per cent companies answered, that regulations facilitated their decision. Binding regulations, guaranteed health and safety standards were supporting delocalisation decision of foreign companies to Bulgaria. In Estonian case, total impact of regulations was even higher than in Bulgaria. In 21.1 per cent of cases, regulations favoured delocalisation, but in 17.6 per cent were against the company. Companies interpreted some mandatory regulations too expensive to follow, especially harmonization of EU and company's standards. For example, many companies declared that they experience 10 times higher costs for air contamination as result of harmonization to EU standards.

Companies, for which non-tariff regulations played a positive role in delocalizing, manufacture under orders from abroad more often than those for which such regulations played a negative role (Table 31). They offer significantly lower wages and report lower percentage of white collar workers. These companies have less often contracts with subcontractors and less stable links.

Table 31 Selected statistically significant (t-test for independent samples) differences between means for companies, for which non tariff barriers regulations were in favour/against delocalisation decisions

	How regulations (about product quality, health and safety) influenced your company's decision to delocalise?	N	Mean	Standard deviation
Production under orders / instructions from abroad	In favour	96	,60	,492
	Against	32	,34	,483
% of white collar employees	In favour	95	13,10	15,926
	Against	32	19,03	26,497
Stability of links	In favour	86	1,98	,152
	Against	31	1,74	,445
Do you have contracts with your subcontractors	In favour	85	1,61	,490
	Against	32	1,94	,246
How you compare your company's wages to the averages in the industry	In favour	96	2,02	,858
	Against	32	1,63	,793

Source: enterprise survey.

Investment incentives to attract FDI and subcontracting activities

Incentives affect investment decisions. However, the emphasis on incentives varies considerably. The potential options include national, regional, or local grants, tax credits, R&D and other special purpose incentives, employment incentives, recruitment and training assistance and site or infrastructure improvements. Incentives can be up-front, or dependent on continuous upgrading of the investment project.

The results of our study show that governments play a modest role in undertaking activities to attract FDI or subcontracting. Only 18.7 per cent of respondents mentioned

initiatives taken in order to attract them to the foreign country or to start subcontracting. The highest positive answer rate was reported for Estonia with 37.4 per cent followed by Greece with 33.4 per cent, the UK 14.8 per cent, Poland 12.2 per cent and Bulgaria 2.0 per cent. In general, it must be stressed that it is mainly large foreign companies that exploit incentives.

By industries, the share of respondents receiving support for FDI or subcontracting was 24.3 per cent for clothing industry, electronics 22.4 per cent, software 14.5 per cent and footwear 8.8 per cent. There is no significant difference between new and old industries. The highest share of enterprises receiving government support was in Estonia's clothing (66.1 per cent) and footwear industry (45.5 per cent), Greek electronic industry (42.9 per cent), Polish electronic (23.8 per cent) and software industry (19.6 per cent) and the UK's electronics industry (25 per cent). This support was not significant in terms of the amount of received funds, which was not satisfactory for many companies.

Companies which take advantage of incentive schemes, base their operations on the production of value added goods significantly more often than other companies (Table 32). These companies compete more often on quality, design and flexibility. They are more stabilized: they usually have contracts with subcontractors and less often plan to relocate activities abroad. Companies which benefited from governmental initiatives, are more active as shown by (statistically significant) higher number of serviced firms on subcontracting basis last year. On average, enterprises which take advantage of active initiatives undertaken by national/local government, are more often foreign companies, which also give subcontracting to a company abroad. Conducted statistical analysis shows that foreign companies have significantly better relations with local and central

authorities than indigenous firms. It leads to the common statement expressed in Poland and Bulgaria that 'it is only foreign companies which benefit from local and national incentives'. This is a "light motif" behind low involvement in some local and national incentives. Among foreign companies especially TNCs benefit from national or local programmes. These large enterprises choose between localities which offer suitable conditions and the largest exemptions. In addition, their lobbying efforts in favour of particular bills, legislation etc. should not be neglected. This phenomenon supports the thesis about growing private governance. Moreover, foreign companies take advantage of initiatives governed by different sources: local, national, EU or even global. On the other hand, some CEE footwear, clothing and software managers argue that it is difficult to adapt to a newly emerging 'thick' international governance structure. Codes of conduct and regulations set up by different institutions (EU, WTO, national and regional authorities) change frequently and are introduced quickly. Companies have very limited time to react and thereby report losses.

Table 32 Selected statistically significant (t-test for independent samples) differences between means for companies which benefit from government initiatives

Indicator	Were there any active initiatives undertaken by national/local governments to attract your FDI or subcontracting?	N	Mean	Standard deviation
Foreign company	Yes	125	1,19	,415
	No	565	1,11	,316
Company which gives subcontracting / outsourcing to a company abroad	Yes	125	1,38	,503
	No	565	1,26	,438
Production under orders / instructions from abroad	Yes	125	,25	,434
	No	565	,46	,499
Production of more complicated goods (higher value added)	Yes	125	,56	,498
	No	565	,38	,485
Design competition	Yes	125	,32	,468
	No	565	,16	,363
Quality competition	Yes	125	,66	,474
	No	565	,50	,500
Competition in flexibility	Yes	125	,33	,471
	No	565	,14	,345
Number of foreign firms serviced on a subcontracting basis in 2003	Yes	94	9,73	11,562
	No	423	6,04	13,056
Contracts with subcontractors	Yes	100	1,83	,378
	No	419	1,68	,469
Plans to relocate any of the 'core', or 'non-labour intensive' segments of your company to another country within the next 2 years	Yes	124	1,82	,384
	No	556	1,90	,301

Source: enterprise survey

In addition to incentive schemes, entrepreneurs call for a stable political and economic environment. As shown below, currencies exchange rates and stability of the financial environment as a key demand of entrepreneurs to their respective governments:

'Currency exchange rate – if it were better, profitability of OPT would be higher. Strong zloty (Polish currency) can perhaps give some firms an incentive to delocalise production abroad.' (Clothing, Poland)

'For countries that are not members of the EU, exports need a certain procedure that is both bureaucratic and time-consuming. Within the EU, there are not any serious problems anymore. Nevertheless, the entrepreneurial climate in Greece is not favourable for companies that want to export.' (Software, Greece)

'There are problems with law amendments; there were around 100 amendments during 10 years of our activities. It is expected that we will have knowledge about all these changes, when even tax office workers have problems to follow them. Moreover, different tax offices have different interpretations of the same regulation. Some regulations are simply mindless e.g. once we couldn't deduct VAT after some changes because shoes were produced not in the same month as they were exported. Finally this regulation was repealed.' (Footwear, Poland)

'Political instability in relations with Russia may cause our delocalisation to this country to secure our position there.' (Electronics, Poland)

Outside assistance

In Greece, Estonia and Poland, new industries were supported more than traditional ones. This is in accordance with economic policy related arguments and policy targets of governments in these countries. In Bulgaria, support was lower and the leading sector was software with 13.7 per cent of companies.

In the UK, dominating provider of support was the regional government. In Greece and in the new industries, the EU was an important source of support close to central government. In traditional industries, more assistance came from the central government (75 per cent of assistance) and less from the EU.

In Estonia and Poland, support of the EU was accompanied by support of central government. In Poland, regional government was also a minor partner in software and clothing industry. The quasi-governmental organisation *Enterprise Estonia*, matching together pre-accession financial funds and structural funds, played a supportive role.

Public sector grants were the dominant form of assistance in the UK, Greece, Poland and Estonia. In Bulgaria, only one company reported receiving a public sector grant. Few subsidized bank loans were mentioned (two in Poland's and one in Estonia's electronics industry, one in Poland's clothing industry, one in Bulgaria's software industry. Also concession as a form of assistance was mentioned (in Greece, one in software industry, in Poland, two in software, two in electronics, one in clothing and four in footwear industry).

There are some significant differences between companies which received outside assistance and those who hadn't received: almost one half of all variables differentiate

‘receivers’ and ‘non-receivers’. Companies which received outside assistance are more often foreign-owned than the others. They usually base their competitive advantage on R&D and product design (statistically significant) and compete less often on labour-intensive segments of the market (Table 33). Receivers of outside assistance are older, less-prone to relocate in near future. They more often report higher export growth. These companies compete on innovativeness and flexibility, not on price, although they report higher labour costs, as they are larger on average (the last difference is not statistically significant). They try significantly more often to employ temporary workers. These companies have higher number of face-to face contacts and keep more personalized than ‘non-receivers’.

Polish and Estonian managers (including those who largely benefit from external funds) openly express their disappointment due to existing regulations which favour large foreign enterprises supported by national government. These rules are perceived as unequal (unfair) for indigenous and foreign companies. After receiving public money, electronic, but also surprisingly few software companies offer low-skilled jobs and do not engage in R&D activities as was widely promised. The use of public procurement was often mentioned as an alternative, in order to support local companies. Nevertheless, it should be noted that such claims ignore the reality of the EU single market and the respective Competition rules.

Table 33 Selected statistically significant (t-test for independent samples) differences between means for companies which (do not) received outside assistance

	Has the firm received any outside assistance from any support programme during 2000-2004?	N	Mean	Standard deviation
Year of first establishment	Yes	158	1981,22	24,406
	No	532	1988,70	18,055
Labour intensive products	Yes	159	,40	,491
	No	533	,56	,497
R&D	Yes	159	,33	,473
	No	533	,14	,350
Design /Product development	Yes	159	,53	,501
	No	533	,43	,495
Total labour costs (1,000 EUR)	Yes	90	1998,79	5057,327
	No	323	942,48	2701,060
Exports growth	Yes	143	3,61	,864
	No	493	3,43	,927
Price competition	Yes	159	,49	,501
	No	533	,60	,490
Competition in innovativeness	Yes	159	,24	,428
	No	533	,14	,342
Competition in flexibility	Yes	159	,23	,420
	No	533	,15	,361
Succeeded in getting orders because of low cost	Yes	159	,33	,471
	No	533	,45	,498
Number of face-to-face interactions per year	Yes	89	20,52	62,422
	No	363	10,90	24,866
Personalised relations	Yes	159	2,53	1,834
	No	533	2,25	1,688
Plans of relocation of the 'core', or 'non-labour intensive' segments of the company to another country within the next 2 years	Yes	156	1,81	,395
	No	526	1,91	,291

Source: enterprise survey.

'The question is not how the government can help us. Help us in what? Who did they give incentives to? They subsidised some companies in order to relocate to Bulgaria and Romania. They gave these companies money and the companies took this money and relocated to Romania. This is a superb achievement of the Greek government!' (Greece, software)

'All EU programs are very bureaucratic. Lot of unnecessary paperwork is included. They are especially difficult for Russian speaking people. Bureaucracy is very rigid.' (Estonia, electronics)

'It seems that there is no trust and strategy for technology industry in Estonia. For example local firms hardly ever win any technology contract. It seems that state wants only to buy foreign goods. Local firms in reality are good and are capable of doing lot of things. They must be more trusted. In reality we don't own even Estonian market.' (Estonia, electronics)

5.6 Investment Incentives: Lessons from past experience

Investment incentive schemes have not always been successful in achieving their objectives. We will briefly review here three such cases in the UK, Greece and Poland and we will attempt to draw a number of useful conclusions for the formulation of state policies in this area.

a) The case of LG in South Wales (UK, electronics).

Inappropriately controlled public support may lead to significant losses. In 1996 LG made investment to Newport (South Wales). The company promised to establish 6,000 jobs and thereby received £131,000,000 grant support. In 2005 some £71,000,000 was

repaid to the then Welsh Development Agency. At a peak period, LG had almost 3,000 employees and 200 worked in supplier firms. In 1999 there was made joint venture between LG and Philips. The Welsh Development Agency lost in net -£60m. The loss represented the jobs created by the projects until they faltered, and the lasting benefit of the infrastructure at the site. Much of the aid provided was paid in the early stages of the projects creating a major risk for the authorities. The similar company LG Philips got in 2006 aid of €206.1 mln from the Polish government for factories in Lower Silesia. The state aid package for each of the nine investment projects comprises a combination of grants, free land and tax exemptions. They promised to employ 12,000 people. The total eligible costs of the nine investment projects amount to €711.1 million. According to the estimates of the Polish side, by the end of 2017 the state budget will have earned around PLN 1.2 billion. Lower Silesia was treated as the EU disadvantage region in terms of economic development, where the public support is allowed. In fact, the public aid should never given to LG Philips taking into considerations the gap between salaries offered by LG and the scarcity of Polish labour force. It may be thereby argued that some Asian consumer electronic companies may move from Poland to cheaper EU countries (e.g. Romania) with more abundant workforce even before the year 2017.

Similar to LG cases occurred with Dell and Samsung. These are controversial projects, as direct state subsidies have been used with the lack of knowledge of potential consequences. With high return on investment TNCs may once more close their factories in 10-15 year time.

b) Investment incentive law 1892/92 (Greece, clothing).

Some Greek firms that were relocated to the Balkans (mainly Albania and Bulgaria) received financial support by the regional incentives law as well as by the Greek Plan for the Economic reconstruction of the Balkans. In this sense the Greek government adopted a state support for a specific path of development which in the case of clothing companies did not work well as it forced one specific form of adaptation (low cost focus), which is not the most sustainable one over the longer term. Thus a state policy that was (probably) mostly directed at the increasing influence of Greece in the area stimulated a specific strategy of adaptation for clothing companies. What this also demonstrates is how non-core/priority industries could become victim of broader state strategies that could however be very successful as far as core industries are concerned (e.g. how did this affect the banking sector and telecommunications).

‘The policies pursued by the state on one hand didn’t facilitate the development of soft infrastructure in the country (i.e. Institutes on cotton, on garment design, as well as provision of high quality education for designers, etc) and on the other hand handed out incentives to everyone that was exporting led to a distortion in the market. The majority of the entrepreneurs thought that this was going to last for ever. Hence, when the export incentives ceased they were in trouble and things got worse when Greece lost its comparative advantages i.e. a low cost country that was EU member and hence there were no restrictions to enter EU market...

There never was a policy to support the sector with skilled workers (designers, chemists of dye works etc). “Brand named product is a very difficult affair”. It is different to say that I export with my own label than to say I export with brand

name. In Greece we do not have fashion designers. No one considers employing them not even as a joke. In other countries they managed to create fashion recently e.g. in Spanish clothing (Zara, Mango etc), but also in footwear, ceramics, hygiene products etc. Turkey has designing schools since 1975.’ (Key informant, clothing, Greece)

c) The establishment of Special Economic Zones (SEZ), Poland

The Polish SEZs are an interesting example of a local development policy. In Poland a heated debate concerned both the expected influence on the regional and national economies of special economic zones created by the national government and the amount of public aid offered to investors (Gwosdz et al. 2007). The EC argued that the generous privileges granted in the SEZs may be classified as an unfair competition and lead to delocalisation of manufacturing activity from Western Europe⁴⁶. As regional policy instruments the SEZs were intended to be a form of state support to problem areas, i.e. underdeveloped or experiencing a collapse of their existing economic base. A limited number of supported areas is one of the prerequisites for this tool to be effective. When the number of SEZs has exceeded 150 and continues to grow, the idea of SEZs as a regional policy tool is jeopardised: companies are attracted more to core areas. As Gwosdz et al. (2007) argue: ‘investors realise that they are in a position to choose virtually any location they want and the local authorities will make efforts to extend special privileges of one SEZ or another over this site’. As a result, the SEZ concept,

⁴⁶ The latter process mainly takes place in the case of automotive industry and home-appliance sector.

which was supposed to reduce regional inequalities hasn't not been properly utilised. Social cost of scattered SEZs located in the places indicated by investors is high: this is a 'pure waste' policy (Gwosdz et al. 2007). In our case the instrument of SEZ is a tool used to attract foreign (mainly Asian) investors in consumer electronics: they appreciate stable regulations offered by the state and local authorities there. However, only a very limited number of the expected software companies has entered supported zones due to the late eligibility offered to software companies.

5.7 Global changes and the role of the state

Governance from the GCC perspective

There are similar tendencies in all four industries regarding the growth of what Gereffi and Mayer (2004) call a 'governance deficit', i.e. the disparity between the degree of internationalisation and global market development, on the one hand, and the regulation and compensation mechanisms, on the other. While the findings are not conclusive, they do provide indications of some relevant tendencies, including, for example, the degree to which ISO standards are significant for companies although the functions that they fulfil are difficult to assess. Thus, a significant number of interviewees argued that they were disappointed by the negative effects that ISO requirements had on their businesses; their main function appeared to be meeting administrative requirements for government quotas and/or funding rather than facilitating their companies' position in the market.

The findings also suggest that the strongest private arrangements are being made between global buyers, on the one hand, who dominate the rules of production and trade,

and sub-contractors and subsidiaries, on the other hand that are aiming to meet quality standard requirements. Different cultural predispositions also emerge in relation to the varying role of government, while there are varying degrees of concern over differences in implementation of EU and national regulations in different countries.

Both companies and key informants felt that governments were not making sufficient efforts in supporting industrial restructuring, especially in terms of funding, education and re-training, upgrading and access to external markets:

'Biggest trouble is with workers. Technical University is also not preparing enough graduates. Education is main issue and our headache. Situation is almost crazy with hiring.' (Estonia, electronics)

'The government is now talking a lot about innovation and using all the right words, but they are not helping businesses to work out how they can do that; because if you think about manufacturing in the last 50 years it's gone through different phases and essentially what it has been doing over the last 20 years is all about lean and low cost and that's great now that isn't going to be enough but that's what businesses have done and they have probably cut cost to the bone. They've cut out expensive people and capabilities, and the capabilities they have kept in are for keeping the cost down not necessarily for innovation and developing the business and that is a real issue..' (UK, electronics)

With the possible exception of software the four sectors discussed here are largely considered to be of low priority for governments. In this respect there is almost no difference between new and old members of the EU.

In footwear, private arrangements appear to be the most essential ones. Most interviewees strongly agree that there is the lack of specific government policies supporting the footwear industry in terms of funding, education and re-skilling, upgrading and access to external markets. Like clothing, the footwear sector is not considered to be a priority in any of the countries studied, which results in little or no government support directed to it. Footwear companies present the lowest percentage in receiving outside assistance (in electronics 58.8 per cent, in clothing 55.6 per cent, in software 45.5 per cent and in footwear 31.6 per cent companies). These numbers could be higher, as over one third of managers argue they were trying to obtain EU funds, but were surprised by the 'length of the complicated process' and consequently gave up or didn't manage to get them. The most commonly mentioned obstacle for some programmes was the necessity of paying all expenses by the company before receiving assistance funds.

In electronics, there exist many environmental standards which regulate the position of firms in the value chain. Some companies complain they are stuck in the value chain due to high cost of introducing these standards. Like in clothing, a significant number of interviewees argued that they were disappointed by the negative effects that ISO requirements had on their businesses. In software there is an enormous role of the largest software companies (e.g. Microsoft, Oracle, SAP), which dictate rules and standards. State governments have no governing power for this industry: it is the domain of private governance.

Following Gereffi and Mayer (2004), it can be argued that there is a tendency for global and supranational institutions and TNCs to dominate the facilitative and the regulatory domains in the clothing sector:

‘Significant regulation is mainly on the national level, regional regulation is quite insignificant. While there may be some variations between England and Northern Ireland there won't be such differences but they could be for rules for company registration for example. But even there now with the possibility to register as a ‘European company’ they can be registered in any EU country.’ (Key informant, UK)

While the role of governments is most significant at the level of regulation and compensation, all four industries that we study call for different forms of state support. Thus, in terms of market support for example, clothing and footwear request mostly facilitating links with external partners and the entry into foreign markets, while in the case of electronics and software it is measures related to the domestic market that appear to be more significant. These could be procurement and stimulating co-operation between TNCs and local companies in large projects, which could engender capacity building and organisational learning.

This is also reflected on the role that business associations play. In clothing and footwear their support tends to be the provision of information and support measures for participation in trade fairs.

Governments, SMEs, as well as – to some extent – those TNC subsidiaries that are strongly embedded in their local economies, appear to be dominating the compensatory domain while governments still remain important players in regulatory terms.

In terms of different realms of governance (public/private), public arrangements appear to dominate the facilitative domain, while private and public arrangements both have influence on the regulatory domain across all studied countries. There is, however, a substantial apparent difference between new and old member states in terms of compensatory arrangements. Such arrangements are dominated, in the case of the EU's new member states by government regulation, while in old member states, and especially UK, they are determined in equal measure by government regulation and by private arrangements.

'Yes, I mean when they brought in the minimum wage thing, that was, because it was all going to go to the minimum wage but I couldn't just pay the girls the bottom line of the minimum wage, I had to increase it, even into the admin staff. It costs us a lot more than £1 an hour in the loss of earnings; it is a lot of money. And to be fair, most, none of our girls were earning in the minimum, wage anyway, I had to proportion a wage increase to compensate for it.' (UK, Small producer)

Quality standards in all four sectors are mostly arranged privately and are dominated by TNCs, whilst the terms of trade are determined both by governments and (increasingly) by global frameworks and regional agreements. For example government regulations concerning labour conditions, health and safety, are to a large extent enforced through

the demands made by TNCs. International certification also acts as a mechanism for attracting foreign buyers. The impact of certificates varies between industries with private certification from global players being a very important form in software, while in electronics there is a combination of international certification and approved partners lists. However the latter is also significant for software.

5.8 The changing role of the state: from a KWNS to a SWPR?

While the above discussion sketches the overall tendencies in the four industries there are differences in the specific role that individual states play and the concrete strategies that they adopt. These differences depend on a number of factors such as for example, the degree to which governments see their role as one of controlling outcomes (e.g. delocalisation) as opposed to intervention on the supply side, the mechanisms in place of negotiation (e.g. presence of forums for negotiation between government, business and labour, and the balance of power), the definition of core and peripheral industries and regions, the degree to which policies of social cohesion are considered important, and the degree and forms of inequalities that are deemed acceptable.

The availability of incentives is not in itself sufficient to have an effect. This depends on an active interest in such incentives and on the ability to utilise them. Thus, for example footwear can only attract a certain type of FDI in Bulgaria where the labour force is very small in a mature industry. Further, programmes to create incentives to train people for clothing and footwear need to take into consideration the lack of interest of young people to work in those industries, and finally the use of funds available to companies depends also on the managerial and entrepreneurial abilities of the managers. Thus,

government policies are embedded into structural factors and are also dependent on existing attitudes within the country and the perceptions of the country from outside. These vary significantly between the countries and industries that are the object of this study. This further emphasises the significance of specific, highly targeted policies that are built on a well developed and on-going communication between involved parties as well as the existence and ability to put into place ad hoc solutions whenever these are deemed necessary.

This sort of analysis moves against suggestions that the market should be allowed to rule while states should limit their involvement to a position of providing overall stability of the business conditions. While there is a significant shift away from the state that intervenes directly, this does not lead necessarily to a passive state. While such a position could be taken (what Jessop calls neo-liberal SWPR) it is neither the only one available nor the most efficient one.

Further, using the example of the failed cluster in the UK North, and picking on one of the governance questions, we can also argue that macroeconomic parameters alone, cannot determine competitiveness. While states can choose to prioritise certain macroeconomic criteria there is nothing intrinsically and universally 'good' about them. Instead such decisions can be part of a strategy but they only lead to competitiveness if they lead to differentiation from the conditions that operate in other countries. This distinction is crucial because it shifts the question from 'what is best' to 'if we do that what follows next', more specifically what sort of businesses is an open economy likely to attract, how long are they likely to stay, what are the consequences for the areas where they operate, etc. In this sense the openness and de-regulation of the UK economy

in comparison to other EU economies is not necessarily what makes it competitive, it just affects the particular role that the UK comes to play in the global strategies of companies, while also being one specific type of state strategy (what Jessop would call neo-liberal SWPR).

All five countries in our study gravitate around liberal and neo-liberal state strategies. Poland and Bulgaria have mostly moved between different KWNS models: from statist towards a liberal strategy, Greece is a combination of KWNS-liberal and SWPR-neo-liberal strategy. It is the UK and Estonia that seem to have the strongest orientation towards supply side intervention with the UK demonstrating some forms of state guidance for parts of the market. (See Figure 22).

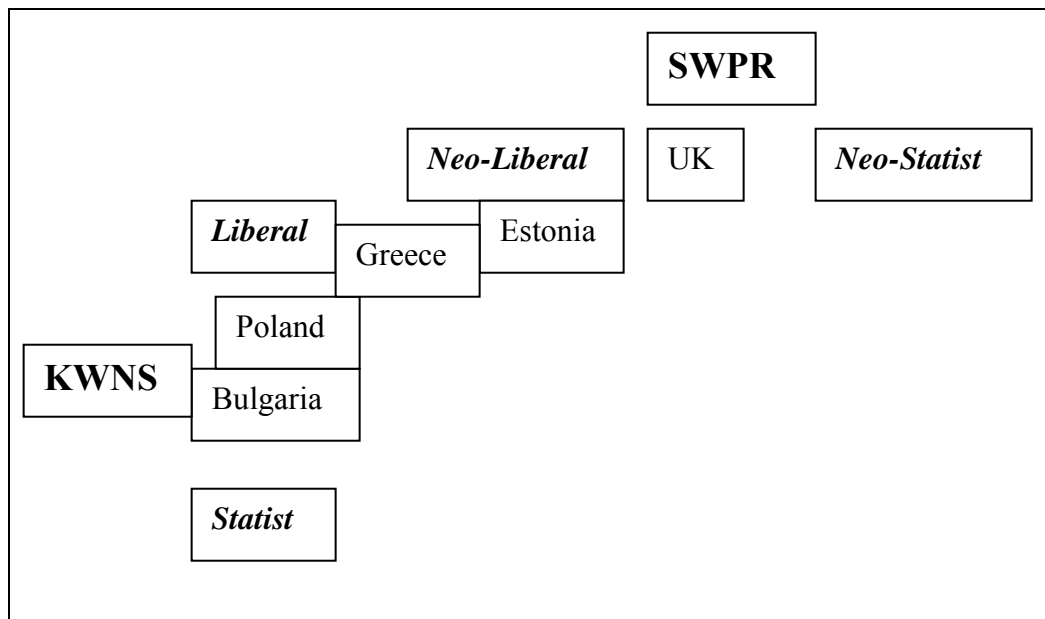


Figure 22 State Strategies

5.9 Conclusions and policy recommendations

The notion of governance has come into prominence in the context of global economic, social and political restructuring where one of the key changes is that co-ordination is not anymore the exclusive domain of states. Indeed broad social processes are becoming increasingly embedded into much more complex institutional arrangements that are organised around diverse spatial scales and different networks. Thus, first, from the perspective of industrial organisation there are new challenges of co-ordination of production across spatially and institutionally distant sites (located within the same country, or in different countries or even in different continents), second, from the perspective of the state the challenge is to establish, within its territory, relatively stable couplings of the increasingly globally mobile capital flows and the largely immobile labour, third, these changes also raise conceptual, analytical and methodological questions about the appropriate units of analysis, levels of abstraction, and their relevance to policy.

Rather than juxtaposing different perspectives and trying to establish, as if it were, the 'best scale' our aim in this report was to discuss governance as a dynamic and multi-level process, where actors as well as objects of governance are constantly being re-shaped. Thus we argued that while delocalisation constitutes a key economic conundrum as well as a political and social concern, delocalisation as such is not an appropriate object of governance given the reduced powers of the state to influence processes within their own territories. Importantly however states are also acquiring new powers of coordinating, or steering, and thus have the ability to influence other levels of governance (e.g. sub-national and supra-national), what Jessop (2002) calls *meta-*

governance. In this sense, issues related to delocalisation and its consequences need to be addressed within a broader social and economic agenda where the role of an active, though not necessarily only and always directly intervening, state is crucial.

More specifically, delocalisation trends could be influenced and to some extent shaped through active industrial, social, labour and tax policies. In addition, while addressing the negative consequences of delocalisation, remains an important policy objective, increasingly such interventionist measures need to be combined with policies that are focused on the supply side and are more about enabling adaptation rather than about short-term responses to crises. For example, one of the mechanisms through which firms can become more research and development-oriented is through state support for improvements in the quality of education and re-training, as well as through the active promotion of creativity. Even more specifically, in the case of the restructuring of the software industry it may be worthwhile trying to link education programmes with the profile of particular industrial clusters of the software industry in order to ensure adaptability.

As far as employment conditions are concerned they continue to be mainly regulated on the national level where minimum standards are set and are regulated through minimum wage and unemployment benefits, for example. Traditional industries, such as clothing and footwear, are much more likely to experience a strong negative impact of worsening employment conditions, and thus employees in these sectors tend to work in a much more uncertain environment as compared to employees in electronics and especially software companies.

It is possible to argue that major market economies (the UK and Greece) rely less on EU funding and institutional support, but get dominating part of support from domestic sources. The managers in the UK acknowledged the active role of regional governments, though the perceived amount of support was small. In Greece, financial means are more centralised. In Estonia and Poland, domestic resources, coming first of all from central government, accompanied by the support from the EU. Regarding industries, the electronics was more supported in terms of value, but the difference with other industries was not large in terms of number of companies. The support was more country- than industry-specific. Semi-governmental organisations had important role in absorbing EU funds and combining them with local resources. The strength of those institutions is related to rules and expertise created to deal with projects.

Different aspects are important in countries of outward and inward delocalisation. For outward delocalisation countries, support for product development and marketing was important. In countries of inward delocalisation, support for creating new workplaces, infrastructure development and training have been more important. However, it must be stressed that according to key informants and managers funds (coming from EU and global institutions) are not spent on the most appropriate tasks. This is true especially for training activities, which should focus on the real needs of companies. In this field there is a large number of programmes developed for CEECs that do not fulfil their intended aims.

This is not to say that states should take the whole responsibility of retraining and education, nor that states and the education system should become an extension of the

needs of business (although such a scenario is certainly not entirely unlikely given the dominance of the neo-liberal agenda). It is rather aimed at emphasizing the key role that governments have to play in developing correcting mechanisms for the failures of market, where short and medium-term orientations are predominant. While some market players can also have longer-term temporal horizons as well as being able to tolerate higher degrees of risk, national governments and supra-national organizations such as the EU seem to be best placed in providing longer term vision and support for sustainable economic and social restructuring.

While making recommendations is difficult given the diversity of economic, political and social environments across Europe we will make a couple of tentative suggestions. Tailor-made re-skilling policies (Figure 23) should be implemented. The clear statement about the necessity of restructuring in footwear and clothing industries is expected by some managers, what would help to alleviate negative results of sudden closures of factories. The common awareness that there is no future for low-end clothing companies (apart from a few niche firms) must be raised. Unfortunately, national governments in all countries do not run any policy towards the clothing sector (although industrial plans were or are developed) and do not prepare employees in this sector for inevitable changes. If they lose their jobs, they will face enormous problems to find alternative employment, especially women which are often discriminated against in the labour market.

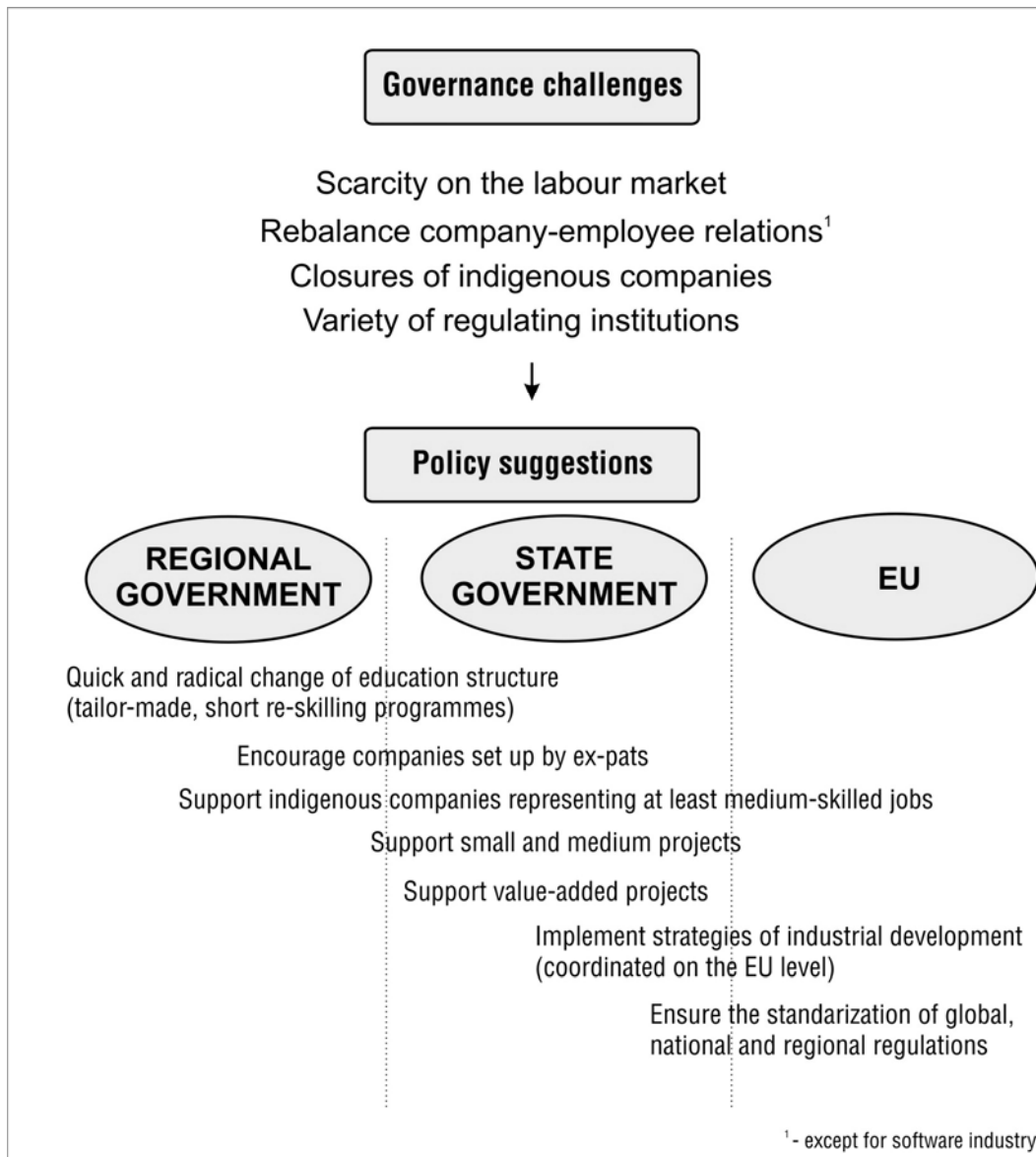


Figure 23 Potential actions directed towards delocalisation

The impact of trade unions and business associations on company decision to delocalise was practically absent in Poland, Bulgaria and the UK, and very limited in Estonia and Greece. Further, non-tariff barriers only had modest influence on company decisions. Our analysis clearly indicates that there is a growing significance of private governance mechanisms, particularly in terms of the great impact that TNCs have in shaping the

labour markets and regional competitiveness. This tendency is strongest in the consumer electronics sector. This conclusion is consistent with what Gereffi and Mayer (2004) call “a governance deficit” at the global level, where mostly contingent private arrangements are very significant. There is however an ongoing process of thickening of governance mechanisms, which is apparent at all levels of governance. Interdependencies are especially visible in for example the case of TNC investment in CEECs where regulation is simultaneously co-ordinated at the global, regional and national levels, as well as by the EU. Further, EU institutions have a very important role to play in extending the scope of supranational governance mechanisms to include regulation, as well as extending the links between different institutional levels within the EU. In all those measures the EU has an important role to play in offering a socially engaged alternative to the dominant neo-liberal form of globalisation and state restructuring.

Here we can further ask why companies are attracted to EU countries? Stability and predictability of the business environment are some of the most often quoted reasons for choosing a location. It must be argued that stable labour and duty regulations reduce uncertainty for foreign clothing, electronic and software companies coming from outside the EU. In addition, it was demonstrated that it was mainly TNCs that benefit from government incentives and outside assistance. It must be stressed that our evidence suggests that subsidising foreign companies in labour-intensive industries usually only have short-term positive effects. Some of the strategies that appear to be successful include offering support to companies that have the potential to upgrade, implementing and strengthening after-care policies, enhancing the local links both between companies and between companies and local institutions. Such solutions however could not be

taken at face value and mechanically implemented as they raise both questions of economic rationality and social justice. This raises the broader question about the appropriate and socially acceptable mechanisms of relatively stable reconciliation that states could establish within their territories, between the increasingly globally mobile capital flows and the largely immobile labour.

The potential of subcontracting and outsourcing has already reached its limits footwear in Greece and Poland as well as clothing in Greece, Estonia and Poland, while in other cases is also reaching its limits (e.g. in Bulgarian footwear, Polish and Bulgarian software Estonian and Polish electronics). Thus, from the perspective of strengthening longer-term competitiveness the key question for CEECs is about attracting higher value added activities. While capacity-building as opposed to different forms of protectionism is usually considered to be the superior option, especially over the longer-term, our earlier discussion suggests that state policies could only be effective if they are highly context sensitive. The latter may mean that different types of strategies could be appropriate in different environments.

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6 THE DELOCALISATION OF LABOUR INTENSIVE INDUSTRIES – SPATIAL DISTRIBUTION IN THE EU

Stoyan Totev, Grigor Sariiski

6.1 Introduction

Most theoretical works relate economic growth with convergence processes. The opponents of the theory of convergence follow Myrdal's (1957) thesis, which is based on the understanding that growth is a process which leads to cumulating spatial economic differences. They suggested a reconsideration of conclusions for convergence processes in the EU because they were formulated without including countries from EU South, mainly LDCs for which the convergence process is not typical (Armstrong, 1995).

These two different approaches lead a lot of economists to share the understanding of the dualistic nature of the development of the EU, (differences in the economic development of the centre and the periphery). Mack and Jacobson (1996) sustain the vision that these processes depend on the spatial specialization which concerns the degree of technological processing – the centrally located EU regions (core regions) have a tendency to specialize and export to the periphery highly technologically processed manufactured goods, while the periphery specializes in the production of low technologically. Going further it is maintained that the location of the industries with constant return of scale (mainly low technological processing industries/LII) is a result of the distribution of those which have an increasing return of scale (high technology processing industries). The location of the LII finds its expression mainly through the delocalisation processes defined by Kalogeresis and Labrianidis (2007) as “.....spatial restructuring of industry at a national, regional or global scale”.

The purpose of this study is to provide an analysis of the economic drivers for the manufacture composition changes by sectors in the EU countries. These changes can throw more light on the delocalisation process since both sectors' and countries' specificity have an important and interrelated influence on the typical characteristics of this process, (Kalogerisis and Labrianidis, 2007). The first question that the study puts forward is what the patterns of change of the industrial structure across EU countries are. The second is to what extent these changes can be attributed to the delocalisation of the LII.

The study is organized in the following way. First the structural adjustment of the industrial composition that takes place with the intensifying of the delocalisation processes within EU countries is observed. Various economic indicators are used to present a picture of economic evolution and structural changes over time. The patterns of concentration and specialisation as well as the changing in the trade structure and the competitive advantages of the EU countries by LII are related to the delocalisation processes. Finally some conclusions are drawn.

There are two questions that arose when elaborating the study: how to assess the delocalisation processes and what will the concept of "LII" be. Usually delocalisation processes are related to FDI reallocation and outsourcing, (Kalogerisis and Labrianidis, 2007); however the study faced serious difficulties to find, at the investigated level (manufacture branches by EU countries – NACE classification, Division from 15-35), FDI data that can be used for this specific research. One fully agrees with the statement "There is no broad and accurate database which can directly tackle the reallocation aspect of FDI" by countries and industrial sectors, (Rojec and Damijan, 2006). This is

why the process of delocalisation of the LII has been researched by using indicators such as the coefficient of location and specialisation, the index of relative comparative advantages, intra industry trade, etc. These indicators are comprehensive since the study is limited mainly to the second and third analytical dimensions of the delocalisation process (*'the sector with its given technologies and markets'* –manufacture branches and *'the environment with its unique institutions, civil society, history and policies* – national and regional level) – see Kalogeresis and Labrianidis (2007).

The next issue that we have to specify when elaborating the study is the concept of “LII”. There is no common understanding of which manufacturing branches can be specified as “labour intensive”. There are bunches of classifications some of which differ a lot from the industries (manufacturing branches) recognised as “labour intensive”. When specifying the classification we consider the following circumstances. In the first place, as already mentioned, this particular study deals mainly with the second and third analytical dimensions relating delocalisation processes to the patterns of changing of the share of the industrial sectors by countries; changes that are mainly linked with the distribution of industries traditionally recognised as labour intensive – textile, clothing, leather and footwear industries. This is proved by the implementation of cluster analysis, which outlines that countries clustered by industrial branches depend on the participation of traditionally recognised labour intensive manufacturing branches. An additional advantage of using this concept is the statement made by Guerrieri (1998)

that for the traditional LII “subcontracting has been often preferred by Western European firms as a more flexible device than FDI”.⁴⁷

In order to obtain a more distinctive picture of industrial composition changes a specific classification of the manufacture branches by sectors is used. This classification groups the manufacturing branches according to the OECD (1987) classification and also uses the categories for the scale return branches proposed by Pratten (1988).⁴⁸

The Dynamic of LII

The dynamic of EU-15 employment in the manufacturing sector is showing a steady decline that began in the late 70-ties when a long-lasting tendency of decreasing the share of the secondary (manufacture) sector from the total GVA started, Figure 24. The smoothening of the decline of the GVA in given periods can be attributed to the positive effect of delocalising activities with low labour productivity – the decline in those employed in the LII (Labour intensive sector) is sharper than for manufacturing as a whole, (see the changes of the shares of the GVA and employed in the labour intensive sector, Figure 24. The negative evolution of those employed in the labour intensive sector runs parallel with a steady increase in the import of this sector for the EU-15. Falk and Wolfmayer, (2005) find that the increase of the import is due to outsourcing activities of EU-15 in low wage countries as well as that this “import from low wage countries has a statistically significant (negative) impact on employment in EU

⁴⁷ This way the problem with the lack of FDI information is at least partly avoided.

⁴⁸ See the five groups (sectors) – “Labour intensive”; “Resource intensive”; branches with “Different factor intensity” (different economic of scale); branches related with “Increasing economic of scales” and “Science intensive branches”, Table 34.

countries...”. Further they outlined that this relation is valid only for the LII. This finding supports the understanding that changes of the manufacture employment composition by different sectors can be attributed to the delocalisation processes.

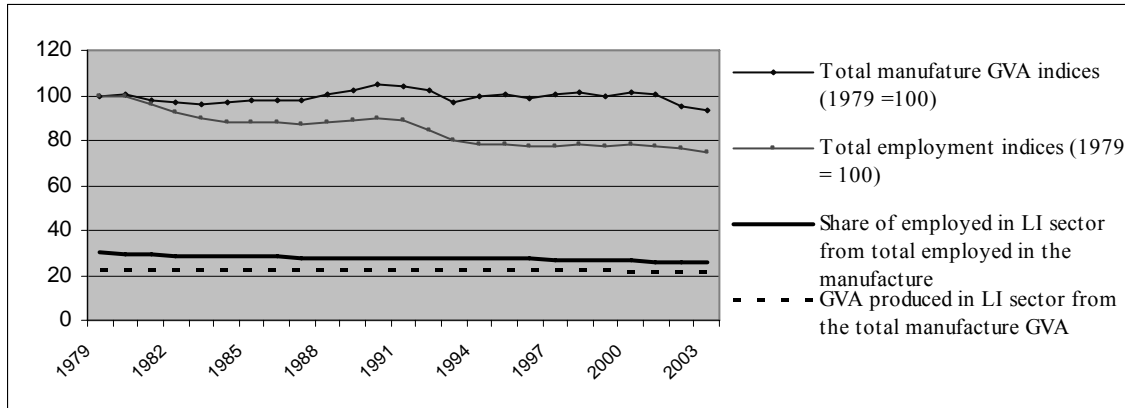


Figure 24 EU-15 manufacturing’s dynamic and share of labour intensive sector

Sources: Groningen Growth and Development Centre, 60-Industry Database.

* For Labour intensive sector, see Table 34.

For the period after 1991 the first step of massive delocalisation of labour intensive activities from the EU-15 started with shifting part of the production processes to Central European Countries. Looking at the most recent data of employment composition in the EU-27 it appears that the Baltic countries as well as Bulgaria and Romania are showing a tendency to increase the share of GVA and employment in the labour intensive sector in the last several years.⁴⁹ The decline of those employed in the labour intensive sector in the Visegrád countries (Central European new member states)

⁴⁹ Eurostat data for manufacture branches NACE classification, Division from 15-35 (not included NACE Division /23: Manufacture of coke; refined petroleum). As new member states (NMS) all countries that joined the EU after 2004 are considered (Malta is not included). In the EU-15 Luxemburg is not included.

for the last several years is higher than the decline in the EU-15. So the expectation that joining the EU will have a prolonged positive impact on these industries for the Central European countries remains unjustified. The increase in the labour cost in the Central European countries has led to losing the position that was gained at the beginning of the 90's. This is confirmed by the MOVE project field survey as well, 52 per cent of the companies from the field survey that answered the question how labour costs influenced the decision to delocalise (Q254), considered that their decision was influenced by labour cost. According to these figures one can state that labour costs do play a significant part as a motivator in the delocalisation process; so the loss of low-labour-cost advantage will result in a decrease in the potential for undertaking delocalisation activities in LII.

The Concentration and specialization of LII

The interest in analysing the concentration (location) of manufacturing production by industries is stimulated by the integration processes in Europe, where the empirical evidence outlined that industries concentration is geographically clustered, (Krugman, 1991). This is valid specifically for the LII, whose distribution within the EU-15 and later within the EU-27 countries is an example of the concentration in given countries that have a similar geographical location.

The employment data analysis revealed a number of important observations with respect to the process of location and specialization as well as to the type of structural adjustment under way, Table 34 and Table 35. The concentration ratios (CR_n, n – number of branches) which measure the share of employment in the largest three or five

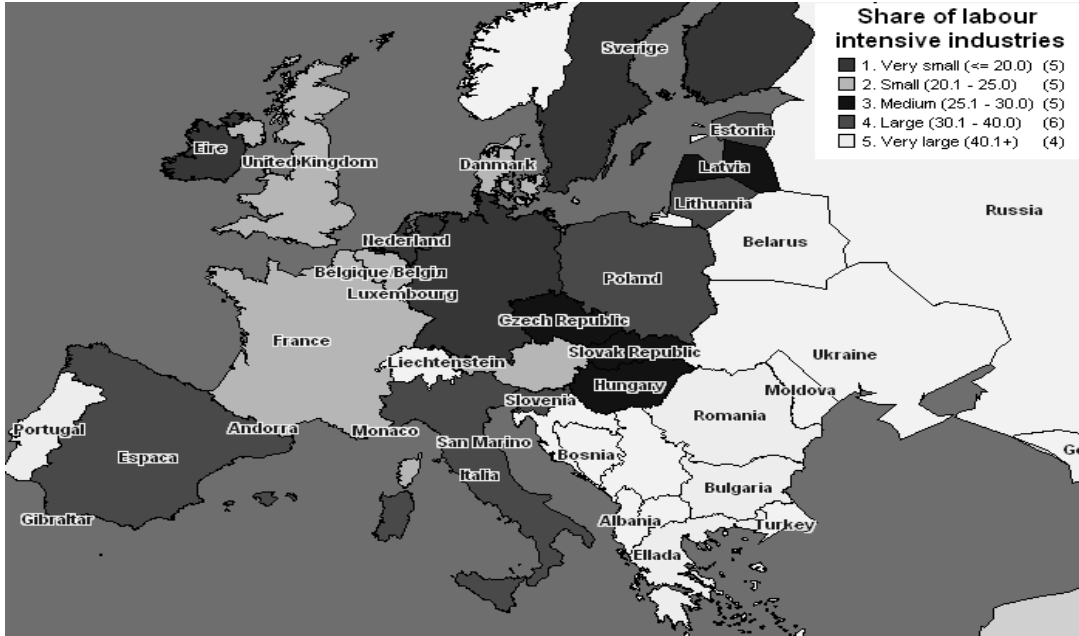
manufacture branches show a modest but clearly expressed process of specialization in the EU countries. The Herfindal indexes measuring absolute concentration and specialization are higher for the labour intensive branches and less developed countries, mainly the new member states; the indexes increase in the period 1995-2004.⁵⁰ There is a clearly expressed process of specialisation in the less developed countries due to an increase in the share of the Labour intensive sector, a process which leads to a divergence in the industrial structures of EU countries.

The Krugman indexes that measure relative manufacturing concentration and specialization revealed a process of concentration and specialization of industries where the delocalisation is easy for realizing – in the so called “Mobile Schumpeter’s industries”, Table 34 and Table 35. Mobile Schumpeter’s industries are the industries where a geographical separation of R&D and production is technically feasible without substantial losses of synergy effects, (Klodt, 1991). The industries where higher increases in the indexes are observed are: Clothing; Electrical machinery; Furniture and manufacture n.e.c. and the Leather and footwear industry.

The most significant increase is in the index of relative concentration of the Labour intensive sector, whose level was also the highest for 2004 (0.26). Next is the Science intensive sector (0.23), Table 34. Concerning the countries’ specialization it can be definitely outlined that the specialization in Labour intensive sector is negatively related with the countries’ level of economic development; countries with different shares of

⁵⁰ The Herfindal index measures absolute concentration and specialization, while the Krugman index is estimating the relative concentration and specialisation, (Totev, 2007).

this sector have different levels of economic development and specific spatial location within Europe, Map 1.



Map 1 Share of Labour Intensive Sector

Sources: Eurostat

6.2 Patterns of industrial structural changes

Analysis of the SSD (sum of square differences) indexes

A more detailed picture concerning the industrial changes of the EU countries can be observed by estimating the SSD indexes, Table 36.⁵¹ A number of notable features distinguish the changes in the industrial structure. The first observation is that the new

⁵¹ $SSD_t = \sum_i^n (a_{it} - b_{it})^2$ where [a, b] is a pair of countries, $i = 1, \dots, 21$ is the number of industries; t are time periods, Table

member states have quite a similar structure in 1995, which is close to one of the well industrialized EU-15 countries, (see Table 36, column ‘three countries with closer structure 1995’). Secondly a well expressed process of diverging of the industrial structures within countries is observed, Figure 25. This is valid mainly for the less developed new member states.

When using the classification presented in Table 34 it is noticeable that in the last ten years part of the new member states approximate the structure of less developed EU-15 countries, while the other part of the new member states remain close to the structure of the more advanced EU-15 countries, Table 36 (see the columns with the ‘three countries with closest structures 2004’). The three Central European countries, the Czech Republic, Hungary and Slovakia, have the closest manufacturing composition to the EU average for 2004. Since the higher changes of the structure are indicative of intensive structural adaptation, it appears that the newcomers Bulgaria and Romania are undergoing such a process, (Table 36).

This adaptation is realised mainly by undertaking subcontracting in the labour intensive sector. One can prove it by observing the extreme increase in intra industry trade of the LII with the main EU countries which provide subcontracting, (Italy and Germany).⁵² The field survey supports this finding; 50 per cent of the export of companies from the footwear and clothing industries is oriented to two-three main countries (see Q97 and Q98).

⁵² UNCTAD/WTO data, <http://www.intracen.org/countries/>

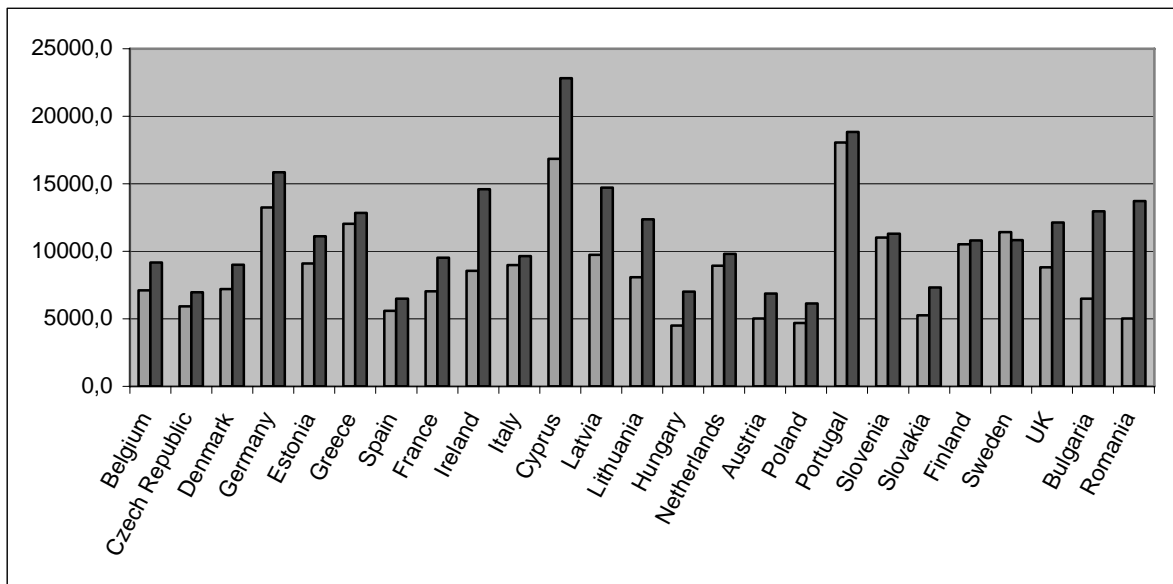


Figure 25 Sum of SSD by countries (1995:grey columns, 2004: black columns) *

Sources: Own calculation based of SSD results

* When estimating the sum of SSD by countries is used the five group classification, see Table 34.

These structural changes, due to the fact that less developed countries like Bulgaria and Romania can realise comparative advantages in LII, lead to an approximation of the structures of Bulgaria and Romania to those of Greece and Portugal, Table 36 (see the columns with the ‘three countries with closest structures 2004’).

Cluster analysis

In order to specify the countries distribution by groups with similar industrial structures cluster analysis was applied, (Huberthy, 1994). The following parameters have been used for that purpose: ⁵³

⁵³ The Discriminant analysis (Huberthy 1994) shows that higher predictor ability what concerns the industrial composition have the chosen parameters.

Relative concentration measured by using the Herfindal indexes, Table 34 (five sectors);

Share of the Labour intensive sector in the total manufacture employment, Table 35;

SSD indexes between given country and the EU-27 average, Table 36;

The ranks of the SSD indexes, Table 36.

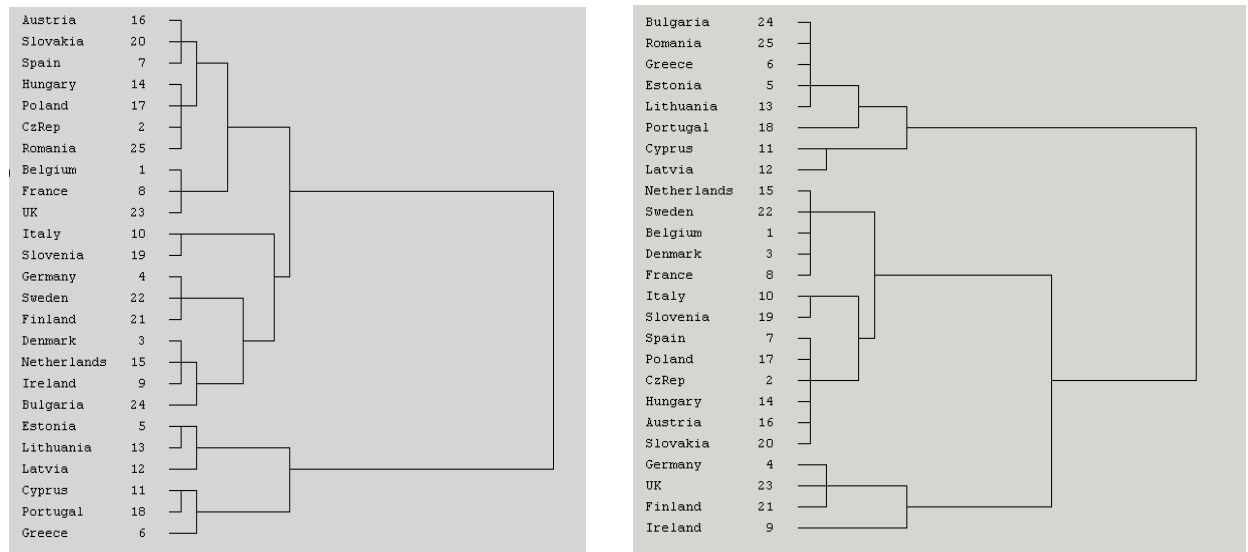


Figure 26 Employment Dendograms 1995 and 2005

Sources: Eurostat and own calculations

The conducted cluster analysis for 1995 divides European countries in two main clusters – see Employment Dendogram 1995. The first includes Greece, Portugal, Latvia, Lithuania and Estonia -- countries that mainly undertake subcontracting up until 1995. One can see the results of the structural adaptation in these countries influenced to a certain extent and from the delocalisation process – they have a much higher industrial specialisation and larger shares of those employed in the labour intensive sector, Table 35. The Herfindal indexes calculated over the separate labour intensive branches for this

cluster have an average value of 0,6 while for the other cluster it is 0,3. The SSD indexes show that the structure of employment for the countries in this cluster is quite different than the typical composition in EU-15 as well as in EU-27.

The larger cluster (rest of the countries) is far from homogenous. There are countries giving subcontracting as well as countries not actively involved in the delocalisation process. The differences in this cluster rise significantly with the industrial structural adjustment over time, influenced by the changes of the involvement of the countries in the delocalisation process in the last decade. This forms a new picture of division in 2004.

The analysis for 2004 specifies three clusters.⁵⁴ The group of Greece, Portugal, Latvia, Lithuania and Estonia is joined by Bulgaria and Romania. Bulgaria and Romania have undergone quite serious changes in their industrial structures as can be seen from the SSD indexes for 1995 and 2004, Table 36; changes that in this particular case are the result of delocalisation processes – the outcomes of the field survey analysis definitely outline that the development of the labour intensive sector entirely depends on undertaking subcontracting. A clear indication of the potential to undertake subcontracting in the labour intensive sector is the share of companies that have a second layer subcontracting relationship with a company located in the same area. The results of the Move project field survey (Q156) do confirm this thesis; 45 per cent of

⁵⁴ In Cyprus the manufacturing sector does not play the same important role in development as for the economies in the other countries. This is why the conclusions and generalization based on the estimated variables will not have the same validation for Cyprus.

Bulgarian firms have a second layer subcontractor in the country, significantly higher than in Poland and Estonia.

One can see a new cluster formed of the four countries with the lowest shares of labour intensive industries in 2004 – Germany, Finland, UK, and Ireland. These countries have undergone a moderate structural change mainly by increasing their positive specialisation in the branches with increasing economies of scale and the science intensive sector, Table 34.

The third cluster positioned between the above two does not have a homogenous structure. On the one hand there are countries, which do not form a clearly distinctive sub-cluster – Belgium, Denmark, France, Netherlands and Sweden. The share of employment in the labour intensive sector in these countries did not change much during 1995-2004 (this means no intensive participation in the delocalisation processes). This can be confirmed from the field survey as well – the countries from this cluster are presented by less than one to six per cent as main markets/customers (Q97, Q134).

On the other side of this cluster one can find both the EU-15 and new member states. The EU-15 countries from this group are Italy, Spain and Austria. Italy and Spain have high shares of labour intensive sector and it can be expected that their role as countries providing subcontracting will remain unchanged in the future. Austria also plays a certain role in the delocalisation processes, which can be attributed to the proximity of the country to the South Eastern European countries. The new member states (Czech Republic, Hungary, Poland, Slovenia and Slovakia) within this group of the cluster had less or more exhausted their delocalisation potential as countries undertaking subcontracting in the Labour intensive sector.

One can maintain that there is a different tendency for the new member states. Some of them approximate the EU-15 average structure, while the others approach the structure of the less developed EU 15 countries, (Table 36). Bohle and Greskovits (2005) also noted these different tendencies for the new member states, “the accelerating eastward migration of trans-national light industries from West European (and nowadays even Visegrád countries) locations transformed some of the Baltic states, Romania, and Bulgaria into the textiles and clothing sweatshops of the EU”. On the other hand they place the Visegrád states that approach the structure even of the well developed EU-15 countries.

The SSD indexes and the Cluster analyses revealed:

Labour-intensive industries are found to be relatively dispersed over the area of the EU-27 in 1995. However a clear tendency of relocation and concentration is observed in 2004 compared with 1995, Table 34 and Table 35. The changing of the industrial structures is intensively influenced by the delocalisation processes; the changes are leading to a general divergence of the industrial structures of the EU countries, Chart 2. These changes lead to countries clustering by industrial structure in the EU space. Countries belonging to the same clusters tend to converge their industrial structures. This clustering depends to a great extent on the nature of countries involvement in the delocalisation process.

Bulgaria and Romania will continue to play a significant role in the receiving sector (countries that undertake subcontracting in the labour intensive sector) of the delocalisation process; the other typical ‘receivers’ -- Lithuania, Latvia and Estonia are

expected to exhaust their potential in the near future; indicative of this are the changes in the share of the Labour intensive sector and trade indicators for the last 4-5 years;

Undoubtedly there still is a delocalisation potential for the UK and Germany but it cannot be expected to be as intense as it was in the last decade. The UK has a higher potential since the share of the Labour intensive sector is higher compared to that of Germany.

In the course of time Czech Republic, Hungary, Poland, Slovenia and Slovakia can be expected to move their activities to so called triangular relations in the delocalisation process, whereby the orders come from developed EU-15 countries and are executed by 2nd layer subcontractors in other countries. The role of the above mentioned new member states in this process is mainly to be responsible for logistics, (Labrianidis, 2001). Finally Italy and Spain will retain their leading position as countries providing subcontracting.

6.3 Trade competitiveness and delocalisation processes

All theoretical approaches predict increasing specialisation as a result of trade liberalisation and EU enlargement leading to significant changes in the EU countries competitive advantages, (CEC, 2003).⁵⁵ Intra industry trade between developed EU-15 countries and less developed new member states, especially in the typical LII like footwear, clothing and textiles can be attributed to the delocalisation processes and more specifically to outsourcing activities, (Falk and Wolfmayer, 2005). The intensifying of

⁵⁵ UNCTAD/WTO data, <http://www.intracen.org/countries/>

the vertical intra industry trade is a clear indicator of intensifying delocalisation activity, (Hoekman and Djankov 1996). The fieldwork analysis under the MOVE Project definitely outlines the interrelation of subcontracting and the intensifying of intra industry trade. The estimated Spearman's rank correlation coefficients are statistically significant and approximately high (around 0.5) for the relations between involvement in delocalisation (Q4) and the purchasing of intermediate products (Q70), the position in the production chain (Q131a) and receiving orders because of low cost (Q119), as well as for the position in the production chain (Q131a) and subcontracting of labour intensive products (Q183).⁵⁶

Looking at the trade performance of EU countries with labour intensive products some important observation can be drawn, Table 37. In general a process of losing comparative advantages in the EU countries is observed. This is valid for the EU-15 countries as well as for the new member states. Secondly the intensity of losing position in labour intensive products is higher for the new member states compared to that of the EU-15. Finally if we relate the relative comparative advantages (RCA) coefficients to the Rank specialization indexes of the EU countries it appears that there are obvious relations between the group of countries that forms different clusters according to their industrial structure and their specialization. In other words one can state that there exists a clear relationship between industrial composition and trade performance.

⁵⁶ The coefficients are estimated for the clothing and footwear industries.

Cluster analysis of trade competitiveness

As an indicator of the successful restructuring of the industry one can use the conformity between the production structure and the export structure, (Landesmann, 1996). This is especially valid for small countries, which are supposed to have open economies and for which it is expected that the composition of production should reflect the composition of exports. An adjustment of the production structure to the trade structure can also be expected mainly within new member states.

When comparing the Employment Dendogram for 2004 with the Trade Dendogram 2003 (specified by the indicators for relative comparative advantages and trade specialization, Table 37 (columns 1, 2, 3 and 7, 8, 9), one can see that there is an almost full overlap between the Employment cluster (Bulgaria, Romania, Lithuania, Latvia, Estonia, Portugal, and Greece) and the corresponding Trade cluster.

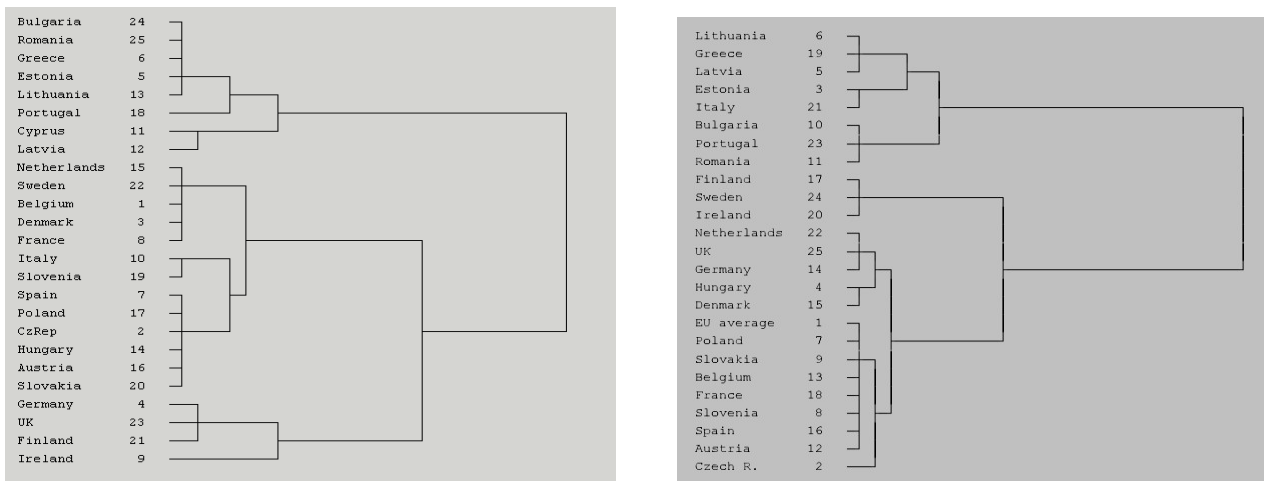


Figure 27 Employment Dendograms 2004 and 2003

Sources: Eurostat and own calculations, UNCTAD/WTO data

The only discrepancy here is that according to the characteristics of trade specialization Italy is in this cluster too. This cluster can be characterized as one of the countries most involved in the export of labour intensive products -- High labour intensive cluster from the Trade Dendogram.

On the other extreme are those countries where the export of labour intensive products is less covered. These are Sweden, Finland and Ireland – Low labour intensive cluster from the Trade Dendogram. The corresponding cluster from the Employment Dendogram includes Finland, Ireland but also the UK and Germany. The last two countries did not fall into the corresponding Trade cluster because as was mentioned before the production structure is expected to mirror the trade structure but this is valid mainly for the small countries.

In between these clusters there is one that is not homogenous. It can be divided into two sub clusters. The first is close to the High labour intensive countries, so this cluster can be defined as the High to medium labour intensive cluster from the Trade Dendogram. This cluster includes Poland, Slovakia, Belgium, France, Slovenia Spain, Austria and Czech Republic. The export of labour intensive products plays a certain role in these countries and most of them are involved in the delocalisation process in both sides – i.e. providing and undertaking subcontracting.

The other sub-cluster from this group includes the Netherlands, UK, Germany, Hungary and Denmark. This cluster can be specified as the Low to medium labour intensive cluster from the Trade Dendogram. For these countries the export of labour intensive products is declining and they are closer to the group of Low labour intensive cluster.

The analysis of trade competitiveness and the delocalisation processes revealed:

The differences between the Trade and Employment Dendogram concerning the forming of clusters decrease in the course of time. If one compares the same Dendograms it can be noticed that in 1995 there is a quite different picture within them. It shows that the structural adjustment processes are calming down. One cannot expect such intensive delocalisation processes in the near future as were observed in the last decade. The formed clusters are also not expected to undergo significant changes in the future. Verification for this is the tight similarity between the Trade cluster and Employment cluster in 2005. This was not observed in 1995.

Intra industry is usually related to trade relations within developed countries. The intensity of the delocalisation process changes somehow this understanding because in the last decades the vertical intra industry trade has increased significantly between well developed and less developed countries. Hoekman and Djankov (1996) stress the roll of vertical intra industry exchange between Western European countries and new member states, when the latter get inputs from the EU (EU-15) suppliers that are then used in the production of goods that are later exported to the EU-15. So concerning labour intensive products the delocalisation process somehow revised the understanding that intra industry is typical for trade relations mainly within developed countries.

6.4 Summary

In the short term perspective within the EU some intensification in the delocalisation activity in the labour intensive sector cannot be expected. Intensive delocalisation such as that observed in the last decade in Europe now can be expected to shift to countries outside the EU. The patterns of delocalisation of certain activities within EU countries

will continue. However the countries that give and undertake subcontracting will differ by industries; from now on growing differences in industrial composition according to the share of the labour intensive branches can be expected. It is also expected that the delocalisation process especially for the Central European new member states will not be based mainly on using the factor of low labour cost, (Faust, Voskamp and Wittke, 2004). There appears to remain some scope for the further delocalisation of the LII, which will be related to the future specialisation and location of LII to a few countries on the EU periphery – Bulgaria and Romania.

EU-15 countries will maintain their position in LII. This is not so obvious for lagging new member states that developed their trade specialisation later under subcontracting relations, relations that as a rule are not stable and long lasting. Conditions can change rapidly if the countries manage to catch up in their development to middle income EU countries. This will mean higher labour costs and losing competitiveness in the labour intensive sector. That can create problems mainly to lagging regions in these countries where labour intensive activities are mainly delocalised. No matter that the delocalisation process cannot be accepted as negative for the lagging new member states. At this stage this is possibly the alternative to economic growth and to solving social problems.

Baltic countries will keep their competitive advantages in the short run while for most Central European countries one can maintain that they already are not attractive for the delocalising labour intensive activities. The comparison of the industrial structure and export structure reveals that the delocalisation possibilities are exhausted for these countries. The increase in labour costs in the Central European new member states leads

to them losing the position that they gained in the beginning of the 90's. Very probably the Central European countries will become oriented to triangular relations in the delocalisation process (Labrianidis, 2001).

Following the new geographical economic theory concerning the location after-effects and the results of cluster analysis it can be expected that the delocalisation processes may have a certain negative impact on a few EU-15 countries. These countries appear to be Portugal and Greece which have similar industrial structures to Bulgaria and Romania.

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Table 34 Relative and absolute concentration indexes

		1995				2004			
Five groups of branches (sectors)	Concentration index	Relative		Absolute		Relative		Absolute	
Labour intensive sector	Man. of textile	0,43	0,20	0,09	0,21	0,45	0,26	0,09	0,20
	Wearing apparel	0,60		0,09		0,86		0,10	
	Footwear	0,71		0,13		0,86		0,15	
	Furniture	0,24		0,09		0,30		0,09	
	Fabricated metals	0,22		0,12		0,18		0,11	
	Recycling	0,51		0,13		0,44		0,12	
Resource intensive sector	Food & beverages	0,23	0,14	0,09	0,20	0,24	0,11	0,09	0,21
	Woods & wood prod.	0,33		0,08		0,37		0,07	
	Paper & paper prod	0,26		0,10		0,22		0,09	
	Non-metallic prod.	0,21		0,09		0,25		0,09	
	Man. of chemicals	0,20		0,11		0,30		0,12	
The sector of branches with Different factor intensity	Manuf. of machinery	0,25	0,14	0,12	0,23	0,30	0,18	0,13	0,24
	Electrical mach.	0,26		0,14		0,33		0,13	
	Medical & optical	0,39		0,16		0,37		0,15	
The sector of branches with Increasing Economic of Scale	Publishing; print.	0,35	0,20	0,11	0,24	0,30	0,21	0,11	0,24
	Rubber & plastic	0,24		0,13		0,18		0,11	
	Man. of basic met.	0,37		0,09		0,25		0,10	
	Motor vehicle	0,46		0,18		0,47		0,19	
	Transport equip.	0,31		0,10		0,35		0,11	
Science intensive(sector)	Office mach; computers	0,50	0,24	0,14	0,24	0,60	0,23	0,13	0,23
	Communication equip.	0,36		0,10		0,41		0,10	

Sources: Eurostat

Table 35 Relative Specialisation indexes and share of employment of LII from total

manufacture

Country	Relative_95	Relative_G95*	Relative_04	Relative_G04*	Share – 95*	Share – 04*
Belgium	0,30	0,18	0,34	0,21	23,7	22,7
Cz. Rep.	0,30	0,21	0,25	0,11	31,0	27,1
Denmark	0,36	0,12	0,36	0,17	21,5	20,2
Germany	0,39	0,28	0,39	0,29	18,1	16,9
Estonia	0,58	0,40	0,55	0,43	38,2	39,0
Greece	0,57	0,47	0,58	0,49	42,1	40,5
Spain	0,22	0,19	0,21	0,19	29,5	30,8
France	0,24	0,11	0,27	0,15	23,8	21,6
Ireland	0,48	0,21	0,61	0,28	18,2	11,9
Italy	0,28	0,26	0,30	0,26	38,5	37,1
Cyprus	0,69	0,59	0,64	0,54	43,9	25,3
Latvia	0,60	0,34	0,70	0,45	25,6	28,1
Lithuania	0,58	0,38	0,68	0,48	32,1	38,3
Hungary	0,33	0,14	0,27	0,14	28,5	25,4
Netherlands	0,37	0,19	0,36	0,18	19,6	19,6
Austria	0,27	0,16	0,26	0,17	27,2	23,4
Poland	0,29	0,20	0,29	0,24	29,3	30,6
Portugal	0,58	0,47	0,57	0,47	49,2	48,6
Slovenia	0,35	0,26	0,32	0,26	38,8	36,4
Slovakia	0,28	0,14	0,32	0,15	27,1	26,6
Finland	0,45	0,31	0,46	0,31	15,2	16,6
Sweden	0,39	0,24	0,37	0,17	14,7	17,8
UK	0,22	0,14	0,26	0,18	24,1	21,2
Bulgaria	0,43	0,23	0,56	0,40	27,4	42,5
Romania	0,38	0,22	0,56	0,38	31,7	44,5

* Estimated on the bases of the five groups of branches (Labour int.; Resource int.; Branches with different factor intensity; Branches with increasing economic of scale and Science intensive branches – see Table 35)

Table 36 SSD indexes and some derivative indicators estimated on the basis of five groups of branches (see Table 35)

	SSD Same country 1995-2004 *	SSD Same country 1995-2004	SSD 95 Sum Rank	SSD 04 Sum Rank	Country 1995 - EU (1995)	Country 2004 - EU 2004	The three countries with closer structure 1995			The three countries with closer structure 2004		
Belgium	11,7	4,9	16	18	85,3	117,7	France	Netherlands	Spain	France	Netherlands	UK
Czech R.	55,2	47,3	19	22	100,3	34,4	Romania	Slovakia	Austria	Slovakia	Hungary	Austria
Denmark	15,5	7,3	15	19	47,3	82,3	France	Sweden	Netherlands	Sweden	Austria	Check R.
Germany	2,5	3,6	3	3	188,3	219,1	Czech R.	Sweden	UK	Sweden	UK	Denmark
Estonia	74,1	1,1	9	11	348,3	399,4	Greece	Lithuania	Cyprus	Lithuania	Greece	Bulgaria
Greece	6,4	5,9	4	8	478,5	488,7	Cyprus	Estonia	Portugal	Lithuania	Estonia	Bulgaria
Spain	21,4	8,2	20	24	92,4	69,8	Poland	Belgium	Hungary	Poland	Belgium	Check R.
France	9,5	11,5	17	17	39,7	70,5	UK	Netherlands	Belgium	Netherlands	UK	Belgium
Ireland	57,1	54,6	13	5	135,6	307,6	Sweden	Netherlands	Finland	Finland	Sweden	Netherlands
Italy	16,2	5,4	10	15	190,5	167,7	Slovenia	Romania	Czech R.	Slovenia	Romania	Check R.
Cyprus	328,5	574,1	2	1	740,6	985,4	Greece	Estonia	Portugal	Latvia	Lithuania	Poland
Latvia	105,1	28,7	8	4	369,5	602,7	Lithuania	Poland	Bulgaria	Cyprus	Lithuania	Poland
Lithuania	162,2	66,6	14	9	311,8	491,0	Estonia	Bulgaria	Poland	Estonia	Greece	Bulgaria
Hungary	+65,9	35,8	25	21	38,5	54,7	Austria	Poland	Slovakia	Check R.	Slovakia	Austria
Netherlands	4,3	1,0	11	16	106,9	91,5	France	Belgium	UK	France	Sweden	UK
Austria	13,7	25,2	23	23	69,2	72,7	Hungary	Slovakia	Poland	Slovakia	Hungary	Czech R.
Poland	62,8	11,8	24	25	72,9	97,2	Romania	Austria	Hungary	Spain	Austria	Czech R.

<i>Portugal</i>	21,4	1,4	1	2	704,6	690,1	<i>Greece</i>	<i>Estonia</i>	<i>Cyprus</i>	<i>Romania</i>	<i>Bulgaria</i>	<i>Estonia</i>
<i>Slovenia</i>	8,5	10,2	6	12	233,1	181,7	<i>Italy</i>	<i>Czech R.</i>	<i>Hungary</i>	<i>Italy</i>	<i>Check R.</i>	<i>Slovakia</i>
<i>Slovakia</i>	32,8	9,1	21	20	55,4	68,6	<i>Austria</i>	<i>Hungary</i>	<i>Czech R.</i>	<i>Check R.</i>	<i>Austria</i>	<i>Hungary</i>
<i>Finland</i>	33,3	19,5	7	13	252,0	215,3	<i>Ireland</i>	<i>Sweden</i>	<i>Netherlands</i>	<i>Ireland</i>	<i>Denmark</i>	<i>Austria</i>
<i>Sweden</i>	25,5	18,7	5	14	192,0	107,2	<i>Netherlands</i>	<i>Ireland</i>	<i>Denmark</i>	<i>Netherlands</i>	<i>Denmark</i>	<i>France</i>
<i>UK</i>	24,7	29,2	12	10	68,1	123,5	<i>France</i>	<i>Netherlands</i>	<i>Denmark</i>	<i>France</i>	<i>Netherlands</i>	<i>Sweden</i>
<i>Bulgaria</i>	266,7	303,1	18	7	174,9	441,4	<i>Austria</i>	<i>Poland</i>	<i>Slovakia</i>	<i>Romania</i>	<i>Estonia</i>	<i>Portugal</i>
<i>Romania</i>	173,7	222,4	22	6	88,6	434,0	<i>Czech R.</i>	<i>Poland</i>	<i>Hungary</i>	<i>Portugal</i>	<i>Bulgaria</i>	<i>Estonia</i>
<i>EU-27</i>	6,9	1,8	-	-	0,0	0,0	<i>Hungary</i>	<i>France</i>	<i>Denmark</i>	<i>Czech R.</i>	<i>Hungary</i>	<i>Slovakia</i>

* Estimated based on NACE classification, Division from 15-35 (not included NACE Division 23:
Manufacture of coke; refined petroleum)

Sources: Eurostat

Table 37 EU-27 Revealed Comparative Advantage and Rank specialisation

indexes⁵⁷

	RCA – (1999-2003)			RCA (1999-2003) minus (1996-2000)			Rank specialization index (1999-2003)			Rank specialization index (1996-2000) minus (1999-2003)		
	Textiles	Clothing	Footwear and Leather	Textiles	Clothing	Footwear and Leather	Textiles	Clothing	Footwear and Leather	Textiles	Clothing	Footwear and Leather
	1	2	3	4	5	6	7	8	9	10	11	12
<i>EU average</i>	0,98	1,35	1,41	-0,27	-0,31	-0,11	49	72	54	-1	-4	-3
<i>Cyprus</i>	0,89	0,82	0,34	-2,01	-1,41	n.a.	45	75	82	n.a.	-36	-49
<i>Czech R.</i>	1,32	0,43	0,36	-0,31	-0,25	-0,34	31	89	79	-1	-9	-9
<i>Estonia</i>	1,52	1,44	1,26	-0,22	-0,27	-0,24	27	60	42	2	-3	-2
<i>Hungary</i>	0,5	0,99	0,84	0,03	-0,41	-0,46	78	66	57	0	-5	-14
<i>Latvia</i>	2,09	2,44	0,31	-0,14	-0,54	-0,08	19	46	84	-2	-8	-1
<i>Lithuania</i>	1,64	3,31	0,46	-0,51	-0,64	-0,64	25	35	75	-5	-4	-22
<i>Poland</i>	0,84	1,14	0,86	-0,18	-0,8	-0,36	47	62	55	-4	-12	-7
<i>Slovenia</i>	1,19	0,78	1,11	-0,13	-0,66	-0,39	36	77	45	-1	-17	-6
<i>Slovakia</i>	0,85	0,95	1,72	-0,26	-0,78	-0,34	46	68	36	-7	-13	-1
<i>Bulgaria</i>	1,32	6,14	2,89	0,18	0,69	-0,3	30	27	21	7	-2	2
<i>Romania</i>	3,40	8,61	6,62	n.a.	n.a.	n.a.	9	1	7	n.a.	n.a.	n.a.

⁵⁷ The RCA index measures the country's revealed comparative advantage in exports according to the Balassa formula. The rank specialization index indicates the specialization that the country have in the trade of given product -- Rank 1 indicates that the country has the highest specialization index in the world for the sector under review, in other words the share of the given product of the countries trade is the highest compared with the shares for this product in the other countries.

<i>Austria</i>	0,84	0,47	1,06	-0,12	-0,11	-0,22	48	86	46	-2	0	-1
<i>Belgium</i>	1,08	0,63	0,74	-0,28	-0,02	-0,13	37	82	62	-3	0	-1
<i>Germany</i>	0,7	0,41	0,35	-0,13	0	-0,05	58	93	80	-6	-1	2
<i>Denmark</i>	0,69	1,07	0,59	-0,09	-0,11	-0,06	60	64	71	-4	2	1
<i>Spain</i>	0,92	0,67	1,51	-0,1	0,12	-0,42	43	81	38	2	7	-2
<i>Finland</i>	0,3	0,13	n.a.	0,03	-0,01	n.a.	93	115	-	5	-3	n.a.
<i>France</i>	0,79	0,58	0,8	-0,09	0,02	0	51	83	60	-1	4	4
<i>Greece</i>	1,83	3,94	0,66	0,09	-1,68	-0,12	23	31	66	5	-7	0
<i>Ireland</i>	0,17	0,12	NA	-0,08	-0,01	n.a.	110	116	-	-9	-2	n.a.
<i>Italy</i>	1,84	1,66	3,67	-0,14	-0,1	-0,73	21	56	16	3	-2	0
<i>Netherlands</i>	0,61	0,44	0,5	0,06	0,03	0	68	88	72	7	5	4
<i>Portugal</i>	2,23	3,1	3,95	-0,47	-0,55	-1,5	14	37	14	-1	-3	-1
<i>Sweden</i>	0,38	0,25	n.a.	-0,01	0	n.a.	88	104	n.a.	-4	-1	n.a.
<i>UK</i>	0,56	0,43	0,34	-0,01	0	-0,1	72	90	83	1	1	-4

Source: COMTRADE data and own calculations

<http://www.intracen.org/countries>

7 THE IMPACT OF INTERNATIONALISATION ON THE CLOTHING INDUSTRY

Christos Kalantaridis, Ivaylo Vassilev, Grahame Fallon

7.1 Introduction

Clothing is the paramount global commodity, having some of the highest levels of import penetration, volumes of trade and supply chain internationalisation. Trade in clothing is among the longest established in the world, yet there has recently been a dramatic increase of global interdependence in production and consumption, with producers from different countries taking turns at occupying centre stage over the past forty years. The location of offshore production has shifted constantly, including Japan (in the 1960s); Southern Europe, Hong Kong, South Korea, Singapore and Taiwan (1970s); mainland China, Sri Lanka and Southeast Asia (late 1980s); and South Asia and North Africa (1990s) (Gereffi and Memedovic, 2004; Gibbon, 2002). The significance of Latin America, Eastern Europe, Turkey and the Middle East have also increased (Begg and Pickles, 2000; Gereffi and Memedovic, 2003).

Accelerating global integration in the clothing industry can be explained by three main factors. Firstly, it has been stimulated by advances in technology - especially telecommunications, transportation, and IT (Castells, 1996; Giddens, 1990), combined with the predominance of neo-liberal ideology and free markets (Jessop, 2002). Secondly, global integration has been facilitated by the sector's low entry barriers (in capital and skills terms) and high labour content - amounting to 60 percent of total costs (OECD, 2004), making re-localisation to countries with cheap and flexible labour relatively easy (Hanzl-Weiss, 2004). Third, integration has benefited from the rise (and

increasing convergence) of global buyers such as retailers, branders and marketers (Gereffi, 1999).

This Chapter sets out to examine the impact of processes of global integration upon inter-organisational relationships and enterprise strategy in the clothing industry, drawing upon the results of extensive fieldwork investigation in five European countries (the UK, Greece, Poland, Estonia and Bulgaria). The next section of the Chapter comprises a review of the literature, forming the basis of a number of testable hypotheses. The main body of the Chapter discusses the findings of the empirical research, while the final two sections provide an overview of the findings, followed by concluding remarks.

7.2 The Literature

The Industry

The clothing industry has undergone substantial recent changes, with exports growing rapidly between the 1970s and late 1990s (CEC, 2002), and a significant decline in sectoral employment in developed countries (Bair and Gereffi, 2003; Dunford, 2002). However, the impact on the overall employment in the supply chain has been less dramatic as employment numbers have risen in the pre-assembly and retail parts of the sector (Pye, 2004).

Despite high levels of offshoring and decreasing employment and output, clothing continues to be significant for developed countries, where the number of companies has not changed dramatically and their diversity has actually increased (Pye, 2004). The EU clothing industry is still heavily concentrated in the developed countries (specializing in

high value added products). Eastern European countries experienced a rapid decline in clothing employment in the early 1990s followed however by a revival during the mid to late 1990s (when their clothing production rose in volume and value terms).

Overview of Trade Governance

Governance comprises the actions of governmental and non-governmental institutions that both encourage and constrain the behaviour of market actors (Gereffi and Mayer, 2004). Governance systems have three main effects on markets: facilitative, regulatory and compensatory.

Trade quotas and especially the Multi-Fibre Agreement (MFA) adopted in 1974 have been the major mechanisms regulating world trade in clothing and textiles over the recent past. An agreement became effective in 1995, providing for a ten-year transition period (ending 2004) during which WTO member countries gradually abolished quotas (Nathan Associates, 2002). A second tier of regulatory mechanisms, governing outward processing trade (OPT), preferential trading agreements (PTA), and free trade agreements (FTA) still remain, however, protecting producers in the US, Japanese and EU trading blocks (Kwan and Qiu, 2003).

Regulations also govern the production and consumption of clothing, covering product quality, environmental, health and working conditions, ethics and social responsibility (Humphrey and Schmitz, 2002). While standards mostly operate at the national level, international standards and codes of practice have also gradually been introduced since the 1950s (Nadvi and Waltring, 2002), including ISO9000 (quality management), ISO14000 (environment protection), SA8000 (social accountability), and WRAP

(socially responsible global standards for clothes manufacturing) (Yeung and Mok, 2004).

Buyers in developed countries

Clothing industry restructuring has been associated with the rise of large buyers including retailers, marketers, and branders (Gereffi, 1999; Gibbon, 2002). A 'retail revolution' occurred from 1965-1980, marked by the rise of giants such as Wal-Mart, K-Mart and Target, and the growth of specialised marketers and assemblers such as Nike (Appelbaum, 2004). Buyers are also becoming increasingly similar, as retailers develop their own brands, while branders increasingly abandon production altogether (Bair and Gereffi, 2003).

Concentration and increasing buyer control have also taken place in a number of national markets. In the USA, Wal-Mart and K-mart control 25 percent of national clothing sales (by unit volume), while the top five account for 68 percent of sales (Gereffi and Memedovic, 2003). The UK clothing sector has also consolidated since the 1980s, being currently dominated by a small number of large, specialised retailers (Dunford, 2002), none having significant manufacturing activities (Gibbon, 2002). Similar processes of consolidation and concentration have occurred in Germany, France, Italy and Japan (Gereffi and Memedovic, 2003).

Relationships

Research Question 1: What is the impact of emerging (chronological and sequential) patterns of global integration on inter-organisational relationships in the clothing industry?

Links between buyers and manufacturers vary in terms of (i) *what part of the process is outsourced*, and (ii) *what types of relationships are involved in bringing the product to the buyer*. Suppliers can undertake (a) the assembly of imported inputs (OPT), (b) full package production - where they supply finished products to buyers' specification, or (c) triangular manufacturing - where the lead supplier only co-ordinates different aspects of the production process (assigned to different subcontractors (Gereffi, 1999)). These different buyer-supplier relationships necessitate differing levels of upgrading on the part of suppliers, including the development of managerial know-how, design capabilities, fabric procurement, property rights protection, export financing, expertise in trade formalities handling, together with the possible development of own brands and retail outlets (OECD, 2004).

Pre-assembly is the highest value-added stage of production, which is commonly carried out in-house by major clothing companies (Abernathy *et al.*, 1999). Marketing, branding and retailing are also highly capital- and knowledge-intensive, making them difficult steps for the upgrading producer to climb. Developing own brands for the national market may not guarantee long term survival unless the product is internationally competitive (Karagozoglou and Lindell, 1998). The choice of suppliers and their location also depends on the segment within which buyers operate. Gereffi (1999) and Gibbon (2002) distinguish between 'upper market segments' (supplied mainly by flexible enterprises, offering high quality services and located mostly in developed countries) and 'basic' clothing (relying frequently on developing country sources).

H1: There is a relationship between country and the market segment focus of clothing manufacturers – with those nearer the EU core focusing more on design and flexible response segments.

Three main forms of outsourcing relationship occur in the clothing industry: subcontracting, joint ventures (JVs), and FDI. FDI is relatively insignificant in the clothing sector (Hanzl-Weiss, 2004) since outsourcing is mostly done through subcontracting and (to a lesser extent) by JVs.

H2: FDI and joint ventures are positively linked to working outside the price sensitive segment of the market (with an either flexible response or design focus).

H3: There is a positive relationship between country and the incidence of FDI and joint ventures.

Buyers can either choose to deal directly with manufacturers, or via intermediaries. The latter can serve as an importers and transmitters of production and organisational expertise (Schmitz and Knorringa, 2000) and can add value through their knowledge of globally dispersed production capacities and demand, and by their capacity to deal efficiently with logistics, diverse national contexts and subcontractors, and internal design issues (Enright *et al.*, 1997).

Buyer/supplier relationships may evolve over time and are often fluid and complex (Tokatli and Eldener, 2004). Suppliers may, for example upgrade and develop a second tier subcontracting capacity, while retaining some production themselves (Appelbaum *et al.*, 2000). They may alternatively decide to play the role of intermediaries (Labrianidis and Kalantaridis, 2004), or to deal direct with producers instead (Kalantaridis *et al.*, 2001). Most buyers are likely to develop hybrid solutions, using both intermediaries and

direct contacts; buyers/supplier links may remain very strong, especially if buyers choose to use existing suppliers to expand into new markets (Enright *et al.*, 1997).

H4: Flexible response and design focused of the markets are characterised by the incidence of strong relationships.

Strategies

Research Question 2: What is the degree of diversity (or commonality) of emerging strategies in the clothing industry, and to what extent are they linked with performance?

Many enterprises seek to reduce production costs by *informalisation* (Annielo, 2001; Appelbaum *et al.*, 2005). The pursuit of cheaper labour, by outsourcing assembly (often by subcontracting) to low cost areas is typical of the clothing industry; DC manufacturers which depend entirely on cost-reduction are most vulnerable to clothing sector restructuring, however (Taplin *et al.*, 2003). Other forms of product-related adjustment may be less risky, including increasing productivity, product range diversification, faster new product development, movement up the value chain, and introducing flexible production (Zeitlin and Totterdill, 1989).

H5: Operating in price sensitive segments of the market is negatively linked to successful adjustment.

Labour flexibility is crucial for adjustment (especially in developed countries), thus it is proving increasingly necessary to treat employees as a resource rather than a cost (Taplin *et al.*, 2003). Improved product quality and better product differentiation require high quality work and highly skilled workers, necessitating investment in training and long-term contracts. High labour turnover can impede such a strategy (Appelbaum *et al.*,

2000) however, and low levels of education and training on the part of clothing industry workers may be particularly problematic (Winterton and Winterton, 2002), leading to a need for government support in upgrading worker skills (Husband and Jerrard, 2001). Increasing flexibility and cost reductions may also require the adoption of systems for minimising inventory levels, centring on 'lean retailing' (Abernathy *et al.*, 1999; Nordas, 2004).

Clothing company strategies must also be embedded in firms' broader institutional and physical environments. Higher priority is, for example, given to the maximisation of 'shareholder value' in the UK than in Mainland Europe, leading to significant differences in the day-to-day operational management and strategic choices of individual companies (Palpacuer *et al.*, 2005), while State policies and path dependencies also exert a substantial influence on the strategies chosen (Tully and Berkley, 2004).

Successful restructuring strategies are likely to involve a move away from manufacturing towards branding and consolidation at the retail end of the chain. It is increasingly typical for leading clothing companies to design and market but not to make their products, earning profits from research, design, sales, marketing and the sale of financial services, rather than from scale, volume and technological innovation (Bair and Gereffi, 2003). There is a danger however in focusing excessively on global buyers and their power, leading to a disregard of local networks, markets and retailing structures in LDCs (Hassler, 2004).

H6: Reduced manufacturing capacity in the EU is positively linked to successful adjustment.

H7: Increased manufacturing capacity in Eastern Europe is positively linked to successful adjustment.

7.3 Findings

Overview

The criteria used for the selection of the enterprises surveyed indicate an apparent international orientation among clothing firms, although significant, inter-country disparities emerge from the findings. In the case of Bulgaria more than 90 percent of sales were directed to international markets, compared with 15 per cent for the UK. Sub-contracting was the primary means of export activity (accounting for over 80 per cent of exports in Bulgaria, Poland and Estonia), although marginal or non-existent in Greece and the UK. OPT follows a similar pattern (See Figure 28)

There is a (predictable) relationship between ownership structures and international development (see Figure 29). Enterprises with direct ownership links (FDI and JVs) demonstrate the greater incidence of reliance on exports, subcontracting and OPT, whereas domestically owned firms placed the least reliance upon them.

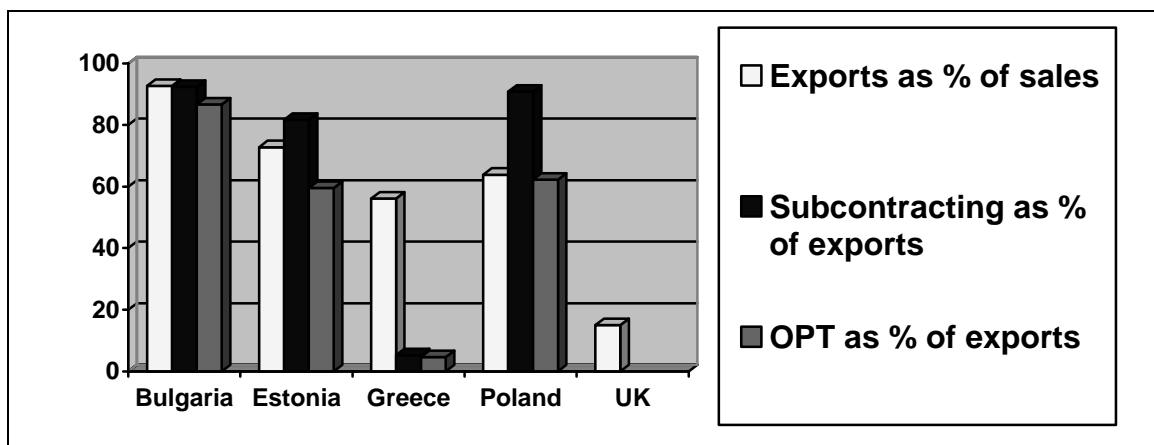


Figure 28 Exports, sub-contracting, intermediate products and OPT by country

Source: Enterprise Survey

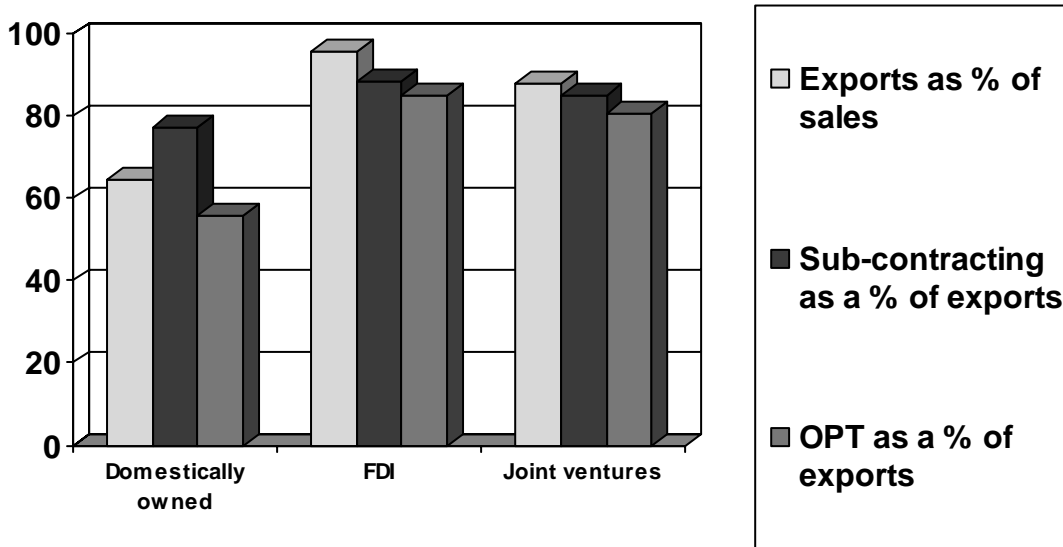


Figure 29 Ownership structure and international development

Source: enterprise Survey

There are also substantial linkages between firm size and ownership structures. All micro enterprises in the sample and over 90 percent of small firms are domestically owned, in comparison to just over 60 percent of large businesses. Larger firms also exhibit more JVs (17 percent) and FDI (21 percent) than their smaller counterparts.

On Segmentation, Country and Ownership

H1: There is a relationship between country and the market segment focus of clothing manufacturers – with those nearer the EU core focusing more on design and flexible response segments.

Market segmentation constitutes an apparently significant influence upon enterprise adjustment patterns. There is a statistically significant relationship between country and market segmentation, with countries nearer the EU core (such as the UK) focusing more on design and flexible response, and peripheral countries (such as Bulgaria and Poland) on price sensitive segments. Estonian clothing firms seem to have moved further than expected towards a design focus, while Greek firms still rely surprisingly heavily on price competition (see Table 38).

Table 38 Market Segments, by Country

		Market segment			Total	
			Price sensitive	Flexible response focus	Design focus	
Country	Bulgaria	Count (%)	49 (83.1)	9 (15.3)	1 (1.7)	59 (100)
	Estonia	Count (%)	15 (25.9)	14 (24.1)	29 (50.0)	58 (100)
	Greece	Count (%)	21 (72.4)	3 (10.3)	5 (17.2)	29 (100)
	Poland	Count (%)	54 (61.5)	28 (31.8)	6 (6.8)	88 (100)
	UK	Count (%)	2 (20.0)	3 (30.0)	5 (50.0)	10 (100)
Total		Count (%)	141 (57.8)	57 (23.5)	46 (18.9)	244 (100)

Source: Enterprise Survey

H2: FDI and joint ventures are linked to working outside the price sensitive segment of the market (with an either flexible response or design focus).

There is no apparent relationship between these variables (see Table 39). The lowest incidence of foreign ownership lies interestingly in the flexible response segment of the market.

Table 39 Market Segments by Ownership

		Ownership			Total
		Domestically owned	FDI	Joint venture	
Price sensitive	Count (%)	112 (79.4)	24 (17.0)	5 (3.5)	141 (100)
Flexible response focus	Count (%)	48 (84.2)	5 (8.8)	4 (7.0)	57 (100)
Design focus	Count (%)	36 (78.3)	7 (15.2)	3 (6.5)	46 (100)
Total	Count (%)	196 (80.3)	36 (14.8)	12 (4.9)	244 (100)

Source: Enterprise Survey

The findings also suggest the existence of a relationship between ownership structures, market segmentation and the national context (see Table 40). In the case of Estonia, for

example, there appears to be a substantial incidence of FDI in the price sensitive market segment (contrary to prior expectations).

Table 40 Ownership Structure and Market Segmentation, by Country

Country				Market segmentation			Total
				Price sensitive	Flexible response focus	Design focus	
Bulgaria	V76	Domestic owned	Count (%)	28 (84.8)	4 (12.1)	1 (3.0)	33 (100)
		FDI	Count (%)	17 (89.5)	2 (10.5)	0 (.0)	19 (100)
		Joint venture	Count (%)	4 (57.1)	3 (42.9)	0 (.0)	7 (100)
	Total			Count (%)	49 (83.1)	9 (15.3)	1 (1.7)
Estonia	V76	Domestic owned	Count (%)	8 (20.5)	12 (30.8)	19 (48.7)	39 (100)
		FDI	Count (%)	6 (40.0)	2 (13.3)	7 (46.7)	15 (100)
		Joint venture	Count (%)	1 (25.0)	0 (.0)	3 (75.0)	4 (100)
	Total			Count (%)	15 (25.9)	14 (24.1)	29 (50.0)
Greece	V76	Domestic owned	Count (%)	21 (72.4)	3 (10.3)	5 (17.2)	29 (100)
	Total			Count (%)	21 (72.4)	3 (10.3)	5 (17.2)
Poland	V76	Domestic owned	Count (%)	53 (62.4)	26 (30.6)	6 (7.1)	85 (100)
		FDI	Count (%)	1 (50.0)	1 (50.0)	0 (.0)	2 (100)
		Joint venture	Count (%)	0 (.0)	1 (100.0)	0 (.0)	1 (100)
Total			Count (%)	54 (61.4)	28 (31.8)	6 (6.8)	88 (100)
UK	V76	Domestic owned	Count (%)	2 (20.0)	3 (30.0)	5 (50.0)	10 (100)
	Total			Count (%)	2 (20.0)	3 (30.0)	5 (50.0)

Source: Enterprise Survey

H3: There is a relationship between country and region (viewed here as proxies for macro-economic stability and development of market institutions) and the incidence of FDI and joint ventures

There does appear to be such a relationship (see Table 41), although it is somewhat different from that originally envisaged. Countries with more stable macro-economic environments and developed market economies (UK, Greece, Poland in descending order) do not demonstrate the greatest incidence of FDI and JVs, but rather those (riskier) countries (such as Estonia and Bulgaria) that offer greater potential opportunities for inward investors.

Table 41 The incidence of FDI and Joint Ventures by Country

		Ownership structure			Total	
			Domestically owned	FDI	Joint venture	
Country	Bulgaria	Count (%)	33 (54.1)	20 (32.8)	8 (13.1)	61 (100.0)
	Estonia	Count (%)	40 (66.7)	15 (25.0)	5 (8.3)	60 (100.0)
	Greece	Count (%)	31 (100.0)	0	0	31 (100.0)
	Poland	Count (%)	88 (95.7)	3 (3.3)	1 (1.1)	92 (100.0)
	UK	Count (%)	12 (100.0)	0 (.0)	0 (.0)	12 (100.0)
Total		Count (%)	204 (79.7)	38 (14.8)	14 (5.5)	256 (100.0)

Source: Enterprise Survey

On Relationships

H4: Flexible response and design focused of the markets are characterised by the incidence of strong relationships.

Firms operating in the design and, to a lesser extent, the flexible response segments appear to exhibit relatively high levels of mutual dependence and personalised relations, and a more asymmetrical balance of power (see Table 42). Price-sensitive firms appear to enjoy longer, continuous relationships with partner businesses, however.

Table 42 Market Segmentation and Strength of Relationships

Average Linkage (Between Groups)		Balance of power (V148)	Mutual dependence (V 149)	Personalised relations (V 150)	Average number of years of continuous relationship (V 144)
price sensitive	Mean	3.94	3.38	2.27	7.6087
	N	117	117	115	115
flexible response focus	Mean	3.96	3.58	2.49	7.1200
	N	50	48	49	50
design focus	Mean	4.21	3.79	2.89	6.3947
	N	38	38	38	38
Total	Mean	4.00	3.50	2.44	7.2611
	N	205	203	202	203

Source: Enterprise Survey

The balance of power seems to rest predominantly in the hands of the buyers (the mean being over 4.00 in all cases except Poland (see Table 43)). Buyer power may exist alongside mutually dependent relationships, however especially in Greek, Bulgarian and Estonian enterprises. Most manufacturer/buyer relationships are relatively impersonal, especially in Greece and (to a lesser degree) in Bulgaria and the UK. Many, non-UK clothing firms service foreign companies by sub-contracting.

Table 43 Nature of Forward Relationships, by Country

Country		Balance of power (V148)	Mutual dependence (V 149)	Personalised relations (V 150)	Number of foreign companies serviced by sub - contracting (V125)
Bulgaria	Mean	4.18	3.98	2.08	5.5574
	N	61	60	60	61
Estonia	Mean	4.14	3.81	3.50	9.4138
	N	58	58	58	58
Greece	Mean	4.69	4.31	2.44	10.1000
	N	16	16	16	10
Poland	Mean	3.67	2.88	1.91	5.7160
	N	78	77	76	81
UK	Mean	4.50	2.00	2.00	
	N	2	2	2	

Source: Enterprise Survey

Relationships are also influenced by firm size; the smaller the firm, the smaller the number of its customers and thus the greatest its degree of dependence. Foreign ownership appears (predictably) to reduce the number of buyer options, increasing the imbalance of power between enterprises, together with mutual dependence. Market focus also appears to be a significant influence on relationships. Enterprises operating in price sensitive segments exhibit the smallest number of buyers, and the greatest buyer power, whilst those with a design focus record the least buyer power and highly-developed personalised relationships.

On Strategies

Firms were asked a sequence of qualitative questions designed to provide an overview of their strategies. The data collected were analysed using the *N-vivo* package, enabling strategic patterns to be identified for each sample country, using hierarchical cluster analysis and the Ward method. Table 44 and Figure 30 provide a summary of the prototype strategies identified.

Table 44 Overview of Strategies

	Competence lock-in	Hybrid	Break out Competences
Product/service	Not own product range so limited scope for action	New product or product design for some of the product range	New product design & brand development
Process	Technological change (invariably in production) in line with needs of parent enterprise	Technological change linked to new manufacturing competences (often knowledge transfer from one dimension (OPT) to the other)	All encompassing technological change including manufacturing and/or lean retailing
Function	Moving up or down the production chain but remaining within manufacturing	Moving up and/or down the production chain – often simultaneously in two different production dimensions.	Moving up the production chain – often away from manufacturing towards distribution. Proximity to the consumer a key source of competitive edge.
Production	Production competences remain at the heart of enterprise strategy.		The importance of production competences and volume production decline.
Market	Serving in the main price sensitive and to a lesser degree flexibility focused market segments	Serving flexible response focus plus one of the other two (flexibility focus or design sensitive) market segments.	Serving in the main design focus market segments.

Source: Enterprise Survey

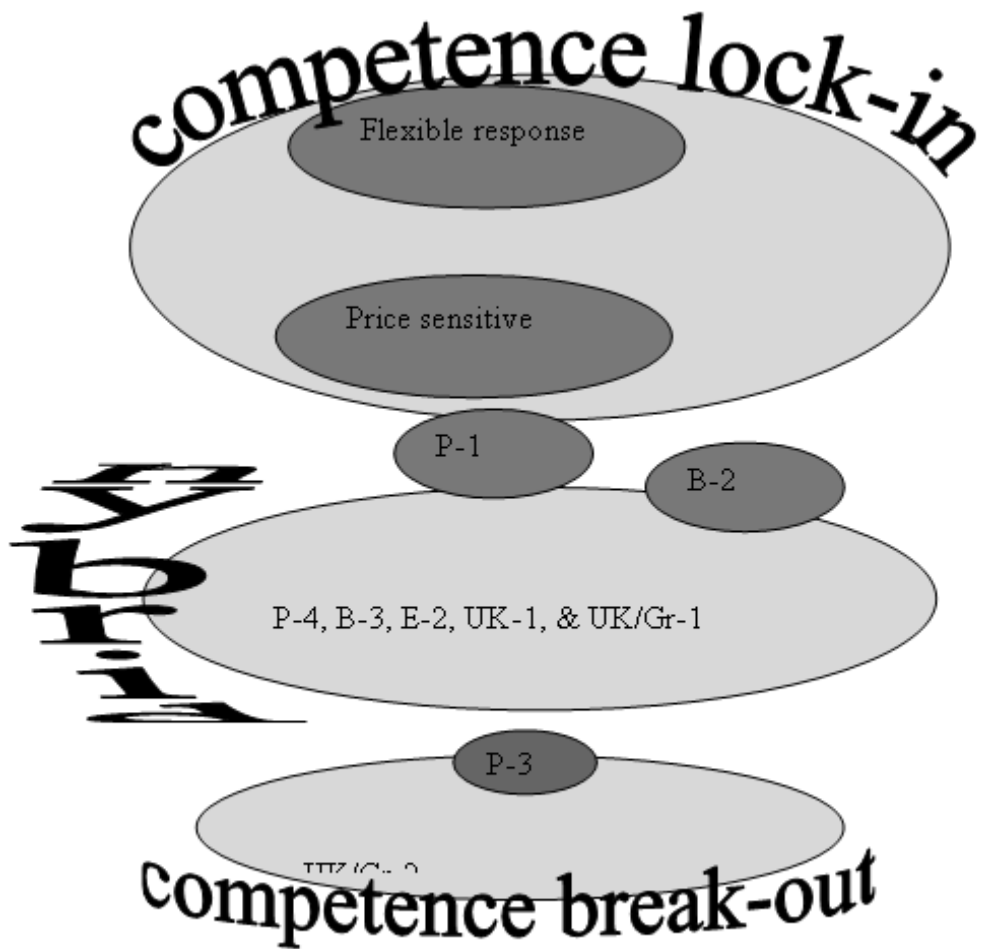


Figure 30 Patterns of Enterprise Strategies

Most emergent clusters are country-specific, suggesting that companies operating in the same market segment but different national contexts may use different strategies (for example Poland 2, Estonia 3, and Bulgaria 3). Companies operating in the same country and market segment may adopt significantly different strategies (for example Poland 1 and 4, Poland 2 and 3, Estonia 1 and 2, Bulgaria 2, 3, and 4). Those operating in different segments and different countries may actually adopt the same strategy (for

example Poland 2 and Estonia 1, Greece 1 and Poland 1). Some more consistent patterns emerge, however. For example, companies operating both in Greece and the UK fall into clusters 2 and 3, while clusters Poland 2 and Bulgaria 4 are identical (as are Poland 1 and Bulgaria 1).

Competence lock-in strategies are most common, accounting for 129 firms (over 50 percent of the total sample). They are (predictably) apparent in the price sensitive segment of the market (for example, Poland 2, Bulgaria 4 and Greece 1). They also appear however in the flexible response segment, represented by the Estonia 1 and Bulgaria 1 clusters (both with a strong export orientation, substantial FDI, but little evidence of functional up-grading). Estonia 3 also appears to adopt a very similar strategy (but for the development of design competences over some of the product range). A strong export orientation and significant foreign involvement are also typical of *lock-in* strategies (apart from Poland 2).

Hybrid strategies form an interesting prototype, including 59 (just over 25 percent) of respondents. Such firms seek to use competences developed by engagement in global production and distribution networks in order to enhance their domestic market positions. Poland (4) and Estonia (2) appear to have developed greater design competences and own brand products than originally envisaged while UK 1, and UK/Greece 1 are somewhat different, due to the declining importance of production. Movement upwards in the production chain appears to be common in the former grouping but less so in the latter.

One cluster (UK/Greece 2) lies within the *Competence break-out category*, comprising a mere 9 companies, all with a strong domestic focus. Poland 3, finally, falls between the

hybrid and *break-out strategies*, comprising 13 brand-owning companies, showing apparent movement away from production, and further up the chain. These firms have still not completed the implementation of advanced technologies, and their focus remains on the price sensitive segment of the market.

On Performance

The degree of success (or failure) in adjusting to changes in the industry was explored, focusing on changes occurring before and after companies' integration with global markets. Four measures of performance were used: employment, turnover, profits and exports; entrepreneurs were asked to evaluate performance on a five point, LIKERT-type scale, ranging from 1 (considerable perceived decline) to 5 (considerable perceived growth).

Figure 31 (below) captures reported adjustment success in country terms, revealing a clear distinction between the performance of Eastern European companies (strong in respect of all measures), and those based in the UK and Greece. The latter indicate a fall in employment – probably due to the relocation of production abroad – although with no apparent adverse effects on turnover and exports. Interesting findings also emerge for profitability, where Bulgarian firms perform best (with Greek enterprises in second place), while UK companies perform marginally better than Polish enterprises. These findings suggest that clothing industry adjustment to global integration may differ between developed and LDCs.

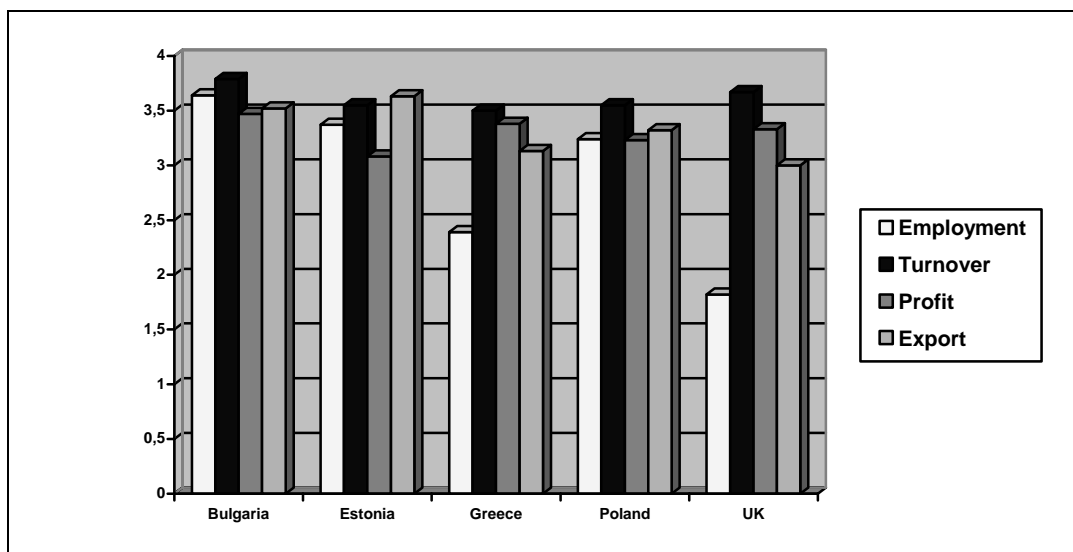


Figure 31 Successful Adjustment by Country

Source: Enterprise Survey

There also appears to be a link between firm size and adjustment performance; larger firms tending to perform best in employment, turnover and profit (though not exporting) terms. This finding may be linked to some extent to country influence – since larger enterprises are found in Bulgaria, Estonia and Poland, than in the UK and Greece (see Figure 32).

There is an apparent relationship between ownership structure and performance (see Figure 33), with FDI and JV companies appearing to out-perform domestically-owned enterprises on a consistent basis. This finding may be linked in part to varying levels of access to resources, such as finance (in scarce supply in Eastern European countries, where the bulk of FDI is accumulated). Country specificity may also be important, in that 48 out of 52 clothing companies with foreign ownership are located in Bulgaria and Estonia – the two best performing countries in adjustment terms.

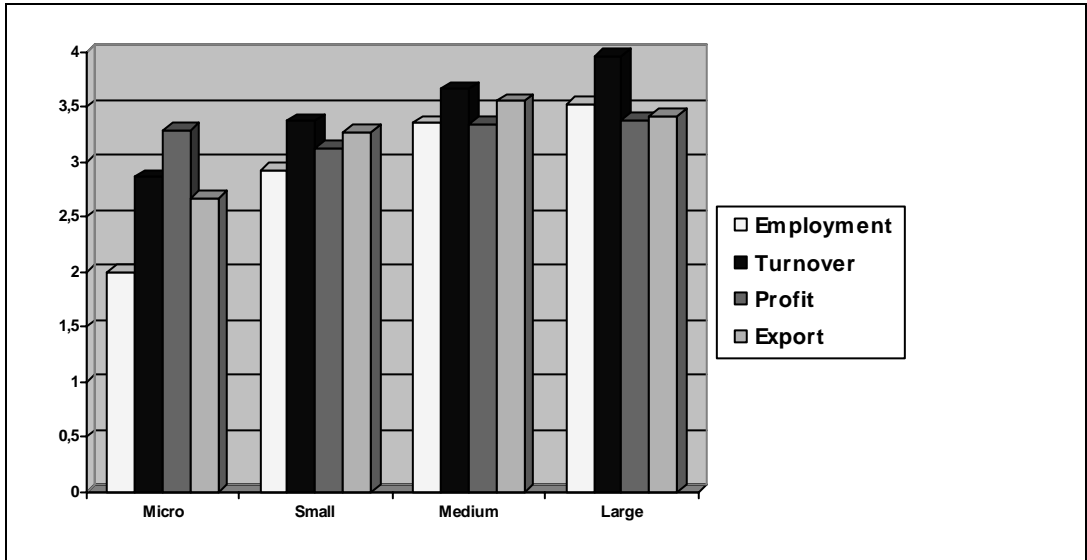


Figure 32 Successful Adjustment by Size band

Source: Enterprise Survey

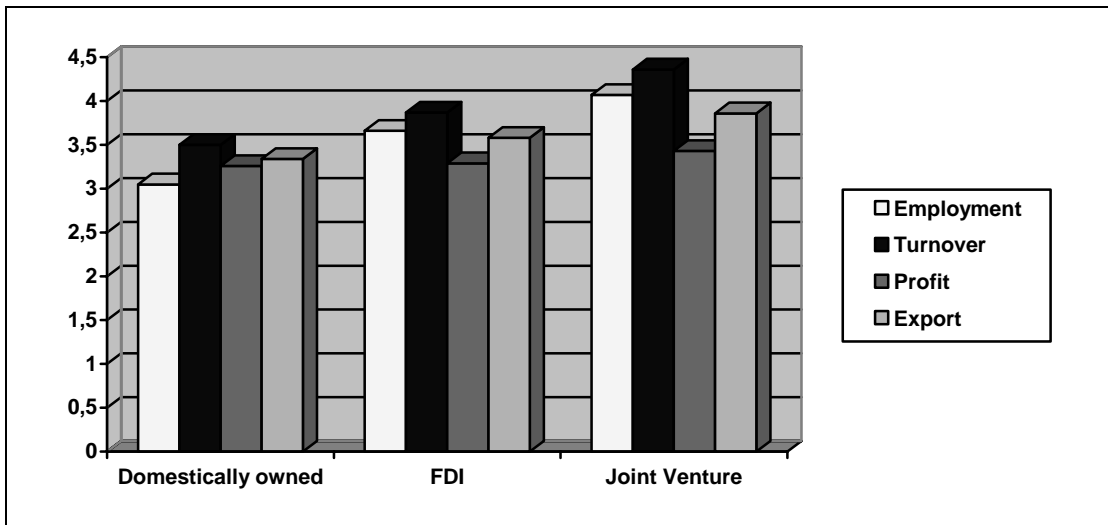


Figure 33 Successful Adjustment by Ownership Structure

Source: Enterprise Survey

H5: Operating in price sensitive segments of the market is negatively linked to successful adjustment.

No clear linkage between market segmentation strategies and successful adjustment emerges from the findings (see Table 45). Enterprises in price sensitive segments appear to perform as well or somewhat better than those with a flexible response and design focus in terms of turnover, profits, and exporting (although rather less well in employment terms).

Table 45 Market Segmentation and Successful Adjustment

		Market segment	Annual average, total employment (V 53)	Turnover progress after de-localisation (V63)	Profits progress after de-localisation (V64)	Export progress after delocalisation (V 96)
Market segment	Pearson Correlation	1	-.057	-.030	-.118(*)	-.002
	N	244	242	234	228	244
Annual average, total employment (V 53)	Pearson Correlation	-.057	1	.538(**)	.350(**)	.155(**)
	N	242	254	246	239	254
Turnover progress after delocalisation (V63)	Pearson Correlation	-.030	.538(**)	1	.643(**)	.245(**)
	N	234	246	246	238	246
Profits progress after delocalisation (V64)	Pearson Correlation	-.118(*)	.350(**)	.643(**)	1	.199(**)
	N	228	239	238	239	239
Export progress after delocalisation (V 96)	Pearson Correlation	-.002	.155(**)	.245(**)	.199(**)	1
	N	244	254	246	239	256

* Correlation is significant at the 0.05 level (1-tailed). ** Correlation is significant at the 0.01 level (1-tailed).

Source: Enterprise Survey

H6: Reduced manufacturing capacity in the EU is positively linked to successful adjustment.

H7: Increased manufacturing capacity in Eastern Europe is positively linked to successful adjustment

Production-focused strategies (coded 1 in Table 46, below) appear to result in weaker performance for UK and Greek companies, although the findings are less conclusive for Eastern European firms. There is evidence in the case of Estonia (although not for Poland or Bulgaria) that a production focus may improve performance (especially turnover and profits).

Table 46 Production Focus and Successful Adjustment

Country	Production		Annual average employment (v53)	Turnover progress after delocalisation (V63)	Profits progress after delocalisation (V64)	Export progress after delocalisation (v96)
Bulgaria	1.00	Mean	3.63	3.77	3.47	3.53
		N	60	60	58	60
	Total	Mean	3.63	3.77	3.47	3.53
		N	60	60	58	60
Estonia	1.00	Mean	3.42	3.44	3.04	3.56
		N	48	48	48	48
	3.00	Mean	3.00	4.50	3.25	4.00
		N	4	4	4	4
	Total	Mean	3.38	3.52	3.06	3.60
		N	52	52	52	52
Poland	1.00	Mean	3.27	3.53	3.27	3.36
		N	67	66	60	69
	3.00	Mean	3.92	4.09	3.55	2.62
		N	13	11	11	13
	Total	Mean	3.38	3.61	3.31	3.24
		N	80	77	71	82
Greece	1.00	Mean	2.00	3.28	3.06	2.89
		N	19	18	18	19
	2.00	Mean	3.50	3.00	2.50	3.50
		N	2	2	2	2
	3.00	Mean	2.90	4.13	4.22	3.50
		N	10	8	9	10
	Total	Mean	2.39	3.50	3.38	3.13
N		31	28	29	31	
UK	1.00	Mean	1.50	3.50	2.50	2.50
		N	2	2	2	2
	3.00	Mean	2.10	3.88	3.75	3.10
		N	10	8	8	10
	Total	Mean	2.00	3.80	3.50	3.00
		N	12	10	10	12

Source: Enterprise Survey

On Governance

The findings are inconclusive, but they do support Gereffi and Mayer (2004) regarding the growth of a 'governance deficit' (where internationalisation leads to global market development, but not necessarily to commensurate increases in regulation and compensation mechanisms). Many respondents expressed disappointment at the negative effects entailed in meeting ISO requirements, whose main function appeared to be meeting requirements for government quotas and/or funding rather than facilitating their own position in the market.

'There is a completely different way of doing business in North America...it is also the import duties there...export licenses are creating delays and uncertainty; in the US they do not need those, only for cases of trade embargos otherwise they can trade anywhere in the world; with other EU countries the regulation should be the same but it is not, it is not enforced; UK regulation authorities take great pleasure in enforcing regulations elimination of trading obstacles and continued positive attitude towards business' (UK based subsidiary of TNC).

'Although there is a clear need for policy towards the clothing industry...the government has not developed any up till now.' (Key Informants Poland).

Strong private arrangements appear to be made between global buyers (dominating production and trade) and sub-contractors and subsidiaries (seeking to meet quality standard requirements). There is concern over differences in the implementation of EU and national regulations in different countries. Different cultural predispositions emerge in relation to the varying role of government, although respondents from all countries

are concerned over the perceived lack of government support for the clothing industry in terms of funding, education, re-skilling, upgrading and market access, and the perceived lack of priority which governments give to the sector.

Following Gereffi and Mayer (2004), it also appears that there is a tendency for global and supranational institutions and TNCs (particular with locally embedded subsidiaries) to dominate the facilitative, regulatory and compensatory domains in the clothing sector (

'Yes, I mean when they brought in the minimum wage thing, that was, because it was all going to go to the minimum wage but I couldn't just pay the girls the bottom line of the minimum wage, I had to increase it, even into the admin staff. It costs us a lot more than £1 an hour in the loss of earnings; it is a lot of money.'
(Small producer UK).

Table 47, below).

'Significant regulation is mainly on the national level, regional regulation is quite insignificant. While there may be some variations between England and Northern Ireland there won't be such differences but they could be for rules for company registration for example. But even there now with the possibility to register as a 'European company' they can be registered in any EU country.' (Key informants UK).

'Yes, I mean when they brought in the minimum wage thing, that was, because it was all going to go to the minimum wage but I couldn't just pay the girls the bottom line of the minimum wage, I had to increase it, even into the admin staff. It costs us a lot more than £1 an hour in the loss of earnings; it is a lot of money.' (Small producer UK).

Table 47 Governance Arrangements: Function

	Realms of governance	
Modes of governance	Public	Private
Facilitative	Property rights Banking and commercial law Competition policy	Market ideology Professional codes and norms
Regulatory	Labour law Environmental regulation Health and Safety regulations	Voluntary codes of conduct Corporate social responsibility Pressure and consumer boycotts
Compensatory	Social insurance Education/retraining programmes Public health policies	Collective bargaining Philanthropy

National governments

Global institutions

TNCs

SMEs and/or local subsidiaries

Public governmental arrangements appear to dominate the facilitative domain, while private and public arrangements influence the regulatory domain in all sample countries.

Compensatory arrangements are dominated by government regulation alone in new EU member states, but in equal measure by government regulation and private arrangements in the UK and Greece.

'We follow all requirements, but none of these has influenced to delocalize.'
(*Bulgarian company*)

Sectoral quality standards are mostly arranged privately and are dominated by TNCs, whilst the terms of trade are determined by governments but increasingly dominated by global frameworks and regional agreements. International certification also acts as a mechanism for attracting foreign buyers. Trade unions are not perceived to play any major role in governance in any of the sample countries.

'The fact that we have a quality certificate helps us. There are customers who are principally interested in that...' (*Bulgarian company*).

On Social Consequences

Most UK and (to a lesser extent) Greek clothing firms have experienced a fall in employment over the last twenty years. Job numbers initially increased in firms located in the new member states, although they too have since experienced (less marked) downward pressures on employment levels. In all cases, many of the lost jobs have been low skilled.

'The groups that are mostly hit are of two types first: semi-skilled workers, both white and from ethnic minorities, and second low skill mainly factory workers, and

mostly women: these are white working class poor and also black: mainly of Pakistani and Bangladeshi origin.’ (Key Informants UK).

‘It is difficult to make people do something, mainly because the textile sector is perceived as a declining sector, which in fact is not true ... investment should be made in youth to improve their skills in order to change the image of the sector as employing rather elder people with very simple skills.’ (Key informants Poland)

Growing wage demands, negative worker perceptions of employment in the clothing sector, and the availability of alternative forms of employment appear to be making recruitment and retention very difficult in all sample countries. Competition from the service sector and grey economy is also making it difficult to recruit new employees to low-end jobs (Aniello, 2001). These are often filled by people who are less mobile, and who are specifically interested in very flexible working arrangements, as well as by both migrant workers (Husband and Jerrard, 2001).

‘Being the simplest intellectual job, the dominance of the textile sector led to vocational and social marginalisation of women. ... the losers include the economically weakest and least mobile groups, unable to re-skill due to manual, mental and intellectual barriers, i.e. mainly elder people and women... People who lost their work in different sectors go abroad in large quantities in search for a job... However, this refers to the clothing sector only to a little extent. Most workers are women and they are much less mobile.’ (Key informants Poland).

‘A lot of the new jobs in the UK are characterised by low pay, flexible hours, and this also means low skill requirements. There are many migrants who are filling

this sort of vacancies, call centres are a good example. East Europeans are filling many of those vacancies, but my impression is that the big majority of them are not here to stay but only come for 4-5 years in order to gain some experience or save some money, the wages are still significantly higher here, and then they tend to go back to their countries of origin in order to establish themselves there. This however creates strong local tensions particularly in the post-industrial areas and opens space that is exploited by the BNP...’ (Key Informants UK)

‘You need continuity though, especially with our game ... I have got a girl called J.R...she is just a walking talking dictionary of clothing if you like... she enjoys talking to people we deal with, she has worked for the company from day one. She came from another company as a specialist trainee designer there and indispensable basically, you know... With her skills she is very specialised, there aren't many jobs out there for her. On the other hand there aren't many Js that are out there for us... You can't get somebody from an agency to come and do that job, so we do it so that each member of staff can cover for each other whilst on holiday. So there is not an accumulation of work for when they get back.’ (UK company)

Difficulties in recruiting workers to high-end jobs, such as design, sale and marketing are also apparent, leading to a limiting effect on companies’ abilities to upgrade, and necessitating a strong emphasis on internal training initiatives.

The clothing sector has, historically been concentrated in specific geographical regions (such as the English North-West, Northern Greece, the Lodz area of Poland, and South-

West Bulgaria); all been heavily affected by the internationalisation process. The process of restructuring has exercised a profound and often localised effect on these regions (compounded by the fall of communism and EU expansion in the Eastern European case).

7.4 Overview of Findings

The methods deployed here make it difficult to capture the dynamics of the internationalisation process. However, it is probable that FDI and JVs – though developing early in the process of integration (in the early- to mid- 1990s) – were preceded by an initial period of lower commitment strategies, coinciding with early reforms in Eastern Europe. The timing of integration, allied to early engagement in the integration process, would therefore seem to be of particular importance in enabling all European clothing firms to exploit global opportunities.

Market segmentation appears to follow the pattern anticipated in the literature in the case of three sample countries. UK clothing firms concentrate primarily on design and flexible response strategies, the Bulgarian focus is on price sensitive markets and Polish firms are heavily reliant on price competitiveness (whilst moving gradually up-market towards flexible response segments). Estonian firms appear to have moved further in terms of market segment development than Bulgaria or Poland, whereas the Greeks would seem to have been particularly slow in moving on from the price sensitive segment. There is also a clear recognition among Greek, Bulgarian and Estonian enterprises, smaller ventures, and foreign-owned firms of the profound inequality in power endowments between buyers and manufacturers.

Competence Lock-in strategies occur not only in price-sensitive market segments, but also where success is conditional upon flexible response. *Hybrid strategies* are also employed, leveraging competences developed through global networks of production and distribution for domestic market advantage. There is little evidence of *competence break-out strategies* (and none for Eastern Europe). However, the findings do offer insights into the process of transition from one type of strategy (such as *Competence Lock-in*) towards another (*Hybrid*).

Enterprise strategies are linked to successful adjustment, but distinctive strategies do not appear to be appropriate for particular market segments or countries. Successful adjustment appears rather to depend on the fit between strategy, context (market segment and country) and enterprise characteristics. Successful adjustment is reported both by enterprises located in countries that enjoy lower labour costs (such as Bulgaria), but also by firms in the UK and Greece (that do not). A greater incidence of strongly performing enterprises can be identified for post-socialist countries, although there are also some strongly performing enterprises in the UK and Greece - further underlining the distinction between the 'fortunes' of the firm with those of the clothing industry as a whole.

In terms of governance arrangements, a gradual shift in emphasis appears to be taking place from the public to the private realm. This trend may be reinforced by the increasing liberalisation of prevailing trade regimes, especially as (national and regional) governments appear to allocate low priority to assisting with the survival of the industry. Public views regarding the future (or lack of it) of the sector reflect the social consequences of a long-period of clothing sector decline in developed countries. This,

combined with a record of relatively low paid and low skilled jobs, offering limited career progression opportunities, means that the sector is confronted with human capital constraints as it often fails to attract young and dynamic individuals. Rather perversely, it is the history of decline that may reinforce decline in the future.

7.5 Conclusions

The findings provide useful insights into the process of integration of enterprises and regions in the global network of production and distribution. Opportunities can be best exploited by a short period of early engagement, involving low commitment strategies, followed by an era of high commitment strategies, with significant foreign investment and JV creation. These give way later to a period of deepening global integration, when organic integration and expansion, and relationships based upon a combination of power and mutual confidence are crucial.

A gradual shift appears to be occurring from public- to privately-driven forms of governance, reinforcing the importance of such relationships. Powerful agents may maintain strong relationships, providing grounds for doubting the prevailing normative views regarding enterprise strategies. Enterprise survival and growth (even in the long-term) may not be attached to a relentless pursuit of up-grading (to counter a perceived relentless pursuit of cheap labour by buyers). A number of alternatives may be open to enterprises, depending on the specificities of the context and the enterprise. This more open-ended (and less deterministic) view of enterprise strategy may be deployed effectively at the micro-level.

The fortunes of the enterprise may not be linked inextricably with those of its region. Successful enterprises may be based in regions where employment in the industry has been decimated, whilst enterprises may also fail in regions experiencing rapid growth. Existing research maintains a predominantly regional focus, influenced by the greater practicality of researching different firms in one locality, rather than tracking entity across different geographical locations. Research in the latter direction though may provide an alternative (and complementary) approach to the study of global patterns of change in the clothing industry.

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8 DELOCALISATION OF ELECTRONICS INDUSTRY

Rünno Lumiste

8.1 Introduction

Electronics industry is one of most globalized activities in the world (Malecki, 1997). Among the foreign trade commodity groups only raw materials and fuels trade value exceeds the trade of electronics products. Different from raw materials industries the electronics industry employs considerable number of people (Belderbos, Zou 2005; Lall, Koo, Chakravorty 2003). Labour intensity and search for new solutions both by public and private actors cause in the electronics industry substantial delocalisation (Chang, Rosenzweig 1995).

Active delocalisation in electronics industry happens in the form of FDI, outsourcing and foreign trade (Blinder 2006). FDI has effect both for host and home economies. Electronics industry similar to car industry creates several links between TNCs and local firms. Importance of such links was discovered already by Albert Hirschmann in 1960-s and 1970-s. Further research has been concentrating on technology and market spillovers (Blomstöm and Kokko, 1998).

Recognition of importance of such spillovers has caused the increased activity of national governments (Liagouras 2006) and EU (von Tunzelmann 2004). Interest of national governments towards electronics is multidimensional. Higher employment rate, increased earnings and acceleration of learning process are common and traditional goals for national governments. However electronics industry presents bigger challenges for national government than simply increase of employment. Electronics industry products and components play substantial role in national security and provide links

between different knowledge intensive industries. Military electronics is main field of research for the development of defence systems. Electronics industry products play major role in emerging knowledge intensive industries like alternative to fossil fuels energy generation, medical products industry and nanotechnology.

Paradox of electronics industry is that it demands people with various qualifications. For success are needed both highly talented creative people and less qualified assembly workers. This paradox of dual nature of workforce is initiator of changes and innovations in electronics. Countries and firms with lesser knowledge base and with big share of manufacturing try to create “own” engineering capabilities and countries and firms with strong know-how outsource manufacturing activities or try to automatize labour intensive operations (Rogers 2006).

Delocalisation has been interest of several researchers (Labrianidis, Kalantaridis 2004). There has been comprehensive research on different forms of delocalisation like FDI, functioning of TNCs (Caves 1996), outsourcing (Radosevic 2003), social consequences of delocalisation to the regions and government policies of facing delocalisation. There is also substantial research on relocations in East Asia and in North American Free Trade Area (NAFTA) (Belderbos, Zou 2005; Hennart et al 1998; Mata and Portugal 2000).

There has been less research of delocalisation of electronics industry in Europe and especially in enlarged EU. In 2004 Enlargement of EU created totally new situation for electronics industry. Global technological development and reduction of trade barriers have made developments in electronics so rapid that those changes could be considered ahead of current state of art in scientific literature. Sign of such gap between real life and

research is use of different surveys and even periodicals as source of references what is relatively uncommon in articles dating back to decade and more (Belderbos, Zou 2005; Radosevic 2003).

Economic position of electronics industry

Supply chain(s) of electronics industry

Two basic functions of electronics devices are the controlling and processing of data and conversion and distribution of electric power. Generation and distribution of electrical power is relatively stable field compared to data processing. Electronics products markets and production process are international by their nature. Big integrated electronics producers are giving for industry global nature by producing of goods and marketing of them globally (Hewitt-Dundas *et.al* 2005).

Electronics industry supply chains present constant changes and responses to the technological and economic challenges. Supply chains of electronics industry are changing all time. Even for the same type of product there could be and often are supply chains with different configuration. Particular design of supply chain depends on products nature, geographical location and time period.

Consumer electronics supply chain is still consisting big integrated firms who produce almost entire product with exception of some key components. Based on intellectual capabilities/ patent portfolio, financial capabilities, business strategy and the availability of technologies consumer electronics firms build the products from own or sourced components.

Generalized scheme of supply chain of consumer electronics products is presented on the Figure 34. Principal actors of supply chain are product developing firms, component producers and assembly firms. Main manufacturing chain is supported by parallel chain of service firms. Due to strengthening environment protection substantial part of supply chain is recycling of used electronics products. Knowledge intensive parts of supply chain could be considered fabrication of production equipment, component production, design and testing of products.

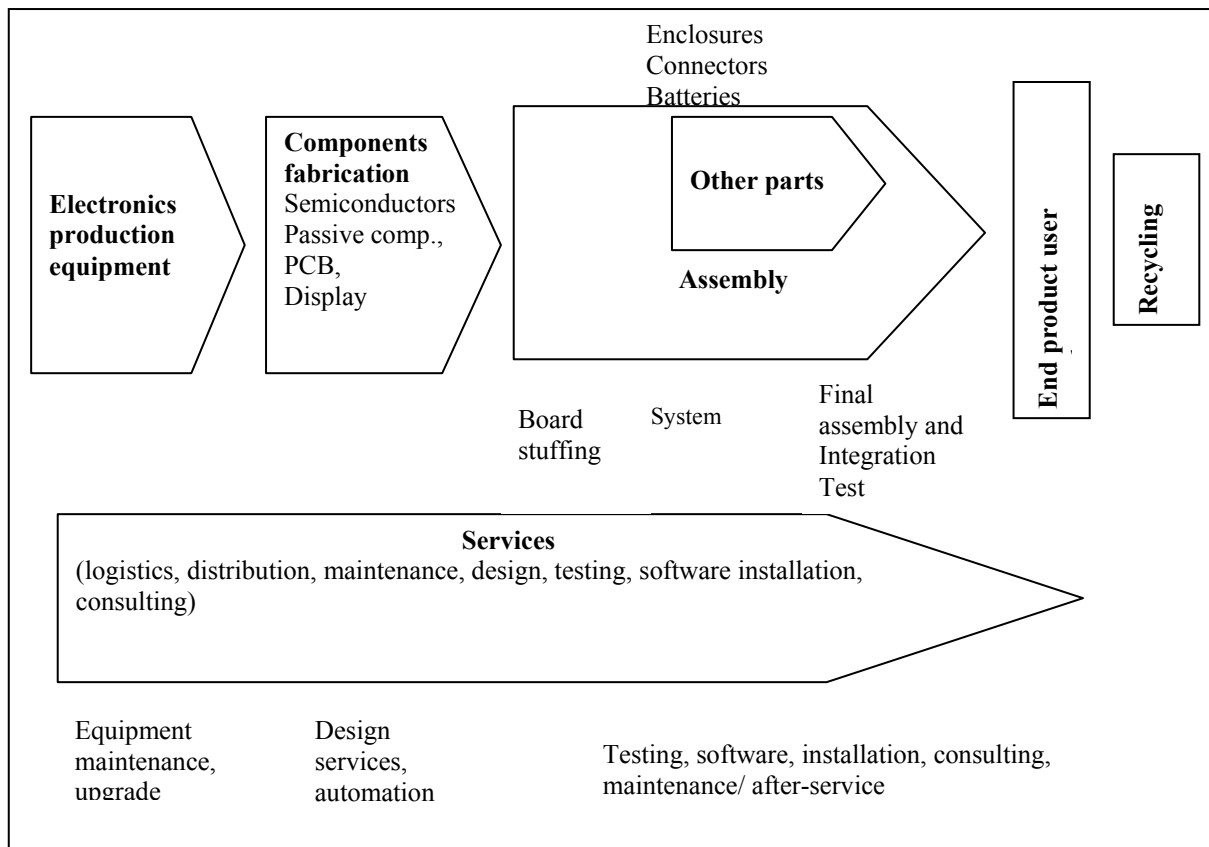


Figure 34 Supply chain in electronics industry in 2004

Source: Booz Allen Hamilton and IFC 2004. Modified by author.

Supply chains in telecommunication present different example from consumer products. Supply chains in wireless communication could be considered as most dynamic and setting the example for whole electronics world in 2006. Strong telecommunication boom in 1990-s forced the OEM (Original Equipment Manufacturer) firms to use subcontractors for extra capacity. During this period EMS (Electronics Manufacturing Service) firms learned the sourcing and assembly operations and built up the production capacity. New EMS firms had very different backgrounds. Some of them were the daughters of integrated firms (Lohja – Elcoteq, IBM-Celestica), some developed from start-ups (Solectron) and some were electronics firms, who specialized on offering manufacturing services. Big changes in telecommunications supply chain happened with the burst of IT bubble in 2001-2002. OEM firms were forced to lean up their personnel and to relocate their production. EMS firms who had built up substantial production capacity had to specialize, optimize the production capacity and also to relocate their production in cheaper labour countries. Beginning of new century has been followed by the extension of services offered by contracting firms. Contract manufacturers have added product design services into their portfolio (Figure 35). New type of firms are called ODM - (Original Design Manufactures). From telecommunication markets are ODM firms now pushing to medical instruments, industrial electronics markets and other sectors (Electronics supply and manufacturing 2004).

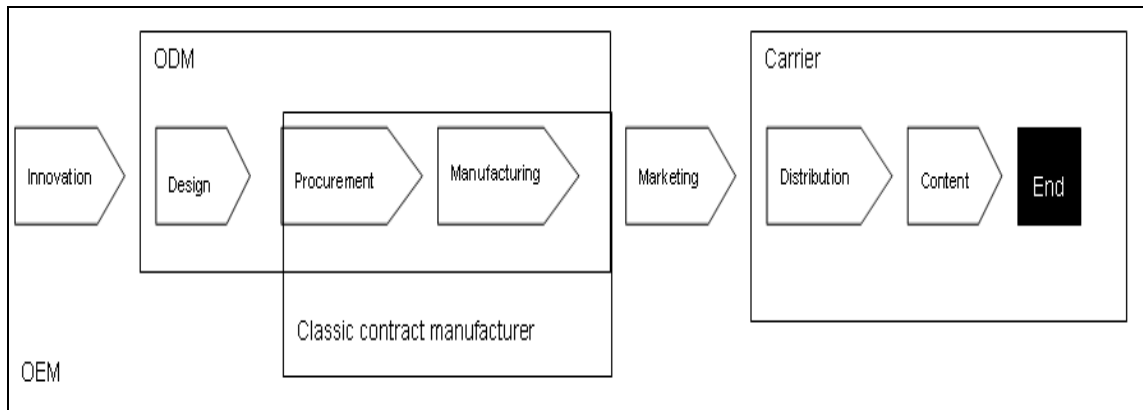


Figure 35 Value chain in telecommunication industry 2005

Source: Infineon annual report 2005

Factor influencing the supply chains in electronics industry is that several firms use shared technology platforms between different products. They use similar components and technologies for different products. For example there is substantial technological closeness between computer monitor made by LCD (liquefied crystal display) technology and LCD TV set. Companies strong in LCD technology use it in several applications (TV-s, monitors, vide cameras, mobile phones).

Electronics firms are also participating in supply chain of other industries like automotive, medical and military. Sometimes they are parts of integrated and sometimes independent entities. Concentration in car manufacturing, aerospace and military industries has lead towards the reduction of suppliers. Growing medical and healthcare sector has benefited new entrants into medical electronics.

Choice of location for different activities depends basically from supply and demand side factors. Among the supply factors are prices like general labour cost, availability and cost of specific labour like engineering graduates, materials cost, transport cost,

environmental cost and land cost. Choice of location is influenced also by closeness to technology creation regions, technology factors like software and hardware interaction and legal issues like local legislation and standards. Own role is played by company specific factors like knowing particular market or favourable political relations between countries.

Demand factors are consumers with the number of population and purchasing power and technology preferences. Industrial electronics site location is determined by the location of related industries like automobile, medical equipment and avionics.

During the last decade (1995-2005) favourable cost conditions for manufacturing have created new factories in China, Brazil, Mexico and Eastern Europe. Among the fast growth consumer markets are China, Mexico, Russia and Brazil. Traditionally biggest electronics products consumer has been US and consumer with most sophisticated demand Japan.

With technical innovations is possible to reduce the size characteristics. Decreasing size of products has reduced the share of transport cost and allows the using of suppliers from far locations. Decreasing transport costs allow also the scale intensive production and concentration of industrial activities. In the period of 1980-2000 revenues per ton mile decreased for air freight 30 per cent and for railway more than 50 per cent (Economist 2004).

Global sourcing of components has initiated the consolidation of electronics distribution and logistics firm consolidation. Enterprises like Ingram Micro and Arrow Electronics are presented in most of the countries and able to deliver big number of components and offer services. Changes in supply chain cause concentration of retail outlets for matured

products like home electronics. For example US biggest retailer Wal-Mart is also number one consumer electronics retailer (Forbes 2004). With the expansion of supermarkets the competition between specialized home electronics stores and general supermarkets is expected to increase.

European electronics industry by geography

By geographical distinction used by industry experts Europe could be divided into three regions: Western Europe (EU-15, EFTA and among it UK, Ireland, France, Germany, Italy, Netherlands, Spain, Switzerland, Nordic Countries), Central Europe (first wave new members of EU or 2004 accession members: Poland, Hungary, Czech Republic, Slovenia, Baltic States) and Eastern Europe (Bulgaria, Romania, Ukraine, Russia) (Carbone 2006). Every region has been specializing to certain parts of value chain and activities. Relative share of employment in electronics industry in EU in 2003 is in Figure 36.

In Western and Northern-Europe are located major headquarters of European TNCs, research centres, design firms and several component and materials suppliers both European and non-European origin. There is also substantial but declining manufacturing base. Manufacturing units in Western Europe remain as producers of top models of products and components (Philips big LCD panels, new semiconductors, medical electronics products, defence electronics products), transform into logistics and service centres or cease to exist. In Western Europe are located firms using substantial volume of electronics like car factories and aircraft producers. Biggest electronics manufacturers are Germany and France. Switzerland occupies niche of top

semiconductors. UK is location for several design firms and basic research institutions.

In Spain and Ireland are mostly located the factories of non-European electronics firms.

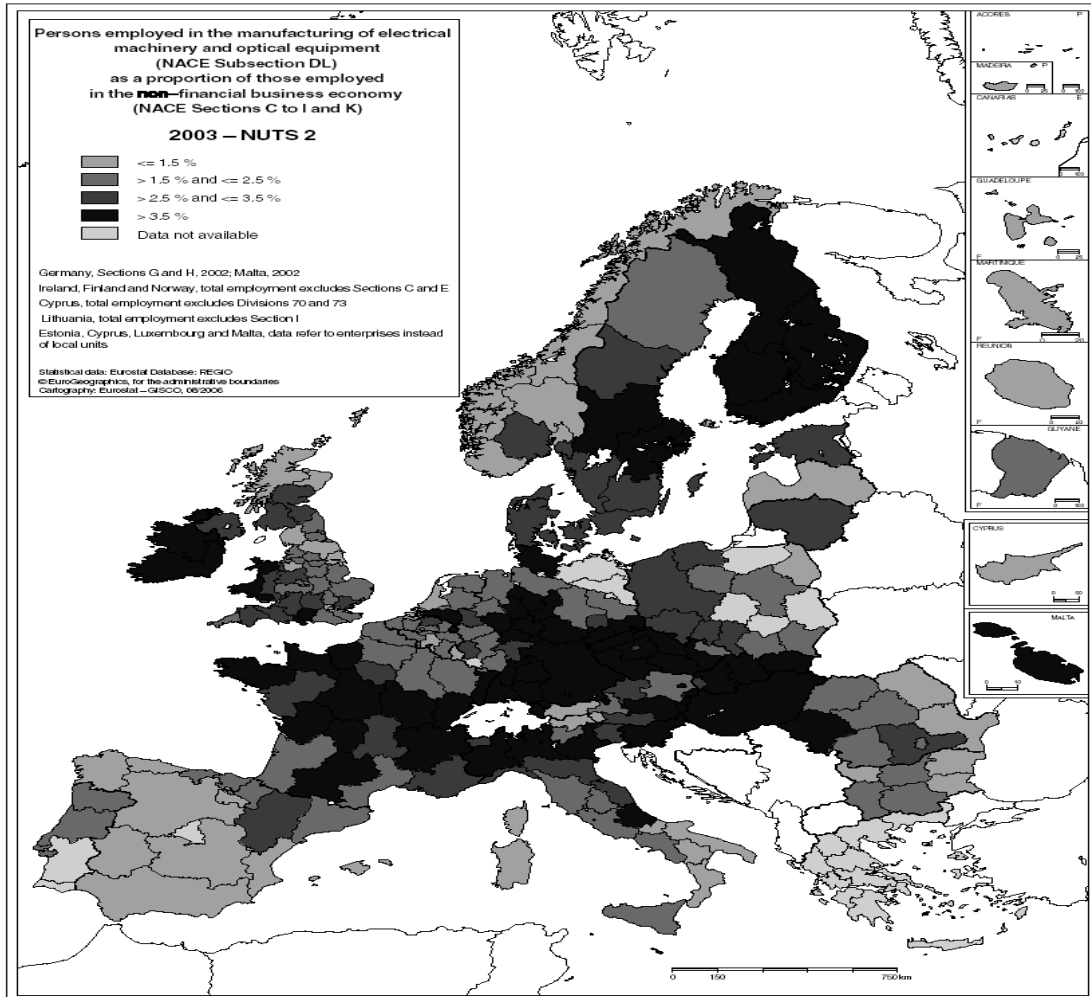


Figure 36 Persons employed in electronics industry

Source: European Enterprise Survey 2006

Enterprise survey (MOVE) conducted in 5 European countries⁵⁸ and 190 electronics firms showed also different functions in supply chain, change of role in supply chain and

⁵⁸ UK, Greece, Poland, Bulgaria and Estonia

different background and history of firms. UK is birthplace of several electronics industry great inventions, products and technologies. However active delocalisation of firms and operations has caused substantial decrease in the physical production numbers. Both local and international electronics companies don't see UK anymore as location for the manufacturing of labour intensive mass-products. UK firms role is product development and design. Different from SME firms in Eastern Europe and other emerging locations several British SME-s have proprietary knowledge: patents and famous trademarks. Patent portfolio and intellectual property management assure that inventors have also in future resources for research and product development. Different picture of electronics industry development path is presented by Greece. Greece with relatively small traditions in electronics has main function in servicing other economics sectors like telecommunication, medicine and maritime. Single entrepreneur-engineers firms constitute the second layer of enterprises supplying to big firms and public institutions. Relatively big share of electronics firms in Western Europe are suppliers for military contractors like Thales, BAE Systems and Finmeccanica (MOVE Survey).

Electronics industry in Eastern and Central Europe faced tough transition period from the end of 1980-s. Enterprises faced the decision to re-profile their activities or cease to exist. This period was particularly difficult for firms producing out-dated final products (MOVE Survey). Growth of electronics industry started form the offering of manufacturing services mainly for the Western-European firms (Radosevic 2003).

Central Europe presents now as a region of manufacturing units with some design capabilities. In Central Europe are located major international contract manufacturers (EMS), European OEM firms and local suppliers. Major engineering and design

operations are committed in foreign owned firms. Contacts of Central European firms are based of logistical proximity and trade ties. For Example Polish firms tend to communicate more with German firms and firms from Baltic States with Finnish and Swedish firms. For example due to transport cost, previous traditions and availability of labour force Poland has specialized as mass consumer electronics producer, Estonia as small batch industrial electronics and telecommunication producer and Hungary as car electronics and telecommunication producer with growing electronics industry services sector (MOVE Survey).

Eastern Europe presents as a new opportunity for the next wave of electronics industry locating. In Eastern Europe are located similar types of contract manufacturers and firms that missed first wave of relocation from Western Europe to Central Europe. Russia, Romania and Ukraine have substantially big internal markets and growing purchasing power and need for customization could be motivation for transfer of manufacturing operations to them. Taking into consideration the lower level of labour cost and similar level of qualifications there could be substantial relocating of manufacturing operations from Central to Eastern Europe in the period between 2007 and 2015.

8.2 Forms of delocalisation

Trade of electronics goods

Trade of electronics products between countries and trade blocks is influenced by duty rates. Highest duty rates for import of electronics products are in China and India (between 30-15 per cent for different products and lowest duty rates are in Japan and USA (between 0-5 per cent). General trend is lowering of tariffs via WTO Information

Technology (IT) Agreement (Borrus, Cohen 1997). Tariffs for electronics imports have two dimensions: geographical and technological. Inside the trading blocks countries have lower or zero duty rates and for outsiders are higher rates. EU has low rates for electronics goods for free trade agreement neighbour countries Turkey, Switzerland, Norway and Ukraine. United States have lower rates for Brazil, Israel and NAFTA partners: Mexico and Canada. ASEAN countries have low duty rates between themselves (Fukase, Martin, 2001).

Another dimension of electronics trade is different duty level for components and final products. In 2006 EU taxed TV sets and DVD players at the rate of 14 per cent and main components at the 4,9 per cent rate (European Commission Tariffs). Different rates for components and finalized products act as an incentives for establishing local assembly units (Borrus, Cohen 1997).

Trade of computers and their parts have has grown almost tenfold during last 15 years. Fastest period of growth was in the beginning of 1990-s with computerization and adoption of personal computers by wide group of users. Earlier leader of computer trades was USA but relocation of factories into East-Asia and growth of indigenous Asian producers has shifted main focus of trade to Asia. Developed countries rely on the imports from developing East-Asian countries.

Main product groups and volume of trade are in Table 48. Traditionally EU has been stronger and with positive trade balance in optical goods and medical instruments. Weaker has been EU in the trade of data processing goods like computers and peripherals.

Table 48 Volume of world trade of electronics products⁵⁹ (In billion dollars)

	1990	1995	2000	2005
<i>Data processing goods</i>				
Export	27,5	123,4	198,8	259,3
Import	29,8	137,5	218,4	272,4
<i>Electrical equipment, electrical components, electronics components, telecommunication, car electronics</i>				
Export	162,6	631,6	983,6	1338
Import	125,2	610,3	992,9	1365
<i>Trade of optical, photographic, measuring and medical instruments (In billion dollars)</i>				
Export	39,9	133,9	194,2	320
Import	35	131,6	191,9	316

Source: United Nations Comtrade Database

Mergers and acquisitions

Delocalisation in electronics industry has different forms and often firms in different geographical locations are involved. Motivations for delocalisation can be divided into marketing, economical and technological. Main forms of delocalisation are creation of joint ventures, selling shares to foreign investors, buying foreign firms, outsourcing different activities and taking subcontracting from other firm. Mainly for marketing reasons in developed markets have Chinese, Taiwanese firms acquired entities and rights to use well-known brand names in Europe and United States. In 2005 Taiwan based BenQ acquired Siemens AG's Mobile Phone business and rights to use certain period Siemens trademark for mobile phones. Similar deals have been conducted between Lenovo (China) with IBM (US) and TCL (China) with Alcatel and Thompson (both France).

Motivation behind the creation of joint ventures could be the adjustment of supply and technological partnership. Adjustment of supply of LCD panels was motivation for the

⁵⁹ Different figures are caused by excluding re-export and re-import

creation of joint venture between Sony and Samsung in Tangjung in South Korea. Motivation to develop and launch at rapid speed new product is behind the technological partnership contracts. New products use number of different technologies and for quick launching of products is optimal way to match with the companies whose core competence lies in needed technologies.

Becoming subsidiary is option for firms in consolidating industries like computer manufacturing, telecommunication equipment and electronics component logistics. Last big British origin electronics firm Marconi-GEC was after the loss of competition for modernizing UK telecommunication infrastructure (21st Century Network) forced to sell its shares to Ericsson. Major acquisition and mergers in electronics have been related to consolidation of industries like Hewlett-Packard with Compaq in computer sector and Alcatel with Lucent in telecommunication equipment sector.

Having foreign shareholders is also common practice in electronics sector. Major electronics firms in Europe and USA are listed companies with big number of shareholders among whom financial institutions play major role. Asian firms have more consolidated ownership structure and family holdings in case of Japan, Korea and Taiwan. Government participation is common in China (PRC).

Subcontracting is process of using other firms in contract bases in its own supply chain. Short delivery time and need for capital drive firms towards the using of different subcontractors. With the time several shorter term partnerships have developed into longer term outsourcing process. Outsourcing is delegation of operations that are considered as non-core for firms.

Outsourcing of manufacturing activities has created whole new industries like contract manufacturing, third party logistics (3PL) and semiconductor manufacturing. In first case bigger electronics firms have outsourced part of manufacturing activities and in the second case logistics and sourcing activities. Semiconductor production have been split into firms committing design and sales activities called fabless⁶⁰ firms and semiconductor foundries called fabs⁶¹ whose main task is production. Most of contract manufacturing firms have close ties with one to three major customers (MOVE project interviews).

8.3 Factors affecting delocalisation

Production cost and markets

Initial reason for transfer of operation from one country to another was price difference for labour. Taiwan, Singapore and Korea were good locations for relocation of US and Japanese manufacturing firms in the 1980-s and 1990-s. Price differences are still one major reason for relocating of manufacturing operations but not the only one.

Salaries in mainland China are very low compared to developed countries. According to statistics in Shenzhen (near Hong-Kong) minimum wage is \$72.50 per month. In addition workers receive housing in dormitory and food from company. At the same time farmers in central and western provinces earn on average \$400 per year or less, while workers in large urban areas like Beijing and Shanghai typically make four times as much, according to PRC government statistics. According to labour relation observers and

⁶⁰ Semiconductor design and sales firms that does not own manufacturing unit

⁶¹ Semiconductor manufacturer without design unit

journalists real salaries are sometimes lower than announced and deduction around \$30 is made from \$75-100 salary. Employees at the factory typically work 11 hours a day, six days a week, and rack up to 70 hours of overtime a month (McLaughlin 2006).

Salaries are part of general cost structure. In addition to labour cost there are other factors that substantially increase the price of bringing the product into market. Operating in different time zones, compressed time frames, visa requirements and higher transport cost are factors limiting the contracting into distant regions. Outsourcing has become more and more process driven by strategic opportunities (ESCA 2005).

Time to market, asset reduction and specialization are becoming more and more important for outsourcers firms. Survey conducted among European firms (MOVE survey) showed that among the major reason for getting orders by firms were felt expertise, reliability and appropriate technology.

Outsourcing has not only helped to save the production cost of international enterprises. It has also offered job, helping people to start new lives in urban environment and in general lifted living standards. In Eastern and Central Europe outsourcing has created new industrial goods markets and in East Asia new consumer markets. Outsource providing enterprises that in the beginning delivered only into markets in developed countries have started also to sell products in domestic markets like China and East Asia. Mass manufacturing has driven prices down and consumers in China, India and rest of the markets previously considered as undeveloped are able to buy mobile phones and TV-sets. Governments in Asia are trying to improve infrastructure and therefore coming important customers for telecommunication and other infrastructure related electronics products. Importance of Asian markets is estimated to grow further (see Table 49).

Table 49 Total electronics, World market share by region (consumption), % in value

	World % 2005	World % 2010	Billion EUR		Growth (1)	Difference between production and consumption (2005)
			2005	2010		
Total world	100.0	100.0	1070	1 428	6.0%	
Europe	27%	25%	292	358	4.2%	-66
North America	31%	28%	329	404	4.2%	-93
Japan	11%	10%	117	136	3.1%	49
China	10%	12%	106	176	10.7%	136
Other Asia-Pacific	11%	13%	117	187	9.8%	39
Rest of the World	10%	12%	109	167	8.9%	-66

(1) Compound annual growth rate

Source: Decision Consulting – June 2005

Market factors and government policies are giving push to manufacturing. Fastest market growth is happening in East Asia and Pacific region. It is expected in few years that China becomes major manufacturing region for electronics production (see Table 50).

Table 50 Total electronics, World production by region, % in value

	World % 2005	2010	Billion EUR		Growth (1)
			2005	2010	
Total world	100.0	100.0	1069	1428	5.0%
Europe	21%	19%	226	272	3.8%
North America	22%	20%	236	284	3.7%
Japan	16%	14%	166	193	3.0%
China	23%	28%	242	394	10.3%
Other Asia-Pacific	15%	15%	156	219	7.0%
Rest of the World	4%	5%	43	65	8.8%

(1) Compound annual growth rate

Source: Decision Consulting – June 2005

Technology and education

Most important single factor determining the drop of electronics products prices is technology development. Among the factors determining the technology development could be mentioned favourable environment with financial, technological and support institutions and workforce with appropriate knowledge skills and attitudes (Radosevic 2003).

Electronics industry localisation choice is dependent of technology factors like closeness to technology creation centres. Several countries have tried to copy Silicon Valley model where technological knowledge is combined by entrepreneurship and venture capital financing. Different countries have tried to copy that model but the level of success has not been equal in Japan or EU.

Probably the most important factor determining the volume of introduction of new products is high-technology entrepreneurial culture (Rogers, 2005). Very often in Europe is attitude that the main supporter of new product introduction should be public sector with public funding. Mainstream financial institutions are also hesitant to finance new spin-offs. As a curious case from 2005 should be mentioned that US venture capital fund was behind the success of such innovation like Skype that was initially developed by Swedes and Estonians (Interviews of MOVE project).

The first and most visible policy from promoting electronics and software industries in emerging economies is preparing of engineers and scientists. Educating of engineers in most of the technology areas requires substantial investments from universities and personal efforts from students. The number and quality of engineers are the concern of

governments in highly developed and emerging economies (See Table 51). The US and UK have used simplified visa requirements for programmers, engineers and other highly qualified workers. 80 per cent of Asia born foreign students (around 650000) are studying in the US and Europe (UNESCO 2004). Two thirds of them remain in the USA.

Table 51 Number of university graduates and science & engineering graduates

	University graduates (million)	Science & engineering graduates 2003 (thousands)
India	3.1 (2003), 6 million (2010)	316
China	2,8 (2004), 3,5 (2005)	337
Russia		216
EU-15	2.0	290 (2001)
Japan	1.1 (2001)	250 (2001)
US	2.2 (2001)	380 (2001)

Source: Eurostat 2005.

Countries like India and China are facing definitely quality problems during the expansion of university system. By estimation in India only 25 per cent of engineering graduates and 10-15 per cent of other university graduates are suitable for work in the IT sector. In China only 1 out of 10 graduates is suitable for work at a multinational firm (Deutsche Bank Research 2005). Despite to that it is only matter of time when quantity changes into quality. Old civilization traditions and talented diasporas are big aid for that. Rising number of graduates gives new opportunities for several social groups of young people.

Patenting and maintaining intellectual property in general is vital part in electronics business. As stated by Fujitsu Inc. (Annual Report 2004) patents are essential for differentiating form partners, assuring strength in alliances and getting revenue from licenses. Patent portfolio management is part of annual reports technology section.

Table 52 Biggest patent recipients in United States

	1997		2005
IBM	1747	IBM	2941
Canon	1499	Canon	1828
NEC	1144	Hewlett-Packard	1797
Motorola	1192	Matsushita Electric	1688
Fujitsu	925	Samsung Electronics	1641
Hitachi	1152	Micron Technology	1561
Mitsubishi Denki K.K.	918	Intel	1549
Toshiba	962	Hitachi	1271
Sony	964	Toshiba	1258
Eastman Kodak	799	Fujitsu	1154

Source: US Patent and Trademark Office

Patenting in United States Patents and Trademark Office is used as commonly recognized technology creation indicator. Patenting patterns have been very stable between the firms and continents. 5-7 Japanese firms, 3-4 US firms, Samsung Electronics from Korea are biggest patentees (Table 52).

Patenting is not only the big firm issue. Survey (MOVE) among the 34 Greece and UK electronics SME-s firms showed that 5 firms with European patents had considerably higher turnover per employee. Invention and patenting of invention can assure for firm long term competitiveness.

8.4 Social consequences

Outsourcing influences almost every actor in supply chain. Most affected have been manufacturing workers in developed countries. Blue collar workers in developed countries who have enjoyed relative work security and high level living standard are facing problems. Loss of job security is risk not only for blue collar workers. Efforts to graduate more engineers in China and India have given results and caused the transfer of engineering jobs to offshore.

Off-shoring doesn't hurt all labour groups equally. Less are influenced by off-shoring service people like people in installing, maintenance and fit. Decline in workplaces and leaving of firms has negative social impact to regions. People have to retrain and sometimes also to relocate. Especially are hurt people in distant regions like in Wales, Scotland, rural Finland and other locations where alternative employment opportunities are narrow (MOVE project Interviews). Decline in rural industries could lead to further urbanization and concentration of people. It is hard to believe that simpler manufacturing could stay in high cost regions.

Outsourcing of all or part of manufacturing operations is common practice for most of electronics firms since 2000. Hard competition has pressed OEM firms to use design capabilities of manufacturing service firms. In the period 2002-2005 R&D budgets of most electronics TNCs decreased. This decline of research budgets forced the OEM firms look for outside development capabilities. Same time manufacturing service firms established design bureaus and hired hardware and software development engineers. Often the new designers and researchers are situated in emerging economies like India, Taiwan, Russia, China and Ukraine. ODM firms are more actively using engineers in emerging countries than OEM firms (Interviews of MOVE project). Process of innovation outsourcing has caused conflicts between brand owners and manufacturing service firms (BusinessWeek 2005). Managing the intellectual property comes more and more important also for EMS firms.

Unemployment level in Europe and wish to new create modern manufacturing workplaces have put multinational electronics firms into more favourable negotiation position vis-à-vis to national and regional governments. Countries and regions trying to

attract foreign investment offer for investor different type of financial and non-financial aid. It should be mentioned as curiosity that some firms receiving financial aid in Central Europe got same type aid approximately decade ago in locations like Wales and Scotland. As high public interest case should be mentioned LG Philips Display who got £220 million aid for the creation of jobs in Newport, Wales and closed factory in 2003 (Interviews within MOVE project). In 2006 company with similar ownership applied for aid of 206 million EUR in Poland and got approval from European Commission (European Commission 2006). Similarly in February 2007 Finnish Government is speaking about asking back research money granted to Finnish origin EMS firm Elcoteq (Evertiq 2007) who in January 2007 decided to leave Finnish manufacturing operations. Big number of jobs created by manufacturing service firms in EU 2004 and EU 2007 member states are relatively simple consisting several manual assembly operations and therefore lowly paid. Another indicator is that international companies in Poland like LG or Jabil or Thomson have high seasonality of TV set manufacturing with appropriate labour contracts – in some companies only 1/3 are permanent contracts whereas the remaining 2/3 are temporary workers or employment agency workers (MOVE project). Government support money raises several questions. If companies relocated relatively easily their activities from Western Europe to Central Europe why not move further when there are business grants. Ukrainian and Turkish governments are eager to develop national economies and willing to negotiate with foreign investors.

Electronics industry is strongly influenced by environmental regulations and laws. This is caused by the fact that several production processes in electronics are hazardous for environment, electronics products use parts from toxic materials and recycling of

electronics products is complicated and costly. Life cycles of electronics products are getting shorter and shorter and consumers create substantial waste. Big driver towards more sustainable production and consumption of electronics is public opinion. Buying of energy saving home appliances and collection of used batteries/accumulators are examples of such behaviour.

Recycling of electronics products is technologically complicated and labour intensive procedure. UN Environmental Programme has warned about the dumping of e-waste in poor African countries (BBC 2006). India and China are affected equally by the problem of electronics waste. It could be also expected that environment conscious consumers and international organizations put more pressure on China to cope with environmental problems.

8.5 Results of empirical survey in electronics industry

Two aspects related to the delocalisation present to us particular interest: enterprise structure with localization and knowledge creation within enterprise (knowledge management).

The empirical research for this Chapter was conducted in the period between November 2005 and May 2006 by five universities in Greece, UK, Poland, Bulgaria and Estonia. Quantitative survey was conducted among 189 firms in the same 5 countries. In addition to quantitative survey with all enterprises were made in-depth qualitative interviews. The respondents represented most of major segments of electronics industry.

Field of activities

Respondents to the survey represented wide aspects of electronics supply chain including: component manufacturers (printed circuit boards, transformers, cable, diodes, sensors, plastic parts), electronics contract manufacturers (EMS, vertically and horizontally integrated firms), contract manufacturers with good design capabilities (ODM type firms), subassembly and system original equipment manufacturers (OEM) and service firms (logistics, sales, maintenance) (see Figure 37).

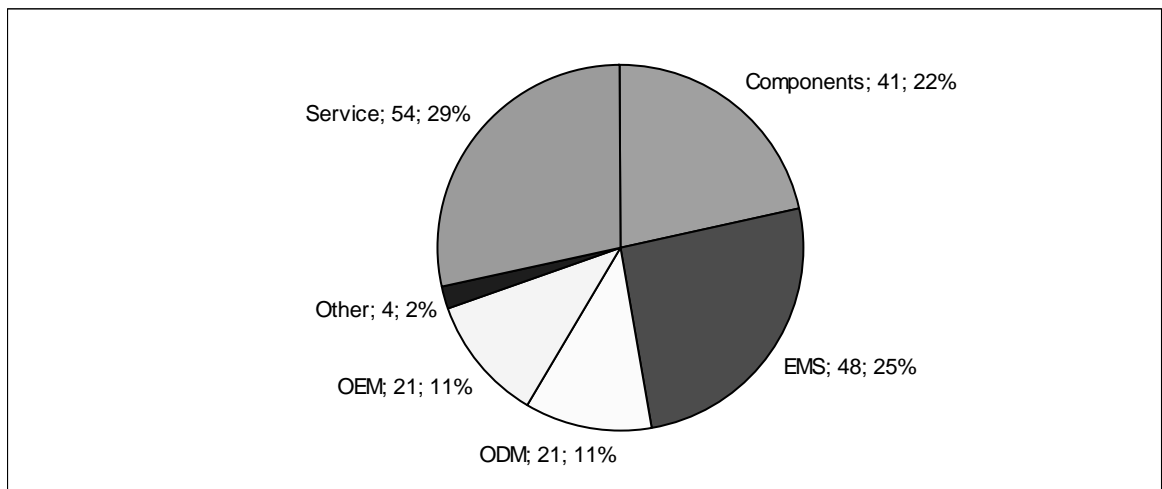


Figure 37 Respondents by the position in supply chain (number, percentage)

Source: Enterprise Survey

Among the survey firms 23 UK firms were mainly from North East England. 24 Polish firms were located in major urban centres mainly in Southern Poland (Wroclaw, Krakow), Northern Poland and Warszawa area. Several Polish firms were located in special economic zones near major industrial centres. 21 firms from Greece situated in Athens and Thessaloniki. 44 firms from Bulgaria were mainly located in major industrial

centres. 77 Estonian firms had higher concentration of firms around national capital: Tallinn.

Core competence

Electronics industry is driving towards shared competency model where certain firms concentrate on knowledge creation and certain firms on efficient manufacturing. Use of shared competency model can be caused both by decision of entrepreneur or by order from corporate headquarter. Shared competency model creates clear distinction between different firms in supply chain. 78 per cent firms took subcontracting from abroad and 50 per cent of firms contracted certain activities to foreign firms (Table 53). Companies evaluated their core competencies before delocalisation process and after.

Table 53 Competitive advantages considered by firms % before/ after delocalisation

	UK	Greece	Bulgaria	Poland	Estonia	Total
Manufacturing of skill intensive products	69,6/ 56,5	36,5/ 45,0	79,5/ 90,9	43,5/ 69,6	50,0/ 59,2	58,2/ 66,1
Labour intensive products	57,1/ 13,0	36,4/ 30,0	52,3/ 36,4	65,2/ 73,9	60,5/ 51,3	57,1/ 43,5
Design and product development	56,5/ 87,0	36,4/ 60,0	31,8/ 38,6	26,1/ 47,8	18,4/ 26,3	28,8/
R&D activities	52,2/ 65,2	45,5/ 55,0	36,4/ 38,6	17,4/ 13,0	11,8/ 14,5	26,0/ 30,6
Inputs supply	0/ 4,3	0/ 15,0	9,1/ 6,8	8,7/ 21,7	50,0/ 48,7	24,9/
Capital intensive products	13,0/ 8,7	9,1/ 5,0	27,3/ 38,6	13,0/ 26,1	11,8/ 17,1	15,8/ 21,0
Distribution and marketing	8`	0/ 5,0	6,9/ 6,9	13,0/ 26,1	19,7/ 23,7	13,0/ 19,9
Other activities	4,3/ 17,4	0/ 0	2,3/ 4,5	4,3/ 8,7	3,9/ 2,6	3,4/ 5,4

Source: Enterprise survey

Enterprise self evaluations show growth of knowledge intensity and more sophisticated production both in Western European and Central European countries. Especially strong is growth of knowledge related activities in UK sample firms. Period of 2001-2006 was

period of active leaving of mass production electronics from UK. In this period substantially reduced UK production capacity several consumer electronics producers like Sony, Celestica and LG Philips. Delocalisation in UK is symptomatic not only for big enterprises but also for SME-s and single entrepreneurs. Delocalisation of medium sized firms happens quite often in the form of outsourcing of less profitable activities. Activities that remain are considered to be competitive. However enterprise answers should be assessed carefully. In some cases undoubtedly world class British engineering firms with international patents did not consider development their core strength and same time more technologically modest Central European firms considered themselves strong in product development and design. Second paradox comes from the factor that competitiveness as such could be relative towards for example of other firms in same region or absolute on the world level.

Most of the firms declared that workforce is the basis of their major strength. Among the sample 48 firms had more than half of their workforce with tertiary education. 131 firms had less than 50 per cent of their workforce with tertiary education. Biggest employers of highly educated people were small service and OEM firms. In UK increased proportionally the employment of educated people mainly service oriented and high-tech components firms electronics firms. In general companies with design activities and service orientation tended to increase the recruitment of educated people both in absolute numbers and proportionally to total workforce.

Company strategy

Company strategy is showing how company sees its current situation and plans future. Michael E. Porter determines three main business strategies as segmentation strategy to business niche, cost leadership strategy and differentiation (Porter, 1985). Due to factors like trade barriers, new legislation or tough competition enterprises could have different acute problems. At certain time period business strategy could cover aspects like sales, technology, environmental management and problems with the coping with labour cost. Business strategy is depending on several factors like perception of market and development of both distribution and supplier networks. Strategy is also determined by status, position in supply chain, availability of different resources and several factors. In general strategy planning is joint task of owners and top management. Role of middle management and unit leaders is performing according to planned strategy.

On the basis of in-depth interviews we determined that position in supply chain and market orientations are main parameters determining business strategy (see Table 54) Entrepreneurs had more holistic view to enterprise and market than managers.

Main goals of enterprises during the delocalisation process were creation and introduction of new products and extension of product lines. For the Estonian and Bulgarian firms main goals were related to the modernization of manufacturing. For UK and Polish firms extension of product line was main goal (See Figure 38). For component manufacturers and EMS firms extension of product line and services was primary goal. OEM and service firms main goals were linked to the introduction of novelties and strengthening of trademarks (See Figure 39).

Table 54 Main strategies of electronics firms based on ownership and position in supply chain

	Local origin and locally oriented	Internationally owned and globally oriented
OEM	Creation of niche products for local consumers (often corporate consumers)	Creation of top products for global consumers. In general have strong brand and patent portfolio.
ODM	Mixed strategy. Sometimes trying to create “own products” but same time having strong manufacturing skills	Offering both design and manufacturing services for international firms.
Service	Satisfying local customer needs. At the same time trying to extend service network to neighbouring regions.	Serving particular area reserved by mother firm. Changes in activities are possible in the case of changed corporate policy.
Component	Supplying for local firms and firms in neighbouring countries. Smallest of them could be called “one controller” companies.	Supplying for global OEM-s. Very often have deep knowledge about component produced.
EMS	Serving local customers	Serving international customers in the same way in different geographical destinations.

Source: Enterprise interviews

Main goals of enterprises during the delocalisation process were creation/ introduction of new products and extension of product lines. For the Estonian and Bulgarian firms main goals were related to the modernization of manufacturing. For UK and Polish firms extension of product line was main goal (See Figure 38). For component manufacturers and EMS firms extension of product line and services was primary goal. OEM and service firms main goals were linked to the introduction of novelties and strengthening of trademarks (See Figure 39)

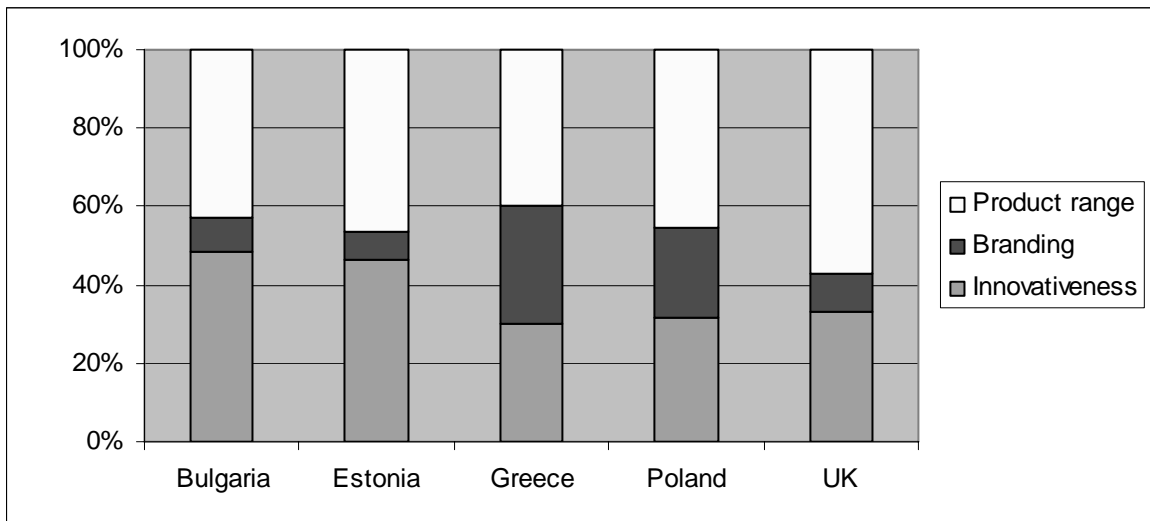


Figure 38 Goals during the last 5 years

Source: Enterprise Survey

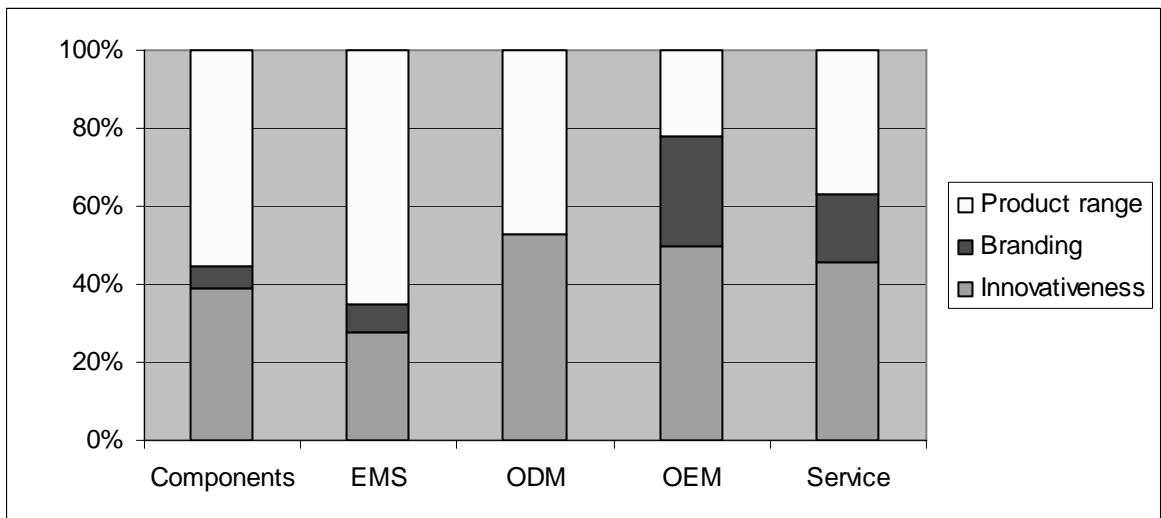


Figure 39 Goals during the last 5 years

Source: Enterprise Survey

Future strategy of Estonian and Polish firms in our sample was relatively similar toward high quality manufacturing. Greek -and UK firms strategy direction is relatively more towards design and quality oriented than in other countries in enterprise survey. Relative absence of cost strategies among the Bulgarian electronics firms could be caused by the fact that cost level of Bulgarian firms is still lower than in other countries (see Figure 40 and Figure 41).

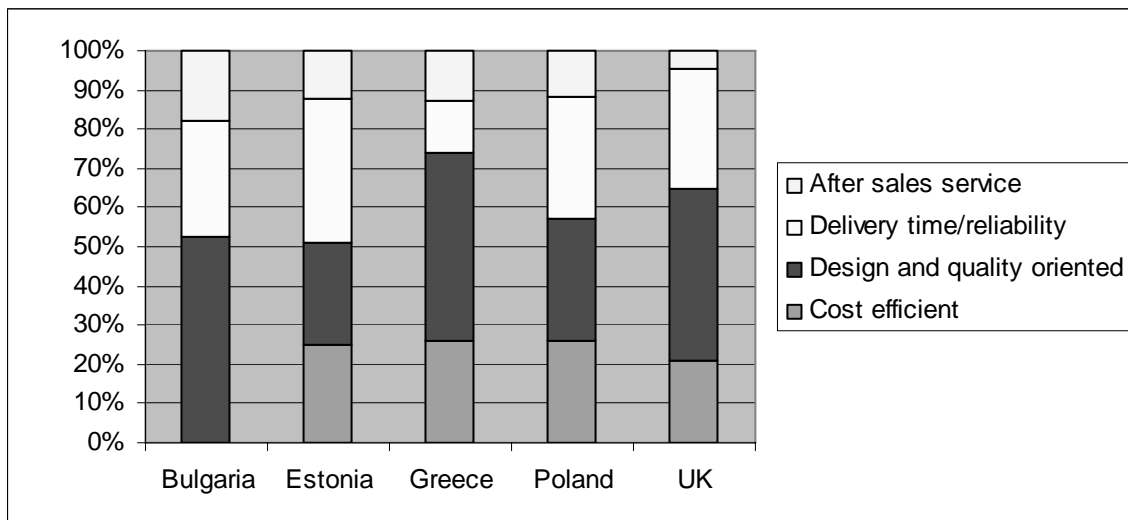


Figure 40 Proportions among the different future strategies based on country of origin

Source: Enterprise Survey

Companies in the beginning of supply chain are tending to have more cost and delivery related goals. Enterprises closer to the end side of supply chain are tending relatively more goals related to after sales services and product design (see Figure 41).

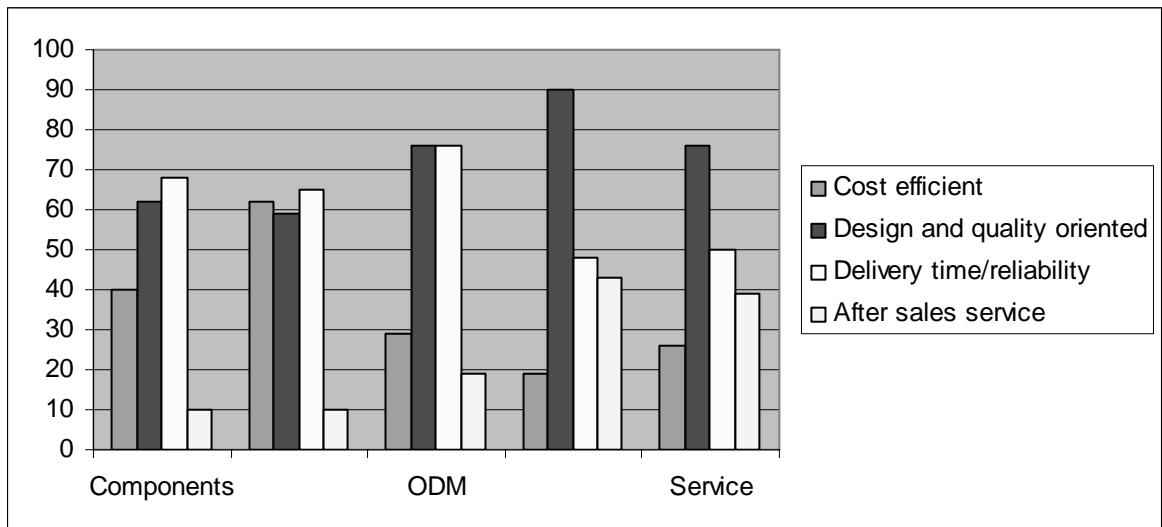


Figure 41 Direction of business strategy based on the position in supply chain (% of all enterprises)

Source: Enterprise Survey

What is outsourced?

Outsourcing is one of key activities for the firm. Typically cost of goods purchasing is biggest cost item for electronics firms. To the big extent also outsourcing strategy determines the success of whole supply chain. Such successful products like Apples iPod, iPhone or Microsofts Xbox 360 are also successful due to well functioning supply chain. It is mutual success of outsourcers and manufacturing firms.

No single firm in electronics industry is able to rely on own resources and capabilities. Only few firms like Flextronics are able to produce wide scope of components and have big number of different technologies in their portfolio but such big firms are rather exceptional.

Enterprise sample was divided into 3 groups: big international electronics firms (with more than 1000 employees worldwide), small international firms (with less than 1000 employees) and local firms operating in single country. After delocalisation process big international firms tended to increase their orders to local subcontractors. This was especially visible in the case of EMS, ODM and OEM firms. Subcontracting by service firms tended to remain on the same level. Orders for local subcontractors by smaller international firms and local firms tended to remain same or slightly decrease after delocalisation (see Table 55). Main goal for outsourcing was the lack of needed technology by own and lack of time. This shows that supply chain of electronics industry becomes more and more sophisticated.

Table 55 Subcontracting by enterprises

	Increase/decrease of using local subcontractors after delocalisation (2 small decrease; 3 same level; 4 small increase)	Reasons from subcontracting from abroad (% of firms)						
		Lack of skilled labour	Higher labour cost	Not enough time	Lack of appropriate technology, equipment	Lack of capital	No access to natural resources	Other
Big internationals	3,5	7	10	16	33	7	0	33
Small internationals	2,9	11	4	15	33	11	8	15
Local firms	2,9	4	12	8	27	4	1	17

Source: Enterprise Survey

8.6 Challenges for European electronics industry (Conclusions)

Electronics industry in developed countries and especially in Europe is facing several challenges in next years. Price pressure both from high technology level countries and low cost countries is coming stronger. Several manufacturing and design firms must

change their business model. First round of changes in electronics industry happened during the telecommunication industry decline in 2002-2004. This caused several bigger and smaller firms to consolidate and to focus on core competencies. Less productive and profitable parts of firms were sold. To the big extent among the sold parts were mass market consumer items like home appliances.

Enterprise survey also showed that TNCs tend to have extensive negotiating power vis-à-vis to firms in supply chain. Price pressure was felt most strongly by electronics manufacturing service firms.

Survey showed also that service activities play substantial and growing role in the supply chain of electronics. There is more and more room for maintenance, installation, sales, logistics and consulting type of activities. Firms who could successfully add to their products additional services gain a lot.

With the trimmed capacities European electronics could find new solutions to the problems. Europe has several advantages like strong capital base, industrial traditions and educated workforce. High labour costs and living standard should be also not seen as obstacle but as an opportunity. High labour cost helps to adopt new automation technologies and to pioneer in labour saving technologies. Europe offers also good platform for design and development activities. Sophisticated market is good platform for development of different niche products in embedded electronics.

European industry in general and electronics in particular has also several problems. Ageing workforce, low skill immigrant workforce and meltdown of industrial skills are only few of them. Popularity of natural science like physics, mathematics and biology has been in decline for years. This makes new intellectual jump difficult. Europe is also

in big extent lacking entrepreneurial spirit and willingness to compete and win. Keeping high living standard is not possible without innovation, at least is such territorially small resource poor continent like Europe. Therefore people should be creative, entrepreneurial and well trained.

As response to price pressure of mass manufacturing firms several Western-European enterprises were forced to move into military electronics sector where pressure of foreign firms is lower. In general public sector contracts are tending to be profitable for firms but too big reliance on some big contracts puts firms under additional risk. Being reliant on big projects is in long term too risky for medium and even big size firms.

Survey (MOVE) among enterprises showed that electronics firms with strong “own” products and know-how can survive and prosper in long term. Continuous participation in development process, careful management and influence to the sale network give potential for success in XXI Century.

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9 IMPACT OF DELOCALISATION ON THE EUROPEAN SOFTWARE INDUSTRY

Robert Guzik, Grzegorz Micek

9.1 Introduction

The IT sector is a fascinating case for research on delocalisation. This is not only the information sector has been the most rapidly developing part of the economy for the last few years, but this is due to the IT sector being the first where offshore outsourcing was for white collar, well paid jobs. It was also the first of services to be delocalized in spite of the traditional view that services are characterised by unity of production and place of consumption. This is no longer a condition as the place has become virtual due to advances in telecommunications and the Internet. Unlike other labour intensive sectors, those who work in IT have to be highly skilled and well educated (Arora & Gambardella, 2005). Competitiveness in the software industry is not based on productivity or even quality, but on ideas and design; therefore the software industry is sometimes called the 'industry of the mind' (Florida et al., 2003).

The aim of this chapter is to analyse the delocalisation of the European software industry in the context of subcontracting and FDI. It draws from the results of a two-year research project based on extensive field work (primary data) and analyses of secondary data. Based on the latter source and literature, the first part of this chapter (section three) has been developed as a review of ongoing processes in the software industry. In section four we try to cover four specific aims:

analyse forms of delocalisation and their extent in the European software industry,
examine reasons behind delocalisation from both perspectives of host and home countries,

briefly describe linkages and cooperation networks between companies from various countries, analyse prospects of further delocalisation to locations outside Europe, especially in the context of India's success in IT outsourcing services.

9.2 Definitions and data sources

The term 'software industry' is interchangeably used with 'IT sector' and is defined hereby as NACE 72 Group⁶² (computer and related activities). It must be remembered that such a definition of IT is only a part of the broader ICT (information and communications technologies) sector⁶³, which, as a whole, is not discussed here. However, because of data availability most reports produced by international organisations (UN, World Bank, OECD) are devoted to the ICT sector. In this report we sometimes employ data for ICT in order to show a general setting, but it should not be interpreted as equal to data for the IT sector. Another important remark to bear in mind is that IT activities are generally larger than the IT sector portrayed in official statistics. Many enterprises, governmental agencies, etc. possess their own IT departments – classified elsewhere. A final remark we like to put here is that many software companies deal with hardware (e.g. IBM, Hewlett-Packard); therefore, some data for the IT sector is exaggerated by hardware sale revenues.

⁶² This includes: hardware consultancy (NACE 72.10); publishing of software (72.21); other software consultancy and supply (72.22); data processing (72.30); database activities (72.40); maintenance and repair of office, accounting and computing machinery (72.50); and other computer related activities (72.60).

⁶³ The ICT sector consists of manufacturing (electronics, office equipment, telecommunication equipment) as well as services (IT, telecommunication, postal services, radio and TV broadcasting).

Most of the secondary data used in the first section comes from Eurostat publications and databases. The conclusions in section two are based on two main sources: 27 key-informant interviews with selected representatives of software companies and organisations (e.g. IT chambers of information technology and information processing societies) and 191 interviews conducted with senior managers and executives of software companies in five countries (Bulgaria, Estonia, Greece, Poland, UK).

Whenever we use the term Central and Eastern Europe (CEE) we mean former socialist countries – now members of EU (e.g. Poland, Czech Republic, Hungary, Slovakia, Slovenia, the Baltic States). Eastern Europe is a more broad category and includes, apart from CEE countries, other former Soviet Union countries and the former Yugoslavia.

9.3 IT industry – trends

The software sector is among the most rapidly growing sectors in OECD countries, with a strong increase in value added, employment and R&D investment. According to ICT Outlook 2006 (OECD 2006), the rapid growth of the sector, especially in Central and Eastern Europe and some non-OECD countries in developing world, e.g. India, deserves recognition as a new wave of globalisation in global ICT. This is not only because of the rapid growth of producers in these countries but also because of the huge growth of the ICT market. Thanks to advances in ICT, more services are now tradable and may be provided from remote locations. Therefore, simple software code writing is now accompanied by a full range of consulting, R&D and other services previously reserved to limited locations in developed countries.

European Software Industry

The EU (EU 25)⁶⁴ software industry employed 2.5 million persons in 2004 and generated EUR 153 billion of value added with a turnover exceeding EUR 308 billion (Table 56). The UK is the country with the highest share in the EU software industry. The turnover of the UK software sector accounted for 26 per cent of the EU, and the generated value-added was 30 per cent of the number for the EU. Other countries according to their share in the EU software sector turnover are Germany (18.4 per cent), France (15.1 per cent) and Italy (11.6 per cent). Country ranking according to contribution to employment does not differ much (UK, Germany, Italy, France). The share of the biggest new member country, Poland, in the EU software industry is 1.1 per cent of the turnover, only 0.7 per cent of value added and with a relatively high share of 2.9 per cent in employment.

Table 56 Main indicators of the software industry for selected European countries, 2004

Variable	EU-25	UK	Germany	Poland	Bulgaria
Value added at factor cost (in million EUR)	152 337	47 006	28 375	1 140*	77
Turnover (in million EUR)	308 209	80 365	56 840	3 281*	204
Persons employed	2 483 170	573 424	370 346	71 280*	12 183
Average personnel costs (in thousand EUR)	49.0	55.9	57.7	16.0*	4.6
Value added per person employed	61.3	82.0	76.6	28.9*	6.3
Wage adjusted labour productivity in %	123	146	133	125*	137

*- data for 2003

Source: Eurostat.

⁶⁴ No data for Greece. For some countries data for 2003.

The higher share in employment than in turnover or value added is a consequence of low apparent labour productivity. Value added per employee is the highest in Ireland (EUR 98,200) and very high in the UK, Denmark and Germany (above EUR 70,000). In Italy and Spain, such productivity slightly exceeds the level of EUR 40,000. In new member countries the highest productivity is found in Slovenia (EUR 31,000), Czech Republic (EUR 20,400) and Poland (EUR 17,000) and is the lowest in Lithuania (EUR 9,800) only slightly higher than for the newest members: Romania (EUR 9,000) and Bulgaria (EUR 6,300). Such a measure of productivity has to be adjusted by differences in labour costs in these countries. The average value added per employee calculated as a percentage of personnel cost was 123 per cent for the whole of the EU and was highest among the 'old members' in Ireland (206 per cent), the UK (146 per cent) and Germany (133 per cent). Such wage-adjusted productivity for new member states was also quite high (above 150 per cent in Latvia, Lithuania, Slovakia and Romania) and around the EU average in the rest of the countries. It clearly shows that thanks to lower wages, the new member countries are very attractive locations for different forms of nearshoring from West European countries.

The software industry is very sensitive to the general economic situation, and its growth is well correlated to changes in GDP. For example, in the period from 1995-2004, the quickest growth of employment in NACE 72, as well as in turnover or value-added in this sector, was observed in Ireland and Portugal. In new member countries, employment growth in this period was higher than 200 per cent, whereas in Germany and the UK, the level of employment in 2004 is similar to 1995. Similarly, value added grew by less than 1/3 in Germany or the UK, whilst in Ireland, it grew twelve-fold, in Slovakia and Poland

– six-fold. Another reason for such a difference is the fact that new EU member countries are lagging behind better developed Western European economies in terms of computer usage, Internet accessibility, etc⁶⁵. Therefore, the internal market is still far from saturation there.

International trade

Ireland is the world-biggest exporter of IT and computer services (above USD 18 billion in 2004) followed by the UK (USD 10.5 billion), the United States and Germany (Table 57). The advantageous position of Ireland can be accounted to the corporate tax environment, making this country a location for exporting activities, especially for American TNCs. What is to be observed is the enormous growth in scale of trade, much quicker than the growth of the sector, which proves the thesis of growing globalisation in the IT sector. A second important observation is the diminishing role of the United States in computer services trade, although we have to remember that a significant part of trade accounted to other countries is generated by local affiliates of US-based TNCs. Although exports from rising economies like Poland has risen more sharply than the OECD average, local market have expanded faster and imports still exceed exports. Last, but not least, the diminishing position of Greece is observed, where exports dropped almost two-fold with a simultaneous four-fold import growth

⁶⁵ With exception of Estonia and Slovenia.

Table 57 International trade in computer services and software goods, 1996-2004, in mln USD

Industry	Computer services				Software			
	Exports		Imports		Exports		Imports	
Country/year	1996	2004	1996	2004	1996	2004	1996	2004
Germany	1 603	7 810	2 379	7 906	734	3 210	946	1 813
Greece	362	197	55	221	24	41	43	140
Ireland	105	18 484	306	362	3 567	2 029	636	246
Poland	28	195	135	419	38	151	16	133
UK	1 706	10 469	519	3 536	1 102	1 523	1 137	1 754
USA	2 775	8 501	422	5 804	3 087	3 030	714	1 244

Source: OECD international trade in services database.

However, Ireland lost its leadership in exports of software goods (Table 57). Spectacular growth of exports is to be noticed from Germany, among others, thanks to the great success of the German company SAP and its ERP systems software, placing it as the biggest exporter of software packages in the world.

The analysis of international trade in software goods and services is incriminated by the quality of available data. In fact, the real scale of outsourcing seems to be much higher than reported in the statistics. The OECD (2006) report gives an example of ambivalence between Indian and OECD statistics – India reported USD 9.6 billion worth of exports of computer services to OECD countries in 2002, whereas OECD countries reported only USD 294 million imports from India. Among foreign owned software companies surveyed in Poland we have found a mechanism of functioning as cost centres, which have reported no sales here (sales were reported in tax-friendly Ireland). Another source of difficulty in capturing trade in software and ICT services is the diversity of delivery channels. Often software is counted as hardware trade when computers with pre-installed software are sold. Trade statistics capture less than one third of the real trade value of the software sector. Additionally, this data may be

distorted by the fact that for tax/duty purposes it is often not the value of software, but the value of physical supports (CD-ROM, diskettes) (OECD 2002).

Value chain in the software industry – delocalised stages

The most value is added in the software value chain during product development, sales and services (Competitive Alternatives 2004). The latter two stages are usually carried out in host countries. The position of a particular foreign software company within the value chain is different for mass-production typical for a majority of companies and customised solutions. The growing emphasis on localisation and product development requires a higher level of software engineering skills and is more reliant on outsourcing and indigenous supply chains, including translation, packaging, manual printing, transport and technical support.

A minority of software companies located in Asian and CEE countries develop original software, while a vast majority operates as software distributors and sales offices for big international companies. Subcontracting for Western (Germany in the case of Poland) and Northern (Finland and Sweden in the case of Estonia) European software companies is also important. Most CEE software companies operate in a low segment of the value chain. Although basic software maintenance remains the most popular software-related activity, CEE companies seem to move up the value chain to software development strategy and systems design (Figure 42). Many overseas companies are set up initially to carry out a basic function, such as relatively low skilled software manufacturing. Within a very short time, corporate management recognises the quality and skill of the indigenous staff and moves other functions there, such as software localisation and

eventually high-skilled product development, technical support and marketing (Coe, 1997a; The Software, 1992).

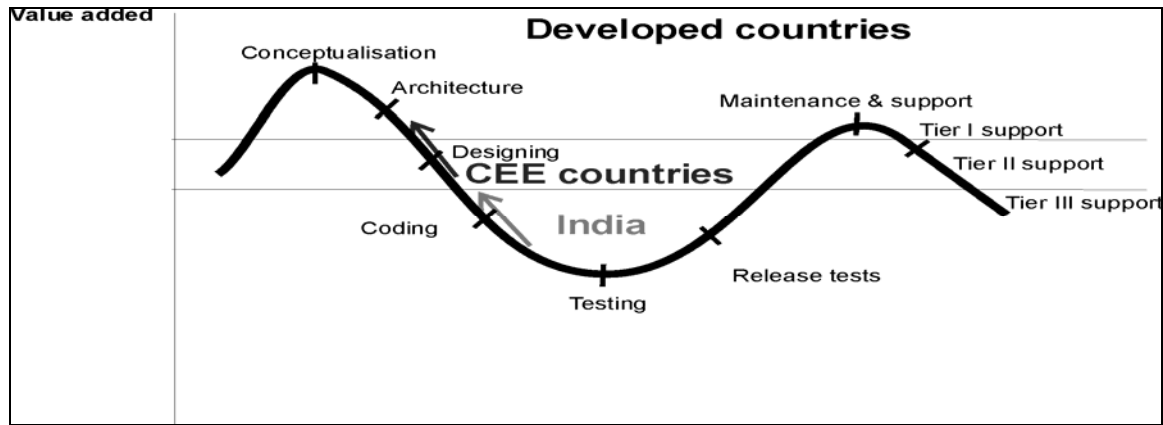


Figure 42 Division of work in outsourcing software development

Source: Based on Ali-Yrkkö and Jain, (2005), modified.

The division of work is also important. Consultants estimate that in an offshore outsourcing arrangement, 15 per cent of the client’s IT staff are retained in a home country, 15 per cent of the supplier’s IT staff are onshore, and 70 per cent of personnel are offshore (Overby, 2003).

Forms of delocalisation

The main types of delocalisation in the software industry identified in the literature are as follows: FDI, subcontracting and offshoring (offshore outsourcing). Non-market based types of FDI appear not only in ‘old’ EU member countries (Coe, 1997b), but also in CEE countries. There are three main forms of footloose or non-market based FDI in the software industry: offshore data processing (business process outsourcing – BPO), offshore programming and software packaged production. While the emergence of the first two of these developments has been well chronicled (Coe, 1997b), the emerging

manufacturing-style international division of labour in the software products industry has received less attention. Software package production and localisation are among the key activities conducted by foreign companies in developing and recently developed countries (Coe, 1997b). Mass-produced software is very different from many other computer services in that it is essentially like any other product and need not to be manufactured in proximity to its consumption.

The extent to which process is subcontracted varies among software companies. Many of them actually replicate disks and assemble the products using their own staff, but some outsource the whole process. The most important type of activities subcontracted in Europe is application development, followed by program and architecture planning and testing (Ali-Yrkkö & Jain, 2005).

Offshore outsourcing⁶⁶, a type of business process outsourcing (BPO), is the exporting of IT-related work from developed countries to areas of the world where there is both political stability and lower labour costs or tax savings. Broadly, there are three types of offshore contract supply of IT:

Supply of application development and support functions

Supply of systems design and integration and support for networks and infrastructure

Supply of IT-enabled services, such as accounting, records management, claims administration and call centres, etc. (Trends 2004).

⁶⁶ Outsourcing and offshoring represent two different dimensions. By outsourcing we mean that other firms take over operations that were previously conducted within the firm (note: relocation is not a requirement for outsourcing). Offshoring, in turn, means relocating activities from one country to another, but not necessarily from one firm to another.

India's position in the offshore outsourcing market is dominant with an estimated market share of approximately 80 per cent (Sahay et al., 2003). A recent study by Frost & Sullivan ("Global," 2004) consulting company revealed that offshore outsourcing goes much beyond what has been occurring in India for the last several years. Centres of offshore supply are found in Ireland and Israel, and interestingly, in China, the Philippines, Central and Eastern Europe and Russia.

Factors behind delocalisation

Delocalisation factors from the point of view of the host country are as follows. A favourable tax regime was one of the main factors in the 1980s. Nowadays, the low cost of labour input and the availability of skilled staff are among the most important reasons. Other factors are: low set-up costs, infrastructural investments, often made by the public sector, and significant, prior investments in educational services. A strong external effect associated with a large outward shift in demand for education, resulting in the entry of private educational providers, also enhances the range and scope of IT skills. Organisational changes and internal restructuring may lead to the outsourcing of IT-related non-core activities (Coe, 1997a). However, the software industry is a clear example of an industry where the flow of ideas has been as important as the flow of physical capital (Commander, 2004; Crone, 2003). Therefore contingent events may also be significant in attracting foreign investment.

The main reason of the delocalisation may be explained in terms of classical location factors. Production moves where it is cheaper. Many papers support the view that the most important motive for offshore outsourcing is lower costs (e.g. Ali-Yrkkö & Jain,

2005; Girma & Görg, 2002; Carmel & Agawar, 2000). However, additional costs, such as management and communication costs, make the cost difference clearly smaller than the wage difference. Relative to US costs, typical cost savings from offshoring fall between 20 and 40 per cent depending on the type of work (Trends, 2004). For programming, the cost savings are closer to 20 per cent while for BPO, the current savings are in the range of 40 per cent. Savings on maintenance and support for legacy systems are around 25-30 per cent. Relative to Canadian costs, savings would be about 10-15 per cent lower (Huws et al., 1999). CIO Magazine (Overby, 2003) estimates 'the hidden cost' of moving IT work offshore at 15-57 per cent of the contract's value. In reality, most IT organisations save 15-25 per cent during the first year; by the third year, cost savings often reach 35-40 per cent as companies 'go up the learning curve' and modify operations to align to an offshore model (Davison, 2004).

The rise of the export software industry in such countries as India, the Philippines, Russia and Bulgaria has drawn attention to the delocalisation of more highly-skilled information processing work. The new global distribution of work in this sector follows yet another pattern. Here, a good supply of highly skilled work, especially IT professionals, constitutes an important attraction (Huws et al., 1999). Both product specialist subsidiaries (developing and producing a limited product line for the global market) and strategic independent subsidiaries (developing lines of business for local, continental or global markets) can have substantial benefits for economies compared to the traditional marketing or manufacturing sites (Coe, 1997b). Crucially, the emergence of such new, higher-performance overseas plants has created employment opportunities

for the less developed areas of the EU such as CEE, Spain, Portugal and Ireland (Coe, 1997b), which rely heavily on the FDI to provide employment.

The disadvantages of delocalisation from a host country perspective are presented below. Growing labour cost may constitute a danger for offshoring. There is an increase in software specialists' wages in India which over the past few years have been increasing at an annual rate of somewhere between 15-25 per cent according to one of the vendors (Ali-Yrkkö & Jain, 2005). The lack of internal quality control procedures is another disadvantage. Apart from well-paid jobs, employees experience some disadvantages of delocalisation. Seasonal and temporary work is typical for IT project-oriented companies (e.g. system or application integrators) (Coe, 1997b). The level of embeddedness of software companies still seems to be relatively low. Some foreign software development firms do not seem to be establishing links with indigenous firms. The majority of large foreign firms are part of international value chains with limited local clustering, which is shown in the case of Flanders (Larosse et al, 2001). Most of the big IT companies have to align their alliance strategies with headquarters abroad, thus limiting the scope of local cluster development. However, a few of the biggest players (e.g. Microsoft and Symantec in Ireland) purchase a majority of their raw materials locally.

There are also remarkable social (language difficulties) and cultural barriers to delocalisation. Delocalisation decisions are hampered by a lack of trust and a perception of risk among clients who are uncertain of the skills, capabilities and credibility of potential foreign subcontractors. Potential information leakage and data security are a concern for investors (Lai et al., 2004). Lack of continuous client-developer interaction

is another delocalisation barrier. Despite good communications links, interaction sometimes needs to be face-to-face.

9.4 Delocalisation of the European software industry – company and key informant survey results

The general characteristics of the poll are presented in Table 58. For the purposes of the study, the survey focused primarily on Central and Eastern European countries (CEEC), which are viewed as the main beneficiaries of the process of global integration in the industry. Thus, 52 enterprises were surveyed in Estonia, 51 in Bulgaria, 50 in Poland, 20 in Greece and 18 in the UK. The enterprises surveyed were not randomly selected. The methods of selection have led to small peculiarities of the enterprises surveyed in terms of size. There appears to be a slight over-representation of medium and large-scale firms (especially in the UK) at the expense of micro-enterprises (apart from Estonia). Age distribution seems to be typical with an average 28 per cent of young companies within the survey. A young companies involvement rate is higher in countries where the software industry constitutes a new wave in economy (Estonia and Bulgaria). Poland is in the middle of the history of the software industry with the first foreign companies entering the market in the first half of the 1990s. Then comes Greece and the UK, both with at least 70 per cent of surveyed enterprises established before 1995.

Table 58 General characteristics of the enterprise survey

Type of delocalisation (share of total in country, %)	UK	Poland	Greece	Estonia	Bulgaria	Total no. of firms	Share in total
Foreign companies	22	66	5	29	16	61	32
Subsidiaries abroad	50	18	25	8	4	36	15
Subcontracting in/outsourcing from companies abroad	61	68	75	54	98	135	72
Subcontracting out/outsourcing to companies abroad	50	20	25	25	4	36	20
Total number of firms	18	50	20	52	51	191	100

Source: enterprise survey.

The forms of delocalisation in the software industry are diversified. Out of 190 interviewed companies 72 per cent undertake subcontracting or outsourcing from a company abroad. It is very common in Bulgaria and Greece (75-98 per cent of companies) and slightly less popular in Poland, the UK and Estonia (54-68 per cent). Almost one third of interviewed companies were affiliates of foreign entities. There are two less popular forms of delocalisation – having a subsidiary abroad and giving subcontracting or outsourcing to a company abroad. These forms are most popular in the UK, although in fact they have become more common in Poland. The Bulgarian software industry ranks the lowest (four companies out of 51 involved in these two forms of delocalisation), but based on key informant interviews, it must be said that Bulgarian companies recognise such opportunities and will take advantage of them in near future. The above-mentioned significant role of FDI leads to a conclusion about the expansion-based nature of internationalisation of the software industry. Foreign companies do not employ a large number of people (19 per cent of total enterprises), but they represent a high financial turnover (42 per cent of total) (Table 59).

Table 59 Share of employment and turnover of companies involved in different types of delocalisation

Type of delocalisation	Share of total employment (%)	Share of total turnover (%)
Foreign companies	19	42
Subsidiaries abroad	60	35
Subcontracting in/outsourcing from companies abroad	73	65
Subcontracting out/outsourcing to companies abroad	56	52

Note: a single company may be included in different types of delocalisation.

Source: enterprise survey.

The extent of delocalisation largely differs in analysed countries. It is very limited in the software industry in Greece, where wages are relatively high, so it is almost impossible to compete with companies from less developed countries. Additionally, the domestic market is of a small size. Delocalisation (caused mainly through expansion) has the biggest scale in the UK and Poland, with Estonia and Bulgaria rapidly achieving the same level.

The interviewed companies largely benefited from delocalisation and reported increased sales after being involved in the process. Turnover has risen in about two thirds of interviewed companies. The number of companies that reported a turnover increase is between 69 per cent and 74 per cent in Bulgaria, Estonia and Poland. Profits have also increased in almost a majority of interviewed companies, especially in Polish and Bulgarian firms (see Table 60).

Table 60 Changes of turnover and profits after delocalisation

	Bulgaria	Estonia	Greece	Poland	UK	Total
Turnover	●	●/●●	-/●	●●/●	●/-	●
Profits	●	●/-	-/●	●/●●	●/-	●/-

●● - strong increase, ● - slight increase, -- - no change, ○ - slight decrease, ○○ - strong decrease

Source: enterprise survey.

Forms of delocalisation and reasons behind the process

Seven variables were chosen in order to identify modes of delocalisation and clusters of similar companies. These indicators include: exports and subcontracting share, number of companies serviced in 2004, share of foreign capital, year of first establishment and employment in the company and in its foreign subsidiaries. The analysed companies were compared to species of birds based on their size, level of travelling (the level of engagement in exports and subcontracting) and number of friends and partners (companies serviced). Enterprises were clustered by the k-average method. The distribution of companies within clusters is not balanced (Table 61) – cluster III includes 118 companies. However, this group of companies is very homogeneous and resistant while increasing the number of clusters.

Table 61 Typology of companies based on involvement in delocalisation

Number of cluster	I	II	III	IV	V	VI	Total (average)
Type	Hawks	Woodpeckers	Sparrows	Swallows	Owls	Parrots	
Indicator	Final centres of clusters						
Average export share (% of total sales)	50.0	62.7	28.3	72.6	14.5	28.6	39.8
Average share of subcontracting activities (% of total exports)	96.7	70.3	48.9	74.0	30.0	36.6	55.5
Average number of foreign companies serviced	9.7	6.9	3.9	2.7	10.0	5.6	4.2
Average foreign share (% of share capital)	20.0	0.0	4.5	97.0	0.0	73.1	25.8
Average year of first establishment	1995	1992	1995	1997	1982	1987	1995
Average employment	402	93	25	33	2486	212	105
Average employment in foreign affiliates	15	15	1	0	6075	0	130
Number of companies	5	17	118	36	4	11	191

Source: enterprise survey.

Insourcing/subcontracting in

The majority of interviewed companies is involved in subcontracting in. Such companies may be found within the first three identified groups of enterprises (clusters I-III). The group of ‘hawks’ consists of five relatively young, usually indigenous and large companies. In comparison to the mean of 40 per cent of all turnover from exports hawk-like enterprises are export-oriented and highly dependent on subcontracting activities (Figure 43), usually working for numerous customers. Seventeen companies classified among ‘woodpeckers’ are very-active, medium-aged and medium-sized indigenous firms. This group includes among others seven Bulgarian and four British

companies. The most common type ('sparrows') consists of 118 small and micro firms. About 3/4 of interviewed Greek, Estonian and Bulgarian companies belong to this group. Subcontracting in is the domain of Greek companies, where over 80 per cent of export value comes from subcontracting from a limited number of partners – almost two thirds of firms have up to three partners. It is worth mentioning that sparrows are involved in export to a relatively small extent.

Subcontracting is of medium significance in export activities: in the survey, 56 per cent of the total exports of companies are on a subcontracting basis. However, only 21 per cent of the total exports of software companies are intermediate products/solutions (sold to other firms abroad for further processing). It means that products developed in host countries are commonly final solutions.

The reasons behind insourcing (subcontracting abroad) reported by key informants are quite striking. According to the enterprise survey, 78 per cent of companies have orders due to representing suitable level of expertise. Among other important reasons are reliability and appropriate technology. Low cost mattered only in the case of 35 per cent of interviewed companies. There are many companies in Poland and Estonia that have similar costs to Western European competitors and compete largely by dedication to work and the resulting high quality. Also companies from home countries (see the following paragraphs) claim low cost is not of the highest importance whilst choosing a subcontractor. It seems to be that factors behind the Europeanisation of the IT sector are less cost-efficiency driven than it seems at a first glance.

‘The rule is to provide a quality product. In bigger contracts we prefer not to sell than sell cheaper’ (Polish small-sized subcontractor).

Low cost reasons behind getting orders are important only in Bulgaria. In other countries this reason was mentioned more rarely (less than 1/3 of companies). Once more, this supports the thesis about the over-exaggerations of the dominant role of low-cost reasons in decision making about choosing a subcontractor. Many key informants representing IT organisations also claim that innovation and skills are more important in delocalisation growth than low cost. The quality of software development in CEE companies complies with European requirements.

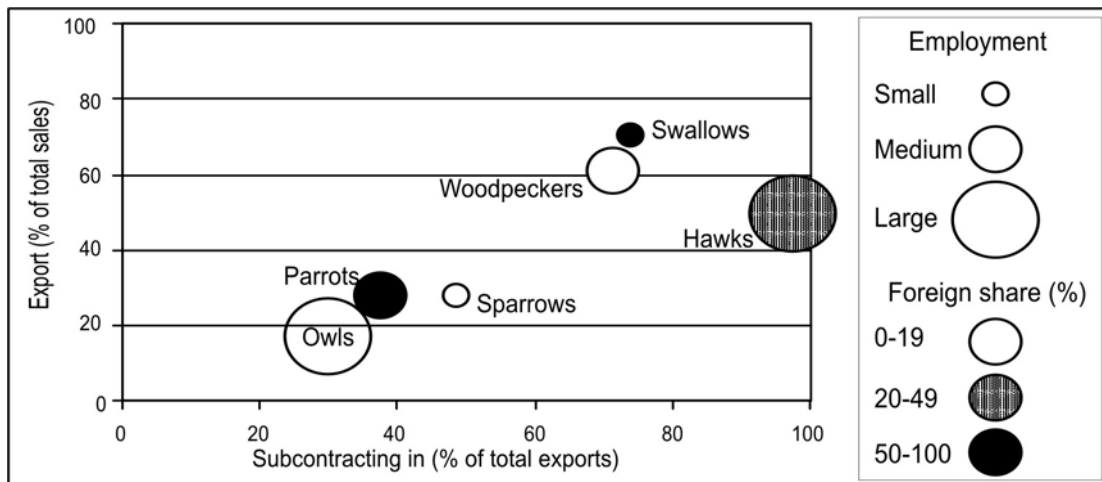


Figure 43 Typology of companies based on employment, ownership, involvement in subcontracting and exports

Source: enterprise survey.

Table 62 Reasons for receiving orders from subcontractors

Reason	Total (% of companies involved)	Countries (% of companies involved)	Share of exports (mean, %)	Average employment
Low cost	35	Bulgaria (62), Poland (29), Greece (27), Estonia (14)	49.5	72
Appropriate technology	52	Bulgaria (68), Estonia (68), Greece (40), Poland (38)	41.9	63
Expertise	78	Poland (91), Estonia (86), Bulgaria (84), Greece (73)	43.9	63
Geographical proximity	20	Estonia (32), Bulgaria (24), Poland (21)	43.9	54
Reliability	57	Greece (80), Bulgaria (78), Estonia (46), Poland (44)	41.7	64

Source: enterprise survey

This Table shows that companies that have received orders due to low cost can be found among the biggest enterprises. Low-cost companies are also more oriented towards exports. What appears to be one of the important reasons behind the search for foreign customers in several countries is the significant delay of public spending in ICT (Greece, Bulgaria Poland). Also, a general decline of the economy was a significant factor for some CEE companies to search for customers abroad.

Foreign companies

FDI is the second form of delocalisation in terms of frequency of occurrence in the sample. Foreign companies are younger and smaller, but more export-oriented than indigenous firms (Table 63). The latter most often have contacts with subcontractors and

are more dependent on them. They represent the lowest number of subcontracting partners and sometimes depend on one foreign partner supplying them with software.

In the survey, FDIs are represented by two types of firms: young companies (cluster IV; 20 firms in Poland, eight in Bulgaria, six in Estonia, one in the UK and one in Greece) that report the highest level of exports and a large involvement in subcontracting and relatively old firms focused on the internal market with a low level of exports and subcontracting in (cluster VI). The first type may be called swallows as they find nourishment and come back home to feed their offspring. Swallow-like companies predict a spring of foreign investments in the software sector. The latter type will be described in reference to subcontracting out.

Table 63 Characteristics of foreign companies

Indicator	Is your firm an affiliate of a foreign company?	
	No	Yes
	Average	
Exports (% of total sales)	32.7	54.8
Number of face-to-face interactions per year	10.9	22.1
Balance of power (1-customer least powerful; 5-customer most powerful)	2.6	2.2
Mutual dependence (1-companies highly dependent on each other; 5-independent)	2.3	1.9
Average number of years of continuous relationship	5.8	4.8
Total employment	123.9	63.9
Year of first establishment	1994	1996

Source: enterprise survey.

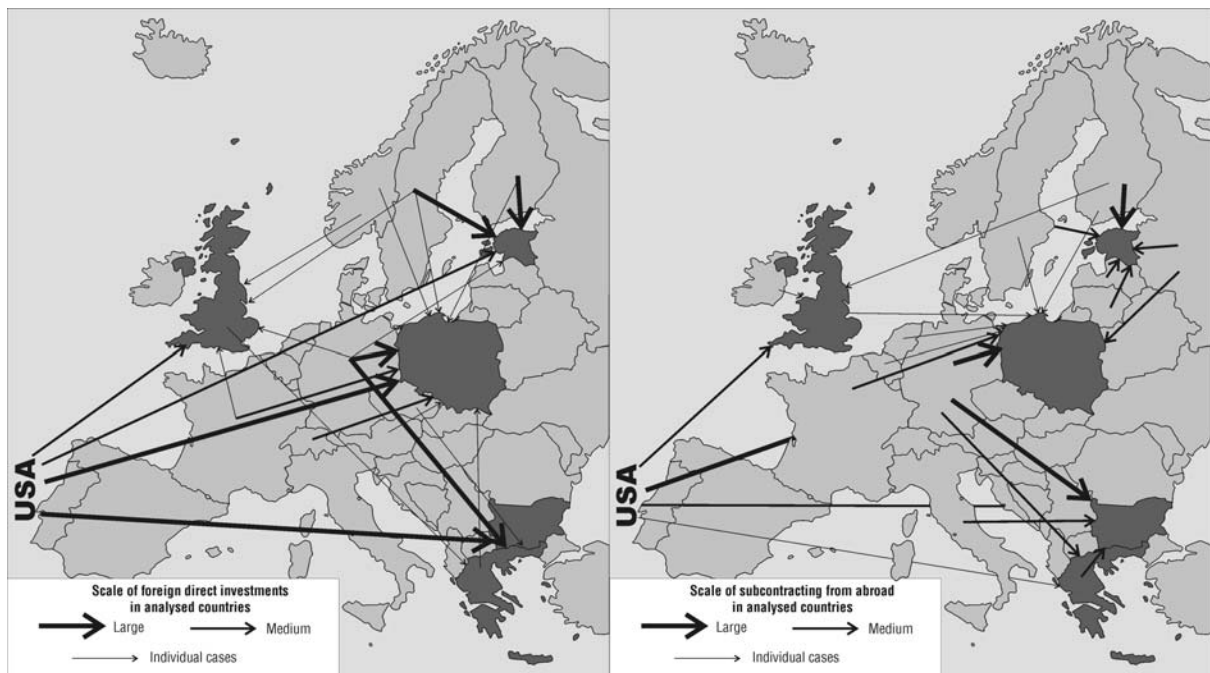


Figure 44 Foreign investments and subcontracting from abroad in analysed countries

The company has policy of employing only very good graduates without experience in order not to pay them too much. The owner saves money on everything, e.g. computers, furniture, company cars - everything is low-cost and underinvested.

Medium American software development centre in Poland

The major foreign investors in the European software industry are US and German companies. Scandinavian enterprises invest in Estonia and Northern Poland (Figure 44) – one of the interesting examples are traditional media enterprises that tend to have stakes in IT companies. Many Estonian software companies are controlled by Scandinavian (usually Finnish) companies.

The reasons behind FDI are strictly connected with the need of a company's expansion in order to secure growth. In CEE, both skills and cost are very important, and also those

countries are themselves market opportunities. Foreign companies deal with competition less often by reducing costs and more often by improving quality. Obviously, in some cases pure cost also matters. It is typical for some large American software companies to conduct labour-intensive software development and testing in Central Europe. There are usually cost-based locations. Cost considerations mean that some of these companies save money and want to pay as low as is possible. On the other hand, Polish managers of some foreign enterprises try to find a way of becoming more independent from their mother-companies

Within Polish subsidiary - there is an unwritten strategy – which Polish team realises – to be more and more self-reliant - to employ not only software specialists, but also business analysts in order to be wholly responsible for projects. To be seen by HQ as not only of a very good technical quality, but also as a wholly capable for innovation. To be better and better (self-improvement).

Medium-sized American software development centre in Poland

There are three types of supply chains that foreign subsidiaries are included in. The most common supply chains are limited to foreign partners and closed within TNC. Additionally, they are not embedded locally. A second, rare type is represented by the local embeddedness of supply chains from the beginning. It usually takes place when the director of a foreign company is of CEE-origin and his/her friends become business partners there. Thirdly, foreign enterprises may become embedded in a region after several years of operating in Central and Eastern Europe – surprisingly, this is not a common example.

Subsidiaries abroad

‘What we tend to do is to set up a small team in Europe that analyses the market there to see if there are sufficient companies with potential (...) We are trying to set up a partnership with them; we would work with them to try to make the first one or two sales and then try and make them sufficiently skilled to be able to do that on their own’.

(Large multi-office Scandinavian company operating in UK)

The fifth type of companies that are largely involved in subsidiaries abroad is not common (cluster V; four companies) and embraces old, very large Polish and British indigenous companies. A distinction between ‘owls’ and other types of companies can be made based on employment in foreign affiliates that are very big (UK) or grow rapidly (Poland). In comparison to other enterprises, the involvement in subcontracting in and exports among ‘owls’ is the smallest in relative terms, but very big in absolute numbers. Typical for this type is the wise choice of partners and consequently the highest number of partner companies that are allowed to be relatively independent from one subcontractor.

‘Company strategy is to be very close to clients. When clients internationalize or make international expansion we follow them or acquire firm in a new region’.

(Finnish company operating in Estonia)

Managers of companies that have subsidiaries abroad claim that among the most important factors in decision to invest abroad are the size of market, its growth and access to regional and global market. Access to a skilled labour force also matters. What motivated companies to invest abroad is usually the high cost of domestic labour and

high social contributions. Greek firms went to the Balkans (Romania and Bulgaria) mostly because they were pushed away by the negative conditions (high wage expectations and desired high posts since the mid 1990s) of the labour market in Greece. They went there in order to find trained and cheap employees.

Search for new markets is sometimes necessary in order to secure the growth of a company. One of the reasons behind setting up subsidiaries abroad by some large CEE companies is to be able to create long-lasting relationships with the main customers by supporting their indigenous customers in expansion to old EU member countries.

Companies that subcontract out

The last group (cluster VI) consists of old, usually foreign companies operating largely in host markets. For these large and medium enterprises cooperation with foreign or mother companies is not as important as penetration into large markets. The majority of parrot-like companies give subcontracting to companies abroad. Some of them mainly sell foreign software. Just as parrots tend to mimic, these companies use what was developed abroad and create a new context providing the host country market with localisation and customisation services.

Among the European countries Germany is to a large extent involved in outsourcing (nearshoring). German enterprises are the biggest customers for Polish, Bulgarian and Greek companies (Figure 44).

What is most striking are the listed reasons behind this form of delocalisation. Companies subcontract from abroad because they feel a lack of specific skilled labour at home (UK, Poland). Shortages of IT skills in a home country were also reported in many

papers to be one of the most important types of lack of in-house resources (Trends 2004).

Enterprises also have to deal with a lack of appropriate technology or equipment (Poland, Greece, Estonia, Bulgaria). Higher labour cost ranks third (UK, Poland, Greece). Greek companies tend to focus on Bulgarian subcontractors, while a few Estonian companies focus on Finnish suppliers. Polish companies use both Russian and British enterprises to be provided with necessary solutions. Almost all of the largest Polish enterprises have invested abroad (chiefly between 2003 and 2006), mainly in Russia or Ukraine. However, cases of delocalisation from new EU member countries are rare, since companies do not possess the required financial capacity to invest abroad. Some of examples in this respect are the Bulgarian Scient (Vietnam), Polish Computerland (Russia), Prokom (Czech Republic), ComArch (Ukraine) and Asseco (Slovakia). There are three modes of activities abroad presented by CEE companies: more common is establishing subsidiaries and arranging partnerships with foreign representatives, quite rare are acquisitions of medium sized foreign companies (in the cases of Polish Prokom and Asseco).

Linkages and cooperation networks

A significant number of companies (over 38 per cent of entities) is involved in supply chains that are a part of international networks. However, there are only nine cases of enterprises that are only included in international networks and do not operate in the domestic market (over 90 per cent of turnover from export). This means that the level of real involvement in international networks is relatively low.

The position of a majority of companies (56 per cent) within supply chains has been upgraded in the software industry. Downgrading cases are rare (four cases reported). Surprisingly, there are no statistically significant differences between different modes of delocalisation and the upgrading/downgrading processes. Different types of delocalisation represent a similar share of upgrading (from 45 to 60 per cent of firms). Qualitative change is observed in the activities conducted by software firms. There are cases of upgrading from simple subcontracting to more arm-length relations (simple exports). The positive process of a shift from software development to consulting services is also observed. There is a transition from simple code writing to implementation of whole projects.

A relatively sophisticated mode of involvement in subcontracting from foreign companies may be shown by a high number of foreign companies serviced by an individual company. On average, it gives 4.2 customer companies per one subcontractor. Surprisingly, the average number falls to 3.5 for affiliates of foreign companies. Almost two thirds of subsidiaries of foreign companies work for up to two customers. The limited number of foreign subcontractors observed in foreign subsidiaries leads to the conclusion of the larger dependence of foreign subsidiaries than of foreign subcontractors. About one third of foreign subsidiaries stressed that they represent the same level of power as their owner. Foreign subcontractors more often find a balanced decision with their partners.

In general, only 34 per cent of subcontractors exclusively service one company. It must be concluded that some companies have already established a network of foreign subcontractors and are not dependent on one of them. The same number of companies is

dependent and independent on their subcontractors. Almost half of the managers feel that there will be moderate consequences of breaking down the relationship with the partner.

Existing subcontracting relations have been continuing on average for 5.5 years – for the longest time in the UK (9.2 years) and for the shortest in Estonia (4.1 years). This average points to a relatively long and strong relationships between subcontractors.

9.5 Conclusions: delocalisation or expansion?

It must be concluded that geography matters. There are not so many cases of companies that invested in a distant country. For some German, French and Scandinavian subcontractors, both geographical and cultural proximity matters and that is why they choose Poland or Estonia instead of India.

Many key informants have pointed out that whereas large, routine projects (e.g. two or three-year contracts, 1 000 employees involved) often come to India or China as well as, the Philippines and South Africa. Central and Eastern European (CEE) companies are relatively small and are not able to fulfil bigger tasks. However, there is a possibility to focus on more innovative, flexible projects that require smaller teams. Based on company interviews and the enterprise survey, it must be said that CEE companies recognise this possibility and enter into rather smaller projects.

In reference to the first aim of the Chapter, there are two simultaneous processes that take place in the European software industry. The most visible form of delocalisation is expansion conducted by foreign companies, mostly US or German-owned, but also more often by companies from former host countries (e.g. Poland). The average value added

per employee shows that new EU members are not lagging behind older EU countries. Similar productivity with lower wages constitutes a key element that attracts foreign partners to Central and Eastern Europe. There are two types of foreign companies. One is a remarkable group of old, usually foreign companies that are not largely oriented towards home markets and mainly operate on host markets. For these large and medium enterprises subcontracting is not as important as penetration into large markets. The second type of foreign companies is represented by young firms that report the highest level of exports and a large involvement in subcontracting. They report a relatively low number of subcontracting partners.

The second major form is subcontracting abroad, which has been rapidly growing in recent years, but started in Europe at the beginning of the 1990s at a very low level. Many indigenous companies have very limited number of partners and represent medium level of involvement in subcontracting. There is also another specific type of companies: very large, British and Polish enterprises, which have invested abroad. They have implemented a wise policy of signing contracts with many partners and remain independent from them.

Despite the dynamic development of offshoring activities thanks to the rapid growth of the whole IT sector there is no job loss in developed countries. Therefore, delocalisation in the IT sector may be considered a win-win game so far. It is more the expansion of foreign and domestic companies abroad than delocalisation as a sector and market growth is observed. Even if delocalisation is observed it is, as Arora et al. (2002) argue, due to shortage of IT skilled professionals in the US and Western Europe as a main factor. An important reason for delocalisation of IT and BPO services is the option of

round the clock operation. In general, the global expansion of IT firms is driven, firstly, by the need for market access and growth, secondly, by economies of scale and costs savings and lastly, by access to skills and technology.

Considering the second aim of the Chapter, the factors behind delocalisation of the IT sector are less cost-efficiency driven than it seems at first glance. There are many companies in Poland and Estonia that have similar costs to Western European competitors and compete largely by dedication to work and the resulting high quality. Also, companies from home countries claim low cost is not of the highest importance whilst choosing a subcontractor. It is clear that going abroad is more connected to growth strategy than as a mean of seeking higher profits. The shortage of human capital in home countries and the promising markets in host countries are reported as the main reasons of delocalisation. Thanks to expansion, FDI and subcontracting the whole IT industry grows, skills and knowledge are spread and, as IT is auxiliary to other economy sectors, general economic growth is fuelled (OECD, 2006).

When it comes to cooperation networks, changes in scale and types of activities being outsourced over time in comparison to the 1990s are reported. Nowadays, a full range of activities are outsourced instead of low-value, labour-intensive software code writing. A move up the value chain among companies who were subcontractors or subsidiaries of foreign companies is apparent.

In reference to the fourth aim of this Chapter, the success of many Central and Eastern Europe IT companies is accounted for by the quality of human capital (dedication and commitment to work), flexibility, involvement and level of expertise rather than to its low cost. According to most of the interviewed managers and key informants, all this,

together with a cultural proximity to the US or Western Europe, gives an advantageous position in relation to India based competitors, where cultural differences are a barrier to successful development of more sophisticated tasks or problems in India. Other factors lowering the competitive position of India are wages, time-zone incompatibility, drainage and the poor creativity of IT specialists.

Further delocalisation of IT sector activities to India or to another low cost country is not perceived as a danger to the European software industry. The cultural barrier, geographical distance and high profitability only for huge projects are factors responsible for eroding India's competitive position as a location for European outsourcing.

According to a vast majority of interviewed managers, delocalisation does not need to be controlled: only political and fiscal stability is of high importance. Therefore, EU membership was reported as an important factor behind investment or choosing a partner. Entrance into the EU by Bulgaria and Romania should further catalyse internationalisation of the IT sector in these countries as was earlier observed in Poland and Estonia.

Future research should cover several fields that include, e.g. the a in-depth analysis of the cost structure of delocalised companies. It is necessary to conduct such analysis in order to establish the role of wage differences in the growth of delocalisation. A more detailed assessment of the scale of neighbourhood effects in various countries would help to understand the role of a cultural and geographical proximity-driven cooperation in software industry growth.

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10 THE IMPACT OF INTERNATIONALISATION ON THE FOOTWEAR INDUSTRY

A) FOOTWEAR INDUSTRY: DELOCALISATION AND EUROPEANISATION

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10.1 Introduction

Footwear, as one of the most labour-intensive industries, has been among the first sectors to be exposed to the processes of delocalisation and global restructuring. The process of internationalisation, however, ran with different intensity in different regions, thus leading to a wide diversity of forms of delocalisation where the links between firms and regions were embedded in different historical, political, institutional and socio-economic environments. Nevertheless we can say that delocalisation followed a general pattern, where the European footwear industry initially, in the 1970s-1980s, shifted production from the more developed, North European, to the less developed South European countries. More distant locations such as Brazil, China, Vietnam, India and Mediterranean African countries constituted the next wave of delocalisation destinations. As far as the CEECs were concerned, their significance grew significantly, mainly through outward processing trade, in the 1980s after the political changes and the establishment of market economies in the 1990s. As a result, currently the biggest share of footwear production of these countries is exported to the EU market.

In this chapter we argue that it is mainly industry and country-specific factors that are shaping the regional map of the European footwear industry. The most important among those factors are liberalised trade policy, low labour costs and organizational flexibility. Among the different forms of delocalisation of the footwear industry international subcontracting is the most widely spread one, while there is also a limited number of joint ventures and FDI, as well as relations based on spontaneous market exchange.

The aim of this chapter is to contribute to a better understanding of the recent delocalisation trends in the European footwear industry. Our main focus is on a) forms and networks of Europeanisation of national footwear industries; b) company strategies and c) delocalisation effects. The presented outcomes of the research analysis are based on detailed data sets gathered from enterprise survey and key informant interviews in five EU countries - Bulgaria, Greece, Estonia, Poland and the UK, carried out under the FP6 MOVE Project (2004-2007).

10.2 Overview⁶⁸

Outward Processing Trade

The leading role that international trade policies played in drawing and redrawing the global commodity map is undisputable, and one of its outcomes is the so-called '*quota geography*' of production. The pattern and intensity of the delocalisation process in labour-intensive industries is therefore strongly dependent on the implementation of trade policy measures; hence, policy issues have been central to delocalisation analyses.

The period after 2005 witnessed the introduction and enforcement of important tariff and non-tariff regulations concerning environmental, social and health standards. Currently, new anti-dumping measures are elaborated in order to protect the EU footwear industry. The latter have been initiated by large footwear producers such as Italy, which is despite the strong negative attitudes to the enforcement of such measures

⁶⁸ Footwear industry is grouped with textile and clothing industries in accordance with their common features as labour-intensive industries and the related common features of globalisation issues. In the literature the three industries are often examined as one sector designated as TCF (Textile, Clothing and Footwear).

in half of the EU countries. Special attention is given to labour-related issues such as working conditions, social movements, etc. These are considered to be important background factors for the spatial division of labour.

The delocalisation of production activities from the EU to the CEEC was enforced under Outward Processing Trade (OPT) agreements in 1980s. It flourished in 1990s after the political and economic changes in the post-socialist countries. The high intensity of outward processing was an outcome of '*special relation between cost-pressure and available skill-set and capacity of CEEC*' (Smith *et al.*, 2005). The OPT contracting continues to be in force although it formally expired in 1998. The OPT has undergone changes in the course of time not only in terms of quota volume, but also concerning the countries, regions and industries involved. The OPT aimed at providing support to the EU manufacturers and retailers particularly in terms of overcoming import quota restrictions under MFA and improving their competitiveness (Graziani, 1997; Dunford *et al.*, 2002). Prolongation of the OPT might also have a negative impact as it can undermine the competitiveness of home firms by forcing them to adopt defensive strategies. Some of the negative consequences are loss of jobs and closure of enterprises. While OPT was very important for the host CEE firms as it provided an opportunity to keep relatively stable levels of production and employment during the period of economic transition, the positive effects were short-lived. The OPT agreements have played a key role in establishing and deepening the existing linkages between companies from the old member states and the new member states (Pellegrin, 1999; Begg *et al.*, 2002). These linkages have been the basis for the establishment of triangular subcontracting networks later (Begg *et al.*, 1999; Kalantardis *et al.*, 2003). Most of the

recent joint ventures and FDI in labour-intensive industries in CEEC are based on previous OPT subcontracting relations (the case Italy - Bulgaria is a good example of OPT evolution in footwear industry). In this connection, Pellegrin differentiates the ‘*footloose off-shoring*’ in the LDCs such as Mexico from outsourcing to CEEC (1999).

In the European footwear industry OPT is still in force through the implementation of international subcontracting as a predominant form of organization of footwear production between old member states and new member states (Rabellotti, 2003). Many researchers have highlighted the asymmetric character of OPT contracts and their negative consequences for the development of companies and regions in CEEC. This is in the sense that subcontracting of basic manufacturing activities defines the low position of host firms in the value chain. Being locked in a position of dependence to foreign contractors host firms only have very limited prospects for upgrading, and most of them actually shift to downgrading (Graziani, 1997, Pellegrin, 1999, Smith *et al.*, 2005). CEE host firms that manage to upgrade are usually large companies with long-standing OPT relations, however, considering the huge number of firms involved in OPT such cases of upgrading are very rare (Smith *et al.*, 2005). OPT intensifies competition within the CEEC and their regions, “where cost pressure dominates and ‘undermines’ local firms’ positions” (Smith *at al.*, 2005). It leads to the fragmentation of the local industry, decrease of wages, de-skilling of the labour force, etc. (Begg *et al.*, 2003).

Analysing the competitiveness of the European TCF industry, in relation to the EU enlargement, Hanzl-Weis (2004) pointed out that Hungary, Slovenia and Romania were the main outward producers of footwear in the beginning of the 1990s. In the second

half of the 1990s Romania's export of footwear to the EU 'skyrocketed' between 1995 and 2001, while other CEEC market shares were stagnating or slightly decreasing. Currently, the footwear trade data shows that 90 per cent of the shoes and the intermediate products manufactured in new member states are exported to old member states (EC report, 2005).

Research Background

The delocalisation of production is a dynamic process with high complexity leading to a great diversity of organizational forms, network configuration and changes of functions ensuing from the distribution of power – control and rent distribution. The delocalisation forms are structured temporally, spatially and by sector and the diversity of organisational forms and production networks is a result of changing patterns of competition and governance in global contracting (Pickles *et al.*, 2006). A range of external and internal factors creates development opportunities and constraints for the firms and regions involved.

The most widely applied research approaches for studying the globalisation of labour-intensive industries are the GVC approach and the cluster approach, as well as the global production network approach (GPN). The latter includes elements of the GCC and elements of the GVC analysis, and actor network theory. Recently, different combinations of the above listed approaches are considered to be crucial for overcoming the limitations of any single research method.

Our survey is based on the main concepts of the GVC as a network-centred analysis. From GVC perspective the footwear industry is integrated into global networks of a

buyer-driven commodity chain, and the value comes from relational rents and from design, marketing and branding (Gereffi *et al.*, 2003: 3). The top position is occupied by the lead firm, which controls the access to major resources and rent distribution. Firms operate in different ways '*combining various production models*' within one commodity chain (Bair, 2006). This is relevant to a higher degree for companies, which operate mainly as subcontractors. Humphrey (2003) underscores that '*a diagnosis of value chain linkages and the particular requirements for competitiveness that they create*' is important to be analysed.

It is envisaged that participation in global networks creates development opportunities and advantages for improving company competences and for the development of new capabilities based on learning from foreign buyers. In this process the role of the lead firm (marketers, branded manufacturers, and retailers) is of key importance (Gereffi, 1999). Research on the footwear chain suggests that in some cases global buyers discourage, if not obstruct, the development of high value added activities by local producers, and the local upgrading opportunities depend on the way chains are governed (Schmitz *et al.*, 2000; Humphrey *et al.*, 2002).

CEE firms operating as subcontractors under OPT are more often involved in regional rather than in global chains, which lessens the learning effect (Pellegrin, 1999; Pickles *et al.*, 2006). Producer-producer OPT relations prevail over retailer-producer relations in the European labour-intensive industries (Bair, 2006) and this fact has a negative impact on the learning process.

Once a company has acceded to the chain, it needs to improve competitiveness in order to keep its position. Upgrading, which is a key concept in GVC studies, is '*essential to*

retaining a competitive edge in export industries' (Gereffi, 1999, Gereffi *et al.*, 2003), i.e. the firm has to move up to higher value added activities. There are four types of upgrading that are discussed by GVC scholars. These are Product upgrading, Process upgrading, Functional upgrading and Inter-sectoral upgrading (the latter is defined in terms of clusters, but in terms of GVC it is considered as organizational upgrading) (Humphrey *et al.*, 2000; Yoruk, 2001). From a GVC perspective, Rabellotti has summarized the processing stages in footwear industry as pre-assembly, assembly and post-assembly (2003). Upgrading of the networks' functions improves company competitiveness. The most important among these are the development of backward and forward linkages as well as performing key organizational functions in triangular configurations. However, CEE companies working as subcontractors (SMEs especially) have very limited ability to take key positions in the triangular production (Smith *et al.*, 2005). Recent studies on GVC focus on the impact of the international trade policy and the regional context of upgrading (Pickles *et al.*, 2006).

Company strategies depend on the company's access to resources, knowledge and freedom of decision-making, as well as on its capacity in terms of capabilities. The issue is strongly related to the ability of the host firm to first, *lock-out* from a dependent position and second, on the existing opportunities for upgrading (Evgeniev *et al.*, 2007). Humphrey (2003) defines the main strategy options for '**combating lock-in**' as market diversification, excellence in manufacturing, effective use of knowledge accrued from within the value chain'. Neidik and Gereffi (2006) argue that company strategies '*were devised in a particular national context*', and other authors analysing the topic in depth find out that there are regional aspects to strategies (Pickles, *et al.*, 2006).

A successful strategy is connected to the company's ability and capability to adapt to the dynamic global economic environment, to create and maintain appropriate vulnerability and quick response to the changes on both the international and domestic markets. Industrial upgrading strategies in terms of shift to higher value added activities cannot be regarded as panacea for successful economic performance. There are cases of redirection of upgrading or replacement of functional upgrading by process and product upgrading, or shift to lower value added activities. The latter strategies could in some cases generate better performance in terms of company sales and profits both in old member states and new member states (Amighini *et al.*, 2003, Pickles, *et al.*, 2006).

EU Footwear Industry

In 2003 more than 27,000 companies operated in the footwear industry of the EU-25, employing about 361,000 workers, while their turnover reached 26.7 billion EUR. If the figures for the new members - Romania and Bulgaria, are added the above figures will change significantly. Romania occupies second place after Italy in footwear industry (in terms of number of industry employees) and together with Bulgaria ranks among the top 10 footwear suppliers of EU-25 (in terms of value).

In recent EC reports (SEC, 2001; 2005) concerning changes in the EU footwear industry, the focus is on industry competitiveness particularly in relation to the processes of globalisation and EU enlargement. The outlined main features and trends of European footwear industry are as follows:

footwear industry has marginal position in manufacturing with 0.5 per cent of the total value added generated in the manufacturing sector and about 1 per cent of employment in manufacturing.

The *decline of firms, employment and production* from recent decades has not changed in recent years. During the period 1995-2003 160,000 jobs have been lost in EU-15 footwear manufacturing amounting to 32 per cent drop.

footwear industry is highly labour-cost-sensitive: labour costs account for 67 per cent of value added.

The productivity is low - about 40 per cent of the average for manufacturing. This is due to the *manual operations*, which cannot be automated yet.

The *increase of labour productivity* measured as value added per employee is pointed as a competitive advantage of the EU footwear industry, but it is mainly due to the decline in employment. The average labour productivity in NEW MEMBER STATES is equivalent to 30 per cent of that at EU-15 level, but *labour productivity was considered to be less significant than labour cost in influencing company decisions to delocalise*.

footwear industry is represented mainly by SMEs: 45 per cent of value added is produced in small, and 25 per cent in medium-sized enterprises.

The industry distribution within European countries shows *high concentration by country* - Italy alone produces 50 per cent of all EU footwear, and together with Portugal and Spain accounts for a share of 2/3. The new member states have significant contribution to the EU total accommodating 30 per cent of employment and producing 9 per cent of the industrial value added in the sector.

The increase of export in 2005 by 33 per cent as compared to 2004 came after years of grave decline. These figures, however, are far below the 1995 export data. In contrast, *the import growth trend* has been incessant for the last decade. For 2002-2005 alone its rate was 57.3 per cent. New member states export out of the EU less than 10 per cent of their production output and the rest of the export goes to the old member states.

In 2005 the pressure of cheap imports from China and Vietnam increased drastically the competition on the EU market. Imported shoes accounted for less than 50 per cent of the sales in 1995, but in 2003 three of any four pairs of shoes purchased on the EU market were imported from third countries. The European footwear market is evaluated as one of the most open markets. The trade liberalisation will support EU imports of raw materials and export of shoes for the higher price segment of the market on the one hand, but on the other hand - market penetration will increase competition.

The shift to low-labour-cost countries leads to strong decrease of production volumes in the EU, but the data for the industrial value added indicates twice slower decline than that of production volume. This fact is due to a range of factors but the most important one is that the value added activities remain in the home countries i.e. EU companies preserve higher positions in the footwear value chain.

It is also outlined that the specialised distribution and niche markets play a particularly important role in the European footwear sector and account for half of its turnover. A special relationship of reliable service and trust has been developed between retailers and consumers, in which children's footwear occupies a special place.⁶⁹

⁶⁹ Ibidem.

10.3 Research Objectives

The research questions put forward are grouped as follows:

Forms and Networks: Who delocalises activities and what activities are delocalised? In what kind of networks do the companies participate and what functions do they have within the network? What kinds of relationship are established within the networks? What is the distribution of power and dependence within the networks?

Company Strategy: What delocalisation challenges do the involved companies face? What actions do the companies undertake to cope with them? What kinds of company strategies are employed and which of them can be deemed 'successful'?

Delocalisation Effects: What is the delocalisation impact on the company's economic performance? What are the social consequences?

The created database consists of a detailed enterprise survey and key informant interviews. The survey of 119 footwear firms is based on in-depth interviews with managers, owners or other managerial staff of randomly selected enterprises affected by delocalisation in five EU countries. Two-thirds of the investigated firms are located in Bulgaria, Poland and the UK. Estonia and Greece have quite a small weight in the sample. The causes and effects of delocalisation of footwear production were further discussed with 26 key informants. These were national and regional experts, representatives of business associations, trade unions, and researchers.

10.4 The Survey

General characteristics

The survey was carried out between the end of 2005 and the beginning of 2006. A total of 119 footwear firms (with 17,056 employees) were interviewed. The average number of employees per company is the highest in Bulgaria (193) and in Poland (142). In UK and Estonia this number is about 100, whereas in Greece it is 44. Large firms, with more than 250 employees, are well represented in Poland and Bulgaria, which could be due to the legacy of the industrial structure during the socialist period (Figure 45).

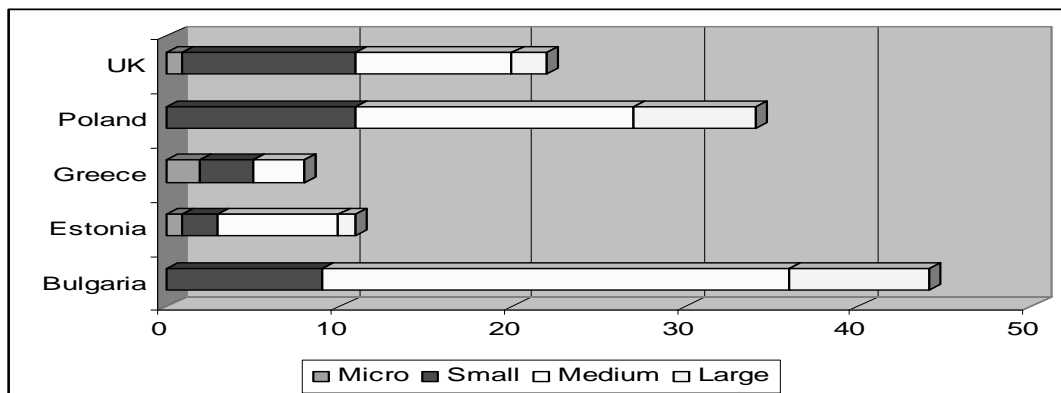


Figure 45 Distribution of companies by size, quantity

Source: Enterprise survey

The surveyed Greek and UK companies were established before the end of the 1980s (87 and 95 per cent respectively). The biggest share of Polish and Estonian firms was that of firms established in the first half of the 1990s, whereas half of the Bulgarian companies were founded in the second half of the 1990s. The emergence of the newly-established CEEC enterprises is especially linked to the post-socialist restructuring of CEE economies and the rapid increase of OPT with old member states inward.

The *product specialisation* of the surveyed firms does not differ from that of the EU footwear industry. More than half of the surveyed firms produce footwear with uppers of leather. The second place is taken by upper parts of shoes. A few firms produce footwear with uppers of textile (Bulgaria and Poland), high fashion sports footwear (Bulgaria and UK) and children's shoes.

Forms and Networks

In terms of ownership structure, in more than 90 per cent of the companies the equity capital is of national origin. The ownership structure in CEEC confirms the significance of international subcontracting or insourcing in the sector. Bulgaria has the highest share of FDI and joint ventures - 36 per cent (Figure 46).

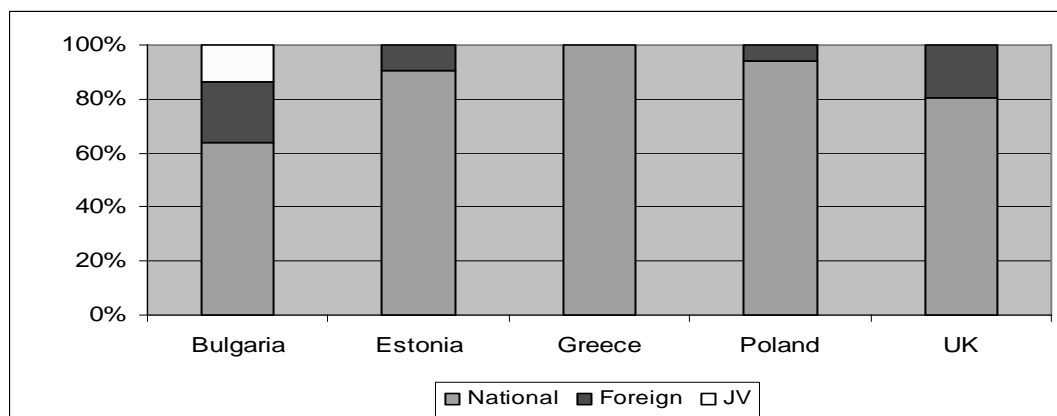


Figure 46 Ownership structure of companies

Source: Enterprise survey.

The *distribution of companies by forms of delocalisation* outlines the predominance of insourcing and outsourcing. Footwear firms in UK (68 per cent) and Greece (75 per cent) outsource production and have subsidiaries abroad (22 and 25 per cent, respectively). UK enterprises have joined the international networks with other activities

such as R&D. Insourcing predominates among 88 per cent of the companies in Poland, 98 per cent in Bulgaria and 91 per cent in Estonia. Bulgaria has the highest share of companies (23 per cent), which are affiliates to foreign companies, mainly Italian. One third of the Polish and almost the half of the Estonian firms outsource production. There are companies in Greece, which work under international subcontracting, but not a single one in UK does so according to the survey.

The results in Table 64 show significant **differences between insourcing and outsourcing** companies along a set of criteria. Having a subsidiary abroad shows a certain form of upgrading for the domestic firm since it tries to reach lower prime cost production and be close to its export market. Our data shows that only a limited number of footwear enterprises have subsidiaries abroad (25 per cent of the Greek firms, 23 per cent of the UK firms). However, an important outcome from our study is that there is a significant and strong negative relationship between companies that do subcontracting and have subsidiaries abroad ($r=-.39^{**}$). Moreover, the insourcing firms usually do not have subsidiaries abroad, whereas outsourcing firms do not show a pattern of determinant focus on having a subsidiary abroad. It becomes clear also that insourcing companies are predominantly not involved in outsourcing to firms abroad, which means that triangular manufacturing in Bulgaria, Poland and Estonia (mostly being insourcing firms, according to our sample) is present, but is very limited.

The companies from the sample were asked several questions related to their upgrading features when they first began delocalising. Thus, from the correlation analysis we detect two important characteristics of insourcing firms, which differentiate them from outsourcing firms. Firstly, most of the insourcing firms indicated that design and product

development were not among their competitive advantages at the beginning of delocalisation, which is somewhat different compared to outsourcing firms, which have less significant, but strong and positive relationship with this indicator. Secondly, most of the insourcing firms indicated that distribution and marketing were not among their competitive advantages at the beginning of delocalisation, as there is highly significant and very strong relationship between the variables, whereas in the case of outsourcing firms the relationship is not significant. This would mean that insourcing firms are somewhat weak in forward channels, whereas we could not identify what is the case for the outsourcing firms. Furthermore, the dependency on buyers is explicit as we analyse the competitive advantage of the footwear firms based on labour-intensive activities. We found a highly significant and strong positive correlation ($r=.69^{**}$) between the competitive advantage of labour-intensive activity at the beginning of the companies' involvement in delocalisation and at present. Moreover the relationship is even stronger ($r=.85^{**}$) when we take into account footwear firms which consider capital-intensive production as their competitive advantage.

Table 64 Comparison of two main delocalisation forms

Variables	Insourcing	Outsourcing
Firms with subsidiary abroad	-.39**	NS
Firms outsourcing abroad	-.62**	NA
Design and Product development as company advantages at the beginning of delocalisation	-.31**	.18*
Distribution and Marketing as company advantages at the beginning of delocalisation	-.26**	NS
After delocalisation, do you produce more complicated (high value added) goods?	.37**	NS
After delocalisation, do you have services like design, marketing, distribution, etc.?	-.26**	.25**
Your company is:		
part of a cluster/industrial district?	-.41**	.25**
part of a national subcontracting network	.32**	-.32**
part of a national network	.20*	-.20*
part of inter-firm trade (hierarchy type)	.16*	NS
Importance of intensity of competition	.26**	NS

Footnote: **correlation is significant at the 0.01 level (2-tailed); *correlation is significant at the 0.05

level (2-tailed); NS – non-significant; NA – non-applicable.

Many scholars consider that working under international subcontracting creates a possibility to learn from doing and one important effect of that is to move from assembly of simple goods to producing more complicated goods. Our findings support this claim, since insourcing firms have a significant and very strong and positive relationship with the variable, which explores the change of company's production from simple to more complicated goods. However, the learning opportunities have constraints. The survey demonstrates that moving to higher value added activities as design, branding, distribution, etc. is very difficult. If outsourcing footwear firms have managed to move to offering these services after delocalising of production ($r=.25^{**}$), the insourcing firms are found on the opposite side ($-.26^{**}$). This means that once the footwear firm begins

outsourcing, it has far more chances to upgrade and to take higher position at the value chain, compared to the firm, which is only insourcing.

The companies are involved in different type and number of networks presented in Figure 47⁷⁰. The insufficient sample of the Greek firms impedes the identification of this issue.

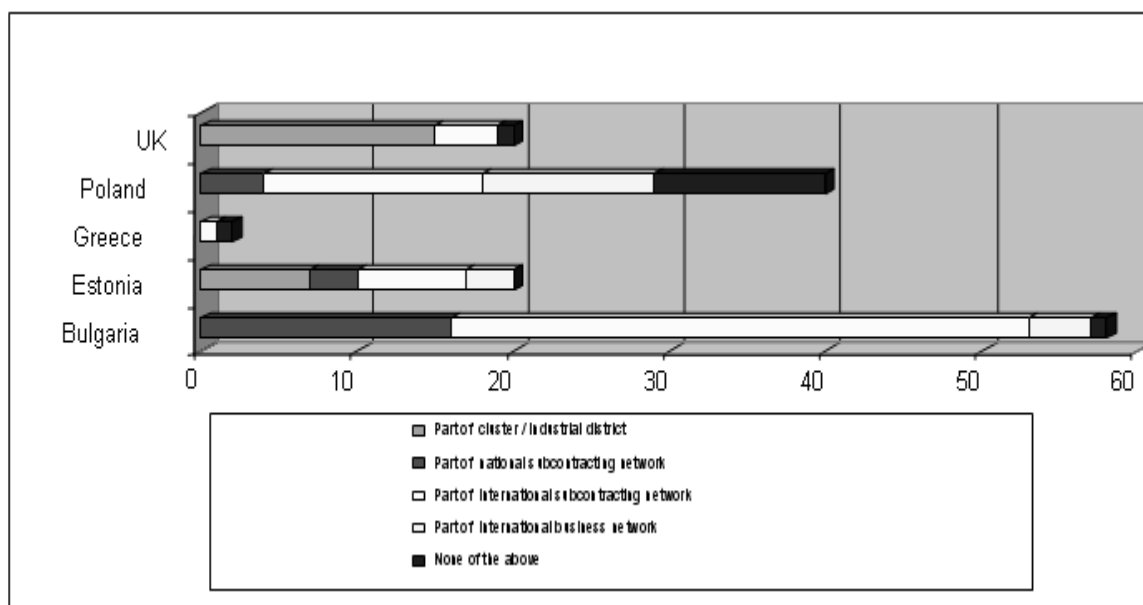


Figure 47 Companies' affiliation by type of networks

Source: Enterprise survey

The majority of the insourcing firms are not part of clusters/industrial districts, which is quite different for outsourcing firms (Table 64). Another important finding is that there is an opposite relationship of the comparison between insourcing and outsourcing firms in respect to the company participating in a national subcontracting network. If participation of insourcing firms in this type of network is important, the participation of

⁷⁰ The number of answers is higher than the number of firms.

outsourcing firms is irrelevant, as our results demonstrate. The national network concerns the second and third-layer subcontractors. Our findings indicate that there is a less significant, but medium to positive relationship between insourcing firms and participation in national networks, whereas outsourcing firms are outward oriented, as in their case there is the opposite relationship with respect to the same variable. Moreover, the type of inter-company trade characteristics is also important. The correlation analysis shows that there is less significant, but positive and medium relationship between hierarchy type inter-company trade and insourcing firms, whereas this relationship is not significant in the case of outsourcing firms. It is likely that intense market competition affects more severely the insourcing firms, compared to outsourcing firms. Highly significant and strong positive relationship is designated in the group of the former, while there is no significant relationship in the group of the latter, as we refer to our results. The firms in Bulgaria, Estonia and Poland more often participate in more than one network.

The survey provides information about the *changes of network functions* of the surveyed firms. The triangular manufacturing is a good option for firms from developing economies to upgrade their network functions, which yields higher value added. However, key functions in triangular manufacturing are still very limited in Bulgaria, Poland and Estonia.

The largest share of Bulgarian and Polish companies does not have any orders to local subcontractors and does not purchase intermediate products. Most of the Greek companies do not develop their contacts with local subcontractors and some of them reduce the existing linkages. Similar practice is applied by two-thirds of the UK firms.

In terms of *export*, on average 57 per cent of the total sales of the surveyed footwear enterprises was directed to international markets (Table 65). Bulgarian and Estonian firms are largely export oriented. The average share of subcontracting is 60 per cent for the whole sample, but it varies significantly - from 91.5 per cent for Bulgaria to 0.0 per cent for UK and Greece. The companies' ranking of the most important factors for receiving orders from foreign firms is as follows: labour costs, expertise, reliability and geographical proximity.

Bulgaria takes leading position in terms of the share of export in the total sales. The largest share is attributed to subcontracting-based export and almost half of it – to export of intermediate products.

Table 65 Export and subcontracting in 2004

Country		Exports share of total sales	Share of total exports on subcontracting basis	Share of intermediate products in total exports
Bulgaria	Mean	82.2	91.5	46.5
	N	43	43	43
Estonia	Mean	65.9	64.6	33.5
	N	11	11	11
Greece	Mean	8.7	0	0
	N	6	6	0
Poland	Mean	42	71.0	34.4
	N	31	29	30
UK	Mean	38.8	0	0
	N	22	22	1
Total	Mean	57.2	60.4	39.6
	N	113	111	85

Source: Enterprise survey

The share of export in total sales has not changed for half of the companies since the beginning of delocalisation, and for more than two-thirds of UK and Bulgarian firms. It has increased to 35 per cent for all firms and for some of them this increase is considerable. These positive trends are registered by 72 per cent of the Estonian firms,

60 per cent of the Polish firms and by less than 20 per cent of the Bulgarian, Greek and UK firms. A decrease of the export share has been noted for about 10 per cent of the UK and Polish firms.

The weight of subcontracting indicates the *degree of dependence* on foreign firms. The export of more than 80 per cent of the Bulgarian and Estonian companies is fully (100 per cent of their export) on subcontracting basis versus only one third for the Polish firms. Above 80 per cent of Bulgarian and Polish firms sell their production under a foreign company's brand name.

The surveyed companies specify three main markets (accounting for more than 50 per cent of the company's export). In Bulgaria, 73 per cent of the companies export to Italy and the rest - to Germany, Greece, and UK. In Estonia, 87 per cent of the companies export to Finland. Greek firms have various external markets - Germany, UK and Russia. Poland's main markets are the old member states.

Almost 71 per cent of the Polish and 84 per cent of the Bulgarian firms have up to 5 customers. The established contacts may be considered optimal for the company's stability in this case. Higher diversity by number of customers is observed for the Estonian firms, because wholesalers are their main clients. In the case of Bulgaria and Poland manufacturers have the leading position among the types of customers, followed by wholesalers and large retailers. Therefore, the production networks are more important than the buyers' ones. Half of the Bulgarian firms and two thirds of the Polish firms practice splitting of the risk of loss of orders by using local second-level subcontractors.

The nature of relationships between partners characterizes the distribution of power and access to resources, knowledge and freedom of decision-making. The selected variables are presented in Table Table 66. The answers were given by companies, which insource production, and therefore UK firms were excluded. The obtained results allow formulation of the following findings:

The relationships are of high stability and contacts are signed rather regularly than whenever necessary.

The control of the production process by the main contractor is often flexible rather than tight.

Almost all Bulgarian and Estonian firms have formal contracts both with their contractors and their subcontractors, which is not a common practice in Poland.

Personal contacts in establishing business links are important for all Estonian companies and for the half of the Bulgarian and Polish firms.

The most frequent manner in reconciling differences of opinions in the Estonian, Polish and Bulgarian companies is by striking a balance (in this case answers account for the lowest share for the three countries). In Bulgaria the decision of the main contractor is dominant for 44 per cent of the companies.

Interruption of relations with customers will lead to moderate or slightly negative effects according to 60 per cent of the Bulgarian and the Polish firms, but it will be severely negative for 70 per cent of the Estonian firms. For the past 3 years half of the Bulgarian firms and 73 per cent of the Polish firms have cancelled contacts with customers. The most frequently pointed reason is a financial one.

Table 66 Main features of relationships in case of insourcing (in per cent)

		Bulgaria	Estonia	Greece⁷¹	Poland
Stability of links	High stability	93.0	80.0	100.0	73.3
Frequency and type of contacts	Regularly	65.2	70.0	0.0	80.0
	Whenever necessary	30.2	30.0	100.0	13.3
	When possible	4.6	0.0	0.0	6.7
Nature of contractual relationship	Formal	88.4	90.0	0.0	46.7
Do you have contracts with your subcontractors	Yes	58.5	90.0	0.0	46.7
When there are differences of opinion, who wins?	You	0.0	0.0	0.0	0.0
	Main customer	44.2	20.0	100.0	33.3
	We find balanced decision	55.8	80.0	0.0	66.7
What would be the implications of breaking down of the relationship on you and your partner?	Severely negative effects	34.9	70.0	0.0	36.7
	Moderate negative effects	44.2	30.0	1	10.0
	Slight neg. effects	20.9	0.0	0.0	53.3
How important are personal relations as opposed to formal ones for you and for your partners?	Very important	23.3	40.0	0.0	30.0
	Medium importance	18.6	50.0	0.0	13.3
	Slightly important	25.6	10.0	0.0	13.3
	Not more important	32.5	0.0	0.0	43.4
Have there been cases when relationships have collapsed?	YES	51.2	50.0	0.0	73.3
How does the main contractor control the process of the work?	Tight Control	34.9	10.0	0.0	25.0
	Flexible Control	65.1	90.0	100.0	75.0

Source: Enterprise survey

Company Strategy

Our survey investigated company objectives for the period 2000 – 2005. The responses of the managers of the companies may be divided into five groups. They differ mainly according to the position of company in the life cycle curve, position in the value chain and position in the commodity chain.

⁷¹ Greek firms which insource footwear production.

Operational improvement, product development and capacity expansion are expressed in the following manner: to increase or keep the level of production output and orders from customers; to increase the volume of production of uppers; to modernise the machine park, improve the quality; to start cutting uppers, not only sewing them; to introduce in the company product mix children's footwear; to implement IT technologies that enable better production control, management and supervision of distribution.

Market development as a priority objective is structured in several subgroups: to set up a retail network (distribution network and trade contract), develop company's own chain of retail shops, open and develop Internet site in order to have broader access to clients, create company's own trademark and brand for securing the position (brand building), penetrate and get established on the European market (Western markets – i.e. France, Germany, etc.) and the markets of Russia; sell directly to big companies; penetrate markets demanding higher quality and price, produce shoes for uniformed services.

The most popular financial objectives are as follows: to enhance financial liquidity, improve collection of receivables from sales; keep the profit margin at a stable level; cut down costs; organize production of high value added goods.

Social objectives: to improve working conditions for workers; limit employment reduction or stabilise the number of employed workers; provide training to employees to understand and use newly implemented technologies.

The corporate restructuring and strategic alliances development objectives, which are very rarely articulated, are the following: to split the company into several divisions (office department, sewing workroom, production department), get rid of unnecessary

property, develop strategic alliances with other firms from the sector to better compete with other rivals.

The companies take a range of upgrading actions towards these objectives, but two are of utmost concern – product range and functions.

Product Range

The decisions about selection of the product range are entirely determined outside the companies in the cases of outsourcing, subcontracting and subsidiaries of foreign companies. In these cases, the contractors' headquarters assign orders for production to the companies that are merely producers. The functions regarding market studies, creation of new models and marketing of the production are not developed in these companies.

In the companies producing their own brands of shoes, the top management level takes the decisions about production variety either alone or in co-operation with designers and marketing specialists. The surveys of the market, the fashion trends, the customers' taste and dealers' requirements are everyday activities in the company.

Such decisions spin around two pillars. The first one is associated with narrower specialisation and response to the needs of specific client groups, e.g. dancers, uniform staff, athletes, etc. The second most often used possibility is to scrutinize the market trends and offer quick and the most adequate possible response to the demands in several broader segments such as male or female casual or high quality shoes. Purchasing of new cutting-edge technologies is another possibility for launching new models of shoes. A mixed approach for choosing a product range is also used where part

of the production is ordered by an external customer and the remaining part of the production capacity is used to produce an own brand of shoe products.

Function (changes in the firm's position in the chain)

The majority of the investigated companies thought that they were moving up the value chain. The most frequent statements were: 'We have moved up the commodity chain from manufacturing to brand management, marketing and design.' These companies take activities, which demand special knowledge and skills, changes in production activity into designing. Another way for upgrading is by using the possibilities for outsourcing of the production functions and activities. Thereby, for example, some of the companies stated: 'The company upgraded its position thanks to higher level of outsourcing to factories in Poland and India.', 'Development of company's own distribution network', 'Subcontracting part of footwear production to China.'

Some of the producers in the UK have entirely ceased their production activities, as they have outsourced production abroad and are only dealing with distribution at present. ('Move away from manufacturing to 100 per cent outsourcing. We emphasize on wholesaling and retailing', pointed out by firm Stead and Simpson).

Only a small number of the surveyed companies reported upgrading in the value chain, while a large part of the companies in the sample did not report any change in their chain position. This is mainly because the nature of the orders from their contractors has remained unchanged. Even in these cases, the companies claim that they are dealing with the production of more complicated models of shoes or parts thereof. Others report

that they have obtained a license of the factory from big companies such as Reebok and Asics.

Delocalisation effects

All the interviewed experts have given prominence to the strong impact of globalisation and internationalisation on the configuration of national footwear industries. The respondents have estimated that outsourcing of production activities allows the *home* firms to cope with the global market challenges and increase profitability. The role of a competent firm management is underlined as crucial. The positive effects, indicated in key informant interviews, are structural changes in national economies, shift of firms from low value added activities to higher value added activities including trade (Greece), retailing and design (UK). The pointed out negative effects are decrease of the production volume and number of employees involved in processing activities (UK), decline of the company's competitiveness (Greece), etc. Experts argue that *host* firms gain from delocalisation through learning. The introduction of know-how in new organizational technologies and training in international production and marketing practices has lead to an increase in branch competitiveness, employees' skills and qualifications, and aspiration for better education and training. Other effects are improving of labour productivity and quality, development of supporting additional activities; incentive for development of own product and own design parallel to subcontracting. The negative effects for host firms have been indicated as follows: full dependence on foreign or national contractors (owners, middlemen), de-capitalisation of

the companies, short-term development prospects, worsening of labour conditions and low wages.

The *trends of economic performance*, as consequences of involvement in delocalisation, outline that one fifth of the interviewed firms did not experience any changes in terms of profit and turnover. More than half of the firms report increase and some of them –significant increase - of turnover and profits. Companies that have faced difficulties in managing new challenges constitute 24 per cent of the sample, and most of them are in Poland. The UK and Bulgarian firms have succeeded to keep and increase the employment, turnover and profits after delocalisation, although different factors stand behind these two cases. The UK firms pointed the shift to the market niche production and development of high value added functions, such as design, marketing and distribution. Bulgarian firms gain from labour-intensive low-cost activities such as production under orders from abroad and production of upper parts of shoes. The Estonian and Polish firms shift to upgraded production process. They produce ‘more complicated goods’ ordered by foreign firms. The Greek firms gain from cost reduction, because they do not develop high value added functions like the UK firms, and most of them do not diversify their production activities.

The labour cost grows in the CEEC and its share as a percentage of the total costs increases considerably for more than 70 per cent of the companies in each country (Figure 48). This fact may lead to a shift of production to locations with cheaper labour price in next years. In UK half of the firms have reduced their labour costs, because they outsourced labour-intensive activities. Two thirds of the Greek firms have not reported about any changes.

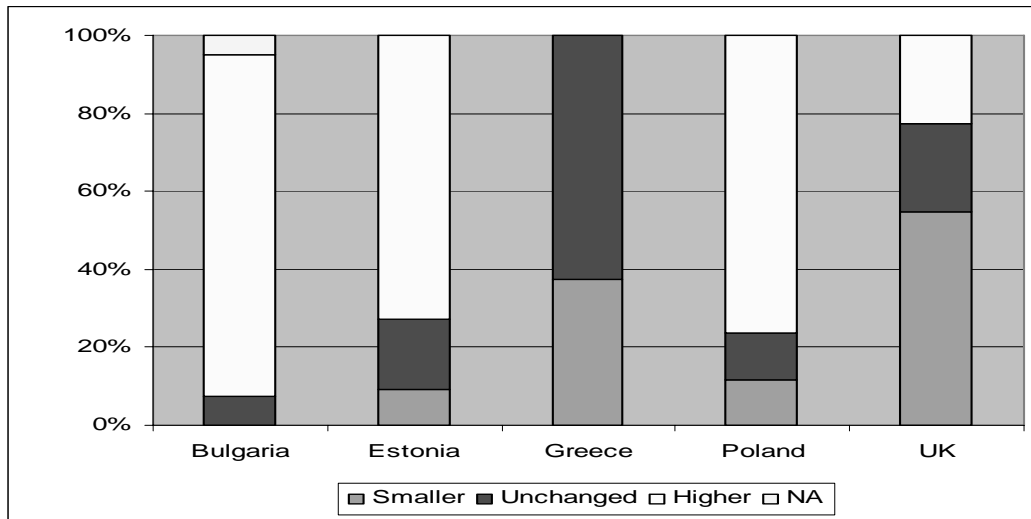


Figure 48 Changes of labour costs as a share of total costs

Source: Enterprise survey

Delocalisation processes also have significant *social consequences*. The shift of jobs has different social, quantitative and qualitative, dimensions in the home and host countries. The changes in employment by comparing the situation before and after delocalisation show considerable reduction of the number of employees in the UK firms and much less in the Greek firms (Figure 49). Within the new member states, Bulgarian and Polish firms display considerable increase of the number of employees, while 2/3 of the Estonian firms report a decrease in the number of employees.

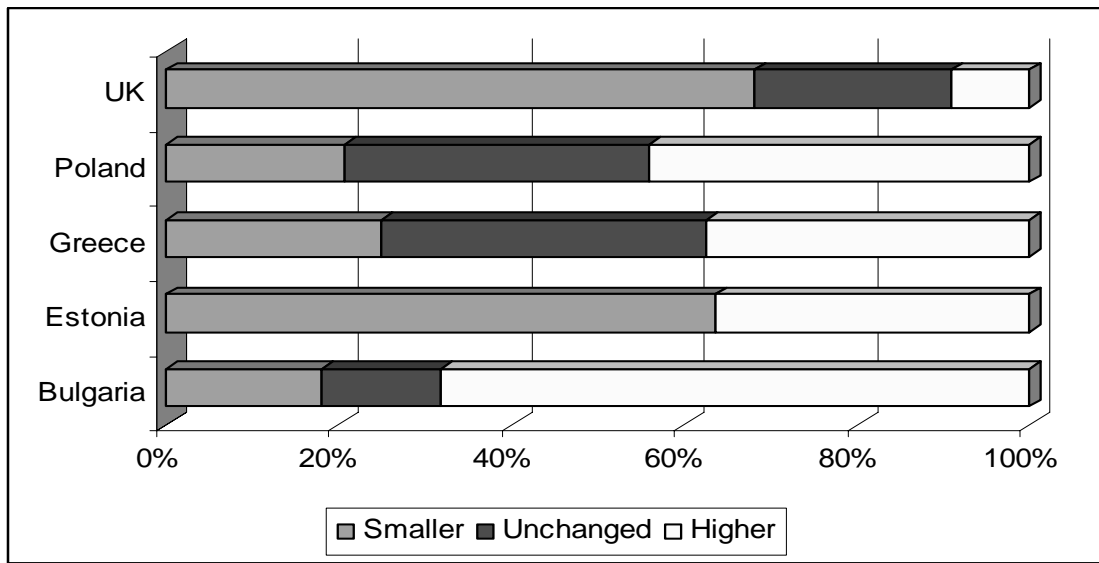


Figure 49 Employment changes after delocalisation

Source: Enterprise survey

The quantitative changes in employment are accompanied by qualitative ones - increase of the number of employees with tertiary education and ‘white collar’ workers. The changes in the quality of company’s personnel by country disclose the type of activities developed during the delocalisation and the changes in position within the value chain. The increase of the share of highly educated personnel in half of the UK firms confirms that they have managed to retain higher value added activities within the UK. The development trend with respect to the white-collar personnel hints at keeping of administrative functions connected with production organization enlargement. In contrast, the employment rate of both groups in the rest of the countries under investigation has slightly changed. This fact shows their capability to respond to delocalisation challenges.

Interviewed experts from the investigated countries point out that *wages* in the footwear industry are lower than in the other labour-intensive industries and in manufacturing as a whole. The surveyed companies have compared the wages they pay to the national average ones in the footwear industry. Average and higher wages are paid in UK firms (46 and 36 per cent of the firms respectively) and in Bulgarian firms (45 and 50), but the wages in Estonian and Polish firms are either average or lower than average. The wages correspond to the labour market potential of footwear industry employees. Scarcity of labour is reported by 80 per cent of the Bulgarian firms and 73 of the UK firms. In Poland this share is 65 per cent.

Delocalisation influences the changes in labour contracting. Half of the Estonian companies report a decrease in the number of temporary and part-time employees. One-third of the Polish firms have increased this type of labour contracting. According to the key informant interviews, certain part of employment is seasonal, which has led to an increase in the level of temporary unemployment in Poland and Greece. In Bulgaria, labour contracts are mainly permanent. When firms have large orders, they employ part-time workers or extend the working time of the permanent personnel. On the other hand, low wages, unattractive work (monotonous, etc.) and bad working conditions are in some cases factors for frequent personnel changes in this industry in all countries under investigation.

The interviewed experts in Poland and Bulgaria are concerned about the low degree of observance of the labour regulations related to contracts and working conditions. There are cases of informal employment in terms of contracting and tax payment in small companies.

10.5 Conclusions

Outsourcing and insourcing linked *home* and *host* firms in the European footwear value chains. A high degree of industry consolidation is observed in all countries (except Greece). The footwear firms are mostly incorporated in regional production networks. The UK firms are an exception to the above case, since their networks are global and buyer-driven.

Classic patterns of upgrading, which lead to the top of the value chain, are achieved by UK firms. UK footwear export indicates a movement towards production of specialised and designer footwear. Vertically integrated companies with an overseas network of suppliers dominate the UK footwear industry. One of the specificities of the UK footwear sector is the complex distribution and retail structure.

After the sector readjusted by declining significantly, *Greek firms* have gained again a momentum to preserve their position somewhere in the middle level of the value chain. The production under subcontracting takes significant place in the export of footwear. More recently some enterprises tried to develop in the field of design, however the majority of the companies prefer outsourcing of production to suppliers from neighbouring low labour cost countries.

German and Italian footwear firms have been outsourcing production to *Poland* under the OPT agreements since the beginning of the 1990s. Recently, the share of subcontracting production in the total output has decreased, mainly because of the changes in the exchange rates and the growing labour costs in comparison with other Eastern European countries. Some Polish firms subcontract production to other countries, aiming to implement new organisational functions as network organizer of

triangular manufacturing. A few Polish firms are trying to locate factories in Ukraine, Russia and Belarus and to gain access to these markets.

Most of the *Estonian* footwear enterprises are involved in cross-border production networks being subcontractors to Finnish and Swedish firms.

The *Bulgarian* footwear industry occupies a low position, from a GVC perspective, producing parts for shoes, semi-finished products and shoes on subcontracting basis. Some of the large former-state enterprises have succeeded in keeping their contacts with UK and other EU firms dating back to the period before the end of the 1980s. In the second half of the 1990s many Italian firms outsourced production to Bulgarian firms. Some of them have established joint ventures or bought ex-state large enterprises. Many of exporting Bulgarian footwear firms take advantage of the demand on the domestic market, for which they produce own brand production and develop company's retail chains.

The experience of Greek and Polish companies in taking the position of intermediates in the chains (functional upgrading) did not bring the expected success. Their strategies comprised targeted stabilization of their current position rather than boosting to a higher one in the European footwear chain.

The long-standing incourcing by firms from CEEC affects strongly their ability to upgrade. The large shares of their export on subcontracting basis indicate the high degree of dependence on the main contractor. The effect of learning is one-sided and leads to manufacturing process improvements only, thus '*pinning firms down*' at their current low position in the chain. There is no access to a broader set of knowledge, which may be beneficial for the firms in their attempt to become internationally

competitive. A very small number of cases were found where the companies demonstrate capabilities to absorb and implement knowledge about international markets. Industrial upgrading is considered by managers as an improvement of existing activities rather than as a shift to activities implemented at the top of the value chains. Some managers have realised the need of such a shift, but they estimated its constraints. They find solution in increasing the number of contractors and the size of orders instead of moving up the chains. In fact, market diversification is considered in quantitative and not in a qualitative way. The cases of strategic mix of market diversification, excellence in manufacturing and effective use of knowledge, are rare. The companies' competence level confines them in the best case to the domestic markets.

The further trade liberalisation and the EU enlargement will continue to reconfigure the production linkages between member states. The role of other European countries, non-member states will increase in European footwear production.

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**B) DELOCALISATION, SPECIALISATION AND SPATIAL
COMPETITIVENESS OF EU FOOTWEAR INDUSTRY**

Stoyan Totev, Grigor Sariiski

10.7 Introduction

This Chapter analyse the footwear industry delocalisation in EU-27 by exploring the processes of location, specialization, trade performance, revealed comparative advantages (RCA), countries competitiveness, etc. The analysis is based on secondary and primary data information. The primary data includes information gathered by the fieldwork investigation proceeded under the elaboration of the MOVE Project. The results for the footwear firms are juxtaposed with the one obtained for all investigated branches.

The study discusses the potential benefits of the delocalisation from the different positions that the participants have in this process. Possible future scenarios and prospects are also analysed. Finally there is an attempt for some conclusions to be drawn.

10.8 Specialisation and competitiveness of footwear industry

Footwear industry is highly located among EU countries.⁷² The coefficients of absolute concentration (Herfindahl index) are one of the highest for the manufacture branches in 2004, (NACE Division 15-37). The index for relative manufacture concentration (Krugman index) is the highest for the footwear industry – 0.86. It was found that the location by countries is tightly related with the geographical position of the countries –

⁷² Location – the part of the footwear industry for given country from the total footwear industry for EU-27. Specialization – the share of the footwear industry in the total manufacture.

mainly South and Southeastern countries, (Table 67, column 7). The export and import data by countries proves that the location coefficients in the new member states and specifically for Bulgaria and Romania are result first and foremost due to delocalisation processes, (see the section International trade).

The process of specialization in footwear industry measured by the share of employed can be directly linked with delocalisation process. The patterns of the GVA and the employment of the EU-15 are showing a tendency where the value added produced by the footwear industry has decreased with a much slower pace than the employment. This can be attributed to two main adjustments, (Economic, 2005):

Decreasing of the lower segments of the footwear production with higher pace as a result of the international competition and shifting the production of the EU-15 to more high-quality products, which offer greater value added.

More intensive decrease of the lower segment can be result also of delocalisation processes, when EU-15 countries relocate part of the production processes with low value added to other countries, such as Romania and Bulgaria.

Table 67 Main indicators of the EU footwear industry (2003)

Indicators	Revealed Comparative advantages (RCA)	Employment changes 2003/1999	GVA/personal cost	Investment per employment	Specialisation (Labour)	GDP per Capita (in PPS) / EU=100/	Number of persons employed / EU=100/	Labour product. (in PPS) / EU=100/	Labour productivity / EU=100/	
	1	2	3	4	5	6	7	8	9	10
	Footw	Footw	Footw	Footw	Footw	Total	Footw	Total	Manuf	Footw
Measures	-	%	-	(000 of €)	%	-	%	-	-	-
EU	-	83	1.31	-	2.2	100	100	100	1.00	1.00
Austria	1.06	-	-	3.0	1.2	124.1	0.61	111.5	1.33	2.21
Belgium	0.74	71	1.31	3.4	0.3	119.4	-	129.5	1.7	-
Cyprus	0.34	-	-	2.0	1.7	84.3	0.08	78.1	0.6	-
Czech R.	0.36	58	1.04	0.4	1.5	78.3	2.99	73.5	0.26	0.45
Germany	0.35	86	1.35	2.8	0.4	109.9	2.38	102.5	1.28	2.84
Denmark	0.59	-	-	4.0	0.4	127.8	-	109.5	1.3	-
Estonia	1.26	-	1.27	1.6	2.0	66.2	-	63.2	0.22	-
Spain	1.51	86	1.27	1.9	2.7	99.9	9.12	98.2	0.93	1.19
Finland	-	81	1.31	2.5	0.7	117.5	0.39	111.4	1.74	3.46
France	0.8	83	1.32	2.5	1.2	109.2	3.95	120.7	1.29	1.71
Greece	0.66	78	-	-	2.4	85.1	0.64	101.2	0.84	2.11
Hungary	0.84	80	1.06	0.4	2.9	65	3.01	73.7	0.31	0.45
Ireland	-	57	1.59	4	0.3	141.8	-	130.5	3.42	-
Italy	3.67	92	1.28	3.4	4.7	102.3	26.99	108.2	0.93	1.75
Lithuania	0.46	40	1.29	0.7	1.2	57.6	0.29	57.6	0.13	-
Luxembourg	-	-	-	-	-	223	0	-	1.5	-
Latvia	0.31	71	-	-	0.4	53.9	0.04	52.2	0.26	-
Malta	-	-	-	0.8	-	72	0.1	-	0.56	-
Netherlands	0.5	78	1.3	8.3	0.3	126.6	0.31	109.6	1.35	4.35
Poland	0.86	70	1.24	0.6	2.0	53.2	5.39	64.3	0.59	0.75
Portugal	3.95	89	1.23	1.5	7.2	70.1	10.57	65.6	0.49	0.64
Sweden	-	87	-	2.7	0.2	118.2	0.08	107	1.2	-
Slovenia	1.11	-	1.42	1.5	3.6	84.3	0.82	80.3	0.37	-
Slovakia	1.72	-	-	1.2	4.6	60.6	3.93	67.7	0.25	0.34
UK	0.34	51	1.8	2.0	0.5	118.9	1.68	109.7	1.38	4.02
Bulgaria	2.89	103	1.14	0.4	3.7	35.1	3.52	35.4	0.08	-
Romania	6.62	123	1.53	0.5	7.2	37.8	22.36	42.7	0.09	0.12

Sources: Eurostat, UNCTAD/WTO; <http://www.intracen.org/countries/>; Economic, 2005 p. 9.

Here one can put the question, which of the above main adjustment plays more significant role in the case of footwear industry. Having in mind that Falk and Wolfmayer (2005), p9 found that outsourcing in low wage countries is highest for leather and footwear industry as well as the results of the primary data from the field work, it can be maintain that the main adjustment goes through delocalisation. One example from the fieldwork analysis is the estimated Spearman's rank correlation between the position in the production chain (Q131a – question 131a from the field work investigation) and subcontracting of labour intensive products (Q183), which shows significant negative coefficient of correlation – 0.6.

One interesting observation is the differences between the labour productivity for all manufacture branches and footwear industry, (Table 67, columns 9 and 10). The variation for the footwear is significantly higher than for the total manufacture branches – the standard deviation for the footwear industry is 1.4, while for the manufacture sector is two times less 0.7. One example is the ratio of labour productivity between Romania and UK, which is 1:15 for the total manufacture productivity, while for the footwear industry is 1:36. These differences can find explanation with the specific flexibility of the footwear industry to delocalise low labour productivity activities to countries with low labour cost, Falk and Wolfmayer (2005). The results of the field survey fully support such explanation – the difference in the labour cost is pointed as a main reason by 77 per cents of the UK companies to get involved in subcontracting/outsourcing activities (Q164). There is a very strong correlation between the question does your company give subcontracting (Q5) and the higher labour cost of production (Q164) – the coefficient of Spearman's rank correlation is 0.8. The

significant variety of the labour productivity for the footwear industry is also a result of the fact that given companies are delocalising their labour intensive activities (Q183a) and reorient in production for specific market niches (Q28) that is allowing them to realise high value added production – there is significant Spearman's rank correlation between the answers for these two questions.

Something that is quite notable is that no matter of the big variation of the indicator labour productivity the coefficient of variation for the indicator GVA/per personal cost is quite low – the standard deviation is only 0.2, (Table 67, column 3 and 8). Even the standard deviation for total manufacture labour productivity is higher – 0.3, (Table 67, column 8). Again this is indicative for the specific flexibility of the footwear industry to delocalise part of the production depending on the factor endowments at personal cost.

There is a strong correlation between the dynamic of decreasing of the employment in the footwear industry and the indicator of GVA/personal cost for the EU-15 – coefficient of linear correlation minus 0.7, (Table 67, columns 2 and 3). This is showing that the EU-15 countries are gaining high position in the value added segments due to decreasing their activity in the low segments of the footwear sector. We found confirmation of this statement in the results of the field survey – 50 per cents of the UK companies in the sample affirmed that they upgraded the position of their company in the supply chain.

10.9 International trade

No matter the strong competition from low-wage countries (above all from Asia), and the fall of the exports, still EU preserves its strong position. The RCA indexes for footwear industry are declining for many countries but they remain higher than 1.0 for:

Romania 6.62; Portugal 3.95; Italy 3.67; Bulgaria 2.89; Slovakia 1.72 and Spain 1.51, (Table 67, column 1).⁷³ The intra industry trade is significant what concerns trade between developed countries (mainly Italy) and less developed new member states (mainly Romania and Bulgaria). Most EU-15 import from Romania and Bulgaria is actually due to parts of footwear that are used to make further parts or finished products that are subsequently re-imported into the EU-15. The increase of the intra industry trade can be attributed mainly to the increasing of the horizontal trade, respectfully to the delocalisation. Hoekman and Djankov (1996), outlined the strong relation between the RCA indexes, intra industry trade and FDI, respectfully to horizontal specialization and delocalisation. One can see from the result of the field survey the gradation of the intensity of intra-industry trade by comparing the average share of the purchases of intermediate products that come from abroad (Q158). These variables are higher for all countries that undertake subcontracting. In the same time it is observed significant Spearman's rank correlation between orientations of production of parts of product (Q24) and undertaking subcontracting (Q4).

The export and import between Italy from one side and Bulgaria and Romania from the other is mainly in the low cost segment of the value chain. The share of the Romanian export to Italy in 2005 accounts to 71 per cents from the total export and the share of the import from Italy is 63 per cents; these figures for Bulgaria respectfully are 73 per cents and 36 per cents.⁷⁴ The Poland trade relations are mainly with Germany and Italy while

⁷³ The index measures the country's revealed comparative advantage in exports according to the Balassa formula.

⁷⁴ Sources: UNCTAD/WTO

the Estonian are with Finland. The analysis of trade specialization revealed that it is stronger for the new member states and this specialization is due to the delocalisation processes. The more developed is a new member state the less developed is the one sidedness of the intra industry trade the less intensively is the delocalisation processes in footwear industry. One can see these explanations confirmed by the results of the field survey by comparing the share of the most important companies in terms of the contracts that the enterprises in the sample give to them (Q168). These figures have the highest values for Bulgaria (80 per cents on average) and far lower values for Poland (23per cents on average). From here on and from the answers of other questions (like Q22) one can conclude that the more developed is one new member states the more successful is in diversification of its business relationships.

The Enterprise survey proved that both sides involved in the delocalisation process significantly increase their export activities. A high level of threatening in terms of import penetration is observed in all countries. Bulgaria and Estonia are less threatened in terms of difficulties to export. The only one explanation for the low levels for Bulgaria and Estonia is that their export is realized on their subcontracting bases as semi-finished products, in this sense they are not threatened in terms of difficulties to export. Their relationships with the contractors are quite significant on subcontracting basis for the two countries – respectfully 91 per cents and 65 per cents. This can be proved and from the interesting observation that Bulgaria and Estonia from one side and Poland from the other have a big difference between the answers about the competition intensity – Bulgaria 3.7, Estonia 3.2, while Poland face fierce competition 4.7 – maximum level 5.0 (Q112).

10.10 Delocalisation processes – Enterprise survey

Regional profile

As it can be expected the Enterprise survey data revealed that in Bulgaria and Poland the urbanized areas are threatened mainly by high quality products, while the group of the other towns and villages are threatened by low quality products.⁷⁵ It is observed a different picture of benefiting (profits) after delocalisation by regions, (Table 68). For Bulgaria we have high figures for the ‘Capital’ and the ‘Other towns and villages’. Similar distribution can be observed in Poland between ‘NUTS II centres’ and ‘Other towns and villages’.⁷⁶

This distribution is in conformity with the observed regional distribution of the FDI, (Totev, 2005). Part of the FDI is attracted more from better communications, infrastructure and potential of the market in the urbanized regions than the cheaper labour force of the less developed regions -- wage-cost competition does not play important role for regional reallocation of these FDI inflows. Other FDI flows are pointed to regions where factor endowments as wage-price cost play main role for attracting them. The regional delocalisation of the footwear industry is following the same patterns. If one look at the picture for the other observed branches it will be seen similar distribution but not so distinctively expressed.

⁷⁵ The distribution of data for the other countries is not allowing this indicator to be interpreted.

⁷⁶ In Poland the NUTS II centres as agglomeration are quite bigger than Bulgarian’s NUTS II centres.

Table 68 Profits progress after delocalisation /footwear/

(average figures 1: considerably smaller - 5: considerably higher)

	Capital	Regional centre (NUTS II)	Regional centre (NUTS III)	Other towns and villages	Average progress
Bulgaria	3.71	2.33	2.78	3.33	3.20
Poland	--	3.50	2.54	3.37	3.06

Sources: Enterprise survey

The regional analysis revealed that there are quite different economic characteristics between the firms participating in the delocalisation process – those in the urbanized areas and the ones in the lagging regions. Probably the only one matching point is that the profits in these two groups are higher compared to the companies’ profits in the other area. Typical features for the companies involved in the delocalisation process in lagging regions are that: their production is less diversified what makes them less flexible to the changing conditions; their competitive advantages (CA) are concentrated mainly in producing labour intensive products; they are using low intensity technology; they are threatened from low cost products; they are more dependent from their partners and the breaking of the relations with the partner will have more significant negative after-effects for them. It is observed significant Spearman’s rank correlation between question settlement type from one side and ‘What is the position in the production chain’ (Q131a); ‘What were the objectives for your company’ (Q85); ‘Functions changes in the

position of company in the supply chain' (Q88a); 'Origin of competition' (Q111) and others.

Enterprise survey of the competitive advantages (CA)

The number of different CA pointed from the companies before and after delocalisation is definitely positive for Bulgaria and not so much for Poland. Actually these are the countries that realized obvious increase of CA. No one from the other countries have negative balance as well. The Enterprise survey analysis revealed that in Bulgaria in terms of gaining CA footwear industry is approximately as much successful as the average figures for all branches. For Poland and UK it is less successful but not significantly. In Estonia and Greece the results definitely are showing that concerning this indicator the footwear industry is not so successful in the delocalisation process as in the other branches. The data show that Bulgaria, Estonia and Greece are the countries that enjoy high figures of having CA in producing labour intensive products. UK is the country that is loosing CA in labour intensive products.

Other question related directed with the CA of the companies is whether the companies are threatened principally by Low cost products or High quality products. The footwear industry principally is more threatened by Low cost products than the other observed branches. If we accept that the competition of Low cost products and High quality products correspond to the place, which the firms have in the value chain the result can be interpreted as: Bulgaria is on the lower level of the value chain; on a lower level but a little bit upper than Bulgaria is Poland; while UK have significantly higher level. Another confirmation of that deduction is that the companies from Central Europe

(Poland and Estonia) are in higher position in the production chain than the ones in Bulgaria, where 86 per cents of the respondents say that are positioned in low and intermediate levels of the value chain against 60 per cents for Poland and Estonia.

The result of the primary data analysis of the CA revealed that both sides participating in delocalisation processes those that provide subcontracting and those that undertake subcontracting gain in terms of increasing their CA. In general the firms that undertake subcontracting gain a little bit more by participating in this activity; in other words delocalisation of footwear industry makes more competitive less developed countries. Poland and especially Estonia are foreseeing to realize advantages not only by exhausting the labour intensive factor but also by producing capital-intensive products. This means that the companies there want to take their own share in the most profitable part of the whole process. The fact of this change confirms the hypothesis of moving the labour intensive part of business away from Central European countries to the Eastern European ones.

10.11 Conclusions

The process of delocalisation of the footwear industry in the framework of Europe will continue. The analysis revealed that it will lead to location of the footwear industry to given countries. It will be manifested by the different dynamics of the employed in the footwear by countries. There are countries that are gaining position due to delocalisation process (Romania), countries that had gained position due to delocalisation and now are loosing them (Czech Republic). Countries with traditions in the footwear industry, which are straightening their position (Italy), countries with tradition that possibly will

lose their position (Portugal). Others are increasing their labour productivity by declining the activity in the low segment and pointing to sustain and even develop the high segment of the value chain (UK). In this way they manage significantly to reduce the differences of the labour productivity between footwear industry and productivity in the other manufacture branches. Some countries will rely on traditional good trade relation with neighbour countries that allow them to have positive trade balance (Estonia, Greece).

The investment within the EU-15 is showing that the major players foresee to support the footwear industry development, (Table 67, column 4). The low investment in the new member states means that the position of the countries that rely on subcontracting will remain – this is mainly valid for Bulgaria and Romania.

Specialization in footwear industry is accepted as risky since the branch is producing low value added products and the production cannot be easily diversified – has limited possibility of re-orientation to new products. Convergence processes within the EU will lead to loose of competitiveness of the footwear industries for lagging countries. The distribution of the answers of the investigated firms that undertake subcontracting concerning the changes in turnover and the profits shows rise of the turnover with involving in delocalisation process but with a slightly lower pace compare with the other branches. Those can means that the possibilities for delocalisation are a little bit more exhausted for footwear industry compare with the other branches. This is mainly valid for the firms from the Central European new member states.

However the analysis definitely outlines that in the framework of the EU up to now the delocalisation process is win-win process in terms of economic development for both

sides. The fall in the employment in EU-15 although quite high in its negative rate in absolute figures is not drastic. This is due to the fact that in the main producers as Italy, Spain and Portugal the drop of the employment is not high. It is the situation in the new member states where the drop in the employment is not related with dramatic social consequences.

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11 CONCLUDING REMARKS: DELOCALISATION CAN SOMEHOW BE MANAGED

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The increased mobility of production – regionally, nationally and internationally – constitutes one of the key challenges confronting social scientists and policy makers. The main dimensions of the challenge could be usefully discussed in relation to four questions: i) *why* are these changes taking place, ii) *how* are they taking place, iii) *so what* and how significant are these changes (impact), iv) is there scope for action? This report attempted to provide new insights and rigorous arguments about a wide range of issues that are captured within these questions. It does so by bringing together academics from different disciplinary backgrounds, located in diverse national settings, and bringing together expertise from a variety of sectoral contexts. The project that underpinned this common venture provided the research teams with a new and unique dataset of comparable data from four industries in five European states. This dataset focused upon industries that could be loosely defined as labour intensive and that are also invariably perceived as being at the forefront of change. Interestingly, the evidence presented in the chapters of this reports provides a picture of diversity between individual industrial contexts that in some respects questions the rationale behind the emphasis placed upon sectors with considerable labour-intensity.

This chapter attempts to bring together the main arguments regarding the four dimensions of the delocalisation challenge. It attempts to decipher similarity and difference, and to advance to our understanding of the phenomenon or even phenomena under investigation. It places a special emphasis on exploring the possible scope and avenues for action, and aims to inform policy decision-making at different levels.

11.1 Why?

Industrial activity is becoming increasingly mobile – within as well as between states. Technological advances in ICTs and change towards more liberal governance regimes underpin delocalisation. The prevailing wisdom suggests that this process is instigated by “relative labour scarcity”. This scarcity is manifested in terms of wages, alternative opportunities in the labour market, outmigration, fast rising expectations/ cultural aspirations, and changing preferences in terms of work and lifestyles (e.g. young people do not want to work in manufacturing they go for services). The impact of these changes is context specific: it would depend on the level of economic development and degree of social stability, and would vary across countries.

In this sense, the shape and direction of delocalisation may be influenced by a broad range of factors, rather than being exclusively dependent on labour cost. While, labour cost is certainly a very important factor, this study demonstrates that even in some of the most labour intensive sectors, it is not always the main consideration. . For example, labour cost considerations cannot solely determine issues such as the choice of destination or the means of achieving delocalisation. *It is not only the labour cost that matters, but the overall environment is crucial* (“Stable environments” save costs). Within this context, global regulatory frameworks, national institutional settings, proximity (not only geographic but also cultural) may be of considerable importance⁷⁷. The evidence presented in the main body of the report suggests that firms, when taking a

⁷⁷ For example in the automotive industry there are cases of companies that delocalised in China and they realised afterwards that the production costs there are in fact high. Take the example of Honda, it argues that it is more expensive to build the Accord in China than in the United States (Donnelley et al., 2007)

decision to delocalise, do not act as perfectly rational, fully informed actors. This is because in some cases the uncertainty of the environment makes such choices impossible or there is lack of sufficient information, but more importantly on many occasions companies seem to ignore or misunderstand difficulties that would be obvious to the ‘rational economic agent’. Some such considerations would include issues around logistics, regulation, the impact of cultural factors to name but a few. There is also the question of stability and of certainty that could lead to substantial additional costs. The decision to delocalise to the EU, NAFTA, or some other well regulated regions provides a more stable and less uncertain environment. While one cannot calculate the exact value added by operating in stable and well regulated environments, working in uncertain environments would most certainly lead to higher costs. Moreover, companies tend to “imitate” others, follow what is “in the air”, without having the whole picture. One company imitates the strategy of the other, or maybe some consultancy companies actually promote the dominant decision of a sector to delocalise to a certain place. Even further, questions about cost more generally, even when fully rationalized are still open to considerations such as what constitutes the ‘core’ of the business and what is the appropriate time horizon over which it should be calculated. In this sense ‘cost’, especially in the case of complex organizations, is also often a rhetorical device through which very different priorities and directions of change could be argued to be appropriate⁷⁸. Thus, we argued that the overemphasis in the literature on labour cost in

⁷⁸ This was well illustrated in the cases of two UK TNCs in the electronics and clothing sectors.

particular, and cost more generally, vis-à-vis other factors needs some correction as well as further elaboration.

11.2 How?

As far as delocalisation is concerned, *diversity is the name of the game*. On the *firm level*, there are firms delocalising that are TNCs and at the same time there are very small firms (e.g. Greek companies delocalising to Bulgaria). So, there is this diversity in terms of the firm size. There is also great diversity depending on the sectors and on the types of internationalisation pursued. As far as *countries* are concerned, there is a great diversity there too, there is *a wide mosaic of countries with various levels of development*. There is no need to go into simplistic categories, like new and old members of the EU; things are much more diverse. It is really too simplistic to classify countries like UK and Greece in the same category. There are all types of differentiations in that. Of course we must not go to the other extreme and say that everything is different, so there is nothing to connect things and no way to analyse things apart from speaking about particularities.

Our analysis shows that enterprise strategy is *multidimensional*. There are no ideal type models. Enterprises may opt for different strategies when they operate even in the same segment of the market and in the same national context. This is because the choice of strategy is not influenced only by contextual factors (i.e. industrial or locality-specific) but also by the firms' resources and competences. These competences are the result of a trajectory, a pathway of changes that have taken place on both the organizational and individual (in the case of entrepreneurs in SMEs) levels.

Interestingly, success is not exclusive to one (or more) enterprise strategies. There are successful enterprises across the board of strategies adopted in all four industries and all five countries. This suggests that success depends first of all on their appropriateness for the industrial enterprise and regional context and also on how well they are applied. All strategies, of course, entail an element of risk.

However, there are strategies that are linked with a somewhat stronger performance than others. These strategies involve a lower degree of dependence upon individual customers or singular markets. This may take the form of either developing generic competences or focusing – in part – upon servicing the needs of the domestic market (a factor that is often overlooked in the literature).

In the companies' breakout strategy enterprises develop these competences without necessarily using them. They develop them maybe in order to minimise risks involved in engaging in strong relationships. There are the generic competences that would allow them to look elsewhere if something goes wrong. Something that is quite interesting is that there are competence lock-in strategies, which are not exclusively linked to the price-sensitive segment of the market as one would have expected.

Enterprise strategies also appear to be linked to specific patterns of external linkages. It is in this area, where some interesting findings emerge. These stress the importance of the interplay between strong linkages, but also the multiplicity of linkages that will facilitate information flows and diminish the threat of 'ossification'. In these instances even dependence may exist alongside relationships of mutual confidence and trust.

Indeed, proximity is a complex and multi-dimensional concept, it takes various forms and it goes well beyond geographical proximity. It is a much more complex thing; for

example proximity of Greece and Bulgaria involves social and cultural proximity, as well as issues of trust all of which are really very important. The question of confidence in relations and dependence is also important, which are not exclusive; sometimes you have dependence or confidence and trust. Of course proximity is not something with universal consequences.

Border areas seem to be the ones most heavily involved in delocalisation. However, there are significant differences between the countries as to the density of delocalisation activities along the borders (i.e. in our case studies, there is on the one hand intense delocalisation at the Greek-Bulgarian and Estonian-Finnish borders, while on the other hand, there is low level of delocalisation of the studied labour-intensive industries at the Polish-German borders), reflecting and at the same time conditioning the development level of these areas.

11.3 So what (impact)

Delocalisation can operate as a key mechanism to spread prosperity to LDCs.

The *consequences of delocalisation are once again very diverse*. They are diverse in relation to time; time span is really important. There are differences according to whether the focus is on short-term or medium-term or long-term consequences of delocalisation. Finally, there are differences according to country, region, sector or firm.

At the regional/national level we may distinguish between strong and weak regions/countries. Looking in the long-run, in weak regions growth in LII may be viewed a “window of opportunity”. It may not be always bad news at the end. Something that is happening in LII may result in something else emerging that will

change the overall outcome, probably from a pessimistic one to one that is either neutral or positive. In strong regions the importance of growth and/or decline of LII may be of limited significance on the whole.

As far as the home countries are concerned, there is an over-exaggeration about job losses in terms of delocalisation, whether it is FDI, subcontracting or outsourcing, etc. Social consequences are not just about numbers of jobs, something that is often not reflected in the literature while in the literature there is this strong focus on number of jobs. It is the qualitative dimensions that in our view are very important.

There is obviously no direct and immediate impact on relation between decreasing number of jobs and unemployment levels, obviously not at the national level, usually not on the regional one as well. It is mainly at the local level that we may see this.

The home country effects of delocalisation as far as loss of competences is concerned are important. In some cases there is a shrinking industry and this leads to the shrinking or disappearance of industry-specific skills. This may create problems in the medium and long-term. For example, in the case of Greece in the medium-run, a clothing company can't delocalise if it can not access in the country of origin key skills such as technicians be send to the country of destination (Bulgaria, FYROM, etc). In the long term, we might have the case if a company of the same sector tries to start afresh, or to go upmarket. Let's say that in a ten-year time, a company decides to become the Zara of the time. They might realise that there are no competences around.

To what degree the irreversible character of losing some competences constitutes a problem? This is not necessarily a huge problem in macro-economic terms for the national economy – it is usually not for the regional economies. And in the long term, it

doesn't matter; some activities, some industries disappear and new ones appear. So, from the economic point of view, even from the social well-being point of view, it doesn't matter.

Delocalisation from one European country to another might be seen as a relocation from one part of Europe to another (even more so within the context of the EU) which will enhance its integration. When a firm is relocated from one area to another within the same country, this is considered as a regional rather than a national problem. In a similar way one might think that what has been described here is not a delocalisation from UK or Greece or Italy or Spain to the CEECs (new Europe), but rather a relocation within the EU-27 and hence a preservation of jobs. To the extent that those jobs can be preserved for the next decade in the new members these countries will be integrated easier within the EU.

The net employment effects of delocalisation within Europe are not indicating a "race to the bottom", they are rather positive at least in the mid-term. Moreover, the social effects of delocalisation are more limited than is often maintained. This is due to the fact that there are intermediating factors (e.g. socio economic and political features of the region/nation) that influence whether the impact is strong or weak. Even in terms of number of jobs, the overall effect of delocalisation processes at the EU level or European level is positive for these industries. Obviously we cannot go on and generalise this for other industries. This is particularly because new jobs come partly, or in some countries to a large extent, to less developed areas where there are limited physical alternatives.

Delocalisation does cause job losses in the home countries but they are quite moderate. However, the phenomenon is not as intense as the hype about it is suggesting. In the context of this study, the only possible exception to that is the UK, where the majority of firms surveyed reported a decline in employment. Surprisingly, at the same time, the UK is one of the countries with the lowest unemployment rates among the EU. Even more surprisingly, areas within the UK with historically high concentrations of the sectors under study (e.g. footwear in Northamptonshire) are displaying some of the lowest unemployment rates, only a few years after the decline of the sectors in question. Perhaps this is due to the particular countries that are the focus of this research while in other countries with a tradition in labour intensive activities (such as Italy and France) the problems might be much more intense.

The effects of delocalisation go far beyond the companies directly involved in the process; they influence the economy as a whole. For example, due to delocalisation Trade Unions might become more resilient while other companies in the area/country have to face more intense competition. Even the threat that a big company will move influences the policies of the trade unions, they are under threat: “behave other wise we will delocalise”.

Relation of delocalisation and economic development

Then, going to the dimension of economic development, there is a convergence of GDP per capita versus convergence of industrial structures. The delocalisation process is going to converge the industrial structure and, at the same time, make an impact on convergence in terms of GDP per capita. The *time factor is very important* for this

process, since the convergence of GDP per capita is changing the conditions of labour cost. So, *in one point, convergence of GDP per capita especially in cases where this is influenced mainly by the labour cost is going to stop the process of convergence of the industrial structures, because delocalisation will not proceed anymore.*

Convergence process within the EU will lead lagging countries to losing their competitiveness in the LII. In the sense that in LII, labour cost plays a much more important role and from some point onwards, convergence means losing the comparative advantages that led to the delocalisation of the labour intensive industry.

Another thing that might not be so totally new is this *maxi profundis* impact of FDI. Obviously, one of the major conclusions could be showing to what extent and how delocalisation affects the long term economic growth or competitiveness – using the notion of economic growth at various geographical scales. This is a crucial result of the study. There is a need for a dynamic view of these globalisation production networks, which empirically is not so easy. But the interpretation should be made in a dynamic way. The triangle dimension has been emphasised several times.

What really matters is how in the long run delocalisation affects competitiveness and economic growth and consequently indirectly affects the number of jobs and the social well-being. So, this is what really matters in the long run.

11.4 Is there Scope for Action?

Delocalisation can be managed

Delocalisation, at least within Europe, is definitely not “a race to the bottom” in terms of its effects on employment, as well as its social effects. One might even argue that they

are quite positive for both home and host countries. Whilst we can not use the experience of five European countries to generalise about the reality of delocalisation the world over, we argue that the evidence presented here suggests that delocalisation can be managed, at least regarding socio-economic and political formations that seem to be broadly similar.

In doing so, governance matters. Indeed, Gereffi and Mayer (2004: 2) argue that today there is crisis of governance in the sense that there is an inadequacy of institutions not only to facilitate market growth and stability but also to regulate markets and market actors and to compensate for undesirable effects of market transactions. The rise of an increasingly global economy, no longer firmly rooted in nation-states, and one that encompasses a large portion of the developing world, is challenging the regulatory and compensatory capacities of both developed and LDCs. Moreover, at the international level little regulatory capacity has evolved to take up the slack. These developments have led to a governance deficit of considerable magnitude.

Moreover, the *outcome of certain changes is not unidirectional*. For example, the abolition of MFA / or Bulgaria joining the EU might have unforeseen repercussions. Trade policy (e.g. MFA etc of EU) shapes the geography of production. That is, Bulgarian firms after that instead of being part of a triangular relation they can be in direct contact with the assignor. Or the fact that Bulgaria became a member of the EU might be a “kiss of death” for some industries (e.g. clothing) since they are gradually going to miss their comparative advantages (e.g. low labour cost, more relaxed labour legislation and more tax incentives to companies). Hence, what this study looks for is softer policy recommendations and, if this is linked to the recognition of the importance

of diversity, it will lead to clever and flexible policy recommendations, not a one-size-fits-all kind of approach.

However, the key challenge is: what are the dimensions of action. More specifically, is action impacting upon the pace and/or direction of change, or ameliorating the effects of change?

Impacting upon the pace and/or direction of change

Regulations on a trans-national level are important because they set the frame. However, they do not determine the form that delocalisation is going to take.

In delocalisation, there is an element of regulation coming from the consumers in industrialised countries that may avoid ultimately the worst excesses of capitalism. It is becoming increasingly apparent that large groups of consumers do not want to buy goods that are made based on the over-exploitation of human beings (e.g. clothes made by a 7-year old). So it is consumers also who put pressure on the producers in terms of standards and regulations. It is not only regulations that are government driven, but regulations that are changing the attitude of the consumers.

In this sense market mediated pressures certainly have a role to play as mechanisms of governance and our study clearly demonstrated that TNCs operating in CEE are actively involved with enforcing not only quality but also ethical standards in the organisation of production of their business partners. Consumer pressure, however, constitutes only one, among many mechanisms of regulation, it has both its limits and limitations and thus can add but cannot be a substitute to formal regulation.

With regard to ethical trade and governance, all approaches are very EU-oriented and the basic idea is that markets are in the EU. But if we look at what is really going on in these industries that have their headquarters in Europe, then we see that other markets – like Russia and China – become more and more important. Furthermore, these are not the only places to produce cheap products, but increasingly they are important markets. And also NOKIA and all Finnish electronics sector are indeed moving in this direction. This is not anymore EU headquarters or anything; nowadays, even product development and also markets move to China. This however does not mean that rules within the context of EU are becoming less relevant but rather that their impact is not anymore simple and uni-directional but instead is complexly inter-dependent on changes that are taking place on the global level as well as in the level of individual states. States for example are acquiring new powers of coordinating, or steering, and thus have the ability to influence other levels of governance (e.g. sub-national and supra-national) (or *meta-governance*).

Substantively, given that both governments and markets fail, though differently, governments can still play a role in developing correcting mechanisms for the failures of market, where short and medium-term orientations are predominant. While some market players can also have longer-term temporal horizons as well as being able to tolerate higher degrees of risk, national governments and supra-national organizations such as the EU seem to be best placed in providing longer term vision and support for sustainable economic and social restructuring. Further, EU institutions in particular can be instrumental in extending the scope and depth of governance on the global level, as well as in shaping the global agenda, particularly in countering overly-enthusiastic neo-liberal visions of globalisation. Withdrawal while a possible option is neither the only

nor necessarily the best one. Our analysis suggests that both states and supra-national organisations such as the EU have a *new*, rather than *no*, governance role to play.

Developing a discussion on such a broad level can neither be supported nor rejected by the experiences of individual companies. As it could be expected company experiences and attitudes towards specific forms of regulation and towards regulation in general varies. Nevertheless, understanding the concerns and conflicting interests of different stakeholders is key to informing specific policy mechanisms. Thus for example the introduction of several EU regulations is costly for the companies and particularly costly for the small businesses. For the TNCs, this is a less significant problem, firstly because of the availability of resources and secondly, because they already have these standards in most of the countries. Even if they are not passed by the national regulations, they introduce them for internal reasons. For small companies that look for every penny, this is a big issue. This is really important: we normally think that regulations are generally good, but they might lead some companies out of business, or put them in a different position. This might be important since it is not advanced in the public governance literature.

There are of course also cases where one has to see with caution what the real meaning of this information is. For example, companies are considering EU regulations to be very costly, but on the other hand this is a condition in order to gain access to the EU markets and to a certain extent exclude others from the EU markets. A basic question that one has to respond to is *why do companies decide to delocalise within the EU, in a more or less regulated environment* and certainly more regulated compared to other countries like China, Moldova or Morocco. Do they benefit from the regulations or some sort of

regulations, or is it that they delocalise to countries of the EU because *they do not plan to behave differently?* it is not really the regulation itself that pushes them to behave like that; it is possibly because they care for the image of the company since, the image of the company, particularly of a larger company, matters. This depends on the company, for example IKEA, which will behave more or less similarly in other countries.

Regulations have some positive aspects for the companies. Perhaps the main reason behind FDI or subcontracting to some countries that are not necessarily really rigid in global terms is the relatively stable environment, the question of reliability and stability – economic, political, etc. And this is provided by some sort of regulations. So they have these benefits and it pays to be in a more regulated environment.

The EU can influence the rest of the world if it sets up a European fair trade trademark that will be rigorously implemented, no matter where the product is produced. It would be the responsibility of the company, as it is now for some big companies even in the clothing industry, to make sure that their suppliers comply with certain standards. This is a way in which big buyers of the EU can have a considerable impact on the rest of the world. In this respect, and coming back to our earlier argument, the development of active, though not necessarily only and always directly intervening regulative mechanisms (on state and the EU levels) is crucial.

Ameliorating the effects of change

There is a big difference between forms of management of an economy. For example, there is management in the economy of the UK which is one of the most liberal economies in Europe, its economy is managed with the right touch (e.g. there is a

minimum wage in the country) and this management has not led to the collapsing of enterprise activities. The economy of the UK has been managed, it is still highly managed, but without disturbing the conditions of supply but through kind of soft and subtle measures that are collectively evaluated as positive (e.g. Role of embassies in creating a facilitating environment for firms to delocalise).

This study does not support policy recommendations that change the conditions of supply (e.g. that artificially reduce the price of labour), because this is not sustainable in the long-term. Even more so it does not support policies that restrict firms to take decisions on how to handle their operations (e.g. “forbid“ them to delocalise).

EU policies are often focused to protect the developed countries against the interests of the less developed ones. That is, EU in those cases that its economy is competitive argues that there must not be any trade barriers, while in the case where its economy is less competitive (e.g. agricultural products and clothing industry) argues for protection. In order to protect the production within EU or within the developed countries, the EU acted against the interests of the LDCs. However, as seen from the exploration of social consequences, these are often modest.

It is very interesting to give the opportunity to the LDCs to find a niche (e.g. agricultural products, part of products that are related to the labor intensive industries). What EU can do with the *globalisation fund* is to manage the effects of delocalisation and not the delocalisation per se. Certainly, it is not only the unemployment issue; it is also the effects of delocalisation in terms of firms that still operate in the same sectors and how they face their own competitiveness increasing or decreasing, because some other firms have delocalised themselves. Try to understand the effect of delocalisation are really

trying to find out not only why firms are delocalizing, but also what was the effects on the firms the regions the people that stay behind. Hence, policies should be oriented not only to the unemployment but to all the issues related to delocalisation.

Regional blocks that include countries with different levels of development often lead to shocks of all the parties involved. Total trade among the NAFTA countries has more than doubled between 1993 and 2002 however, as Anderson and Cavanagh (2004) argue, there are problems in all three countries. That is, on the one hand Mexico did indeed attract a significant number of jobs in export processing factories. However, despite substantial productivity growth, real wages in manufacturing dropped between 1994 and 2000 and this is due in part to the fact that NAFTA has failed to protect the rights of workers to fight for their fair share of economic benefits. Mexico in the 2000-2003 period lost more than 230,000 export assembly jobs, 35% of these were due to shifts in production to China. This job flight has raised fears that *Mexico's strategy of attracting investment by offering low wages is short-sighted*. NAFTA forbids governments from placing requirements on foreign investors that would ensure benefits for the broader economy (e.g. to require that investors use a set amount of local content in manufacturing).

11.5 Final Thoughts

The delocalisation processes, explored by social scientists and addressed by policy-makers at different levels, is a complex and continuously evolving phenomenon. In fact, one may argue that delocalisation may be best captured as a multitude of often converging but sometimes diverging phenomena that have industrial, locational and

enterprise specificities. Research to date has focused primarily upon the commonality and tended to diminish the importance of diversity. We believe that this report offers the point of departure for the introduction of a corrective.

The work of our research team also highlights the importance of distinguishing between analytical units: for example the reality of delocalisation processes may differ between firms, networks, regions and nations. The importance of this rests with its impact upon policy. Indeed, specific actions and/or initiatives may have significantly differential results. This necessitates an explicit statement of intent.

Action can be taken in order to influence the processes as well as the consequences of delocalisation. However, it is apparent from our work that what is needed, from the outset, is a clear identification of the ultimate aims of policy action. Indeed, a clear distinction between competitiveness and 'employment' social actions may enable us to identify initiatives that are more focused and sustainable in the long-term.

Moreover, it is important to recognise that there are clear boundaries regarding the potential impact of such action. Indeed, policy initiatives that attempt to alter the conditions of supply, by artificially reducing costs in one location, in relation to all others, may be hard to sustain in the long-term. Rather perversely, the more successful such actions are (thus impacting positively on growth and subsequently incomes) the less sustainable it becomes.

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