50 WORKING PAPER

Global Competition, Institutional Context, and Regional Production Networks: Up- and Downgrading Experiences in Romania's Apparel Industry

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List of Abbrevations

ATC	Agreement on Textiles and Clothing
CAGR	Compound annual growth rate
CEE	Central and Eastern Europe
CM	cut-make
CMEA	Council for Mutual Economic Assistance
CMT	cut-make-trim
EC	European Commission
EU	European Union
GNP	Gross National Product
GPN	Global Production Networks
kg	Kilogramm
MFA	Multi-Fibre Arrangement
NSI	National Statistics Institute
OPT	outward processing trade
ROO	rules of origin
TNCs	transnational corporations
UK	United Kingdom
UN	United Nations
USD	US Dollar

Abstract

Regional suppliers still play an important role in the global apparel industry. By studying the experience of Romania's apparel sector, the paper highlights, first, the importance of multi-scalar institutional, macro and policy contexts in analyzing the articulation of and up- and downgrading experiences in global production networks. These include the Multi-Fibre Arrangement, EU trade agreements and accession, the global economic crisis, and the specific institutional and policy context of post-Socialism. Second, the paper stresses the existence of diverse, non-linear and uneven up- and downgrading trajectories and of re-active adaptation rather than pro-active firm strategies. This questions the ideal upgrading account often portrayed in chain and network research.

***Keywords**: Romania, apparel, global production networks, trade policy, upgrading, downgrading*

1. Introduction

The past ten years have witnessed important shifts in the global apparel sector. The elimination of quotas and safeguards coincided with the global economic crisis resulting in a shift to low cost countries in Asia and consolidation among supplier countries and firms. China emerged as the dominant apparel exporter and the number one sourcing location for global buyers. However, there has always been and remains a regional dimension to apparel sourcing. Industry dynamics play a fundamental role in understanding the position and the up- and downgrading trajectories of regional suppliers. However, these dynamics unfold within institutional and regulatory contexts, including global liberalization, regional trade agreements, rules of origin (ROO) and the specific institutional, macro and policy context in regional supplier countries.

This paper assesses the interplay of competitive dynamics and institutional and regulatory contexts in the apparel industry and its implications on regional sourcing in Europe. It focuses on analyzing the consequences of the integration into Western European apparel networks and the related up- and downgrading experiences of firms in Romania, the largest apparel exporting country in Central and Eastern Europe (CEE). Motivated by a low-cost but skilled workforce in geographic proximity to end market in Western Europe and specific EU trade regulations (outward processing trade – OPT), Western European lead firms integrated firms in Romania into their sourcing networks. This led to the survival and growth of the apparel sector in the 1990s in a context of otherwise widespread deindustrialization; however at the expense of a disintegration from the formally integrated textile sector and functional downgrading to an assembly role. Since 2004 exports have decreased related to the phase out of the Multi-Fibre Arrangement (MFA) and increased competition, rising costs in the context of EU accession and the specific integration of Romania into apparel GPN through OPT. Firms reacted in different ways that included firm closures and a consolidation of the sector, forms of product and functional upgrading, a turn to the domestic and non-traditional export markets and relocations. Even more in the context of the global economic crisis, these reactions are taking place in a highly competitive and precarious context which puts into question the rewards conventionally associated with upgrading strategies.

By studying the experience of Romania's apparel sector as a regional supplier, the paper highlights two aspects that have been under-represented in the chain and network literature, although mostly taken up in the Global Production Networks (GPN) research strand. First, the importance of multi-scalar institutional, macro and policy contexts in which organizational industry dynamics and up- and downgrading experiences are embedded and evolve are stressed (Bair 2005; Henderson et al. 2002; Coe et al. 2008). For CEE countries this involves the specific institutional and policy context of post-Socialism, EU trade agreements and accession, and the global economic crisis. Second, the existence of diverse, non-linear and uneven up- and downgrading dynamics (Pickles et al. 2006; Tokatli 2013) and of defensive rather than pro-active firm level strategies question the ideal trajectory of upgrading often portrayed in chain and network research.

The paper is largely based on trade and national sector data, including aggregate statistics from UN Comtrade, Eurostat and the Romanian National Statistics Institute (NSI) as well as firm-level data from the Orbis database. To complement this data, a large number of institutional interviews and few selected firm-level interviews were conducted in 2008/09 and updated in 2014. Altogether, we conducted 45 semi-structured institutional interviews with a particular focus on business associations, trade unions and governmental institutions. Semi-structured interviews at the firm level with representatives of management and workers were conducted at twelve export-oriented apparel firms. These firms provide a varied sample based on differences in firm size, geographical location, type of lead firm and production

networks (branded manufacturers vs. retailers), and institutional specificities (former state-owned vs. greenfield location).

The paper is structured in four sections. The first section stresses two areas in the chain and network literature that have been under-represented and to which our analysis contributes. The next section discusses global and European macro-regional dynamics in the apparel industry with a focus on the importance of fast fashion and regional trade agreements. This is followed by an assessment of the up- und downgrading experiences of Romanian apparel firms in the 1990s and 2000s. The last section concludes.

2. Institutional context, macro policies and upgrading complexities

Over the past two decades, a body of literature has evolved using chain or network frameworks to conceptualize and analyze how global production is organized and governed and how this affects the development prospects of firms, regions and countries. By studying the experience of Romania's apparel sector, the paper highlights two dimensions that have been under-represented in the chain and network literature, although mostly taken up in the GPN research strand (Coe et al. 2008; Henderson et al. 2002; Bair 2009).

First, the chain/network literature has to a large extent focused on the analysis of transnational corporations (TNCs) and inter-firm relations. As a result, it has neglected the role of non-firm actors, most importantly the state, and the broader multi-scalar institutional, macro and policy contexts within which production networks are embedded (Henderson et al. 2002; Bair 2005; Hess/Yeung 2006; Neilson/Pritschard 2009; Neilson et al. 2014; Smith et al. 2014; Smith 2014; Plank/Staritz 2011). Given the prevailing bias towards the state as the key reference frame and actor, and the simultaneous neglect of firms not only in development studies but more generally in the social sciences (Fischer/Parnreiter 2007), the concentration on firms has certainly made it possible to study more thoroughly corporate strategies and organizational dynamics. This 'reversal' is, however, problematic given the influence that non-firm actors and institutional and regulatory contexts have on corporate strategies and industry dynamics and ultimately on the shape of production networks, upgrading trajectories and development outcomes (Coe et al. 2008). For Romania – and CEE more generally – three aspects deserve special attention (Pickles et al. 2006; Smith et al. 2014).

A first aspect that needs explicit consideration is the institutional layer constituted by trade policies at various scales, including their respective ROO. At the global level, the MFA and its phase out through the Agreement on Textiles and Clothing (ATC) have had significant effects on competitive dynamics and buyers' sourcing strategies and, hence, trade, employment and upgrading patterns (Gereffi/Frederick 2010; Staritz 2011). The intensification of regional trade agreements was a response to heightened competition from Asian countries as the integration of peripheral regional countries was intended to enhance the competitiveness of core countries (Dickerson 1999; Bair/Dussel Peters 2006). EU's trade policy and in particular the OPT agreements and its ROO specifications were central instruments that significantly impacted on the way in which CEE apparel firms were integrated into Western European production networks (Begg et al. 2003; Pickles et al. 2006; Plank/Staritz 2011).

In addition to trade policy, the historical legacy of the state socialist past, including its industrial fabric and existing social networks (Czaban/Henderson 2003; Lane/Probert 2009; Schüßler 2009) as well as the 'transition' process[1] and its strong bias towards 'free market' policies and reliance on foreign capital (Becker/Jäger 2010; Bohle/Greskovits 2013) have structured CEE integration into apparel production networks. In the run up to EU accession the policy context changed importantly. The field of exchange rate policy is a prime example with strong appreciation of the Lei impacting significantly on the revenues of Romanian apparel exporters (Sellar 2007). Also labor markets were flexibilised and visa policies were altered resulting in a large outward migration that led to labor shortages which was particularly felt in the apparel sector (Ciutacu 2006; ILO 2010; Plank/Staritz 2011). In addition to rising labor costs firms were also facing rising utility costs as a consequence of EU accession. These policy changes conditioned the scope of action for upgrading strategies.

Besides trade policies and the specificities of post-socialist transformation, the global economic and specifically the Euro zone crisis impacted on the traditional sources of demand. This was most obvious in the downturn of established end markets in the EU-15 but also underlined by the abrupt fall in nascent demand in the domestic market. Against this background the gradual shift to emerging countries is embraced as an option for market diversification. Further, the crisis also impacted on the organization of production networks as competitive pressures and consolidation that started after the MFA phase out accelerated (Staritz 2011). It, however, also led to a reevaluation of largely Asian focused sourcing strategies with some retailers re-considering regional suppliers in view of rising global uncertainties and a reinforced focus on flexibility (TW 2011; Salomon 2013). In CEE, the crisis also altered the credit-based consumption model that was fueled by Western European banks. Banks faced restrictive credit conditions as a reaction to the crisis which made access to consumption credits for the middle class more difficult (Becker/Jäger 2010).

The second area to which our paper seeks to contribute relates to the concept of economic upgrading. Economic upgrading – commonly understood as a firms', regions' or countries' trajectory from lower- to higher-value activities (Bair/Gereffi 2003) – has become a cornerstone in chain and network research. Upgrading is generally differentiated in upgrading within production, involving process and product upgrading and functional upgrading which involves taking over higher value functions beyond production such as input sourcing, design, product development and branding (Humphrey/Schmitz 2001, 2002; Tokatli 2013). The conventional view conceives economic upgrading as both a linear and pro-active process. Based on experiences encountered in the apparel sector in Romania, we highlight three aspects that deviate from the standard upgrading typology.

The conventional notion of economic upgrading suggests a linear move of firms (or regions and countries) from lower exporter ranks to working up their way in GPNs by improving production processes, shifting to more complex products and taking over more and higher value functions. This view does, however, not capture the diverse, non-linear and uneven upgrading trajectories of firms (Pickles et al. 2006; Bair 2005; Tokatli 2013). Rather than following one road from low value to higher value activities firms assume different roles and pursue a variety of strategies simultaneously and may end up with different positions in different GPNs (Pickles et al. 2006; Tokatli 2013). This is related to different demands of specific product mixes, end markets and buyers, and, more broadly, to upgrading efforts and processes being complex and contested affairs and involving risks and uncertainty (Bair 2005; Ponte/Ewert 2009; Gibbon 2008). These differentiated forms of upgrading depend on

[1] We use the word 'transition' in brackets as it is criticized in the literature for its perception of a linear transition from state socialism to one specific – Anglo-American – version of capitalism. Several authors prefer to use the expression transformation to underline the 'variety of capitalisms' (Henderson 1998; Pickles et al. 2006).

industry dynamics and governance structures in specific production networks as well as on institutional, macro and policy contexts (Morris/Staritz 2014; Smith et al. 2014).

Another aspect of how the standard view on upgrading inadequately captures the firm-level realities is the implicit assumption that 'breaking in' and 'moving up' are the only potential outcomes in GPNs. However, integration into GPNs can also result in downgrading (Gibbon/Ponte 2005; Milberg/Winkler 2013). In particular functional downgrading may be a precondition to enter certain GPNs. In the case of CEE this issue is of high relevance as these countries had disposed of broader industrial capabilities producing for the domestic market and Council for Mutual Economic Assistance (CMEA) markets but their integration into Western European production networks did generally not draw on and use these broader capabilities (Begg et al. 2003; Pickles et al. 2006). Functional or product downgrading may however also be more voluntarily adopted by some firms particularly to reduce risks associated with functions such as input sourcing, design or branding and a focus on high value, low volume products (Gibbon 2008; Ponte/Ewert 2009).

The last deviation from the conventional view on economic upgrading concerns its conception as a pro-active strategy of firms to improve their positions in GPNs. The underlying rationale is that such a move would yield increased gains in the form of higher profits and/or more secure positions. However, upgrading processes can be – and are often – triggered by 'external events' or 'shocks' that 'force' firms to upgrade. Viewed from this point economic upgrading looks more like a survival strategy and re-active adaptation to heightened competitive pressures which questions the conventional rewards associated with upgrading (Pickles et al. 2006; Plank/Staritz 2013). Further, shifts in functions do not necessarily result from "suppliers successfully 'wresting'" (Tokatli et al. 2008: 277) functions from lead firms; instead, certain functions and responsibilities that lead firms do not consider as part of their core activities anymore are off loaded onto suppliers together with the associated costs and risks (Bair 2005; Tokatli 2013).

3. Industry dynamics, trade policy and regional suppliers in the apparel industry in Europe

The apparel industry in Europe has experienced dramatic transformations, particularly since the 1990s, which involved the relocation of manufacturing capacities from Western European countries to CEE and North Africa. The deepening of these regional production networks has been propelled by changing industry dynamics and corporate strategies as well as the macro-regional integration process driven by regional trade agreements. The extension of these networks enabled Western European lead firms to access suppliers that offer lower costs as well as short lead times, responsiveness and flexibility. For supplier firms in CEE, the integration into Western European production networks offered increased export and employment opportunities, but at the same time it often led to concentration in low-value and flexible production arrangements.

While labor cost is a main factor in sourcing decisions of lead firms in the apparel sector, other considerations have also become important. One of the most influential trends is the increasing importance of time. This is related to the shift to lean retailing and just-in-time delivery where buyers defray the inventory risks associated with supplying apparel to fast-changing, volatile and uncertain markets by replenishing items in short cycles and minimizing inventories (Abernathy et al. 1999, 2006). The increasing dominance of fast fashion – a business model that is based on increased variety and fashionability and permanently shrinking product life cycles – underlines these developments (Tokatli 2008). Retailers such as Inditex/Zara have come to be known as the avant-garde in this respect and have gained increasing shares of the world apparel market. Shorter lead times, quick

response and flexibility have however become important not only for genuine fast fashion retailers (Plank et al. 2014). Also many traditional retailers follow fast fashion sourcing strategies at least for specific product lines. One consequence of this development is that geographic proximity to end-markets has increased in importance in sourcing decisions (Salomon 2013).[2]

Organizational dynamics in apparel GPNs have to be assessed in the context of the changing regulatory landscape as production networks and developmental outcomes are also determined by "several layers of institutional environments" (Bair/Gereffi 2003: 165). In particular the MFA quota system impacted on trade and employment patterns in the apparel sector and its phase out has increased global competition and consolidation. This liberalization process is, however, uneven as tariffs still remain relatively high compared to other manufacturing sectors and hence preferential market access continues to strongly impact on the articulation of apparel GPNs (Staritz 2011; Frederick/Staritz 2012). Regional trade agreements have favored the emergence of regional production networks in Europe, North America and Asia and were part of a broader strategy to secure the competitiveness of the apparel and textile complex in the core countries of the Triad (Bair/Dussel Peters 2006).

In Europe, special trade agreements – referred to as OPT – created favorable conditions for the offshoring and outsourcing of labor-intensive production steps to nearby countries to exploit low labor costs (Pellegrin 2001). This was achieved by allowing EU-based firms to temporarily export inputs for processing to an OPT-partner country and re-import products under preferential conditions, i.e., only paying duty on the minimal value-added (labor) taking place in the neighboring country (Pellegrin 2001).[3] In the case of apparel, it generally involved the export of EC/EU inputs (fabric, cuttings or semi-finished apparel) to nearby lower-cost countries in CEE or North Africa which made them up into ready-to-wear apparel for re-import into the EC/EU. These trade arrangements promoted a specific division of labor where low cost regional neighbors were largely responsible for labor-intensive assembly production – known as cut-make (CM) / cut-make-trim (CMT) in the apparel industry and 'Lohnsystem' in Romania – whereas more capital-intensive and higher value activities remained based in the EC/EU. As integration deepened in the context of EU accession or the Euro-Mediterranean Partnership these specific ROO regulations were expanded but production structures remained sticky due to a deep seated division of labor based on OPT relationships (Begg et al. 2003).[4]

The OPT arrangements laid the ground for a flourishing intra-European apparel trade in the 1980s and particularly after the collapse of state socialism in the 1990s.[5] Western European apparel manufacturers and retailers increased their involvement in the region, but in different ways based on geographical location, cultural affinity, national industry pressures and existing structures and business contacts (Pincheson 1995; Textiles Intelligence 1997; Begg et al. 2003).[6] German manufacturers started to outsource specific production processes already in the late 1960s to the European environs, including former Yugoslavia, Hungary

[2] Location per se does however not constitute a major advantage or entry barrier on its own as distance can be compensated by other factors such as infrastructure and logistics, local availability of fabrics and vertical integration, supply chain management and other firm-related capabilities and management practices.

[3] In the case of apparel these preferential conditions were either reduced tariff rates (tariff OPT) or expanded quota access (economic OPT) (Pellegrin 2001).

[4] In CEE, there was also limited support for upgrading of the apparel sector given the generally very liberal policy context after the collapse of state socialism and that the apparel sector was seen as a 'sun set' industry (Smith/Pickles 2010; in contrast to other sectors such as electronics, see Plank/Staritz 2013).

[5] This production model was already embraced before the formal adoption of OPT in 1975 by some Western European firms, which outsourced sewing operations to (the then) Yugoslavia, or Romania, as early as in the late 1960s.

[6] The use of OPT transactions varied across the EC/EU. Germany was among the first to rely on OPT transactions with around 70 % of EU OPT with CEE originating in Germany in the 1990s (Pellegrin 2001). France, the Netherlands and Belgium were also very active at an early stage while the UK and Italy were latecomers (Baden 2002).

and Romania (Schüßler 2009). In contrast, Italy was a relative latecomer, due to relatively low domestic wages, the outsourcing potential that was available domestically, the focus on up-market products, and the late date of initial capitalization of the Italian industry (Baden 2002; Sellar 2007). The restructuring process of UK's textile and apparel industries also started in the mid-1990s. Like German retailers, large UK retailers often used UK-based manufacturers as intermediaries to subcontract production to CEE and North African countries (Begg et al. 2003). France was an early and prominent actor in apparel relocations focusing on North African countries, including Tunisia and Morocco, due to their colonial legacy in the region and the common language (Textiles Intelligence 1997).

In the context of regional trade agreements and fast fashion, regional supplier countries increased their market share in the EU-15 in the 1990s and early 2000s to the detriment of some higher cost East Asian countries and more importantly established European supplier countries, particularly Portugal, Spain, Greece and Italy (Baden 2002; Palpacuer et al. 2005). Romania was the largest CEE supplier in 2004 accounting for 4.3 % of EU-15 apparel imports (Table 1). The boom in apparel exports from CEE and North Africa lost momentum in 2004/05 with the MFA phase-out, as orders shifted to China and other low-cost Asian apparel exporter countries (Gereffi/Frederick 2010; Staritz 2011; Frederick/Staritz 2012). However, these reductions have not been as dramatic as expected by those foretelling the elimination of regional suppliers (Conway 2006). The global economic crisis had mixed effects – on the one hand it reduced demand in EU-15 markets which led to a dramatic export reduction in 2008 and 2009 but on the other hand some retailers re-assessed their largely Asian-focused sourcing strategies in the context of global insecurities (TW 2011). In this context, regional suppliers' market share continued to decline but at a relatively modest level, losing market share from 27 % in 2004 to 21 % in 2008 and 19 % in 2013. CEE countries experienced a declining share from 12 % in 2004 to 9 % in 2008 and 8 % in 2013.[7] Romania's market share also declined – from 4.3 % in 2004 to 2.3 % in 2008 and 1.9 % in 2013 (Table 1).

[7] There have been important shifts in apparel exports within CEE. After the collapse of state socialism the most important exporter was former Yugoslavia which accounted for half of all exports to the EU-15 in 1991. During the first half of the 1990s, Poland, Romania and Hungary became important sourcing locations accounting for almost 55 % of total CEE apparel exports in 1995. By the end of the 1990s and the 2000s, the initial core supplier countries Poland and Hungary had lost in importance largely driven by rising (labor) costs in light of EU accession while Bulgaria and Romania continued to expand exports with Romania becoming the primary location for OPT in the region (Pickles/Smith 2010). With the MFA phase-out and EU accession also some of these lower-cost CEE suppliers came under pressure as reflected in the decline of exports from Romania. Only Bulgaria and some non-EU member states, including Macedonia, Serbia, Albania, Bosnia and Herzegovina and the Republic of Moldova increased exports after 2004. Most recently, Poland improved their export performance in the EU-15 market.

Table 1: Top 15 apparel importer countries to the EU-15

	in Mio €						in %					
	1995	**2000**	**2004**	**2008**	**2011**	**2013**	**1995**	**2000**	**2004**	**2008**	**2011**	**2013**
WORLD	**50.377**	**78.117**	**85.518**	**103.829**	**116.378**	**114.306**						
EU-15 (Intra)	21.838	30.513	32.765	38.874	41.009	41.759	43,3	39,1	38,3	37,4	35,2	36,5
China	3.542	7.450	11.038	24.330	29.440	25.679	7,0	9,5	12,9	23,4	25,3	22,5
Bangladesh	967	2.567	3.689	4.667	7.802	9.454	1,9	3,3	4,3	4,5	6,7	8,3
Turkey	3.189	5.322	7.520	7.612	8.239	8.338	6,3	6,8	8,8	7,3	7,1	7,3
India	1.588	2.005	2.434	3.826	4.651	4.047	3,2	2,6	2,8	3,7	4,0	3,5
Romania	***972***	***2.558***	***3.679***	***2.349***	***2.292***	***2.184***	***1,9***	***3,3***	***4,3***	***2,3***	***2,0***	***1,9***
Poland	1.604	1.826	1.153	1.421	1.976	2.117	3,2	2,3	1,3	1,4	1,7	1,9
Morocco	1.631	2.356	2.417	2.386	2.194	2.092	3,2	3,0	2,8	2,3	1,9	1,8
Tunisia	1.729	2.567	2.586	2.580	2.404	2.046	3,4	3,3	3,0	2,5	2,1	1,8
Vietnam	271	732	610	1.201	1.660	1.770	0,5	0,9	0,7	1,2	1,4	1,5
Cambodia	43	282	517	554	1.075	1.731	0,1	0,4	0,6	0,5	0,9	1,5
Pakistan	434	595	906	865	1.269	1.364	0,9	0,8	1,1	0,8	1,1	1,2
Sri Lanka	424	831	806	1.113	1.284	1.285	0,8	1,1	0,9	1,1	1,1	1,1
Indonesia	908	1.800	1.320	1.114	1.311	1.174	1,8	2,3	1,5	1,1	1,1	1,0
Bulgaria	252	774	1.046	1.132	1.128	1.075	0,5	1,0	1,2	1,1	1,0	0,9
Czech Rep.	436	528	711	609	602	572	0,9	0,7	0,8	0,6	0,5	0,5
Reg. suppliers*	**12.746**	**20.599**	**23.330**	**22.141**	**22.558**	**21.898**	**25,3**	**26,4**	**27,3**	**21,3**	**19,4**	**19,2**
CEE-20**	6.049	10.055	10.460	9.078	9.258	9.037	12,0	12,9	12,2	8,7	8,0	7,9

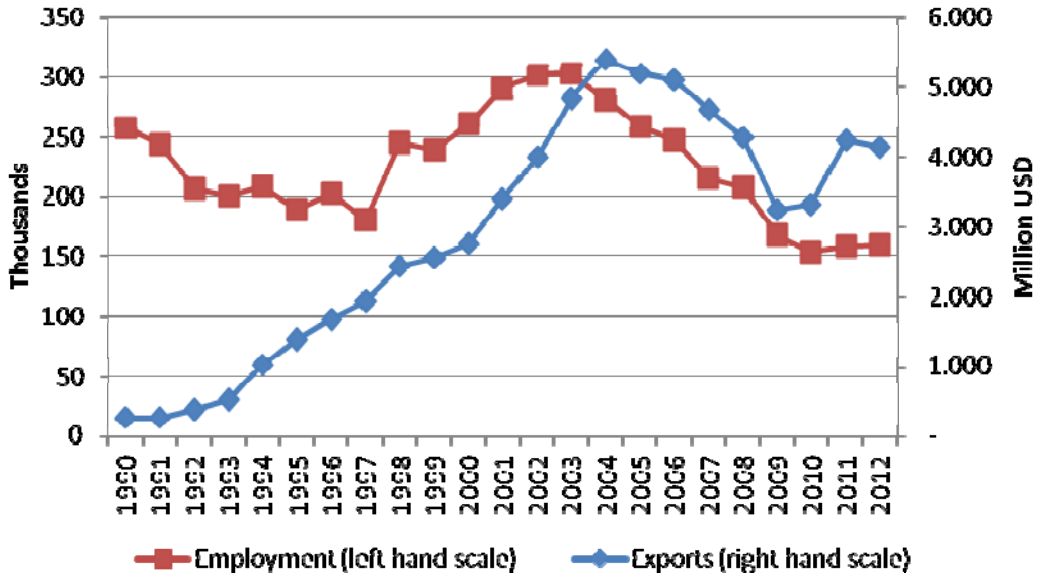
Source: Eurostat: Comext – Apparel represents HS61+62; World value represents the sum of EU-15 intra and extra trade.

Note: * Regional suppliers: MENA-4 (Egypt, Jordan, Morocco, and Tunisia), CEE, and Turkey.
** CEE: Romania, Poland, Bulgaria, Czech Republic, Hungary, Slovakia, Slovenia, Estonia, Latvia, Lithuania, FYR Macedonia, Croatia, Serbia, Montenegro, Albania, Bosnia and Herzegovina, Moldova, Ukraine, Belarus, and Russia.

4. Economic up- and downgrading in Romania: From full-package to OPT– and back?

Romania experienced an apparel boom since the mid-1990s based on OPT which came to an end in the mid-2000s. This is most prominently reflected in exports and employment that took of (after the 'transition shock') in the early 1990s. In the context of the MFA-phase-out and rising domestic cost pressures the sector experienced a consolidation staring in 2005 that was accelerated by the global economic crisis with a large decline in 2009. Exports increased again in 2011 (with employment however increasing to a lesser extent) and subsequently stabilized at the level of the early 2000s (Figure 1). Against this background the economic upgrading experience of Romania's apparel sector can be divided into two phases – in the 1990s and early 2000s functional downgrading was coupled with process and product upgrading, and from the mid 2000s onwards different strategies that included forms of product and functional upgrading took place in a highly competitive context.

Figure 1: Exports and employment in Romania's apparel sector



Source: Exports: UN Comtrade (2014); Employment: NIS (2014), Time series break in 2008 due to change from NACE Rev. 1.1. to Rev. 2.

4.1. The 1990s and early 2000s: Down- and upgrading under the 'Lohnsystem'

The textile and apparel industries had an important role in the industrialization process under state socialism in Romania and CEE more general (Begg et al. 2003). In the context of the larger project of 'socialist industrialization' the apparel and textile sectors were vertically integrated within the CMEA framework (Pickles/Smith 2011). Large textile combines provided yarns, fabrics, trim and other inputs for apparel manufacturers and organized distribution networks. Commercial activities such as financing, marketing, branding and sales were maintained by state departments, in the case of Romania CONFEX (CCC 1998). The decision of Romania's leader Ceauşescu to secure Romania's autarkic status, including the decision to repay the entire foreign debt, shaped the industries' development throughout

the 1980s. In order to earn foreign currency, exports were promoted[8] while imports were discouraged. As a result, textile and apparel production was highly domestically integrated as almost all production stages were carried out in Romania (Interview Stakeholders 2008/09).

Alongside the overall economic downturn and deindustrialization, production in the textile and apparel industries declined sharply after 1989. However, the apparel industry recovered quickly due to OPT relationships with Western European firms (i.e. branded manufacturers and retailers) and had an important role in stabilizing employment during the 1990s absorbing a fifth of total industrial jobs and accounting for more than a quarter of total exports in the early 2000s. OPT transactions with Western European firms were for many firms the only way to survive in the 1990s, as they guaranteed demand and provided materials and machinery firms could not finance otherwise and organizational, financial and sales know-how (Interviews Stakeholders & Firms 2008/09). The developed industrial fabric and skilled workers as well as existing business contacts were important institutional contexts to the rapid integration into Western European apparel GPNs (Begg et al. 2003). In particular those firms that had gathered experience in exporting to non-CMEA markets under state socialism quickly recovered based on OPT relations (Lane/Probert 2009). Along the same line, CONFEX managers that acquired apparel production units in the privatization process drew on their business contacts with Western European firms to attract orders (CCC 1998; Interviews Firms 2008/09).

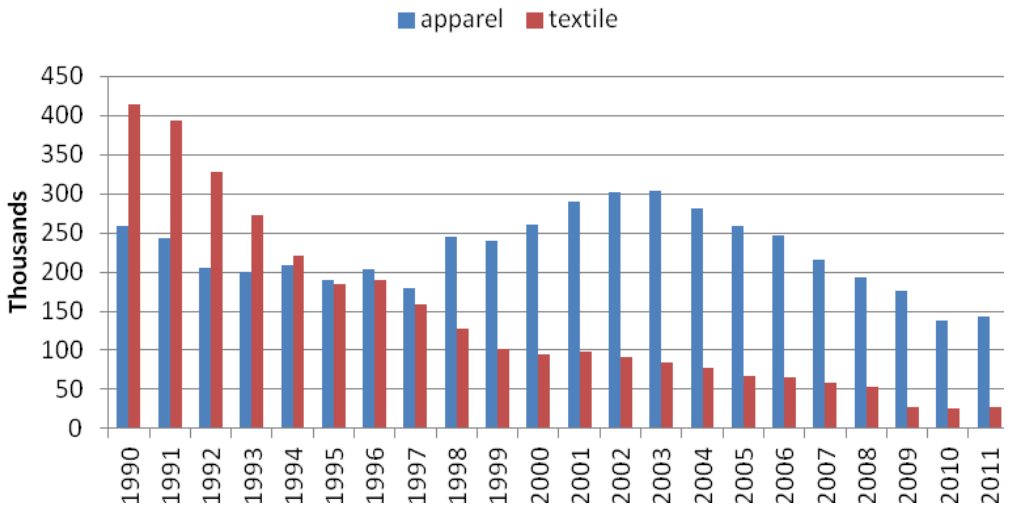
The rise of Romania's apparel sector through OPT had ambivalent effects on firms´ economic upgrading trajectories. On the one hand, it led to functional downgrading. The specific integration promoted by OPT established a division of labor that led to the disintegration of the domestic textile and apparel complex at the industry level and to a change from full-package production to assembly manufacturing at the firm level. This was especially true for the former state-owned firms which used to produce yarns, fabrics and apparel, had design and product development departments, and their own brands (Interviews Stakeholders 2008/09). The activities of these firms were reduced to the sewing of fabric into finished products according to the patterns and designs provided by Western European buyers. They could no longer use their own fabrics and design and product development capabilities under OPT. Thus, OPT resulted in a de-skilling of the workforce that had been employed previously in full package production (Interviews Stakeholders 2008/09). This also impacted on the average firm size as the former state-owned plants were either closed down or split into smaller units and privatized and smaller, newly founded private apparel firms emerged with more than half of the firms being micro-enterprises with less than ten employees in the early 2000s (Pincheson 1995; IFM 2004; Bota/Gut 2007). Further, it induced a strong increase in textile imports, almost exclusively from Western Europe, and a related decline of the domestic upstream sector. While textile employment fell continuously from 414,000 in 1990 to 95,000 in 2000, employment in the apparel sector decreased from 258,000 in 1990, reaching its lowest level of 180,000 in 1997, but then increased again and caught up with the 1990 level by 2000 (Figure 2). Romania became the second largest importer, after the US, of textiles from the EU-15 in 2002 (UN Comtrade 2014).

On the other hand, OPT production for the EU-15 market promoted process and product upgrading as Romanian producers obtained know-how and technology due to relationships with Western European manufacturers and retailers (Yoruk 2002). In particular German branded manufacturers which accounted for an important share of OPT trade with Romania until the late 1990s assisted their OPT partners, both technologically and organizationally, to

[8] The privileged status that Romania enjoyed concerning trade relations to Western Europe due to the "maverick communist" image that had been ascribed to Ceaucescu during his early years played an important role in Romania becoming the major CEE apparel exporter already in 1988 (Textiles Intelligence 1997; Lane/Probert 2009).

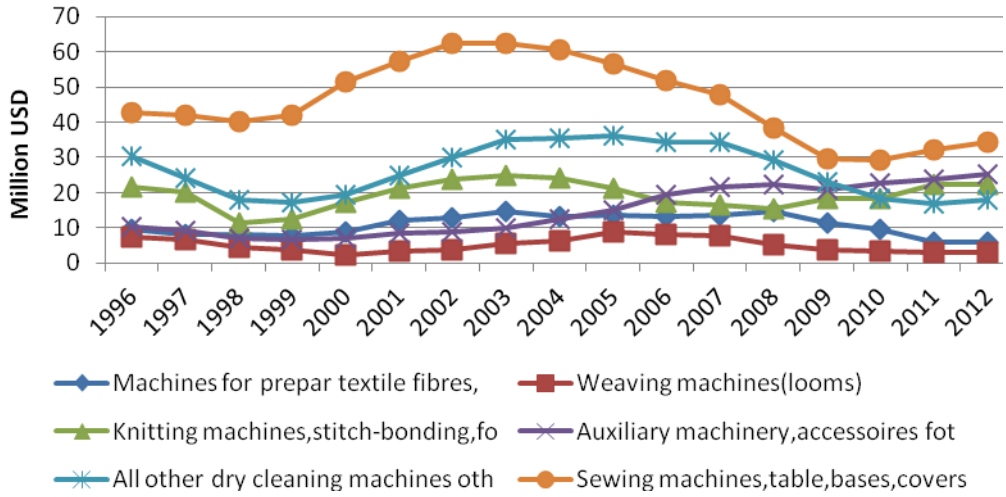
enhance quality and productivity (Wortmann 2005). Most important were improvements of quality, delivery time, speed and flexibility related to fast fashion souring principles that were largely unknown in Romania before working for Western European buyers (Interviews Firms 2008/09; see also Pickles et al. 2006). Given the technological level of the industry – due to Romania's turn to autarky in the 1980s the last renewal of machinery and equipment in most firms occurred before the 1980s (Yoruk 2002; Bota/Gut 2007) – technological modernization was concentrated on renewal of production equipment, i.e. sewing machines and other basic operational equipment, throughout the 1990s and early 2000s (Figure 3). More sophisticated equipment such as automatic cutters and CAD systems were not widely employed in the 1990s which improved in the first half of the 2000s (WIIW/CEPS 2005). However, there were still only around 250 CAD systems in place in Romania by 2004, and most of them were second-hand (De Coster 2004).

Figure 2: Employment in Romania's apparel and textile sectors



Source: NIS (Statistical Yearbook, Section: Labour Market; Indicator: Average Number of Employees), Times series break in 2008 due to change from NACE Rev. 1.1. to Rev. 2

Figure 3: Romania's imports of apparel and textile machinery



Source: UN Comtrade (2014), 3-year average.

Based on the long tradition of the apparel sector and hence the existing industrial fabric, production capabilities and a skilled workforce as well as integration into the higher quality and fast fashion segment of Western European production networks, CEE countries' exports included higher value and more complex products (Begg et al. 2003; Pickles/Smith 2011). Romania has a long history of manufacturing comparatively sophisticated products, particularly for German branded manufacturers that started to order in Romania in the 1960s (Schüßler 2009). This is reflected in the relative strong importance of not only low value product categories (e.g. men´s cotton shirts and trousers) but also of more sophisticated products such as men´s wool jackets and trousers and women's synthetic fiber jackets in the top 10 export products to the EU-15 in the 1990s and early 2000s. Product concentration was further relatively low (compared to low cost Asian suppliers, Frederick/Staritz 2012) with the top 10 products accounting between 40 % and 46 %. The average unit values of Romania's apparel exports (at the HS 6 digit level) were slightly higher than the EU-15 average in 1995 ranking 4th after Poland, Turkey and Tunisia. Unit values rose further alongside an expansion in volumes with Romania ranking second after Tunisia in 2004 (Table 2).[9]

Table 2: Unit values of top-10 suppliers to EU-15

1995	Qty.	Val.	Unit Value	2004	Qty.	Val.	Unit Value	2013	Qty.	Val.	Unit Value
	100 t	Mio €	€/kg		100 t	Mio €	€/kg		100 t	Mio €	€/kg
EU-15 (Extra)	17.289	28.538	17	EU-15 (Extra)	36.828	52.753	14	EU-15 (Extra)	43.606	72.547	17
EU-15 (Intra)	7.574	21.838	29	EU-15 (Intra)	10.301	32.765	32	EU-15 (Intra)	17.679	41.759	24
China	2.480	3.542	14	China	10.036	11.038	11	China	17.327	25.679	15
Turkey	1.676	3.189	19	Turkey	4.117	7.520	18	Bangladesh	8.209	9.454	12
Hong Kong	1.563	2.547	16	Bangladesh	4.521	3.689	8	Turkey	3.427	8.338	24
Tunisia	931	1.729	19	***Romania***	***1.761***	***3.679***	***21***	India	2.055	4.047	20
Morocco	949	1.631	17	Tunisia	1.121	2.586	23	***Romania***	***999***	***2.184***	***22***
Poland	673	1.604	24	India	1.731	2.434	14	Poland	831	2.117	25
India	1.081	1.588	15	Morocco	1.344	2.417	18	Morocco	928	2.092	23
Romania	***541***	***972***	***18***	Hong Kong	990	1.923	19	Tunisia	727	2.046	28
Bangladesh	1.132	967	9	Indonesia	944	1.320	14	Vietnam	898	1.770	20
Indonesia	645	908	14	Poland	599	1.153	19	Cambodia	1.140	1.731	15

Source: Eurostat: Comext – Apparel represents HS61+62; World value represents the sum of EU-15 intra and extra trade.

[9] Interpretations of unit values have to be taken cautiously as they may reflect higher quality and more sophisticated export products but also a loss in competitiveness related to increasing costs.

4.2. The late 2000s: Diverse upgrading paths in a highly competitive context

Romania's apparel boom reached its peak in 2004. Production under the 'Lohnsystem' became increasingly unviable as a main motivation of this production model is low labor costs. This competitive advantage eroded against the backdrop of increased international competition in light of the MFA phase-out and a changing policy context in the run up to EU accession leading to shrinking export revenues (owing to the 'strengthening' of monetary policy) and rising (labor and utility) costs. Particularly the tightening labor market related to outward migration with around two million Romanians working abroad (Ciutacu 2006; Popescu/Popa 2013) and more appealing employment opportunities in sectors such as retailing impacted on apparel firms (ILO 2010; Interviews Firms 2008/09). Further, demands of lead firms, particularly retailers, increasingly include functions beyond CMT such as input sourcing and financing and involvement in design and product development[10] (Staritz 2011; Frederick/Staritz 2012). The global economic crisis accelerated these competitive pressures as demand in traditional end markets and the domestic market declined. However, the crisis also entailed shifts in sourcing policies of at least some buyers that re-focused on 'nearshoring' in the context of global insecurities and a reinforced focus on flexibility (Salomon 2013). Against this background economic upgrading experiences after 2004 have been divergent as apparel firms reacted in diverse ways leading to different and simultaneous upgrading paths – some pursued as active strategies and others forced onto suppliers – that can be grouped into four broad categories: (i) product upgrading to smaller run, higher value products, including niche products; (ii) limited functional upgrading in traditional EU-15 export markets; (iii) market diversification to domestic and non-traditional export markets; and (iv) relocations to poorer regions within Romania and to neighboring non-EU countries.

These different upgrading trajectories depend on access to resources and government support. The latter played a limited role given the government's lack of will and capacity to pursue active industrial policies and its perception of apparel as a 'sun set' industry. In particular in the important areas of skill training and access to finance government support was largely missing.[11] Given the lack of government support, upgrading strategies required firm-level resources and access to funds which were difficult to acquire for the majority of small and micro firms. Hence, at the firm level a consolidation process has been underway since 2005 which has been reinforced in the context of the global economic crisis – reducing the number of firms from roughly 6,000 in 2005 to 4,300 in 2012.[12] In particular the segment of smaller firms that were formerly subcontractors to larger firms to fill OPT orders has declined (Figure 4; Interviews Firms 2008/09). But also larger firms that focused on larger run productions and higher degrees of automation were negatively affected, as particularly high volume orders shifted towards Asia (Interviews Stakeholders 2008/09). Firm level responses also depend on their ownership structures (Smith et al 2014; Morris/Staritz 2014). Particularly some branded manufacturers from Italy and Germany and to a lesser extent the UK and France, are not only involved in sourcing but are part-owners of plants in Romania which played an important role in sustaining orders and production after 2004.[13] Out of roughly 4,300 firms active in 2013 around 10 % have foreign participation – with the overwhelming majority having a foreign controlling stake and almost 200 Italian controlled firms. These firms together accounted for almost the same turnover in 2012 as all local

[10] The development of new products and design remain however the core competence of most lead firms.

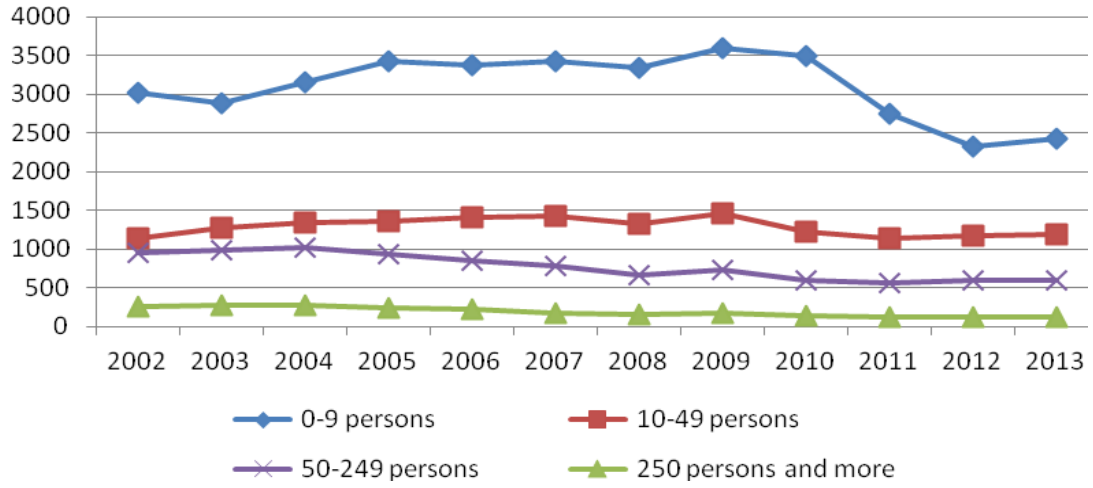
[11] Regarding skills, the established vocational training system was 'reformed' during 'transition' with many training facilities geared towards the textile and apparel sectors being dismantled. The government's perception on the apparel sector changed in the late 2000s. However, besides an understanding of the problems related to the dominance of the 'Lohnsystem' very limited actions to support upgrading were taken (IFM 2004; Lane/Probert 2009). One of the few initiatives taken concerned support for the adoption of OHS and CSR standards (ILO 2010).

[12] Sellar (2007) highlights that a number of particularly micro enterprises is registered for other than production reasons (e.g. taxes). Hence, the number of firms might be overrepresented in official statistics.

[13] Smith et al. (2014) highlight a similar development in Slovakia.

owned firms and experienced an increase since 2004 while local firms experienced a decline in particular in the context of the crisis. Turnover per employee is also significantly higher on average in firms with foreign capital – in 2013 it amounted to roughly 18,000 Euro as compared to 12,500 for local firms (Orbis 2014).

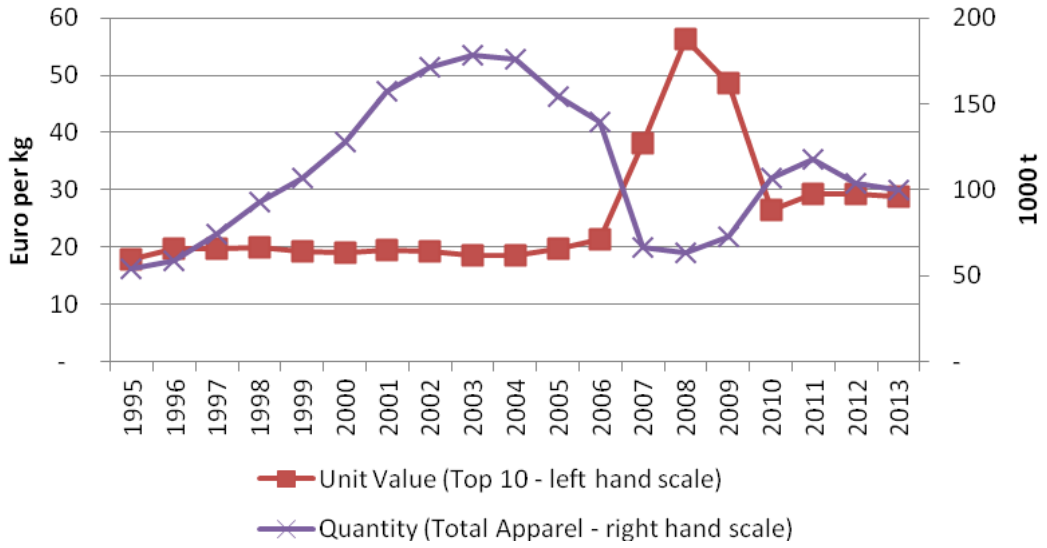
Figure 4: Number of firms by size class in Romania's apparel sector



Source: NIS – Tempo Database (Tables: INT101H and INT101S), Time series break in 2008 due to change from NACE Rev. 1.1. to Rev. 2.

First, firms have continued to pursue product upgrading related to cost pressures and eroding competitiveness particularly in the high volume-low value product segment. Average unit values of EU-15 exports continued to increase slightly between 2004 and 2013. The average of the top 10 products (at the HS 6 digit level) increased from 18.5 Euro/kg in 2004 to 56.3 Euro/kg in 2008 which declined again to 28.8 Euro/kg in 2013. The peak in 2008 is exceptional and coincides with a drastic reduction of export volume (Figure 5). Over the period 2004 to 2013, product upgrading is exemplified by some of the top 10 product categories showing a significant upward trend in unit values for e.g. men´s jackets of wool, women´s synthetic fiber jackets, men´s cotton shirts and wool pullovers. Further, some higher value products emerged among the top 10 categories since the crisis, including brasseries. In 2008, Romania exhibited the highest average unit values in the EU-15 market among the top-10 suppliers. Unit values declined but remained above the average in 2013 with Romania ranking fifth after Tunisia, Poland, Turkey and Morocco (Table 2 above). This product upgrading between 2004 and 2013 occurred together with reductions in volumes which questions a pro-active upgrading path and hints to 'forced upgrading' as large volume-low value production was no longer competitive and shifted to other countries (Interviews Firms 2008/09). However, despite the reactive nature Romanian firms were still able to remain in or shift to these higher value products which require capabilities to ensure high quality, produce flexibly and meet small orders and accommodate increasing cost pressures (Interviews Firms & Stakeholders 2008/09). Product upgrading has sometimes taken place in tandem with functional upgrading to full package production and design/product development involvement but has also been combined with continuing production under the Lohnsystem, particularly in production networks of branded manufacturers.

Figure 5: Unit values and volumes of Romania's apparel exports to the EU-15



Source: Eurostat: Comext – Apparel represents HS61+62, by HS6 (Table: DS-016893).

Second, firms have tried to take on more responsibilities in traditional EU-15 production networks and move away from the assembly role. This has been in particular important as lead firms, particularly retailers, have sought to work with suppliers that can take over more functions such as finishing, input sourcing and some design/product development involvement. This process has started in the late 1990s as the custom benefits from OPT phased out in 1998 in CEE but in Romania it only accelerated in the mid 2000s. The easiest and most widely observed upgrading trajectory already under OPT was to carry out additional finishing activities such as washing, labeling, packaging and bar-coding. Investments in finishing activities, including laundry, embroidery, patchwork and printing, have increased which can be supported by machinery import data (Figure 3 above).[14] Firms have also upgraded to 'full-package' suppliers which involves organizing and financing inputs and a limited number of firms also managed to add design and product development capabilities selling ready-to-sell collections to EU-15 buyers (Lane/Probert 2009). These latter two upgrading trajectories have however been less widespread and successful firms often continue to produce under the Lohnsystem to sustain their broader business activities (Interviews Firms & Stakeholders 2008/09; Popescu/Popa 2013). According to data from the Ministry of Economy, imported inputs under the Lohnsystem accounted for 85 % of total apparel exports in 2004 which declined to 75 % in 2006 and to around 65 % in 2008 (ILO 2010). Industry estimates confirm this picture (Interviews Firms & Stakeholders 2008/09). This is supported by a survey of 102 apparel firms in 2011 that shows that only a small share of firms have implemented a strategy to reduce Lohnproduction during the global economic crisis as most consider the Lohnsystem as the only viable production model (Popescu/Radu 2011). Local constraints to full package production have been the lack of access to finance as banks are reluctant to provide credits to apparel firms which is required particularly for full package production, shortage of skilled labor due to migration, and the limited local supply base (Lane/Probert 2009; Popescu/Radu 2011). The domestic textile sector did – with some exceptions – not survive 'transition'. Even though investments in trims, accessory and to a lesser extent textiles increased in the 2000s, the large majority of textile is still imported (NIS

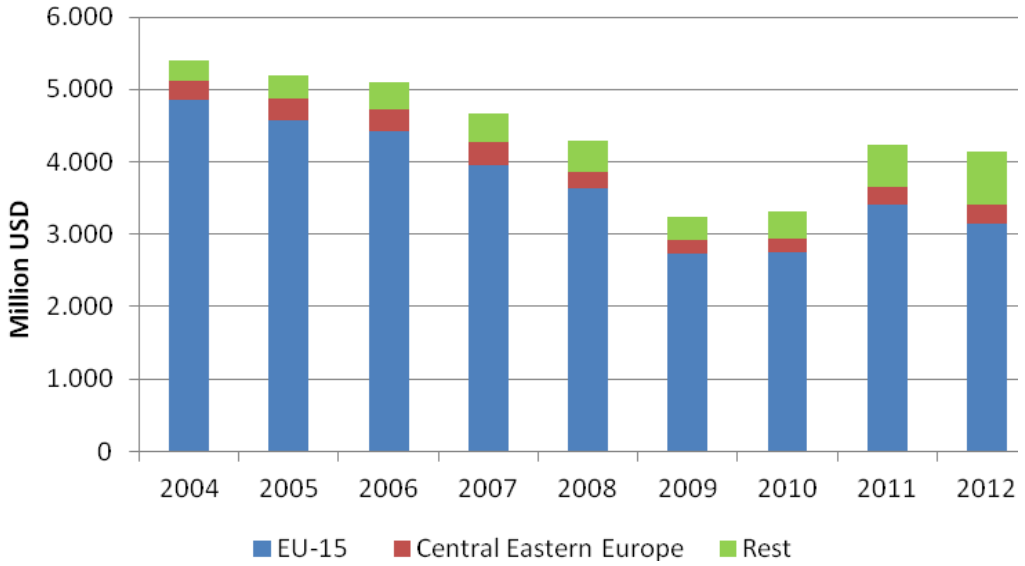
[14] Sewing machinery imports generally reflect the development of apparel exports declining after the mid-2000s and rebounding post-crisis. However, imports of washing and dry cleaning machinery increased until 2005 and then remained stable until 2008 indicating the increased importance of finishing activities.

2014; De Coster 2006; Sellar 2007). Romanian firms had further limited contacts to textile suppliers in non-EU-15 countries as under OPT input sourcing was organized by the Western European partners. Hence, EU-15 textile imports still accounted for 75 % of total textile imports in 2012 with Italy (31 %), Germany (19 %), the UK (9 %), Turkey (8 %) and France (7 %) being the top 5 importers. In contrast, China accounts for barely 4 %.

Third, firms have tried to diversify end markets including the rediscovery of the domestic market to reduce dependency on traditional export markets. Another motivation was that for some firms these markets have offered more advantageous cost structures and better functional upgrading possibilities to design and branding. Firms often pursue these strategies along continued Lohnproduction for EU-15 markets (Interviews Firms & Stakeholders 2008/09). Apparel exports to the EU-15 accounted for over 90 % of total apparel exports from 1991 until 2004 and the lion share went to four countries, namely Italy, Germany, the UK and France. This share declined to 76 % in 2012 with increasing shares for other CEE countries (6.1 % in 2012), the US (3.6 %), China (3.1 %), Japan (2.7 %) and Russia (1.9 %). Between 2004 and 2012, non-EU-15 markets grew with a CAGR of 23 % while EU-15 markets shrank by 4.5 % (Figure 7). These non-traditional export markets also seem to offer better prices as measured in average unit values (at the HS 6 level) amounting to 29 USD/piece and 53 USD/kilo in non-EU-15 markets versus 11 USD/piece and 36 USD/kg in EU-15 markets.[15] Besides new export markets, production for the domestic market became increasingly important with a strong increase from 2000 (25 index points) to 2008 (145 index points) (Figure 8). Throughout the 1990s domestic demand was low and largely served by micro-firms that produced low-value products or by imports, largely from Asia. With rising incomes Romanian suppliers, however, started to target the emerging Romanian middle class often alongside export production (IFM 2004). Romanian apparel sales exhibited the strongest CAGR worldwide (39 %) between 2004 and 2008 (AT Kearney 2009). With the global economic crisis, domestic demand has however slumped and not yet recovered (Figure 8). Functional upgrading to design and particularly branding has been a strategy particularly for the domestic market with around 400 brands developed by Romanian firms (Yoruk 2001; Bota/Gut 2007; ILO 2010; Popescu/Popa 2013; Interviews Stakeholders 2008/09). The success of upgrading into branding has however been limited given the difficulties to enter foreign markets and competition in the domestic market with particularly Western European lead firms entering the Romanian market in the context of EU accession and H&M, Inditex, and international retail groups that franchise international brands, including FF Group Romania and Azadea Group, playing dominant roles (Marketline 2014; Euromonitor 2014). The share of Romanian apparel firms that can successfully compete with international firms has been very small, in particular in the middle and higher value segment. In the lower value segment, competition from Asian imports squeezes small local producers that traditionally served this market segment.

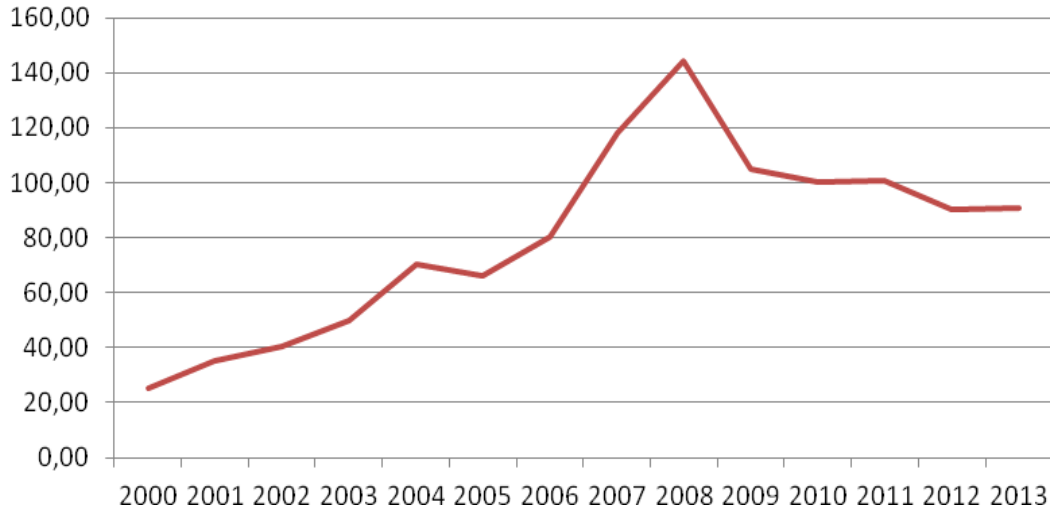
[15] In UN Comtrade, volumes are reported in pieces or kg but for some product categories (around 25 % in 2012) quantities are not reported.

Figure 6: Romania's apparel exports by main end markets



Source: UN Comtrade (2014), Apparel represents HS61+62.

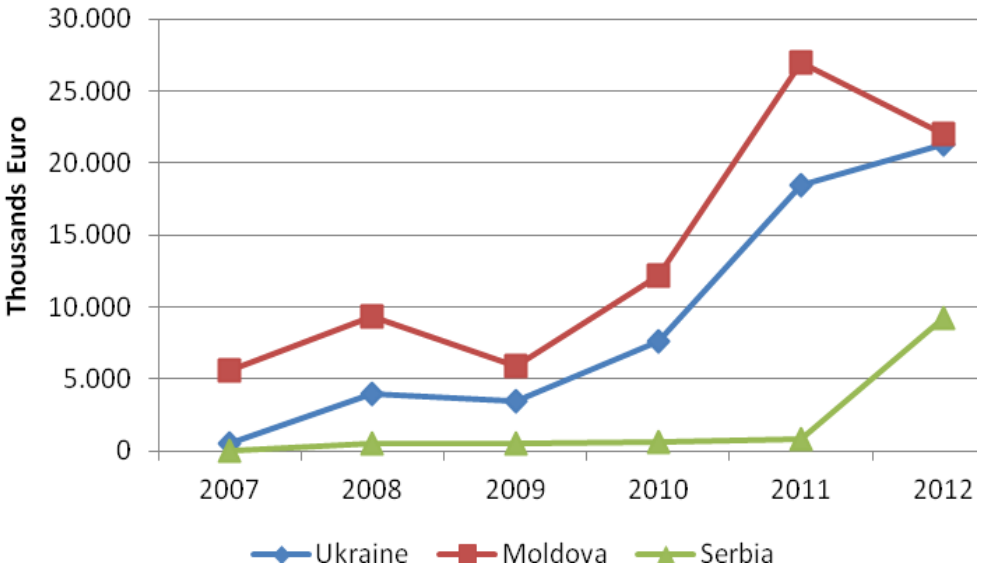
Figure 7: Index of turnover of apparel production for domestic market (base = 2010)



Source: Eurostat: Short Term Statistics – Turnover in industry, domestic market (Table: sts_intvd_a).

Fourth, firms have relocated or subcontracted, in particular low value production, to more remote and poorer regions within Romania or to lower cost neighboring non-EU countries to reduce (in particular labor) costs and counter labor shortage (Interviews Firms 2008/09).[16] Notwithstanding regional differences, the labor-shortage has increased the overall bargaining power of workers (Plank/Staritz 2011). Some firms offered better wages and working conditions to retain or attract particularly skilled workers or offered free transport to attract workers from more distant areas. Another option was relocation. The relatively stronger expansion of new firms in poorer counties (measured as GDP per capita at the NUTS3-level) since the crisis underlines the internal relocation pattern with the counties Vrancea (rank 38 out of 42 counties), Girugiu (rank 36) and Teleorman (rank 33) showing the highest increase in production. However, the shift is not uniform as also some richer counties (e.g. Ilov and Cluj) are in the upper ranks given their established production structures. The rise of OPT apparel imports to Romania from the Republic of Moldova, the Ukraine and Serbia shows the increasing importance of cross-border relocations in sustaining cost-competitive production (Figure 9). From an economic upgrading perspective both strategies can be seen as forms of functional upgrading taking place at the Romanian intermediary firms that have broadened their functions from the production of apparel to the organization and management of subcontracting networks. Another, however it seems not widespread, strategy to deal with labor costs and shortage was the use of migrant workers from Asian countries (including China, Vietnam, Bangladesh and the Philippines) under the working permit scheme (Plank/Staritz 2011).[17]

Figure 8: Romanian OPT-apparel imports



Source: Eurostat: Comext – Adjusted EU-EXTRA Imports by tariff regime (Table: DS-041719).

[16] Smith et al. (2008) highlight similar cases where Slovakian suppliers established cross-border networks incorporating Ukrainian firms.

[17] The issue of migrant workers gained some publicity in January 2007 as 300 female Chinese workers who were employed legally under the work permit scheme in an apparel factory in Bacau protested for higher wages (ILO 2010).

5. Conclusions

Our analysis of the Romanian apparel sector reveals the considerable influence of multi-scalar institutional, policy and macro contexts on the articulation of and upgrading prospects in GPNs in addition to industry dynamics. Corporate strategies are central in explaining the development of the Romanian apparel industry, as Western European lead firms (re)discovered the capabilities of Romanian firms and workers and benefited from low-cost but skilled labor as well as from short lead times and high flexibility due to geographical proximity which are increasingly important in the fast fashion environment. This engagement took place however against the background of EU OPT arrangements that have been the basis of the development of the Romanian apparel export sector and promoted "quite deep-seated production and contracting processes" (Begg et al. 2003: 2202) that remained long after the OPT trade system officially phased out. While the EU´s trade regime was a crucial driver the fact that Romania was a large apparel producer under state socialism and had exported to Western Europe as early as the late 1960s allowed the rapid integration into Western European production networks, that also include the production of higher value products. The domestic institutional and macro policy context changed with EU accession that accelerated cost pressures and triggered responses at the firm level. Lastly, the global economic crisis drastically demonstrated the downsides of a dependent export oriented integration model given the sharp decline in demand in traditional export markets. The global economic crisis has had however contradictory effects as it also lead to some re-evaluation of largely Asian-based sourcing strategies.

The development of the apparel sector in Romania further questions the conventional view that conceives economic upgrading as a linear and pro-active process. We observed diverse, non-linear and uneven up- and downgrading trajectories. First, integration into Western European GPNs under OPT resulted in functional downgrading from full-package production to assembly manufacturing and a disintegration of the domestic textile and apparel complex. Functional downgrading was however accompanied by process and product upgrading. Second, firms have tried to move away from the increasingly precarious Lohnsystem in the context of increased competitive pressures related to the MFA phase out and EU accession. This occurred in multiple ways and firms often continued simultaneously to work for their 'Lohn' clients. They tried to pursue product upgrading and to develop full package and design/product development capabilities for traditional EU-15 markets. Market diversification to new export markets and the domestic market has been an important strategy to deal with high competition and escalating buyers' requirements in traditional markets and allowed for some functional upgrading – in the domestic market also to branding. Others have relocated production to poorer regions within Romania and abroad. These responses were related to firm-level resources and ownership structures. Third, these upgrading experiences took place in a very competitive environment and can hardly be described as pro-active strategies but rather as survival measures and re-active adaptation. Product upgrading after the MFA phase out coincided with a large reduction in volumes as large volume-low value orders shifted to lower cost countries and hence 'forced' suppliers into focusing on low volume-high value production. Also some forms of functional upgrading into finishing and input sourcing can be perceived as re-active adaptation or 'forced' upgrading as buyers adapted their core activities and off loaded lesser profitable functions onto suppliers.

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