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Industrial and Firm Upgrading in the European Periphery

The Textile and Apparel Industry in Turkey and Bulgaria

by

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I hereby declare that this thesis contains no materials accepted for any other degrees in any other institutions. This thesis contains no materials previously written and/or published by another person, unless otherwise noted.

To my mother, who has greatly inspired my life

ABSTRACT

Under what conditions is upgrading of the light leading export sector possible? This dissertation embarks on the case of Turkey (1983-2003) and Bulgaria (1995-2003) to analyze the factors that determine local upgrading, thus furthering economic development and improving standing in the global economy. Drawing on primary reports, interviews, secondary literature (Sectoral Analysis, Global Value Chains and Business Association) and empirical analysis at the sectoral, network and firm level, the thesis demonstrates Turkey's success and Bulgaria's failure in industrial and firm upgrading. The claim of the thesis is that the modern state and the modern sector are not just static entities. The effects of the new technologies of production and organization of services have a tremendous impact on them which creates a diversity of responses. The responses drive the process of collaboration between the state and the sector. This collaboration is identified as *State-Sector Aptitude Building* and it helps local firms to re-position in higher value added segments of global value chains to improve industry's export position in the global economy.

KEYWORDS: textile and clothing industry, global value chains, sectoral analysis, industrial and firm upgrading, Central and Eastern Europe, periphery, Bulgaria, Turkey.

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When I started the PhD program at CEU in September 2001, I did not have even the slightest idea that professional and personal life will be affected to such an extent by the selection of topic and countries. I embarked on a topic related to the textile and clothing industry, which I hardly new. I remember that it was my theoretical interest in Global Value Chains and Sectoral Analysis which drove me into this. Three years after my inception, I was already involved with the national strategy team for development of the clothing and later, the textile strategy of Bulgaria.

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TABLE OF CONTENTS

LIST OF TABLES viii
LIST OF FIGURES ix
LIST OF ABBREVIATIONS x

CHAPTER I. INTRODUCTION....1
1.1 SCOPE OF THE STUDY....1
1.2 COUNTRY CASES AND RESEARCH QUESTION....2
1.3 THEORETICAL APPROACHES, MAIN CONCEPTS AND ARGUMENT....4
1.4 STRUCTURE....9

CHAPTER II. THEORY AND RESEARCH METHODOLOGY....11
INTRODUCTION....11
2.1 THEORETICAL BACKBONE....11
2.1.1 Sectoral Analysis....11
2.1.2 Global Value Chains....15
2.1.3 Business Association literature....23
2.2 CAUSALITY....25
2.2.1 Variables....25
2.2.2 Hypotheses....33
2.3 QUALITATIVE AND QUANTITATIVE RESEARCH ANALYSIS....34
2.3.1 Industrial Analysis....34
2.3.2 Firm Analysis....39
CONCLUSION....43

CHAPTER III. TEXTILE AND APPAREL INDUSTRY IN TURKEY....44
INTRODUCTION....44
3.1 INITIAL CONDITIONS....44
3.2 STATE POLICY IN THE POST-1983....48
3.2.1 Integration into world markets....49
3.2.2 Exchange rate policy....53
3.2.3 Trade liberalization with EU....54
3.2.4 Foreign Direct Investment....58
3.2.5 Privatization....60
3.2.6 State industrial policy....61
3.3 BRANCH ASSOCIATIONS....68
3.4 TURKISH REALITY....73
3.4.1 Competition through informalization....73
3.4.2 Competition through labor....77
CONCLUSION....81

CHAPTER IV. INDUSTRIAL AND FIRM UPGRADING IN TURKEY....83
INTRODUCTION....83
4.1 SECTORAL LEVEL....83
4.1.1 Low value added position in the 1980s....83
4.1.2 Climbing up in the 1990s....87
4.1.3 Upgrading in the post-1995....89
4.2 NETWORK LEVEL....94
4.3 FIRM LEVEL....102
4.3.1 Survey results....102
4.3.2 Analysis of three firm cases....114
CONCLUSION....126

CHAPTER V. TEXTILE AND APPAREL INDUSTRY IN BULGARIA 128
INTRODUCTION 128
5.1 INITIAL CONDITIONS 128
5.2 STATE POLICY IN THE POST-1995 139
5.2.1 Integration into world markets 139
5.2.2 Exchange rate policy 143
5.2.3 Trade liberalization with EU 144
5.2.4 Foreign Direct Investment 146
5.2.5 Privatization 147
5.2.6 State industrial policy 150
5.3 BRANCH ASSOCIATIONS 152
5.4 BULGARIAN REALITY 155
5.4.1 Competition through informalization 155
5.4.2 Competition through labor 158
CONCLUSION 165

CHAPTER VI. INDUSTRIAL AND FIRM UPGRADING IN BULGARIA 167
INTRODUCTION 167
6.1 SECTORAL LEVEL 167
6.1.1 Low value added export position in 1995 167
6.1.2 Low value added exports in 1996 and 1998 169
6.1.3 Low value added exports in 2001 170
6.1.4 Low value added exports sustained in 2003 172
6.2 NETWORK LEVEL 176
6.3 FIRM LEVEL 183
6.3.1 Survey results 183
6.3.2 Analysis of three firm cases 195
CONCLUSION 210

CHAPTER VII. RESULTS FROM MULTIVARIATE ANALYSIS.....211
INTRODUCTION 211
7.1 APPLICATION OF THE MULTIVARIATE ANALYSIS 213
7.1.1 Justification for the comparison of the two samples 214
7.2 TESTED MULTIVARIATE RESULTS WITH STATISTICAL PROCESSING 218
7.2.1 Inter-correlation analysis of variables 218
7.2.2 Creation of new indexes and dummy variables 221
7.2.3 Regression models of variables and indexes 225
CONCLUSION 230

CHAPTER VIII. CONCLUSION.....231
INTRODUCTION 231
8.1 COMPARATIVE OVERVIEW 231
8.1.1 Similar starting positions, different outcomes 231
8.2 SECTORAL ANALYSIS AND ITS REVISION 236
8.2.1 High SSAB in Turkey 238
8.2.2 Low SSAB in Bulgaria 242
8.3 FINAL WORDS 244

REFERENCES.....258

APPENDICES.....269

LIST OF TABLES

TABLE 1 COMPARISON OF PRE-1980 AND POST-1980 ECONOMIC POLICIES IN TURKEY ... 49
TABLE 2 FOREIGN-OWNED FIRMS IN THE TURKISH T/C INDUSTRY ... 59
TABLE 3 FOREIGN INVESTMENT LICENSES IN THE TURKISH T/C INDUSTRY ... 59
TABLE 4 SUBSIDIZED INVESTMENT PROJECTS IN TEXTILE : TURKEY ... 62
TABLE 5 INVESTMENT CERTIFICATES GIVEN TO THE TURKISH T/C INDUSTRY ... 63
TABLE 6 SIZE DISTRIBUTION IN THE TURKISH T/C INDUSTRY (2001) ... 75
TABLE 7 AVERAGE WAGES, LABOR COSTS AND EMPLOYMENT STRUCTURE IN THE TURKISH T/C INDUSTRY (APRIL 2004, USD) ... 76
TABLE 8 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (1983) ... 84
TABLE 9 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (1988) ... 85
TABLE 10 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (1991) ... 87
TABLE 11 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (1995) ... 88
TABLE 12 INTEGRATION OF TEXTILES AND CLOTHING INTO GATT ... 89
TABLE 13 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (2001) ... 90
TABLE 14 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (2003) ... 91
TABLE 15 STATE CAPITAL INVESTMENTS IN BULGARIA (1977-1988) ... 133
TABLE 16 FOREIGN DIRECT INVESTMENT IN BULGARIA BY SECTORS ... 147
TABLE 17 CASH PRIVATIZATION IN THE BULGARIAN T/C INDUSTRY ... 148
TABLE 18 NUMBER OF ENTERPRISES AND EMPLOYEES (1983-2003) ... 156
TABLE 19 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (1995) ... 167
TABLE 20 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (1996,1998) 169
TABLE 21 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (2001) ... 171
TABLE 22 UNIT VALUE ANALYSIS OF EC TEXTILE AND APPAREL IMPORTS (2003) ... 172
TABLE 23 EC APPAREL TRADE WITH BULGARIA (1995/2003) ... 174
TABLE 24 COMPARISON OF THE TWO FIRM SAMPLES ... 214
TABLE 25 FACTOR LOADINGS FOR THE RELATIONSHIP BETWEEN TRADE AGENTS ... 222
TABLE 26 FACTOR LOADINGS FOR FIRM UPGRADING ... 223
TABLE 27 PATTERN MATRIX OF DEPENDENCY AND RANKING ... 224
TABLE 28 FIRM DEPENDENCY MATRIX ... 224
TABLE 29 FIRM RANKING MATRIX ... 225
TABLE 30 REGRESSION OF UPGRADING INDEX USED AS DEPENDENT VARIABLE ... 225
TABLE 31 REGRESSION OF UPGRADING INDEX WITH CONTROL FOR SMALL FIRMS ... 227
TABLE 32 REGRESSION OF UPGRADING INDEX WITH CONTROL FOR LARGE FIRMS ... 228
TABLE 33 SEPARATE REGRESSION MODELS FOR BULGARIA AND TURKEY ... 229

LIST OF FIGURES

FIGURE 1 EXPORT ROLES OF INDUSTRIAL UPGRADING 20
FIGURE 2 TURKISH TRADE IN TEXTILES WITH THE WORLD 50
FIGURE 3 TURKISH TRADE IN CLOTHING WITH THE WORLD 50
FIGURE 4 TOP FIVE CLOTHING MARKETS: TURKEY 51
FIGURE 5 TOP FIVE TEXTILE IMPORTERS: TURKEY 52
FIGURE 6 SECTORAL SHARE OF TURKISH EXPORTS TO THE EU MARKET 56
FIGURE 7 EU TEXTILE AND APPAREL IMPORTS (1983-2003): TURKEY 93
FIGURE 8 MAJOR EXPORT MARKETS: TURKEY 103
FIGURE 9 DOMINANT CONTRACTS OF TURKISH FIRMS WITH FOREIGN BUYERS 106
FIGURE 10 SHARE OF TURKISH FIRMS' TWO MOST IMPORTANT SUPPLIERS 107
FIGURE 11 SHARE OF TURKISH FIRMS' INVESTMENT 111
FIGURE 12 MARKETING AND DESIGN DEPARTMENTS IN TURKISH FIRMS 112
FIGURE 13 BULGARIAN TRADE IN TEXTILES WITH THE WORLD 140
FIGURE 14 BULGARIAN TRADE IN CLOTHING WITH THE WORLD 140
FIGURE 15 TOP FIVE EXPORT MARKETS: BULGARIA 141
FIGURE 16 TOP FIVE TEXTILE IMPORTERS: BULGARIA 141
FIGURE 17 SECTORAL SHARE OF BULGARIAN EXPORTS TO THE EU MARKET 144
FIGURE 18 EU TEXTILE AND APPAREL IMPORTS (1995-2003): BULGARIA 174
FIGURE 19 MAJOR EXPORT MARKETS: BULGARIA 184
FIGURE 20 DOMINANT CONTRACTS OF BULGARIAN FIRMS WITH FOREIGN BUYERS 185
FIGURE 21 SHARE OF BULGARIAN FIRMS' TWO MOST IMPORTANT SUPPLIERS 186
FIGURE 22 SHARE OF BULGARIAN FIRMS' INVESTMENT 190
FIGURE 23 MARKETING AND DESIGN DEPARTMENTS IN BULGARIAN FIRMS 192
FIGURE 24 CONCEPTUAL FRAMEWORK FOR FIRM UPGRADING 211

LIST OF ABBREVIATIONS

AATEB	ASSOCIATION OF APPAREL AND TEXTILE EXPORTERS IN BULGARIA
ATC	AGREEMENT ON TEXTILE AND CLOTHING
BA	BRANCH ASSOCIATION
BAATPE	BULGARIAN ASSOCIATION OF APPAREL AND TEXTILE PRODUCERS AND EXPORTERS
BAKI	BRANCH ASSOCIATION OF THE KNITTING INDUSTRY
BCCI	BULGARIAN CHAMBER OF THE CLOTHING INDUSTRY
CAD	COMPUTER-AIDED-DESIGN
CAM	COMPUTER-AIDED-MANUFACTURING
CBA	CURRENCY BOARD ARRANGEMENT
CEE	CENTRAL AND EASTERN EUROPE
CMT	CUT-MAKE-TRIM
CRI	COMPETITIVENESS RESEARCH INSTITUTE
CMEA	COUNCIL OF MUTUAL ECONOMIC ASSISTANCE
CUD	CUSTOMS UNION DECISION
DEIK	FOREIGN ECONOMIC RELATIONS BOARD
EBRD	EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT
EURATEX	ASSOCIATION OF THE EUROPEAN TEXTILE AND APPAREL INDUSTRY
EUROSTAT	STATISTICAL DIVISION OF THE EUROPEAN UNION
FDI	FOREIGN DIRECT INVESTMENT
FTA	FREE TRADE AGREEMENT
FTZ	FREE TRADE ZONE
GATT	GENERAL AGREEMENT ON TARIFFS AND TRADE
GDP	GROSS DOMESTIC PRODUCT
GFI	GREEN FIELD INVESTMENT
GTZ	GESSELSCHAFT FÜR TECHNISCHE ZUSAMMENARBEIT
GVC	GLOBAL VALUE CHAIN
IAF	INTERNATIONAL APPAREL FEDERATION
IMF	INTERNATIONAL MONETARY FUND
ISI	IMPORT-SUBSTITUTION INDUSTRIALIZATION POLICY
ITKIB	ISTANBUL TEXTILE AND CLOTHING EXPORTER'S ASSOCIATION
JV	JOINT VENTURE
MBO	MANAGEMENT-BUY-OUT
MFA	MULTI-FIBER ARRANGEMENT
NEM	NEW ECONOMIC MECHANISM
NSI	NATIONAL STATISTICAL INSTITUTE
OBM	ORIGINAL BRAND-NAME MANUFACTURING
OEM	ORIGINAL EQUIPMENT MANUFACTURING
ODM	ORIGINAL DESIGN MANUFACTURING
OPT	OUTWARD-PROCESSING-TRAFFIC REGIME
R&D	RESEARCH AND DEVELOPMENT
SA	SECTORAL ANALYSIS
SIA	STATE INDUSTRIAL ASSOCIATION
SMEs	SMALL-AND-MEDIUM-SIZED ENTERPRISES
SOEs	STATE-OWNED-ENTERPRISES
SPO	STATE PLANNING ORGANIZATION
SSAP	STABILIZATION AND STRUCTURAL ADJUSTMENT PROGRAM
TCMA	TURKISH CLOTHING MANUFACTURER'S ASSOCIATION
TEKSIF	ISTANBUL TEXTILE WORKERS' UNION
TTEA	TURKISH TEXTILE EMPLOYERS' ASSOCIATION
TURK-IS	ISTANBUL LABOR UNION OF TEXTILE WORKERS
WB	WORLD BANK
WTO	WORLD TRADE ORGANIZATION

Chapter I. Introduction

1.1 Scope of the study

If textile production has been important in the history of industrialization of the present economic giants, it is of particular importance for developing countries and transition economies of today because they find through the textile and clothing (T/C) trade an easy access to the global economy.[1] Many developing countries and Third World economies invest in their T/C industries and rely on them in order to create employment and obtain export revenue. For at least a dozen of developing countries, T/C constitutes more than a quarter of total export as of today. This ratio goes beyond 60 per cent in countries such as Bangladesh, Honduras, Pakistan, Nepal and Sri Lanka.

Rapid transnationalization of the T/C industry in the past two decades has helped firms from some developing countries to integrate with firms from developed economies, learn from them, transfer know-how and technology, invest in new machinery and long-term programs for local upgrading. Yet, others have turned into centers of low-cost production, where local firms are engaged in labor-intensive manufacturing, controlled by foreign firms. This transforms the local firms into highly dependent entities with low opportunities for upgrading and short-term life cycles.

What determines which states will further their development by improving their standing in the international division of labor? Michael Shafer (1994) analyzes this question in his book *Winners and Losers: How Sectors Shape the Development Prospects of States* by applying sectoral analysis to study leading export sectors in four developing economies. The present study proposes identical inquiry to analyze the factors that

[1] Clothing, apparel and garment shall be used interchangeably throughout the thesis.

determine local upgrading, thus furthering economic development and improving standing in the global economy. Turkey (1983-2003) and Bulgaria (1995-2003) are in focus during the time when their T/C industry is leading export sector of the economy.

1.2 Country cases and research question

In 1983, few people would have believed that Istanbul would become a global fashion center and that Turkey would be one of the major global suppliers of textile and apparel goods only two decades later. At that time, the Turkish T/C industry was the major exporter as it registered 28 % of total export earnings ($1.6 billion), but it took only a slight share of GDP (1.7 %) as the state just made a move from strictly limiting imports to actively encouraging exports. The clothing sector represented a tenth of total export earnings ($0.5 billion), but it was a small fraction of the economy. In fact, the Turkish T/C industry was not only a small producer, but also a small employer as it engaged 2.5 % of total manufacturing employment (The Undersecretariat of Foreign Trade 2000).

Two decades later, the Turkish T/C industry augmented to 32.2 % of export earnings, 5.5 % of GDP, 20.7 % of industrial output and 10 % of industrial labor (The Undersecretariat of Foreign Trade 2004). Moreover, Turkish clothing exports alone reached $10 billion (24 % of total export), while textile exports were worth $5.2 billion (8.2 % of total export). This is a spectacular export growth, especially for the Turkish clothing sector which increased twentyfold since 1983 (UN, Comtrade 2003)

The European Union (EU) is the largest market for the Turkish T/C goods. In 2003, 73 % (€8 billion) of the Turkish apparel export and 37 % (€1.4 billion) of the Turkish textile exports went to this market, reaching a tenfold increase from 1983 (Eurostat). In fact, the EU market has consistently remained the most vital market for Turkey since

1983 by taking between 65 % and 80 % of total T/C exports, annually. In 2003, Turkey was the second largest EU T/C supplier, the third largest global supplier of clothing, and the tenth largest global supplier of textile goods.

It would also have been difficult to predict in 1991, when Bulgaria commenced a transition from centrally-planned to market economy, that the country, which built a heavy industrial basis during socialism, would transform into one of the top ten EU suppliers of clothing at the beginning of 21st century. A small sector of the economy during the 1980s (2.5 %-3.5 % of total export, annually), the Bulgarian T/C industry increased the tempo in mid-1990s when it registered 15 % of total export ($0.45 billion). In 2003, it already had a quarter of total Bulgarian exports ($1.7 billion) and it earned 3.3 % of GDP, 10 % of industrial output and employed 25 % of industrial labor (NSI 2004, Sector Development Strategy 2004: 9-10, WIIW 2003, UN, Comtrade 2003).

As in the case of Turkey, the EU market became the most vital market for Bulgaria as its share varied between 65 % and 80 % of its total T/C exports after mid-1990s. In 2003, Bulgaria exported to the EU circa 75 % of its total T/C goods and textile exported to EU was valued at €0.1 billion, while apparel was estimated at almost €1 billion. In fact, Bulgarian clothing exports increased sevenfold since mid-1990s (UN, Comtrade 2003).

On its path toward full EU membership and in just a few years of intensified foreign trade exchange with this regional actor, Bulgaria was transformed from a position of small T/C exporter into one of the major EU suppliers of clothing. However, its clothing exports are mainly comprised of low value added goods. Today, EU imports from Bulgaria mainly assembled goods because Bulgarian manufacturers fell into a *lock-in* position in labor-intensive production segments. In fact, a high number of Bulgarian

firms are heavily dependent on foreign buyers, foreign supplies and trade agents; and the manufacturers primarily work as subcontractors for foreign firms, thus retaining low value added for the local economy.

Turkey, which has been in a Customs Union with the EU since 1996 and an EU candidate since 1999, does not have the same problem as Bulgaria. Turkish firms managed to *lock-out* from a dependency position vis-à-vis foreign buyers, foreign supplies, and trade agents sometimes in mid-1990s and began to export full-package goods, targeting middle and up-market segments of the EU market, thus gaining higher value-added for the local economy compared to what they were gaining in the 1980s.

How can we explain the divergence in local upgrading of Turkey' and Bulgaria's textile and clothing sector? The leading theoretical approach of this dissertation uncovers that the characteristics of the light leading export sector (e.g. textile and clothing) provide governments with the autonomy to formulate policy programs that would affect restructuring of the industry to enhance international competitiveness. Moreover, it claims that the state has the upper-hand in a light leading sector context over institutional and business actors and as a result faces easy time to restructure. Then, how can we explain that, in reality, Turkey managed to restructure its leading export sector, while Bulgaria failed. Therefore, the ***research question*** which motivates this study is: *"Under what conditions is upgrading of the light leading export sector possible?*

1.3 Theoretical approaches, main concepts and argument

The leading theoretical framework which the study applies to analyze development of the textile and clothing sector in Turkey and Bulgaria is the *Sectoral Analysis*, while *Global Value Chains* and *Business Association* are complementary approaches.

The basic argument of *Sectoral Analysis* is that leading export sectors are the main links between a specific country, the state's capacity to progress and the international economy (Shafer, M. 1994: 2).[2] A country's activity in a specific sector is quite stable and changes proceed slowly because sectors are fixed. The sectoral attributes, namely capital intensity, economies of scale, production flexibility, and asset/factor flexibility, produce distinctive state structures and capabilities, external and internal distributions of power, and sets of societal actors which affect similarly the state (Shafer 1994: 10). Shafer contends that countries that rely mainly on the export of extractive (heavy) industries (copper and mine, oil, etc.) are having significantly more problems in adjusting than countries that rely on a light manufacturing base (e.g. textile and apparel).[3] This comes as a result of the respective opposition, which the state is faced, that differs substantially. Put it differently, the state capacity is higher in case of light leading sectors and lower in case of heavy leading sectors. Therefore, a state with textile and apparel (light) leading export sector would be expected to have an easier time to restructure.

Central concepts of the thesis are restructuring and industrial upgrading. *Restructuring*, as Shafer defines it, is "a state-led effort to reallocate resources and reorient economic activity by altering the sectoral composition of the economy to reduce the country's vulnerability to the current leading export sector, or to seize greater or safer opportunities presented in other sectors, or both" (1994: 10). *Industrial upgrading* is a concept identified as "a process of improving the ability of a firm, industry or an economy to move to higher value added, more profitable, and/or technologically more

[2] Peter Evans (1983) introduced the concept of *state capacity* which is the ability of a state to formulate policy and have it enacted.

[3] Terry Lynn Karl in "The Paradox of Plenty" (1997) continues the Shaferian line of thought. She focuses on the relationship between economic sectors, interest groups and state institutions to argue that heavy industries pose a challenge to the state which is unable to define the national interest because the state acts solely in the interest of the leading sector.

sophisticated economic niches" (Gereffi and Tam 1999: 12). More specifically, it refers to the challenges of improving the productivity of such investments and extending them to new products and functions, which results in rise of value-added of exports and better positioning of the economy in the international division of labor (Waldner 1999: 168).

Global Value Chains approach is consequential for its focus on upgrading opportunities of firms, the exercise of control of firms and the improvement of the industry's export position. The attempt is also to refine and extend *Sectoral Analysis* by arguing that sectoral actors are necessary partners for state support to be efficient. This is feasible by using the insights of *Business Association* scholars, who claim that the function and effective cooperation of business (or sometimes called branch) associations with the state helps local upgrading.

The strong collaboration between state and sectoral actors is the response of peripheral economies to transnationalization in a global world. This is what integrates the theoretical approaches of this dissertation work. It is based on the understanding that the development of transnational networks of economic activities generated unpredictable and unprecedented chances for accessing new markets, acquiring new skills and technology and developing international comparative advantages in peripheral states. However, there is a concern that globalization also provides an environment for uneven local development, which fragments industries, and marginalizes the regions and the actors that do not link with the global value chains.

The claim of the thesis is that the modern state and the modern sector are not just static entities. The effects of the new technologies of production and organization of services have a tremendous impact on them which creates a diversity of responses. The

responses drive the process of collaboration between the state and the sector. This collaboration is identified as *State-Sector Aptitude Building* and it helps local firms to re-position in higher value added segments of global value chains and improves industry's export position in the global economy.

Since this study focuses on two peripheral states (Bulgaria and Turkey) and their dependence on the core (European Union), it inevitably falls in the ambit of developmental theories. The dependency theorists introduced the distinction between core and periphery in the 1960s in the context of the critique of the dominant modernization school of thought.[4] Immanuel Wallerstein (1976) has greatly contributed to the understanding of this distinction and the development of the world system theory. The author identifies four different categories in the capitalist world economy, core, semi-periphery, periphery, and external, into which all regions of the world can be placed. According to him, the peripheral states lack strong central governments or are controlled by other governments, export raw materials to the core and rely on labor practices under the dependency of core economies. The core exploits much of the capital surplus produced by the periphery through unequal trade relations.

It is thought by many scholars that Wallerstein's insertion of the concept of semi-periphery is the most useful contribution to the world system theory. Semi-peripheries are those areas which represented either core regions in decline or peripheries attempting to improve their relative position in the world economic system. Wallerstein explains that they often served as buffers between the core and the peripheries.

[4] For thorough discussion of dependency and world system theory, you may refer to Wallerstein I. (1974); Hopkins T.K. and Wallerstein I. (1994); Andre Gunder Frank (1967, 1969, 1978, 1979).

Sectoral Analysis disagrees with the dependency and world system theory which give a primacy to the international system and do not accept that peripheral states are able to improve in one system of domination of the core. Liberal approaches also argue that international markets carry growth and individual wealth in the domestic economy and give a limited role to the state, the same as dependency and world system scholars contend. Michael Shafer (1994:5) does not take state, but *stateness*, defined as "the extent to which, and the conditions under which, it is possible to give explanatory weight to the state". Thus, the author would predict successful restructuring of peripheral states which are tied to the global economy via light leading sectors, whereas heavy leading sectors limit the possibilities for restructuring as the economy falls into a developmental trap.

At the other extreme are the pluralists, Marxists and other approaches which explain policy outcomes as a result of the distribution of power between interested societal actors. These scholars bring into focus the costs and benefits among groups of classes and the societal actors which seek to influence state action. These approaches also view the state as unimportant and they do not find international factors as variables for the outcome. The *Sectoral Analysis* complements such approaches because it offers the origins of change, as sectoral attributes explain the capacity for collective action and the policy agenda with which the state officials are confronted.

Between the two extremes lie the state-centered views of planned change.[5] At the international level it is based on the role of international organizations to provide the

[5] Some trace the view on the role of the state to earlier schools of thought, like the German historical school of Fridrich List, who was in turn driven by the American economists of the 18th century, like Alexander Hamilton. For this argument you may refer to Chalmers Johnson (1982). Some others trace these ideas back to 16th century Europe, especially England and Venice, like Erik Reinert (1994). For more elaboration on the developmental role of the state, refer to Evans, P. (1995), Meredith Woo-Cumings, ed. (1999) and to an excellent volume of collected articles of leading developmentalists, compiled by Wilber K. Ch. and Jameson, K.P., eds. (1992).

capital and coordinate the restructuring effort. At the national level, state-led development has been on the agenda and it drew heavy attention on the export-led growth policies of developing economies. At the local level, the paradigm relies on state-sponsored creation of local capacity to support restructuring. Path dependency is a strong criterion for state-centered views, which means that capabilities of state actors are dependent upon decisions made in earlier periods. *Sectoral Analysis* diverts from this criteria and it argues that the state can develop innovative institutional capabilities.

1.4 Structure

The thesis consists of eight chapters. The following *Chapter II* lays the theoretical framework by looking in-depth at Sectoral Analysis and the insights from Global Value Chains and Bussiness Association literature, presents the causality of the theoretical argument and highlights the research methodology.

Chapter III and *Chapter V* set the background as they review the development of the Turkish and the Bulgarian textile and apparel industry, respectively. In the former, major emphasis is put on the period 1983-2003, but initial conditions are also discussed with a major focus on import-substitution industrialization policy. In the latter, the period 1995-2003 is under scrutiny, preceded by elaboration on sectoral development in the socialist period. The two chapters deal extensively with general and specific state policies that influenced the evolution of the sector and explore the role of branch associations.

Chapter IV and *Chapter VI* employ tools to study industrial and firm upgrading in Turkey and Bulgaria, respectively. These empirical chapters first apply unit value analysis of textile and clothing exports to the EU market, then, the linkages of domestic with foreign firms are explored to accentuate the position of the firms in the apparel

global value chain. An examination of the results from a survey of textile and clothing firms, conducted by the author, follows. It analyses firms according to a set of dependency and upgrading indicators. Finallly, in-depth analysis of three domestic textile/clothing firm cases unveils specific firm characteristics and explains the result the linkage with foreign firms produces for local firm's development.

Chapter VII utilizes statistical analysis of a number of variables, derived from the author's survey, to find out that state' and business associations' support, combined in one variable, produces the most significant factor which influences upgrading of firms from these two peripheral economies.

Chapter VIII concludes by presenting the major findings and identifies the limitation for local upgrading in peripheral countries. It analyzes the role of state' and business associations' cooperation for support of local upgrading and it visualizes implications which the argument in this thesis, relying on the empirical findings, has for further theorizing.

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The study only aims at an intra-industry comparison and it cannot actually test the sectoral approach as a whole by explaining inter-industry shifts. Yet, it challenges the *Sectoral Analysis*, which underscores that equivalent sectors in different countries pose similar challenges to the economy and arrive at similar policy outcomes. The contrast is found in industrial and firm upgrading in the case of Turkey, and the limitations observed in the case of Bulgaria. The dissertation explains the importance of *state-sector interaction* which is likely to be significant condition that has an impact on upgrading of the leading export sector in peripheral economies.

Chapter II. Theory and Research Methodology

Introduction

The objective of this chapter is to set forth the theoretical underpinnings of *Sectoral Analysis*, which is the leading theoretical approach. *Global Value Chains* and *Business Association* literature complement the theoretical framework as the former adds specific knowledge of how to study industrial and firm upgrading, while the latter emphasizes on the role of sectoral actors for helping local upgrading. The variables and hypotheses of the thesis are presented, the research methodology is discussed in-depth and conclusion summarizes the major findings.

2.1 Theoretical backbone

2.1.1 Sectoral Analysis

The sectoralist tradition in developmental studies is focused on colonial, post-colonial, and later, Third World countries. The *Sectoral Analysis (SA)* approach shows how economic development, including its social and political components, can be traced to the specific economic activities a country undertakes. The unit of analysis is the leading export sector of the economy and its impact on the state.[6] After Innis (1950s), Hirschman and Watkins (1960s and 1970s), Ommer, Fergusson, Gourewitch, Rogovski and Karl built sectoral analysis in the 1980s focusing on primary commodities (oil, minerals and agricultural commodities), while sectoral studies in the 1990s dealt with the role of electronics, machine tool industries, car making, and other complex sectors in

[6] Leading sector refers to sector through which the domestic economy is tied to the international economy. (Shafer 1994: 2). The leading sector has the highest share in total export earnings of an economy and it is assumed that it should be studied when it passes the threshold of 15 % of total exports in Second World economies.

developed countries, such as the United Kingdom, Japan, the United States, France, and Germany (Hollingsworth, J., P. Schmitter, and W. Streeck 1994).

There is a similarity in the analysts' broad understanding of sectors as decision arenas and challenged by variety of new forms of organization of domestic production and international outsourcing techniques, industrial organization and new modes of governance (Schmitter 1990: 33, Evans 1995: 12, Shafer 1994). A commonality is their interest in the meso-level analysis but also they agree that economic and socio-political configurations at the sectoral level affect the patterns and prospects of development.

Greskovits (2002: 7-8) notes "with its explicit sociological and historical orientation, structuralism, qualitative argumentation and mainly non-mathematical methods the sectoral approach, even in its recent variants, falls much closer to old development studies". The Shaferian approach to sectoral analysis applies similar tools to pose a challenge to the dependency theorists who ask "how and under what conditions it is possible to overcome a situation of dependency" (Packenham 1992: 73).

Dependency theorists contend that the development of the periphery is totally dependent on the "will" of the core and what we observe is a change of forms of dependency, rather than change away from dependency. In other words, a peripheral state can only overcome dependency in the world economy if it "delinks" from the world economy. Shafer, instead, explains why certain peripheral states are able to improve their standing in the global economy, while others are not by focusing on the national political economy context. Thus, the scholar discovers that restructuring of the economy is dependent not on the activities of the core countries, but on the sectoral characteristics of the leading export sector in the developing country. More specifically, the sectoral

approach posits that if the dominant link of the state economy to the international economy is a high/high (*heavy*, italics are mine) leading sector, state capacity of the sector to further development is limited. The high/high sector is characterized by high capital intensity, high economies of scale, production inflexibility, and asset/factor inflexibility and the state becomes a part of the so-called developmental trap. Conversely, in a country with low/low (*light*) leading sector, characterized by low capital intensity, low economies of scale, flexible production, flexible assets and factors, such industry can augment the state's ability to address restructuring challenges.

Why it is easier for a state to restructure a *light* than a *heavy* industrial base? According to Shafer (1994 : 12), the following more specific suppositions can be made about light sectors:

a) Low barriers to entry exist, the markets are highly competitive and multinational companies play a minor role in production, whereas firms tend to be small, geographically dispersed, and mutually competitive;
b) Profit margins are thin, but firms can compete through market conforming strategies, governments can help compainies gain a competitive advantage and restructure the industry, e.g. through product diversification, encouragement of investments in machinery, know-how and technologies, establishment of brands, etc.;
c) Production and asset/factor flexibility allows effective responses to economic downturns, e.g. by giving incentives to actors to switch activities, and thus lower the pressure on the state for economic intervention;
d) Flexible, penetrating tax authorities extract revenue and govenrment agencies monitor and regulate the companies' activities;

e) State leaders enjoy a greater autonomy from sectoral actors and are able to set a national interest that is autonomous of sectoral interests;

f) Leading-sector opposition is weak and the government is in a favorable position towards the opposition, which is scattered as a result of the domination of small firms.

Therefore, Shafer's explanation to the question why light leading sectors are more flexible than heavy leading sectors for industrial restructuring is because when they face short-term market shifts, they respond by varying output levels or product mix. When market pressures are long-term, they exit from the declining sector and enter another sector that has better perspectives. Restructuring does not create much opposition and much pressure for state subsidies because of the inability of dispersed firms and non-unionized labor to capture the state. Once assistance is needed, the state is prepared to provide it because in a light national political economy state institutions are tailored to the needs of monitoring, taxing and regulating flexible and dispersed actors (Shafer 1994: 12-18).

There are a few deficiencies of *Sectoral Analysis* that could be adjusted in the present study. *Firstly*, sectoral analysts would argue that it is not permissible to apply development concepts generated by analysis of Third World economies to countries from the European periphery, like Turkey and Bulgaria. However, because the Second World has experienced similar transformation to the Third World in terms of being *late-comers* to the global economy, *SA* can indeed apply. *Secondly*, when the *SA* is used to explaining the development of Second World economies, only multi-sectoral economies (leading sectors exhibit export potential between 15% and 40%) are found, unlike Third World

economies where usually the leading export sector has very high proportions of total export (70 % - 90 %). It means, implicitly, when one analyzes multi-sectoral economies, one has to deal with more complex explanation since the leading export sector has not concentrated so much the attention of the state. *Thirdly*, while Third World economies are characterized by leading exports of primary commodities, Second World economies feature manufacturing industries as their lead exports, which however, does not contradict the *SA* application. *Finally*, the present thesis takes upgrading of the leading export sector as criteria for development, instead of explaining inter-industry shifts. This is deemed legitimate since it also explains local development and state capacity to help it. In order to accommodate this, the *Global Value Chains* approach is introduced as complementary to the leading theoretical framework because it offers the tools to study industrial and firm upgrading.

2.1.2 Global Value Chains

The Global Value Chains (GVCs) paradigm is a network-centered and historical approach that probes the levels of the nation-state to better analyze structure and change of the world economy. The use of GVC allows for extension of the focus on the domestic political-economy of *Sectoral Analysis*.

GVC is closely linked to the broader literature on international competitiveness and two main factors explain shifts in location and organization of manufacturing in GVC - the search of firms for low labor cost and the pursuit of organizational flexibility (Gereffi, Gary and Miguel, Korzeniewicz 1994: 6).

The analysis of GVC scholars primarily focuses on the opportunities and constraints companies face in upgrading. The approach allows study at the firm level (either

individually or within the network of particular commodities), but also devotes attention to the examination of the macro-historical concerns that usually characterized the world-system literature, and the micro-organizational and state-centered issues that have stimulated recent studies in international political economy (1994: 9).

Unlike dependency theory, according to the GVC approach, the world does not fall into clear boxes of core and peripheral countries. For instance, the companies, that control the chain, may set rigid exploitative terms, but depending on conditions, may permit or directly induce upgrading by low-income country producers (Gibbon 2000: 1-2). Hence, similar to *Sectoral Analysis*, the GVC approach tends to disagree with the core-periphery distinction of the world economy and the fate of peripheral countries which entirely depend on the core.

When Gary Gereffi, the founder of GVC, lays out the main elements of the analysis, he devises a framework of four dimensions (1994): a) *input-output structure* (a set of products and services linked in a sequence of value-adding economic activities); b) *territoriality* (spatial dispersion or concentration of production and marketing networks, comprised of enterprises of different sizes and types); c) *governance structure* (authority and power relationships that determine how financial, material and human resources are allocated and flow within a chain); and d) *institutional setting* (a set of institutional factors that specify local, national, and international conditions that shape each activity within the chain).[7]

The first two dimensions have been particularly important to analysis related to apparel commodity chains. The *input-output structure* is what makes the chain into a

[7] The first three dimensions are developed by Gary Gereffi (1994: 206-233), while the last one is introduced by Gary Gereffi and Tony Tam (1998: 5).

chain, while the *territoriality* dimension is important because "it is the unequal spatial distribution of benefits in the chain between cores and peripheries that provide the focus of Gereffi's analysis, which is a theme well known in Wallerstein's work (Sverrisson A. 2004).

The *governance structure* has received the most attention by scholars and it is essential part of the GVC analysis because it explains the power and coordination relationships in the chain, as well as the obstacles for accessing higher positions in the chain. According to Sverrisson (2004 :18-19), this yields the highest value to the GVC concept because "it identifies the authority and power relationships that determine how…resources are allocated and flow within a chain and its corollary, that there are networks in which the flows are determined in other ways" (Gereffi 1994: 219 cited by Sverrisson 2004:19). The clearest examples of value-chain governance are in sectors such as garments, processed fruit and horticulture, where the power of the buyers is clearly evident (Gereffi 1999). Features about governance that have received agreement among GVC scholars:

a) Coordination within value chains can take various forms, like inter-firm networks, quasi-hierarchical relationships between powerful lead firms and independent but subordinate firms in the chain, and vertical integration within enterprises;
b) Where powerful lead firms do exist, their power stems from two attributes: their market power and their positioning in chain segments in which they can create and/or appropriate high returns.

Gereffi distinguishes between two distinct types of *governance structure* - producer-driven commodity chains *(PDCCs)* and buyer-driven commodity chains *(BDCCs)*. In the

PDCCs, such as the automobile, aircraft, computer and electrical industries, the barriers to entry are located in large scale, high-technology production facilities, involving heavy investment and scale economies (Raikes et al. 2000: 6). In these chains, the multinational company or other large industrial enterprise play a central role in controlling the production system, including its backward and forward linkages (Gereffi 1994: 216). International outsourcing is common, especially for labor-intensive production processes. *BDCCs*, which apply to apparel value chains, differ from producer-driven commodity chains because they have low barriers to entry in production. This is similar to what sectoral analysts argue about light sectors. Producers are subordinate to the key agents controlling design and marketing, especially the control of international brand-names and retailing, where barriers to entry are high and profits are concentrated. Often, the ownership of the brand and the chain of shops are indistinguishable, e.g., Benetton, Ralph Lauren, Lee Vi's. Production is usually outsourced to a system of subcontractors, the majority of which are located in developing countries, and the lowest technology, quality and value added is positioned in the least developed countries.

The major difference between *PDCCs* and *BDCCs* is that in the case of the former, the coordinating centre orders and receives final product that can be directly sold, whereas in the latter, the coordinating centre orders and receives components, which must be assembled, painted, etc. before they are sold. The common feature of both chains is the fact that there is a centre which purposefully acts and controls the network.

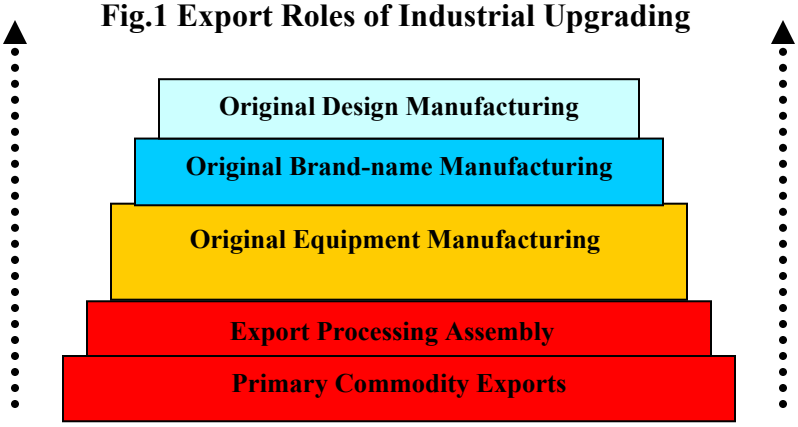
The final dimension in the GVC structure, *institutional setting*, has received the least attention by scholars. It looks at the environment within which the chains act (the role of

governments and branch associations, but also technical schools and universities, infrastructure, among others) that could be local, regional, global or a mix among them.

The GVC approach carries high academic weight in cases when textile and apparel are analyzed. Gary Gereffi applied GVC to analyze the global apparel commodity chain in East Asia, Mexico and the Caribbean basin (Gereffi 2002). The approach has also been used to analyze upgrading of the Brazilian apparel industry (Cruz-Moreira J.R. and Alfonso F. 2000), while Ulrik Vangstrup (1997), Jennifer Bair (2002), Bair and Gereffi (2001) worked on the Mexican case to explore the linkage capabilities on the basis of GVC. Denis Yoruk (2001), in her paper *"Patterns of Industrial Upgrading in the Clothing Industry in Poland and Romania,"* is one of the few scholars to explore upgrading in two post-communist countries based on the GVC approach. Pickles, Smith and other scholars have also contributed to understanding of upgrading of apparel firms in Central and Eastern European countries. They analyzed upgrading possibilities for Bulgarian and Slovak firms within 'local institutional contexts' in which the national and regional features of ex-state socialism and transition create a 'dynamic field of opportunities and constrains'. They proved that the trajectories of firms' upgrading depends 'not only on over-determined nature of firm-level action – not only driven by lead firms and buyers from core export markets, but by a much wider range of forces in complex production networks'. (Pickles et al. 2006)

The GVC scholars distinguish *industrial upgrading* by defining several export-roles (Gereffi, G. 2002: 53): a) primary exports (raw materials, like cotton, wool, hemp, etc.); b) assembly processing; c) original equipment manufacturing (OEM); d) original brand-name manufacturing (OBM); and e) original design manufacturing (ODM).

Fig.1 Export Roles of Industrial Upgrading



Source: Author's construction based on Gereffi, G. (1995, 2002)

The figure above depicts the stages of upgrading according to GVC and by using these roles one can identify the consequences for industrial development as a result of interaction between the domestic industry and the world economy. For example, if the industry is characterized by Primary Commodity Exports (PCE) and Export Processing Assembly (EPA), then it is considered that the industry has completed the first step in the upgrading process because it teaches exporters about the price, quality and delivery standards used in global markets. Substantial entry to the global value chain is the move towards Original Equipment Manufacturing (OEM). It is called also full-package production, which represents a qualitative move upward as it fundamentally transforms the relationship between buyer and supplier in a direction that gives far more autonomy and learning potential for industrial upgrading to the supplier (Gereffi and Tam 1998: 18, Gereffi 2002).

The entry to assembly position requires low labor costs, political stability, and favorable access to export markets. However, the move from assembly to full-package role requires that local infrastructure of firms offer variety of inputs for the industry (fabrics, thread, buttons, zippers, labels, etc.) at the quality and quantity required for export production. In addition, the role requires a good relationship with buyers, willing

to place full-package orders (Gereffi 2002: 54-55). The final stages of upgrading are the Original Brand-name Manufacturing (OBM) and Original Design Manufacturing (ODM) export roles which are characterized by high value added exports. Firms from developing and underdeveloped economies hardly reach these two stages because of the high entry barriers and difficulty to maintain international competitiveness. Firms that develop and sell branded products exert substantial power in the chain, particularly about when and where manufacturing will take place and how much profit is produced in each stage.

The *industrial upgrading* analysis that defines export roles would fail to address important features of local development if *firm upgrading* is not reviewed separately. Kaplinsky and Readman (2000) define upgrading at the firm level as "the outcome of certain improvements in the firm capabilities as well as acquisition and integration of (external) knowledge via external factors, which let the firm be faster than its rivals". According to Gereffi (1999), it is crucial that local firms are integrated with lead firms (marketers, branded manufacturers, retailers) in order to experience upgrading. These domestic networks could involve universities, consultancy and market research agencies, research institutes, state institutions and branch associations. But, local firm upgrading can be fostered not only with the help of lead firms but also with the support of domestic or foreign agents. For instance, Hakansson (1987) and Yoruk (2001) argue that these types of networks, which involve foreign lead firms and other agents, could mobilize the external resources between actors and develop new knowledge. Moreover, they may come together to build the interaction between state, market and firms (Kim and von Tunzelmann 1998). Hence, the capabilities of firms to upgrade would be evaluated through the utilization and the extent of national and international linkages.

There are several particular forms of *firm upgrading* outlined by GVC scholars:

—*Product upgrading* is moving into more sophisticated product lines in terms of increased unit values (e.g., cotton shirts to cotton suits);

—*Process upgrading* is transforming inputs into outputs more efficiently by reorganizing the production system or introducing superior technology. It explains increasing of the efficiency of internal processes such that these are significantly better than those of rivals (Kaplinsky, Morris and Readmann 2001);

—*Functional upgrading (or intra-sectoral*, as some scholars call it*)* is acquiring new, superior functions in the chain, such as design or marketing or abandoning existing low-value added functions to focus on higher value added activities (e.g., Torreon's blue jeans industry upgrading from maquila to ''full-package'' manufacturing in Bair and Gereffi 2001);

—*Organizational/managerial upgrading* (henceforth called *organizational*) measures the improvement of efficiency and effectiveness of production and non-production activities by acquiring new forms of managerial techniques, application of ISO standards and buyer's audits (Yoruk 2001).

Central to successful *firm upgrading* is the learning dynamics by which local manufacturers develop their competitive advantage. Through continuous information exchange and joint problem solving, suppliers can learn to meet lead firms' standards and reach higher position in the production network. However, there are several types of

obstacles to local upgrading in peripheral economies that can be found in respect to the nature of activities performed within global value chains. *First*, local firms from peripheral economies face substantial entry barriers into the most profitable activities within the value chain. Strategic services such as marketing and R&D are protected by strong economies of scale and by the complexity of competencies required to perform these activities. *Second*, local firms might find it difficult to overcome dependency vis-à-vis foreign buyers, suppliers or trade agents and *lock-in* the low value-added segments of the chain if the state and market institutions do not support a common strategy for helping these local firms develop. *Third*, the advantages provided by geographical proximity in strengthening network relations might impede *industrial upgrading* in distant locations. Therefore, while learning is the key mechanism that links participation in global value chains and firm upgrading, the positive or negative effects of this participation on local upgrading depends on how a country utilizes the linkage (Gereffi and Tam 1999: 10).[8] A possibility for the developing economy to utilize the linkage that would bring firm upgrading in the host economy is the role of business associations, discussed in the following subsection.

2.1.3 Business Association literature

Business Associations (BAs) are frequently regarded as special interest groups that are rent-seeking.[9] However, recent empirical research of BAs in developing countries

[8] Gereffi and Tam (1999) point out two main reasons for possibilities to upgrade: learning-by-doing and social embeddedness: a country may be more easily accepted into a GVC because of previous social networks that link the country with members of the GVC.

[9] Business associations are also known as branch associations, employer's associations, trade associations and business interest associations. They are long-term organizations with formal statutes regulating membership and internal decision-making in which the members are individual business people, firms, or other associations that are not necessarily linked by ownership. In *The Rise and Decline of Nations*, Mancur Olson (1982) emphasized that interest groups, like business associations, always pursued distributive objectives, seeking unproductive rents rather than the common or public interest.

proves that their functions and activities promote efficiency in the economy (e.g. production and technological upgrading, reducing information costs, strengthening property rights, improving horizontal and vertical coordination in the industry). The activities of BAs have begun to be highlighted by research on the role of institutions for economic growth. In fact, the empirical studies of rapid growth in East Asia have gone beyond the developmental state by illustrating the important role of extensive collective action by the private sector. In addition, there is an expanding literature on economic governance in industrialized countries that demonstrates the ways in which various kinds of networks, including BAs, have helped to develop comparative institutional advantages and boost exports in particular sectors (Evans P. 1995, Doner, F. Richard and Gary Hawes 1995, Maxfield, S. and B. R. Schneider, eds. 1997, Campos J. and R. Hilton 1996, Fletcher, W. Miles 1996).[10]

Conversely, understanding of whether, how, and under what conditions these BAs contribute to growth, especially in developing economies, is heavily constrained (Doner and Scheider 2000a). To a certain extent, this reflects the negative presumption about special interest groups of Mancur Olson's theories of collective action and their extension in the New Institutional Economics (NIE).[11] Most NIE scholars regard BAs negatively and there is no systematic research on their functions and impact for local development.[12]

[10] For elaborate discussion of the collections of cooperating firms, bound together in formal or informal ways, rather than atomized firms, that constitute the market, refer to Granovetter (1995). For relevant discussion of economic governance in advanced economies, see Hollingsworth and Boyer (1997).

[11] Brigitte U. and Waarden F. (1999) oppose three of Olson's hypotheses in his 1982 book, namely a) contrary to Olson, the number of associations does not rise over time; b) the argument that the greater the number of special interest associations the worst, is not valid. On the opposite, the greater the number of associations, the more opposition will develop among them which will not construct a position that they will not dominate the public policy; c) interest associations do not necessarily threaten growth.

[12] NIE scholars focus largely on overcoming market imperfections and provision of public goods at the macro level, such as regulation, clear property rights, education and judicial services. For a broad discussion of scholarly work of NIE and business associations, please refer to Doner and Scneider (2000b).

The studies that have shown that BAs contribute to economic performance do not contradict Olsonian arguments that BAs are tempted to seek rents; however, they do demonstrate that existing theoretical perspectives cannot account for the conditions under which associations might make more positive contributions. There is, however, little attention of scholars on market failures at the meso or micro levels where one might expect associations to be most active. That is why this thesis also asks: *What factors make the business associations function with more productive goals so that firms, the sector and the state can benefit from their existence?*

2.2 Causality

2.2.1 Variables

The sectoral analysts set forth variety of explanatory variables that affect economic development. Gerschenkron (1962) and Hirschman (1968) argued that small/large firm's distinction, producers' versus consumers' good or domestic versus export markets is what affects development. Later, Hirschman (1977) re-directed his attention to national versus foreign origins of business elites, while Frieden (1988) made the distinction between "liquid" versus "fixed" character of assets and Kurth (1979) discussed the sectoral "age" measured against the product cycle. Schmitter (1990) found importance in the "sectoral governance mechanisms" such as markets, alliances, networks, hierarchies and states.

The GVC scholars, similar to Schmitter's idea, elaborated on the argument that networks of firms, or more particularly, the type of governance chains, is what explains upgrading opportunities for firms and industries. That is why the GVC literature began to look for factors which explain the type of chains. One such factor is the role of ethnicity, as a variable shaping the commodity chain. For instance, Xiangming Chen argues that the

structure of investments in Mainland China by companies from Hong Kong and Taiwan were shaped by pre-existing relations based on kinship (Xiangming Chen 1994: 165-187). Similar results were derived by Laura Reynolds, who found that ethnic identification between Asian producers in the Dominican Republic and Asian wholesalers in the US created and maintained the trade networks that were essential to exports of fresh vegetables. The significance of state action as explanatory variable that shapes the organization of enterprises within commodity chains was also emphasized. Chen puts the state policies as a pivotal factor for development and integration of the value chain networks that link Mainland China, Taiwan and Hong Kong. Wilson and Zambrano, in the same volume, suggest that state policies were crucial when the crack cocaine value chain networks and its nodes were analyzed in the case of Colombia. There were also a number of empirical studies using the GVC approach, which refer to specific sets of regulations as being important for the structure and the operation of chains. For example Dolan et al. (1999) show how the UK Food Safety Act of 1990 has had a significant effect on the fresh fruit and vegetable GVC, effectively excluding small African producers from some of the more lucrative markets for fresh produce sales to northern Europe. Moreover, the importance of international regulation is evident in the case of the Multi-fiber Arrangement (MFA), which was instrumental in generating the 'concentric ring' structure observed in the global apparel commodity chains (Gereffi 1994a, 2002).

The thesis follows Shafer's logic which explains development as a function of the characteristics of the leading export sector, namely capital intensity, economies of scale, production and asset/factor flexibility. To recall, Shafer contends that if the developing economy links to the global economy through a heavy leading sector then it faces a more

difficult time restructuring that it would if it links through light leading sector. Hence, Shafer would predict that since the leading export sector of Bulgaria and Turkey is that of textile and apparel (*light*) sector then the state in both cases would face unproblematic time to restructure that sector and bring forward its upgrading. More particularly, the state capacity would allow for upgrading of the leading export sector. According to Shafer, state capacity has three varieties, namely *State autonomy* (the extent to which the state leaders are able to insulate themselves from vested interests by controlling channels of interest representation and autonomously defining national tasks (1994: 19); *State absolute capacity* (the extent to which the state has the authority and means to extract and deploy resources, a technocratic, meriocratic, and internally cohesive bureaucracy, and effective monitoring and regulatory capabilities (1994: 20); and *State relative capacity* [it reflects the balance of state's resources and institutional capacity, augmented by those of its allies and the resources and capacity for collective action of the societal actors it confronts (1994: 21)].

Contrary to Shafer's prediction, Bulgaria and Turkey differ in terms of industrial and firm upgrading of the leading export sector because the relationships between states, sectors, firms and the global economy have been affected by renovations in the techniques of production, design, management and marketing techniques, technological and social organization of production, financial area and services.

Can peripheral countries deliberately change the position they fill in the global economy? The situation of the new world economic order offered an opportunity for competition with cheap labor and flexible exchange rate regulations. However, the capacity to compete in the long-run necessitates a design of specific policies that

encourage firms to invest in new machinery, technology and know-how, targeting agglomeration effects by establishment of industrial districts or clusters, creation of forward and backward linkages of firms within the sector, use of local inputs, etc. Therefore, once there is a light leading sector that expands and its local firms begin to link with global firms into global value chains, learning and transfer of know-how, technologies, marketing strategies, branding and design must be promoted by state and branch association actors in order to convey industrial and firm upgrading in the peripheral economy. Hence, state involvement has to be taken as one of the determinants of what export position an industry is occupying in the world economic order.

Desire and capability of state, however, should not be equalized. According to Evans (1995), sometimes aspirations of the state to move in and create comparative advantage might be not only ineffective, but also counterproductive. Therefore, the important question is not how much state involvement, but what kind.

Evans (1995) claims that state involvement depends on the types of states and the relations with the society, which create different capacities for action.[13] In the paper "State-Society Synergy", Evans (1996) actually explores the importance of social capital in development of states. The scholar supports Putnam' (1993: 35-42) and Jeffrey Nugent's (1993: 623-32) synergy hypothesis which argues "the existence of the state and the rules it establishes and enforces can strengthen and increase the efficiency of local organizations and institutions, which could improve collective action, thus increase state's power".

[13] According to Evans, the state can be a producer, or can focus on playing the role of *midwife*, inducing the private sector to become interested in a new sector. Then, the state can support this group and nurture it, which he calls *husbandry.* Together, midwife and husbandry create the foundations for new sectors.

In the light of this, the main *thesis* of this work is that the difference in upgrading of the leading export sector of the economy is a result of *state-sector interaction*, measured by so-called State-Sector Aptitude Building (SSAB). This is a new concept, defined by the author of this dissertation as:

> *Collective action by state institutions and sectoral actors (branch associations, export promotion centers, etc.) for industrial and firm upgrading through coordination, intervention and support,which is expected and consistent over extended period of time.*

In the case of Turkey, it is claimed that there is ***High SSAB.*** This is explained by new interpretation of *State capacity*, identified as the state's role in strengthening the capacity of sectoral actors which improves state's own capacity to help development of its leading export sector. ***Low SSAB*** in the case of Bulgaria is what expounds why industrial and firm development is not achieved. The Bulgarian state did not fortify the capacity of sectoral actors, which were transformed into poorly organized and dysfunctional. That throws light on the question why the state missed the opportunity to increase its own capacity and promote industrial and firm upgrading of its leading export sector.[14]

This thesis emphasizes on the importance of *state-sector interaction* in the form of *SSAB* as an important condition that helps upgrading of the leading textile and apparel export sector in Turkey and Bulgaria. As such, the present study attempts to further the understanding of the catalysts which are likely to prompt actors to modify their collective action strategies in a given institutional context. Business associations and the state can mobilize and gradually develop capacity into a SSAB that can help local industrial and firm upgrading in peripheral economies.

[14] One might think of two other possibilities for low SSAB, which shall not be regarded in this thesis because of the limited number of cases: a) state support is present, however, sectoral interest is poorly organized; and b) state support is missing, but sectoral interest is well-organized.

The causal model (*See Appendix A*, Model for T/C Development in the European Periphery: 260), which explains upgrading of textile and apparel activities in the European periphery with the examples of Turkey and Bulgaria involves the so-called *state-sector interaction* (***independent variable***). As already emphasized, it can take the form of either High or Low SSAB. On one hand, the *state-sector interaction* presumes, following *Sectoral Analysis*, that the sector does not act independently from the state because the public institutions, incentives and legal frameworks are only important as they directly inflict upon industrial and firm upgrading. Therefore, *State capacity* is a necessary element in this interaction. However, the contemporary global economy requires the state change its functions. An example of a strong ***"State support"*** today is the state that devises specific policies targeting development of the sector. The state can extract and redistribute effectively resources, initiate, implement and monitor economic development through its regulatory policies and instigate human capital formation. It can provide concessional finance for Small-and-Medium-sized Enterprises (SMEs) that would find entry barriers by liquidity constraints. It can establish the testing and quality control standards needed to penetrate foreign markets because producers will free ride on private attempts to create them.

State support can be further recognized by situations in which the government encourages integration into world markets, applies exchange rate policy which favors exports, liberalizes trade with the major market where export sectors have potential, creates conditions for Foreign Direct Investment (FDI) and privatization that would favor local development or, puts emphasis on market-economy instruments to encourage

private investment and engineers specific industrial policies that increase international competitiveness of the export sector.

The strong state also empowers sectoral actors to undertake certain functions, which are traditionally in the hands of the state. These can take the form of quota negotiations by business associations, quality control, supporting private institutions that provide research and extension service because these functions must develop ahead of the market and firms in the early ages of growth.

Conversely, the state can formulate the national policy but cannot act independently from the sector. The organization of business interests in a highly dispersed sector, such as the textile and apparel, is likely to be very important for local upgrading. An example of "***Branch association (BA) support***" is when the sectoral actors become strong *individually* by increasing their membership list and helping their members with training seminars, codes of conduct, encouraging private investment, transfer of knowledge and marketing strategies from foreign firms, research and innovation, export of full-package products, promotion of own-brand and own designs manufacturing, contacts with foreign firms and organization of trade fairs.

The BAs can also become strong *collectively* by lobbying the state for export credits, investment schemes, preferential treatment for imports of machinery, establishment of industrial clusters and export-processing zones, participating in drafting new laws that are relevant to the industry. Moreover, they can voice the needs of the sector not only in the domestic, but also in the international arena through lobbying and negotiating for better international trade rules for the domestic industry.

In general, the role of sectoral actors is to become not only consultants, but also be coordinators and involved in partnership with the state to instigate upgrading of local firms and the industry as a whole. It is highly important that the state-sector cooperative attitude is preserved and reinforced for extended period of time. This reassures the local firms that state and business association support is expected and consistent.

In *Turkey*, the cooperation between the state and the BAs over extended period of time had a positive impact on industrial and firm upgrading. The state was strong by being engaged in specific industrial policy for development of the sector. It also expanded the functions of Turkish sectoral actors. A clear example is the fact that in the 1980s and 1990s it was not the state, but the T/C business associations which led the textile quota negotiations with the EU and USA. Gradually, during the 1990s, the T/C business associations became members of international organizations, such as the International Apparel Federation (IAF) and the European textile and apparel organization (EURATEX) and extended the lobby from the national to the international level.

In *Bulgaria*, the state BAs which had been the market channels and key negotiators with transnational buyers were dissolved in 1991. Thousands of new and privately owned textile and apparel enterprises mushroomed during the 1990s but there were no sectoral actors to organize them and represent them before the state. The Bulgarian state, in contrast to the Turkish state, did not help the development of the BAs by expanding their activities neither there was a set of specific policies targeting development of the sector.

The ***dependent variable*** of the causal model of this thesis is the change in upgrading that we observe with the exports, networks and firms in Turkey (1983-2003) and Bulgaria (1995-2003). Turkey is characterized as a case of *Ascending Local Development* where

one finds local upgrading, while Bulgaria is discerned as a case of *Descending Local Development,* where one discerns limited upgrading.

Indicators at three levels of analysis identify the change in the dependent variable:

a) **Firm —** product, process, functional and organizational;

b) **Network —** participation of more domestic firms in local networks of production, distribution, retailing, marketing or services;

c) **Sectoral —** upgrading of the value added of exports.

2.2.2 Hypotheses

The central hypothesis **(H1)** of this thesis is that *state and branch associations coordinate with each other, intervene and support industrial upgrading, which is expected and consistent over an extended period.*

In Turkey, the state has initiated specific state policies targeting the sector and transferred powers and selective incentives to sectoral actors in order to empower the private business to respond to the international competitiveness. Moreover, the state has transformed the sectoral actors to be partners in policy-making and enforcement. The BAs serve as middleman between private business and the state since neither labor nor business has organized themselves, separately or jointly, to push for industrial upgrading in a de-fragmented sector. Branch associations work to provide training and marketing research, participate in committees which draft new laws related to the industry, work for international and domestic lobby initiatives. These activities provide more opportunites for improvement of sectoral performance.

Th opposite is found in the Bulgarian case, where business association are weak and formally existing structures without any substantial power in decision-making and enforcement.

The central **(H1)** that qualitatively probes the importance of *SSAB* for industrial upgrading is also examined quantitavely at the firm level by also testing several other factors which are hypothesized to affect upgrading of Turkish and Bulgarian firms:

(H2) *dependency from foreign buyers, suppliers and top export market;*

(H3) *concentration in subcontracting/direct exports;*

(H4) *full or partial foreign ownership of domestic firms;*[15]

(H5) *dependency from trade agents;*

(H6)*investment and turnover;*

(H7) *firm's own size.*[16]

2.3 Qualitative and quantitative analysis

2.3.1 Sectoral level

The state and branch associations' support for upgrading of the textile and apparel sector in Turkey and Bulgaria is the focus of the *qualitative approach* at this level. It studies their role and analyzes the implications of different policies which target the development of the T/C industry.

Primary reports, obtained from the Bulgarian Ministry of Economy, Varna University of Economics - Varna, Turkish Undersecretariat of Foreign Trade and Bosphorus University - Istanbul, were analyzed for this research. Materials found in National State

[15] Borrowed from Hirschman (1977), refer to p.25 of the thesis.
[16] Adopted from Gerschenkron (1962) and Hirschman (1968), refer to p.25 of the thesis.

Archive-Sofia and its archive branches in Varna, Stara Zagora, Vidin and Dobrich are utilized in order to improve the discussion of sectoral development.

Another source of information included personal interviews. A total of forty (40) interviews with textile experts, branch association officials and public officials from ministries and agencies were conducted between 2002 and 2005.

Interviews with the three most important national textile and apparel T/C agencies in Turkey, namely Turkish Textile Employers' Association (TTEA), Turkish Clothing Manufacturer's Association (TCMA) and Istanbul Textile and Apparel Exporters Association (ITKIB) provided insight into the understanding of how business actors assist in industrial and firm development. These agents were also crucial sources of primary reports and data.

The three most representative national textile and apparel agencies in Bulgaria, namely Branch Association of the Knitting Industry (BAKI), the Bulgarian Chamber of the Clothing Industry (BCCI) and the Association of Apparel and Textile Exporters from Bulgaria (AATEB), later renamed Bulgarian Association of Apparel and Textile Producers and Exporters (BAATPE), were also very helpful in conducting this research.

Other agencies, such as the Competitiveness Research Institute - Istanbul, the Istanbul Labor Union of Textile workers (TURK-IS), the Istanbul-based Foreign Economic Relations Board (DEIK), former employees and textile experts from the Textile Research Institute - Sofia complemented the findings.

The *quantitative approach* involves Unit Value Analysis (UVA). The UVA method studies unit values of exports, distributed in three market segments of value added – low, medium and high. The analysis tracks product upgrading of sectors of economies which

export to one and the same market over a certain period of time within a particular context of international trade policy. Thus, UVA is a useful tool to study industrial upgrading.[17] Moreover, product quality analysis allows also studying competitiveness because upgrading does not necessarily mean increased competitiveness and vicing versa. For instance, an export structure, as Graziani (2002: 54) suggests, could be downgrading and still be competitive in the lower quality levels. In general, this statement might be true, but one tends to disagree if it concerns specifically the T/C industry. This is because the international competition in this sector has become so fierce, especially after the progressive elimination of textile quotas under the Agreement on Textile and Clothing (ATC) between 1994 and 2004, part of which are also Turkey and Bulgaria. Hence, firms, which concentrate on the lower ends of the product quality, could easily be driven out by cheap imports from major rivals, like China and India in short-term periods.

There are at least two distinct ways to apply the UVA methodology. The first one is used by Graziani (2002), which is similar to the one employed by Freudenberg and Lemoine (1999). It considers the quality differences between the unit value of the imports of a certain number of countries into the EU and the unit value of the same products/product groups of the average intra-EU import (the average unit values of the exports of EU member states between each other). The second methodology, applied by Fontagne et al. (1997), Landesmann and Burgstaller (1997), is to calculate the unit values of the trade flows in terms of the average of extra-EU flows (the average unit values of the exports of all other countries to the EU market).

[17] One should be careful with the unit value analysis since unit values are second best proxies for the price and quality component in international trade, as opposed to the actual market prices. There might be different unit values for different years because of the trade protection measures. In addition, discrimination might exist among particular EU countries regarding imports under EU quota regulations. However, the author controlled for these impacts in the UVA application by selecting particular years for analysis and cautiously treating some vulnerable product groups.

There is a specific difference in both approaches. In the first case, the focus of the analysis is on whether or not there is a process of catching up in terms of upgrading between outside EU countries and the EU average level. In the second case, the UVA focuses on quality levels of the importers to the EU market. Since the target of this thesis is to compare upgrading between export structures of countries that export to the EU, utilizing the second type of the proposed methodology of UVA is preferred. In this case, the differences of the unit values (value/tones) of the product/product groups of Bulgaria and Turkey to the EC is estimated and compared to the average unit values of the product/product groups of the imports to the EC from all suppliers to the same market (average unit value of extra-EC imports). By doing so, one can identify at what quality level one could find the countries' exports to the EC market compared to extra-Communitarian imports in distinct periods. The possibilities are the following:

a) **Up-Market** – high value added exports, if the unit value of Bulgaria's and Turkey's T/C exports is >15 % from the average unit value of Extra-EC imports of the same goods;
b) **Middle-Market** – medium value added if the unit values are ± 15 % of the average unit value of Extra-EC imports; and
c) **Down-market** – low value added if the unit values of exports are <- 15 %.[18]

Data from three sources are carefully selected to study industrial upgrading, based on the UVA methodology: Eurostat (1983) paper version of EC imports, electronic version of the Comext, Eurostat (1988-2001) and publicly availably electronic version of Comext, Eurostat (2003). The author resorted to highly disaggregated 6-digit product

[18] Both types of the UV analyses agree on this percentage range of product quality level. However, the lath for the estimates in 2003 is raised to ±20 %. This is a result of the WTO liberalization of trade and China's entrance to WTO, which has substantially influenced price levels in the post-2002.

data of the Harmonized system (HS-6) for textile and apparel products of articles 50 until 63 from the databases.[19]

UVA in Turkey is studied between 1983 and 2003, while in Bulgaria it is analyzed for the period between 1995 and 2003.[20] Distinct periods of time have been selected to take into account four factors that might have posed external or internal shocks. The first factor is the imposition of the Agreement on Textile and Clothing (ATC), eliminating 49% of the textile quotas of the European Community by 2001.[21] But, the first effective removal of textile quota barriers was in 2002 (17 %) and this had a significant impact on international textile trade, especially if one considers 2003, which is the final year that falls in the analysis of unit values. The second factor is the destabilization of the political and economic environment in Central and Southeast Europe and the discontinuation of the Council for Mutual Economic Assistance (COMECON) which affected the Bulgarian economy.[22] The third factor is Turkey's entrance into the Customs Union with the European Union, while the fourth factor is Bulgaria's macroeconomic stabilization, which came after the introduction of the Currency Board Arrangement (CBA) in July 1997.

[19] The dataset is unified, thus homogeneous products are compared.
[20] EU-10 (in 1983), EU-12 (1988-1991) and EU-15 (1995-2003) are considered for the unit value analysis between 1983 and 2003.
[21] To recall, the lifting of quotas under ATC took 1990 as the first year for consideration. Therefore, quotas, which have already been lifted in the period 1990-1994, before the signing of the ATC, have formally been registered to be lifted again for the period 1995-2001.
[22] COMECON is founded in 1949 to facilitate and coordinate the economic development of the socialist block. Bulgaria is among its founders.

2.3.2 Firm level

There are approximately 1,000 exporters in the Bulgarian T/C industry and 2,000 in Turkey.[23] This is the number of firms that function legally. Several data sources are used to address the specifically designed for the research purpose questionnaire (*Appendix B*, Questionnaire: Firm Upgrading in Bulgaria and Turkey: 261-265).[24] The first one is the Bulgarian comprehensive catalogue of textile and apparel firms (2002). It contains approximately 500 addresses of Bulgarian T/C producers. This source is complemented with the 2003 list of top 40 exporters, provided by AATEB. The combination of the two data sources helped construct a unique database of Bulgarian T/C exporters that represents over 70 % of total textile and apparel exports. A database of all nationally represented BAs in Bulgaria was not created because only one of them managed to present a membership list of 80 firms in 2003.

For the case of Turkey, sources were compiled primarily from the 2003 database of TTEA and TCMA. TTEA represents more than 100 textile/knitting firms, while TCMA represents more than 440 clothing firms. Both databases contain firms, most of which are registered in Istanbul, but are not manufacturing solely in the Istanbul area.

The rationale for selecting these particular Turkish data sources has to be explained further. Governmental sources claim that over 70 % of the Turkish textile and apparel production is done in the Istanbul area. For instance, the ITKIB has registered as their members over 19,000 textile and apparel exporters in 2003.[25] The high number of

[23] These estimations are based on primary research of documents and reports (Bulgarian catalogue of textile and apparel firms, 2002; Sector Development Strategy, December 2004; Turkish databases of textile and apparel exporter's unions; personal interviews with textile experts in Bulgaria and Turkey).

[24] The questionnaire addresses six sections: 1) General information; 2) Production and Investment; 3) Markets; 4) Buyers 5) Suppliers and 6) Incentives. It is unique and has been designed with the help of scholars and experts in the field of textile and apparel. Among them, the author would like to thank Dorothee Bohle, Jennifer Bair, Mihály Laki and Petar Nikolov.

[25] This is officially posted at the www.itkibg.org, accessed by the author in December 2003.

members is due to the fact that ITKIB membership of exporters of textile and apparel goods from the Istanbul area is compulsory. That would mean that a firm, which exports even once, must become ITKIB member, and is therefore not an ideal source of data for this analysis. This explains why a common database of the two business associations, which represents firms that function permanently on the market, is likely to be more representative for Turkey.

Participant firms were randomly selected from the constructed database of Bulgarian and Turkish samples. The sampling method was modified for four stratification purposes. The first one is the *geographic stratification*. Data was obtained from firms, representing different regions in Bulgaria and Turkey. The most important production regions in Bulgaria are divided in the following manner (*Appendix C*, Map of Bulgaria: 266): Northwest (Vidin, Vratza, Montana), Northeast (Varna, Dobritch, Russe), Southeast (Stara Zagora, Sliven, Bourgas, Yambol), Southwest (Plovdiv, Blagoevgrad), Central-West (Sofia) and Central (Lovetch, Pleven, Sevlievo). The production regions in Turkey are clustered around large textile and clothing production centers, divided for the purpose of this research in the following manner: Bursa, Denizli, Gaziantep, Istanbul, Izmir, Kayseri and Tekirdag (*Appendix D*, Map of Turkey: 267). These production centers represent a concentration of T/C firms, whose headquarters are usually based in Istanbul.

The second is the *firm size stratification*. Firms were divided into small (10-49 employees), medium (50-249) and large firms (over 250) and, for both, Turkey and Bulgaria, mostly SMEs were sampled, since they represent the bulk of the industry structure in the two countries. The third is the *subsector stratification*. Since both industries export mainly apparel products, predominantly labor-intensive firms (apparel),

rather than capital-intensive (textile, knitting, printing, finishing and dyeing firms) were selected. The final is the *market stratification*, which included firms that predominantly export to the EU market.

The survey instrument was a questionnaire and data collection has been conducted in three different ways:

- *personal interviews with the firms*: The interviewee was usually a manager (owner, executive director, general manager, chief accountant) because the information that needed to be traced spanned a period of two decades and required holistic knowledge about the structure and functioning of the firm, the relationship with foreign buyers and local suppliers, and development of the local industry as a whole. On average, the interview lasted two hours, coupled with a visit of the production facilities. In cases where the firm was very open and transparent, it allowed interviews with different departments within the firm structure. For instance, the author conducted interviews for three days in *Altinyildiz* and managed to talk to the general export manager, production manager, marketing and sales department directors, and workers.

For the Bulgarian interviews, the author traveled to Sofia, Stara Zagora, Varna, Sevlievo, Russe, Kazanlak, Burgas, Dobrich, Plovdiv, Vidin, Montana, and Mezdra in order to interview local firms from the sample. Some of the firms were transparent, like *RUEN*, where the executive director of the firm and major shareholder, but also the distribution and the financial departments were interviewed. After *RUEN* entered into a bankruptcy in 2003, the author interviewed the procurer, tasked to save the company from liquidation. Other firms, such as *Sunnytex* in Mezdra, among the biggest Bulgarian exporters in 2001, cancelled the interview on the day of the appointment.

- *indirect interviews with the firms*: five Turkish students from Istanbul Universities were engaged to interview some of the firms from the sample. This was necessary because some of the managers of small firms in Turkey preferred to have the conversation in Turkish. After the interviews, the Turkish students submitted the filled questionnaire and commented on particular open-ended questions. In Bulgaria, two students were recruited to assist the research. One of them interviewed a large firm from Sliven, Bulgaria, while the other student interviewed Bulgarian firms from the sample that attended a closed annual meeting of BAATPE in 2003.

- *collection of data via agents:* In Bulgaria, the author was engaged in the core research team, involved with the development of the Bulgarian Apparel Strategy in the period February 2004 - December 2004 and the Bulgarian Textile Strategy in the period May 2005 - December 2005. As part of the research team, firms from the sample were encountered during three official meetings with a cluster of textile and apparel firms (in Russe, Sofia and Plovdiv). There was also an attempt to collect responses from Turkish firms through the Foreign Economic Relations Board (DEIK). They published a Turkish translation of the questionnaire on their website (www.deik.org) from July 2004 through October 2004. However, this failed to produce any results, which confirmed the expectation that business is best approached through personal interviews.

The proportionate stratified sampling has yielded the following results:[26] from a sample frame of 100 respondents in each of the two countries, an effective response rate of 62 % (+ 1 unusable questionnaire) in Bulgaria and an effective response rate of 44 % in Turkey was reached. Thus, the author was able to apply a *qualitative* analysis at the

[26] Units were selected randomly from each strata and when there was a non-applicable entity, then cluster sampling was used (each 10th firm in the list was chosen to see whether it matches the criteria).

firm level. In addition, a dataset of all 106 firms was created and based on the advanced statistical research analysis, performed by the program SPSS 12.0 for Windows, a *quantitative* method in the analysis of upgrading and dependency of firms was utilized. By using the multivariate analysis, it was possible to study a group of variables, which indicate which firms are upgraded, which firms are less dependent and what are the most influential factors that affect firm upgrading. For this purpose, several groups of variables and indicators were studied. (*Appendix E*: 268).

Conclusion

The chapter outlined the major theoretical contributions that underpin this study. Posing the question under what conditions is local upgrading possible, this chapter laid the foundations of an argument, which considers the importance of interaction between state and sectoral actors, called State-Sector Aptitude Building. It is argued that Turkey managed to achieve industrial and firm upgrading, while Bulgaria failed as a result of the distinction between High/Low SSAB (independent variable) which has a lasting effect on the dependent variable (Ascending/Descending Local Development), studied at three levels of analysis (Firm, Network and Sectoral). The major claim is that there is a need for cooperation between state and sectoral agents for industrial and firm upgrading to be achieved. Thus, the thesis puts major emphasis on the *institutional setting* as a factor for industrial and firm upgrading The chapter introduced seven hypotheses to be tested through qualitative and quantitative tools, applied at sectoral and firm level of analysis.

Chapter III. Textile and Apparel Industry in Turkey

Introduction

The chapter explores how the textile and apparel industry in Turkey developed as the leading export sector of the economy between 1983 and 2003 and what challenges were faced during this process. The *first section* emphasizes the initial conditions and particularly the import-substitution industrialization (ISI) policy which had the greatest impact on the development of the sector before 1983.[27] The *second section* explains development of the industry and state policy after 1983 by focusing on general and specific measures the state undertook. The *third section* introduces the functions and activities of major branch associations in the Turkish T/C industry, while the *fourth section* examines the informal nature of the sector and labor issues which are likely to have induced international competitiveness of the domestic T/C industry. The conclusion summarizes the major findings.

3.1 Initial conditions

During the medieval era, sultans, caliphs, kings and other nobles, sought rich textiles, produced in towns and cities, both within the Ottoman Empire and outside of it. For centuries, the heavy silk brocades of Bursa (a textile center today) and the gold threads, silk and gold weaves of Aleppo were well known in Europe (Quataert, D. 2004: 1-2).[28] Denizli and Kadıköy, present-day textile centers, were major centers of weaving of the Ottoman Empire as far back as the 1900s. For instance, Quataert reported that 15,000

[27] ISI is a trade and economic policy based on the premise that a developing country should attempt to substitute products which it imports, mostly finished goods, with locally produced substitutes. The program promotes high exports and minimum imports to increase national wealth.

[28] Turkish brocaded velvet cloth (design: carnations, roses, tulips) from the end of 16th-beginning of 17th century is found at the Museo di Tessuto a Prato, Italia, next to world famous velvet cloths from Italy (Venecia, Firenze, Prato), France, Portugal (the same century).

were employed in the cotton cloth weavers and dyers at Kadıköy, which used imported British yarn (1993: 58). In 1914, the Ottoman silk industry employed about 400,000 textile workers, three-fourths of whom were engaged in Bursa, another contemporary textile center. During that time, a significant clothing industry emerged in Istanbul, the capital of the empire, and major T/C production center as of today.

The difficult dissolution of the Ottoman Empire in 1923 affected textile production in the Turkish Republic. Only a small number of public and private textile manufacturing facilities continued operating. In fact, textiles were a major import for Turkey due to the 1923 Treaty of Lausanne, which did not allow duties and tariffs on imports until 1929 (Hale 1981: 47). Exports were minimal and included only raw fibers, raw cotton and a small volume of wool hand-knotted carpets (Cumhüriyet Halk Partisi 2003). Textile enterprises constituted only 14.3 % of the total 65,245 formal manufacturing enterprises with 48,025 textile workers or 18.7 % of total manufacturing workforce (Hale 1981: 43).

The Great Depression aggravated the poor export performance of the Turkish textile industry. However, private initiative in the Turkish textile sector grew two decades later (during the 1950s). This came as a result of the increase of tariffs on textile imports and the increase of import quotas for textile machinery. However, major impact was the 1950 establishment of the Turkish Industrial Development Bank (*Türkiye Sanayi Kalkinma Bankasi*) with a program of foreign exchange credits to help local manufacturers buy equipment. In addition to these protectionist measures, the state policy supported the cotton growing on land irrigated by the new Seyhan Dam in Southeast Turkey.

The development of the domestic T/C industry was dramatically affected by the introduction of the ISI policy, embraced as a general strategy of the Turkish government

in the post-1960s period. This was the planned development with high state interventionism in consonance with the new constitution of 1960 (after the military coup), which adopted *etatist* idea of development (Fikret Şenses 1994: 51-73; Sallama Shaker 1995), known as "a state capitalist approach in which the state assumed the leading role in the mobilization and allocation of resources" (Sallama Shaker 1995: 23). The government established the State Planning Organization (SPO) with functions similar to the socialist state: to prepare long-term programs and annual plans. The first five year plan ran in the period from 1963 to 1967.

The development of the Turkish textile and apparel industry was affected by the creation of a developmental state, brokering the governing political and military elite and economic interests which maintained progress (Keyder 1987: 293-308, Eralp 1990: 230-234). For instance, one of the most significant changes in the Turkish economy was the increasing share of the industrial sector (Elif Çepni 2003: 94). The State Economic Enterprises (SEE) became the means of implementation of the development policy (Fikret Şenses 1994: 52).[29] Moreover, SEEs not only played a key role in investment and creation of industrial employment, as it grew from 362.3 thousand in 1970 to 711.9 thousand in 1980 (TÜSIAD 1981: 17), but also in the development of the private sector (Heper 1990: 290).[30] As a result, the private textile and apparel production grew rapidly to reach 85 % of total production and engage 79 % of employment in the textile sector and 97.3 % of employment in the private sector in by end of 1970s. Overvalued exchange rates, quantitative restrictions and direct import restrictions, bilateral trade, a

[29] Fikret Şenses (1994) explains that the creation of state enterprises has started in the 1930s when they have appeared in a variety of manufacturing activities, following the provision of substantial incentives in the 1920s to private entrepreneurs to create indigenous entrepreneurial class. These state enterprises, during the ISI period served not only economic, but also social goals (TÜSIAD report 1981: 30).

[30] Fixed state capital investment grew from 53 % share compared to private investment in 1970 to 60 % state investment compared to private investment in 1980 (SPO, TÜSIAD 1981:23-24).

strict system of exchange control, and a variety of tax and credit incentives for manufacturing investment, were among the main tools of the ISI policy (Fikret Şenses, 1994:52). However, the domestic T/C industry benefited little from state investment policies. In fact, total fixed investments in manufacturing activities decreased from 67 % in the period 1963-1967 to 43 % in 1979. Only one-ninth of the total manufacturing investment in 1978-1979 was in the textiles sector (SPO, TÜSIAD 1981: 23-24).

As a result of its high interventionist role, "the state came to be respected, as well as feared" (Heper and Evin 1988: 251). Moreover, the ISI policy created vested interests, since private sector groups attempted to influence governmental policy, as far as the tariffs on various import items and quantitative restrictions gave immense power to domestic entrepreneurs (Sallama Shaker 1995: 25).

What was the power of the T/C industry vis-à-vis other sectors of the economy at the very end of the ISI period (late 1970s)?

TÜSIAD (1981: 21) confirms that the T/C industry was much worse off than other sectors, such as the Food, Beverages and Tobacco sector (48 % state production and 58 % state employment), Chemistry, Petroleum and Rubber (55 % state production and 22 % employment), Basic Metal Industries (41 % production and 67 % employment) and even the wood products, furniture sector (29 % state production and 43 % state employment).

The Turkish economy achieved modest real growth rates of 7 % in the period 1963-1976, while in the final period (1977-1980) before the political crisis, the Turkish economy grew by only 1.3 % (annual average). The registered cumulative FDI in the Turkish economy until 1979 was estimated at modest 228.5 million USD (Ziya Öniş

1992: 91). In fact, there was only one Joint Venture (JV) in the textile sector, which operated in Turkey under JV Law 6224 for the Encouragement of Foreign Capital Investment. This was far less compared to the chemicals sector with 20 JV (TÜSIAD 1981: 147). Important factors, which negatively affected inward investment in the ISI period: bureaucratic red tape, the requirement to report and receive cabinet approval for all financial and operational decisions, and lack of confidence in the governmental policy consistency (TÜSIAD 1980: 148).

The two oil shocks of the 1970s put the Turkish economy on the path of economic decline. The situation was exacerbated in late 1970s, when a $1.8 billion loan from the International Monetary Fund (IMF) tied the Turkish government to radical reform, which was designed to introduce the export-oriented growth model. The economy failed to recover until the 1980 military coup. Considering the difficulties in the 1970s, managing the political stability became a major concern for the political elites and the public bureaucracy. As a result, Turkey established a political regime that emphasized order, stability, rule enforcement and executive effectiveness. That is why the years 1980-1983 are considered a turning point of economic and political development in recent Turkish economic history because that is when most of the economic reforms, which encouraged export-led growth, were introduced.

3.2 State policy in the post-1983

The Turkish state resorted to IMF's Stabilization and Structural Adjustment program (SSAP) in January 1980. The program represented *"a radical transformation of economic policies with far reaching effects throughout the economy"* (Şenses 1994: 51;

Shaker 1995: 31).[31] For a period of three years, the military regime, which was in power, achieved stabilization because it was able to put an end to economic failures, fight inflation, and restore political harmony and social order. It also laid the foundations for the export-led growth model of the economy, which was a turning point in the Turkish economic history. As a result of the IMF program, the Turkish state began to withdraw from state capital investment and instead pushed for the private sector to grow in the post-1983 period.

Table 1 Comparison of Pre-1980 and Post-1980 Economic Policies in Turkey

ISI period: 1960-1980	EIO period: post-1980
Self sufficiency	Integration into world markets
Fixed Exchange Regime	Flexible Exchange regime
Excessive controls over foreign trade regime	Trade liberalization
*FDI conditions are limited	Create conditions for expansion of FDI
Dominant role of State Economic Enterprises	Privatization
Heavy state intervention in product markets	Putting more emphasis on the price mechanism and investment policy aimed at completion of ongoing projects with modest inputs

Source: adopted from table 3.5 on p.41 in Çepni, Elif (2003). *The Economy of Turkey in retrospect,* Beta Basim, Istanbul; *additional criteria added by the TÜSIAD (1981:32); **Note:** the economic policies include also negative/positive real interest rates and overvalued/realistically valued domestic currency.

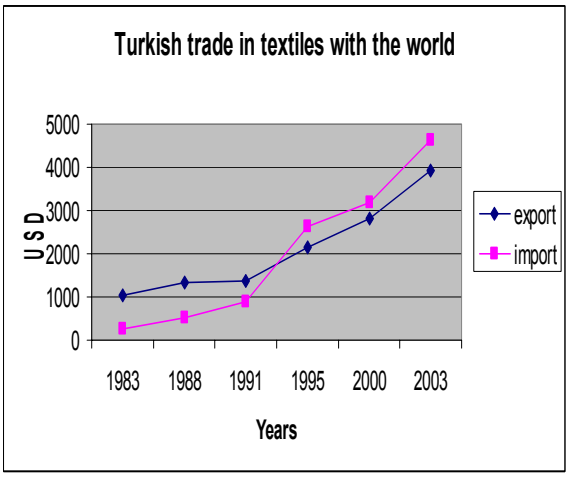
The following subsections shall investigate the impact of Turkey's general and specific economic policies on development of the leading export sector of the economy in the post-1983.

3.2.1 Integration into world markets

Textile and apparel exports increased substantially between 1983 and 2003. At the beginning, Turkey was exporting textile and apparel goods to the world estimated at $1.6 billion, while in 2003, the exports increased to $15 billion.

[31] The main policies, implemented by a strong team of technocrats led by Turgut Özal as deputy prime minister, were guided by a three-year stand-by arrangement with the IMF and five successive Structural Adjustment Loans, devised by IMF and the World Bank.

Fig.2



Source: UN, Comtrade (1983-2003)

Fig.3

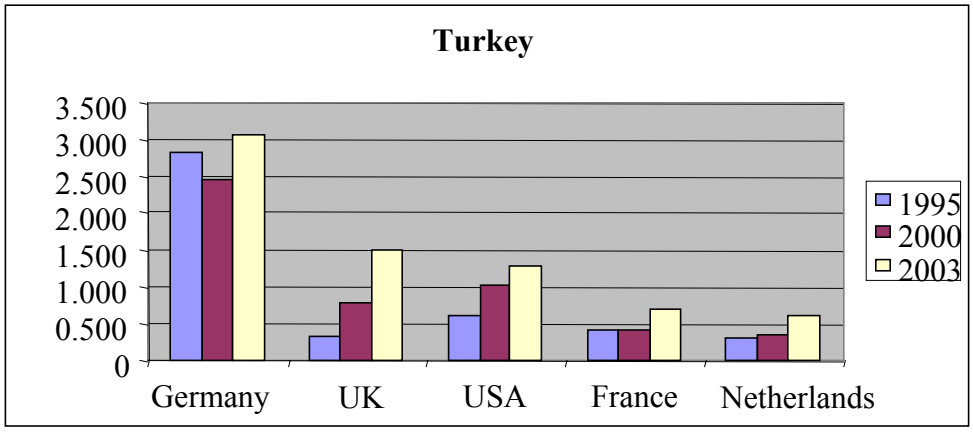
Source: UN, Comtrade (1983-2003)

As a result of the successful integration of its T/C industry into the global economy, as seen from the two figures above, Turkey became a net exporter of apparel goods and net importer of textile goods during the examined period. Textile exports increased by 270 %, while textile imports by 1,850 %. At the same time, Turkish clothing exports grew by 2,050 %, while Turkish imports of apparel were insignificant.

In 2003, Turkey ranked third, after EU-15 and China, among the global textile and apparel exporters (ITS 2004). The EC/EU is the top export market of the Turkish textile and clothing goods, and it has absorbed between 65 % and 80 % of total exports in the post-1983 period (65 % share in 2003).[32] That is how we can explain that four of the top five export markets for Turkish clothing between 1995 and 2003 are within the EU-15 zone (see Fig. 4, next page).

[32] Data for the 1987-1988 indicate 72 % of total textile and apparel exports directed to the EC, calculations of Sübıdey Togan (1994: 172); data in the post-1990 period obtained from the Udersecretariat of Foreign Trade, April 2004, cited in the ITKIB Report 2004, entitled "Turkish Textile & Apparel Foreign Trade (2003-2002-2001 annual).

Fig.4 Top Five Clothing Markets (in b. USD)



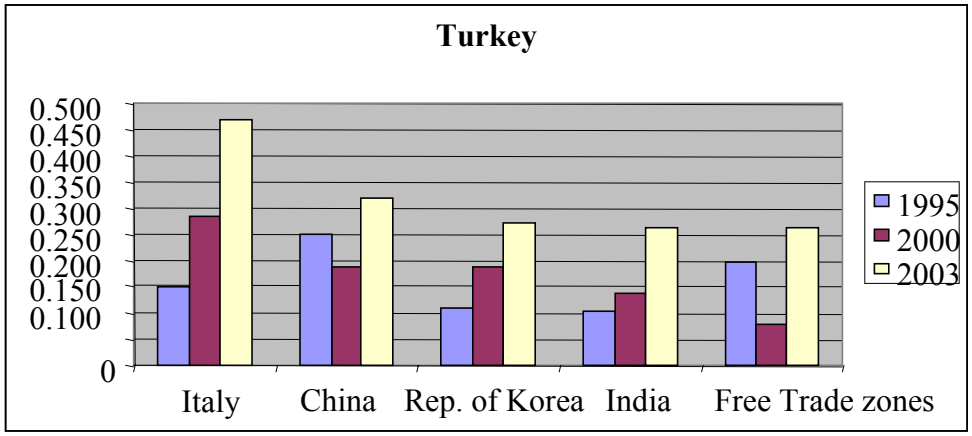
Source: UN, Comtrade, 1995-2003

The top five export markets of Turkish clothing goods account about 70 % of total clothing exports in all years presented. Germany has always been the most important clothing export market for Turkey. Although, Turkey increased its clothing export to the German market by 2003, the share of this top export market decreased from 46 % in mid-1990s to 30 % by 2003. This indicates a lower dependency position of Turkey to its main export market between 1995 and 2003, thus a higher diversification of the Turkish clothing export markets is observed.

Turkey also maintains very high levels of textile exports. Germany is again the leading Turkish textile export market, with a share of a quarter of total textile exports, which is preserved between 1995 and 2003. This again shows low dependency position of Turkey to its main export market and high diversification of the textile export markets. In addition, the Turkish Free Trade Zones (FTZs) have played an important role as one of the major textile markets for Turkey. In fact, the FTZs became the third important textile market in 2003 by doubling the share of textile exports in the period 1995-2003. The role of Turkish FTZ as centers for clothing production has increased in the past decade and that is why it shall be analyzed separately in subsequent subsection.

It is relevant also to discover the leading textile importers for Turkey. The top five textile importers take between 40 % and 45 % share of total textile imports which indicates less dependency on particular importer countries.

Fig.5 Top Five Textile Importers (in b.USD)



Source: UN, Comtrade, 1995-2003

Another observation is the limited presence of EU countries (only Italy has 13.6 % share) among top textile importers for Turkey.[33] It is likely that the availability of international subcontracting agreements between EU firms and Turkish firms is very limited. The Turkish FTZs have again played a role. In 1995, they were the third important textile importer, but decreased substantially five years later to recover their position again in 2003 with 7.6 % share. Finally, the presence of Southeast Asian countries among the leading textile importers for Turkey is a phenomenon observed also in developed economies' textile industries as a result of the liberalization of textile trade under WTO.[34]

[33] According to UN, Comtrade (2003), Germany is the 6th textile importer for Turkey with 7.5 % share of total textile imports, while France is 8th (3.5 %) and UK is 10th (3.3 %).
[34] Turkey is a WTO member since 26 March 1995.

3.2.2 Exchange rate policy

The textile and apparel sectors require a large labor force and their products are primarily for exports. Hence, local entrepreneurs are highly dependent on the exchange rate policy of the government. The exports gain competitive advantage if the local currency is devalued because the domestic production costs decrease and the international competitiveness increases vis-à-vis producers from other countries.[35]

As outlined in the previous section, the export-led growth model, pursued by the Turkish state in the post-1983 period, pushed the local textile and especially the apparel sector to increase their integration into the world markets. It was the state policy of devaluation of the Turkish lira (by 48 %) which boosted the exports in early 1980s. In fact, the Turkish state continued to resort to this leverage instrument to improve its international competitiveness. If between 1970 and 1979, the national currency was depreciated by 9.2 % against the USD and the DM, the average annual devaluation of the Turkish lira between 1980 and 1989 was 44 %, while between 1990 and 1999 it was fixed at annual average of 78.9 % (Central Bank, SPO data). Furthermore, Turkey experienced a very high depreciation of the Turkish lira (by 114 %) in 2001 as a result of financial/banking crisis (2000/2001). In an attempt to manage the crisis the Turkish lira was further depreciated by another 50 % in February 2002. By December of that same year, as a result of macroeconomic stabilization reforms, the lira experienced only 13.5 % depreciation and similar level was preserved throughout 2003.

Although, the factor of depreciation of the Turkish lira became a common practice of the Central Bank, thereby directly benefiting the T/C industry, it is important noting that

[35] For instance, Gary Gereffi (2002: 56) argues that a critical factor in the sharp decline of Taiwan's and South Korea's apparel exports in the late 1980s was not only their rising wages, but also the sharp appreciation of their local currencies vis-à-vis the US dollar after the Plaza Agreement was signed in 1985.

local firms had to be very flexible and learn fast how to develop and upgrade in an environment of macroeconomic instability, which kept two-digit inflation rate for the period between 1983 and 2001 (average annual rate of inflation stood at 60 %).

3.2.3 Trade liberalization with EU

Turkey's exports increased substantially during the past two decades due also to trade liberalization and the economy's integration with the European Community (EC). Although important, this factor should not be considered solely as positive and influential in boosting high value added of Turkish T/C exports because the EC did not favor Turkey, particularly in regards to the T/C industry.

Turkey applied for EC membership in 1959 and signed the Turkey-EU Association Agreement (Ankara Agreement) in September 1969, which provided a prospect of membership, rather than a guarantee (art.28 of the agreement). The Agreement envisaged a progressive integration through the establishment of Customs Union. Despite the Association Agreement with the EC, Turkey had to sign an Additional Protocol in 1973 which did not release abolishment of customs duties on imports to the EC of sensitive goods (such as textiles, agricultural and oil products and steel).[36] Therefore, Turkey did not enjoy advantage of the liberalized regime to the EC market as a result of the Association Agreement, although Turkish exports to the EC of sensitive products, including textiles, represented about two-thirds of all exports at that time. Moreover, the benefit of the Association Agreement was further undermined by safeguard clauses and the effective erosion of concessions that were given to non-associates under the EU's General System of Preferences (GSP) and Mediterranean policy. As a result, the international competition for the EC textile and clothing market increased substantially.

[36] See Art. 8, 10 and 11 of the Additional Protocol.

Furthermore, the EC was protective in character since it imposed restrictions on trading sensitive products, including textiles.[37]

Between 1973 and 1995, Turkey had obligations to reduce custom duties and charges made on EU imports into Turkey and according to the Protocol, Turkish imports from EU were divided into two lists. Those products that Turkey easily achieved international competitiveness relatively early were placed in a 12-year list to be achieved by 1985, while others, considered as uncompetitive, were put on a 22-year list.

The EU's Global Mediterranean Policy, adopted in 1975, had a largely negative impact on the Turkish textile exports since EU signed various bilateral preferential trade agreements with Mediterranean countries in the past two decades. These countries' textile exports competed with Turkish exports to a high extent in the agricultural and textile sector.[38] These agreements generally undermined the concessions granted to Turkey. For instance, Algeria and Spain received tariff cuts between 65 %-75 % in these two sectors, while Israel received better terms from the EU on 53 items during the 1980s. Furthermore under the GSP, the EU granted similar trade preferences in the textile sector to developing economies, which also had a major impact for curbing Turkish potential for textile exports to the EU. Finally, Turkish cotton yarns, which consisted of a major portion of the textile exports, were restricted from being imported in some EU countries, like the UK in mid-1970s.

As a result of the neoliberal and outward-oriented policy of the Turkish government after 1983, Turkey managed to abolish all import quotas from the EU, which signaled Turkey's willingness to integrate with the EU. But, the EU continued to be protective

[38] For more details on the EC's Mediterranean Polic*y,* refer to Gingsberg, Roy Howard (1993:154-167).

until early 1990s. The Turkish state removed customs tariffs with the EU and due to the Matutes package (adopted in June 1990 by the European Commission), in March 1995, a decision by the European Parliament was taken that Turkey was granted Customs Union in December 1995, which is relevant today. The Customs Union Decision (CUD) has an economic dimension, which contains the following:

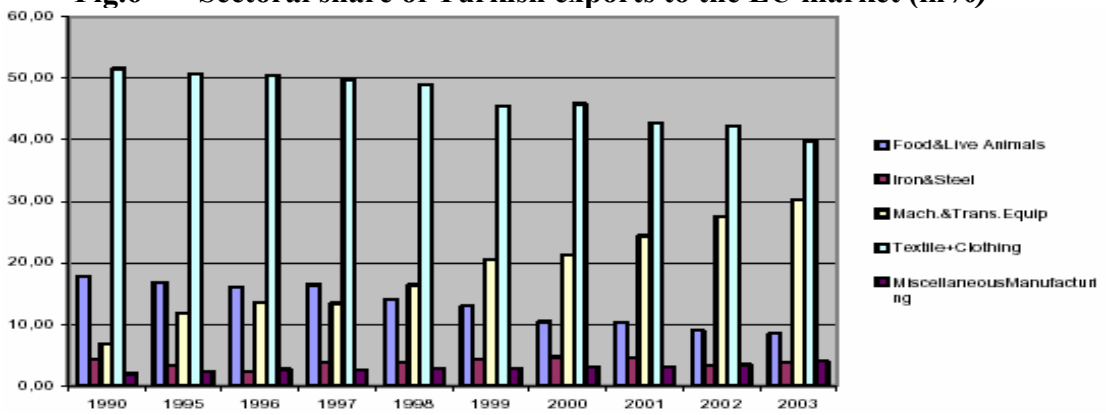
a) The elimination of customs duties, quantitative restrictions and measures of equivalent effect on trade in industrial goods between Turkey and the EU and the alignment of Turkish customs tariffs with those of the common customs tariffs of the EU in industrial products (Articles 4-11, Decision No.1/95 of the EC-Turkey Association Council, 1995);
b) The harmonization of Turkey's commercial policy with that of the common commercial policy of the EU (art.12);
c) The alignment of Turkish legislation with that of the EU in the areas of competition rules, the protection of intellectual, industrial and commercial property (art.31);
d) Abolition of the voluntary restraints arrangements that limited the export of Turkish textile to the EU.

Apart from the liberalization of tariffs and adoption of the EU's common external tariff (CET) for industrial products and the industrial components of processed agricultural products by Turkey. The CUD also embraced a number of integration elements such as the adoption of the Community's Common Commercial policy towards third countries including textile quotas, the adoption of the free trade agreements with all the EU's preferential trade partners, and harmonization of Turkey's legislation to that of

the EU in the area of competition policy, intellectual and industrial property rights and public procurement and technical barriers to trade, among others (WTO 1999; Harrison et al. 1996). In addition, Turkey adopted specific EU technical legislation, which regulated Turkish textile producers to the EU level. As a result of the technical approximation, the products of the Turkish textile and ready-made clothing have been entering into the EU market without quotas since January 1996. However, the Customs Union did not impede the usage of non-tariff barriers, which posed a great obstacle on the competition of the products on which Turkey is more advantageous in EU.

The liberalization of trade with the EU carried a negative trend of textile and apparel exports from Turkey to the EU market between 1990 and 2003.

Fig.6 Sectoral share of Turkish exports to the EU market (in%*)*



Source: State Planning Organization, State Institute of Statistics (1990-2003).

The figure above reveals that the capital-intensive sector of machinery and transport equipment began to gain share as percentage of total Turkish export to the EU market. In 1990, it had 5 %, while thirteen years later it took about 30 % of total exports. This was at the expense of the Turkish exports of T/C goods which decreased by 12 % between 1990 and 2003. Therefore, it might be concluded that the liberalization of trade with the EU benefited the Turkish T/C industry, but only after 1996 and still, not as much as other sectors of the economy.

3.2.4 Foreign Direct Investment

The SSAP of Turkey, introduced in 1980, placed a major emphasis on FDI as a source of capital inflow and transfer of technology and know-how. The "24 January decisions" of the SSAP included some arrangements related to international capital (Çepni 2003: 103-109, Ziya Öniş 1994). A Foreign Investment Law 6224 in Turkey was introduced already in 1954.[39] However, it managed to attract only $228.5 million through 1979, and none of this was in the textile and clothing field.[40] FDI continued to register low growth in the 1980-1990 with a cumulative actual inflow of $2.9 billion and 3.7% (about $107 million) of total FDI entering the local textile industry.[41] Only 12 foreign companies invested in T/C industry in the 1980s that was significantly low compared to the huge market and production capacity, but by 2002, the Turkish textile and apparel industry achieved some progress in attracting FDI, as seen below:

Table 2 Foreign-Owned Firms in the Turkish Textile and Apparel Industry

Apparel			Textile	
Year	**Number of firms**	**Capital (m. TRL)**	**Number of Firms**	**Capital (m. TRL)**
1990	58	44.686	26	62.817
1991	74	211.081	32	51.045
1992	84	224.054	32	51.045
1993	88	276.592	31	140.090
1994	99	416.429	35	153.437
1995	108	672.224	33	127.920
1996	121	916.516	39	202.635
1997	135	1.258.853	47	1.751.036
1998	137	2.631.069	49	2.695.485
1999	158	11.300.000	56	4.500.000
2002*	204	----------	61	----------

Source: Turkish Treasury reports, 2000 * data obtained from the report "Turkish Textile and Apparel sector, DEIK (Foreign Economic Relations Board), July 2002 :13, *April 2002.

[39] The first effort of the Turkish government to attract FDI was with the adoption of Law 5583, which was limited in scope. It was replaced by Law 5821, which was broader in scope, but full of restrictions. The failure to attract FDI brought the government to adopt Law 6224, enacted on Jan.18, 1954, which was prepared with the consultation support of the American expert, C.B. Randall. This law lifted all the restrictions from the preceding law and operated by 1980 as a liberal law, at least in terms of the legal framework. For more discussion, refer to Asim Erdilek (1982:12).

[40] According to the Ministry of Commerce (until 1977), the sectoral distribution of the FDI in Turkey was as follows: automotive industry (27.9 %), the chemicals and the rubber sectors (27 %), Electrical and Electronics Industry (12.8 %) and Tourism (8.7 %).

[41] DPT (1990), Table 7.3:100 and Ziya Öniş (1994), Table 7.5:102.

During the 1990s, the Turkish government supported the industry by relaxing the financial burden of investment through deferred tax payments, reductions, etc. (Baris Tan 2001: 37) Furthermore, it established the General Directorate of Foreign Investments (GDFI) as a one-stop agency within the Undersecretariat of Treasury to assist the foreign investors in exploring investment opportunities and process their investment applications and grant licenses for investment incentives, registration of license, know-how, technical assistance, management and franchising agreements. This led to the increase of the granted foreign investment licenses in the T/C industry, before and right after the realization of the Customs Union with the EU (1994-1998).

Table 3 Foreign Investment Licenses for the Turkish Textile and Apparel Industry

Year	No. of licenses	Foreign Capital (m. USD)	Share in total Manufacturing	
			No. of licenses	Capital
1994	63	23.9	14.4 %	2.2 %
1995	65	40.9	15.8 %	2.0 %
1996	54	40.9	15.3 %	6.5 %
1997	83	85.7	18.8 %	9.9 %
1998	65	52.3	14.3 %	5.1 %
1999	46	27.8	11.1 %	2.5 %
2000	39	41.3	9.3 %	3.7 %

Source: State Planning Organization: Fundamental Economic Indicators, 2000

From 1994 to 2001, foreign capital in the Turkish T/C industry has amounted to 350 m. USD, and estimated at about 500 m. USD in the post-1980 era (DEIK, 2003). A total of 204 apparel firms with foreign ownership have been registered to operate in the sector by April 2002 (25 % of them from Germany, 10 % from Britain, 10 % from Netherlands, 8 % from Italy), while 28 % of the registered foreign textile firms were with German capital, 8 % with British and another 8 % with US ownership.

As already discussed above, during the 1990s, the government increased its incentive basket in order to attract FDI. Yet, it also introduced FDI-related screening, approval and share transfer, which increased administrative work and limited to a certain extent

investors' interest. This was corrected in June 2003, when a new Law on Foreign Direct Investments (No.4875 from 17 June 2003), amending a number of other laws related to the rights of foreign owners, was passed. As a result, the FDI regime in Turkey was liberalized. For instance, all types of FDI permits issued by GDFI were abolished and Turkey adopted international standards for definitions of "foreign investor" and "foreign direct investment". Finally, the Law introduced a policy shift from ex-ante control to a promotion approach with minimal ex-post monitoring, which is likely to impact future FDI inflow. This policy improved the investor business climate, protecting the acquired rights, but its impact has yet to be fully evaluated.[42]

3.2.5 Privatization

The Turkish government stressed particularly the emphasis on "privatization as a key instrument for reforming the economy" (Shaker 1995: 34). Despite this political commitment, between the starting point of privatization (1986) and December 2002, the total amount of privatization amounted to $8.9 billion, 50 % of which was generated after 2000 (Ercan and Öniş 2001: 109). [43] The reason for the low performance of privatization in Turkey has been attributed "to the relatively open yet fragmented political system with a significant legacy of state interventionism" (2001: 110). In fact, although the privatization program started in 1986, the legal framework for regulation was established only in 1994 as a result of EU pressure and the establishment of the Customs Union.[44] The lack of governance and commitment of the Turkish government and the high turnover of top management of the Privatization Administration, coupled with the

[42] For more information, refer to The Undersecretariat of Treasury, www.foreigntrade.gov.tr.
[43] Bulgaria, in comparison to Turkey, was able to attract a total of $1.6 billion from privatization (InvestBulgaria, Foreign Investment Statistics 2005).
[44] The principles, procedures, authorized agencies and other issues regarding privatization are all set out in the Privatization Law No. 4046, dated 1994.

unstable macroeconomic environment, contributed to the overall failure of privatization. Despite this, the Turkish state managed to privatize 50 % of the textile state enterprises (13 existed in 1979, employing around 30,000 workers) by 2003.[45] Tender announcement for the sale of five premises of Sümer Holding (one of the biggest textile and apparel firms), whose network of production plants and sales outlets are spread all around Turkey), was announced only on March 29, 2004 and has not completed yet.

3.2.6 State industrial policy

Investment and export incentives

The governmental policy towards SMEs in the 1980s and early 1990s took the form of provision of cheap loans by the following banks: Halk Bankasi, the Development Bank of Turkey, Industrial Investment and Credit Bank and Turkish Eximbank (Kaytaz 1993: 234-235).[46] According to Togan (2003: 25), through the 1980s, Turkey used two important tools of industrial policy, which influenced the T/C industry as major export earner: *investment incentives* and *export incentives*. In each of the cases, the government tried to intervene by allocating resources through subsidies, although the export-led-growth model did not prescribe such direct interventions into the economy. Laws and decrees regulated the incentives and they targeted reducing the cost of investment, external financing and increasing profitability, while export incentives were regulated by various regulations, laws, decrees, decisions, etc.

One of the objectives of the reform from 1980 was to speed the administrative procedures for exports and the Office of Incentives and Implementation (TUD) was

[45] Reported by the Black Sea Economic Council report, www.bsec-business.org.
[46] The Turkish T/C industry predominantly includes SMEs, which number reaches more than 10,000, besides the large and modern integrated establishments, reported by Turkish branch associations.

established as a separate department to the State Planning Organization for this purpose. The exporters started to receive export incentive certificates with or without supporting documents for export, which they used to obtain short-term credits (8-12 months) with lower interest rates compared to other short-term credits from commercial banks (Togan 1994: 71-72).

As a result of these measures, the distribution of subsidized textile projects increased between 1980 and 1989, as seen from the table below:

Table 4 Subsidized Investment Projects in Textile : Turkey

Years	Total investment value in 1985 million TRL	Number of projects	Average value of project million TRL
1980	218.742	31	7.056
1981	678.933	94	7.223
1982	270.548	106	2.552
1983	437.071	102	4.285
1984	730.149	166	4.398
1985	545.740	303	1.801
1986	676.606	356	1.901
1987	686.664	370	1.856
1988	751.588	345	2.179
1989	898.480	501	1.793

Source: "Yatirimlarda Azalma Suruyor", Dunya, 1991, cited from Leander A. (1997).

Turkish state subsidies in clothing were restricted by the international agreements in late 1980s as GATT and the EU have introduced principles against dumping by putting additional anti-dumping tax to the importer country.[47] Turkey has adopted the EU and the GATT norms in its laws in 1989 and since then Turkey put on hold all direct incentives and allowed subsidies only in the field of R&D and environmental protection. Initiative certificates given in this scope have fluctuated in years. The number of these certificates, which have been especially high before and after the Customs Union agreement with the EU came into force (1995-1998), plunged to 242 with the effect of Asian and the Russian

[47] Office journal of the EC, Council regulations (EEC), 2176/84 on protection against dumped or subsidized imports from countries non-EEC members, No:201, 30.7.1984.

crises in the year 1999. The number of these certificates increased to 515 in the year 2000, and then fell to 370 when Turkey was in financial crisis in 2001.

Table 5 Investment certificates given to the Turkish T/C industry

Year	Number	Total Investment (000 million TRL)		Total Fixed Investment (000 million TRL)	Labor
1990	326	23.815	* (8 billion USD)	22.455	56.898
1991	253	14.096	(3.5 b. USD)	13.099	60.187
1992	337	46.558	(6.7 b. USD)	43.383	21.596
1993	742	190.520	(17.3 b. USD)	179.457	57.554
1994	342	87.415	(5.8 b. USD)	82.890	28.053
1995	2.360	2.580.820	(51.5 b. USD)	2.397.178	241.370
1996	1.124	762.772	(15.2 b. USD)	731.791	81.204
1997	1.213	826.042	(16.5 b. USD)	796.563	92.237
1998	794	647.701	(13 b. USD)	635.893	60.537
1999	242	233.172	(0.4 b. USD)	232.789	22.983
2000	515	629.816	(1 b. USD)	629.816	32.303
2001	370	1.092.842	(1.1 b. USD)	1.092.842	6.327
Total:	**8.618**	**6.042.732.929**	**(140 b USD)**	**5.765.318.931**	**754.922**

Source: Competitive Advantage for Turkey (2003). *From Sustainable Development for Textile and Clothing Industry.* CD-version: Istanbul, Chapter 13; *Exchange rate conversion, author's calculations, based on 1 USD=3.000 TRL (1990), 1 USD=4.170 TRL (1991), 1 USD=7.000 TRL (1992), 1 USD=11.000 (1993); 1 USD=15.000 (1994) ; USD=50.000 TRL (1995-1998) ; 1 USD=600.000 TRL (1999-2000) ; 1 USD=1.000.000 TRL (2001).

The table indicates three relevant observations. The first one is that the investment certificates were granted primarily for fixed investment projects (circa 95 % of total). The second one is that around 10 % of officially registered Turkish T/C labor force has been embraced by the investment projects and the third one is the high amount of investment in the Turkish textile and clothing field (140 b. USD) between 1990 and 2001.[48] About 63 % of total investment permissions in 1995 were granted to the textile and clothing industry by the Turkish government (the year with the highest amount of investment certificates), which have decreased to 34 % in 1996 and 15 % in 1999, but again grew after 2000. This is reported by the permanent representative of the Turkish textile and apparel exporter's association in Brussels, Haluk Özelçi (2004 :33), who further noted

[48] Similar figure was referred in report by DEIK (2002).

that about 30 % of total investment permissions by the Turkish government were granted in 2003.

During the 1990s, the investment incentives granted by the Turkish state involved exemption from customs duties and fund levies (related to imported machinery and equipment and not to raw materials and intermediate goods), investment allowances (e.g. readjustment for inflation and allowance rate of 200 % for investments over $250 million, starting from 1999). The state also permitted VAT (Value Added Tax) exemption for imported and locally purchased machinery and equipment and exemption from taxes, duties and fees when there is above $100.000 investment and investment in developed regions (Istanbul, Kocaeli, Ankara, Izmir, Bursa, Adana and Antalya), first priority regions (50 cities determined by the Council of Ministers) and normal regions (the remaining cities).

The Turkish government played a major role in supporting new textile machinery imports with investment subsidies. The official data reports Turkish annual imports of textile machines have increased from $0.4 billion in 1989 to $0.8 billion in 1992 and $1.5 billion in 1995 (State Institute of Statistics, Ankara). Moreover, the progressive increase of new T/C machinery import continued, as in 1996 (the first year of CUD), the annual textile machinery import stood at $2.3 billion. After that, it began to decrease to $2 billion in 1997, $1.3 billion one year later and to $0.9 billion in 2000. In an interview, the Director General of ITKIB emphasized that in the 1990s it was common practice that Turkish businessmen went abroad to purchase textile machinery (Tuncer Ogün, 10 October 2003, interviewed by the author, Istanbul).

In the period 1996-2000, Turkey imported textile (and leather) machinery that worth $7.2 billion and sewing machines estimated at $0.5 billion (State Institute of Statistics 2002). Thus, it became the third important textile importer for that period after USA ($12 billion) and China ($10.8 billion). For instance, Italy and Mexico imported less textile machinery compared to Turkey, respectively $5.3 billion and $4.6 billion.

In 2001, the domestic apparel industry received incentives that equaled 10.3 % of total incentives given by the Turkish government in the same year (DEIK 2002). Governmental incentives in the 2003 were distributed for projects in the clothing industry, which reduce inequality among regions, create employment, make use of advanced technology and increase competitiveness. The targeted region for investment projects in the clothing industry in 2003 was Anatolia, due to a large state project in the Anatolia region. This project, called GAP, affected the domestic cotton production.

Southeastern Anatolia Project (GAP)

GAP is the largest project ever attempted in Turkey. Originally, it started as an energy production and irrigation project to seek utilization of rich land and water resources of the region. It was converted into an integrated regional development project upon the completion of the GAP Master Plan in 1989. GAP called for $32 billion spending between 1989 and 2010. Under 13 sub-projects, it included 22 dams and 19 hydroelectric power plants on the Euphrates and the Tigris rivers. Upon completion of the project, nearly 1.7 million hectares of land will be irrigated.

Among the perspective industries in the GAP region is cotton (ginning, yarn, weaving, ready-made clothing). The state has provided variety of incentives, like income tax refunds, reductions in customs duties, VAT and other tax concessions. On 21 January 1998, the Turkish parliament passed a law, granting additional incentives:

a) Exemption from all income tax payments for five years including the investment period. These taxes will be paid at 40-60 % reduced rates until end of 2007, depending on the number of employees;
b) The payment of income and corporate taxes could be deferred for 2 years;
c) The employer's share of the employee social security payments is to be paid by the Turkish government;
d) 50 % reductions on the cost of electricity consumed during the investment period and the initial 3 years of operations;
e) The state-owned land is given for new investments without charge.

The state has also helped the creation of two free trade zones, twelve industrial zones and thirty-four small industrial estates in the GAP region by 2003, which is expected to influence, in the near future, investment of private entrepreneurs in the T/C industry.

Industrial districts

The state encouraged the development of two types of industrial estates in Turkey. Small manufacturers formed cooperatives to build workshops and industrial districts started to appear in the large cities.[49] The support was mainly in providing assistance for planning, construction credits through the Halk Bankasi, infrastructure and service facilities and the acquisition of land. Between 1965 and 1990, 212 districts, covering 58,000 small and medium sized establishments, were completed. Additionally, with the help of the Ministry of Education, about 200,000 people were trained in the Vocational Training program. The T/C industry has mostly benefited from the policy towards SMEs as far as this sector became the most important hard currency earning sector of the Turkish economy at the end of the 1980s (Parilti and Turkant 2001:7).

[49] Istanbul-based Yenibosna, Merter and Şirinevler in Istanbul; Çorlu, close to Tekirdag, etc.

Free Trade Zones

The Turkish state introduced specific legislation on the establishment of the Free Trade Zones (FTZ) in 1985.[50] Textile and clothing are among the main scope of production in the FTZs and the maximum period for an operating license is 99 years. Contrary to most Free Zones of the world, sales into the domestic market are allowed in the Turkish FTZs. Strikes and lock-outs are prohibited for a period of ten years from the date of operation of each zone. These state incentives transformed the FTZs into main export markets for the Turkish textile industry.[51]

After the FTZ were established, operational activities in Antalya, Mersin, İzmir-Aegean, Istanbul-Atatürk Airport, Trabzon and Istanbul Leather Free Zones were successfully launched. By October 1994, the FTZ in Adana-Yumurtalik, Istanbul-Trakya, Zonguldak-Filyos, Mardin, Eastern Anatolia and Istanbul Ataturk had been established and the total volume of trade within these six free zones has exceeded $4.3 billion. The benefits for enterprises that invest in the FTZs are the following: 100 % income and corporate tax free; exemption from VAT, unless selling to Turkey; 100 % exemption from banking and credit charges and customs tariff during importation into the Zones. There have been many foreign investors who have opted for the FTZ, as for instance in the Aegean, Adana-Yumurtalik and Trabzon Free Zones, there are enterprises with a substantial share of foreign capital of 96 per cent, 25 per cent and 94 per cent, respectively.

[50] The Free Zones Law (No.3218) was enacted on 6 June 1985. A Free Zones Administration, attached to the Prime Minister's Office was established in 1983 and Antalya and Mersin's seaports were designated as free zones on 12 November 1983. Current information is to be found on www.dtm.gov.tr.

[51] The FTZs represent the third important textile market for Turkey after Germany and USA since in 2003 Turkey exported to the FTZs textile products, estimated at around 450 million USD (UN, Comtrade, 2004).

3.3 Branch associations

Business associations (BAs), representing the textile and apparel sector at the national level, appeared before 1980. The Istanbul-based Turkish Textile Employer's Association (TTEA) was established in 1962 and transformed into a Turkey-wide organization only one year after its foundation. The main functions of TTEA are to protect the interests of the employers, mainly assisting them to conduct collective bargaining agreements. This last function came as a response to the rise of Textile Trade Unions in the 1950s. The Turkish Clothing Manufacturer's Association (TCMA) was created in 1976 to address priority issues and seek solutions within the Turkish clothing industry, which at the time was very small and produced exclusively for the domestic market. The Istanbul Textile & Apparel Exporters Association (ITKIB), which became one of the most important Turkish BAs, was established in 1986 to gather and provide information to its members, to grant export certificates and to negotiate voluntary export restriction agreements with the EU and with the US.

The first Turkish T/C BA had 100+ members in 2003 and all of them large textile firms with a turnover of over $10 million. According to Arslan Türker, R&D Department Director of TTEA, the basic task of the association is still making collective bargaining agreements (16 October 2003, interviewed by author, Istanbul). But, since TTEA became a member of EURATEX[52] in 1997, it embarked on international mission. Mr. Türker explained that TTEA takes part in committees which discuss trade policy and the Customs Union in the framework of EURATEX, but also sits on committee on social affairs, intellectual property and statistics. The association had to be very active at the international forum because whatever decision EU takes about the T/C industry affects

[52] Euratex is a non-profit trade organization, dedicated to the promotion of the European textile and apparel industry. It has 26 member countries. More information could be found on www.euratex.org.

Turkey as well because of the Customs Union. Mr. Türker clarified that the international dimension of TTEA expanded in the 1980s when Turkey began to export mostly to Europe. In fact, TTEA became a member of other influential international associations, like the International Commission for Fashion and Textile Colors (INTERCOLOR) and the International Textile Manufacturers Federation (ITMF).

The TTEA staff involves 25 permanent employees, while on specific projects, they invite additional consultants. The organization has a multi-million USD annual budget, which is solely sponsored by the membership fees, while some other funds come from governmental and EU funded projects. The collective bargaining is their main role because they represent the employers. Thus, TTEA negotiates with the largest Labor Union – TURK-IS because about 10 % of the textile workers are unionized. The collective bargaining agreements, which TTEA and TURK-IS sign are accepted as a model and implemented by other sectors of the economy.

The second influential T/C Association (TCMA) came as a result of the need to address priority issues and problems and seek solutions in times when the Turkish clothing industry was very small and produced exclusively for the domestic market. In 2003, TCMA had 406 members. As explained by the Director General of TCMA, Ms. Esin Benöz, these were only the active members, who pay the membership fee, but in addition to that TCMA worked with hundreds of other SMEs (16 October 2003, interviewed by author, Istanbul). All of the active members are large firms, having between 400 and 6,000 employees, which represent about 70 % of clothing export from Turkey.

When explaining the four stages through which the clothing industry developed since the 1970s (subcontracting, own-manufacturers, vertical integrated firms and brand and design-making firms), the TCMA Director General emphasized the importance of the liberalization of textile trade in 2005, which prompted firms to create their own designs and brands. In fact, TCMA has played an important role as promoter of the concept of Turkish firms exporting their own products with their own designs and brands.

When asked about the local subcontracting arrangements in the Turkish T/C industry, Ms. Esin Benöz explained that there are at least 8-10 local subcontractors that work with exporters of clothing. These subcontractors are not members of TCMA, but the association is doing vocational and marketing training for them. The interviewee said that TCMA emphasizes on the importance of Horizon 2005 and teaches local firms how to increase their productivity, how to comply with the codes of conduct (environmental, social codes) and increase their awareness to what is going on in the whole world. Esin Benöz, the Director General of TCMA, underscored:

> "We believe that we are all in the same ship. If the ship crashes, we all sink. Therefore, we have to give hand to make the ship float".

An example of how they help local entrepreneurs is a project, jointly started in 2002, together with COSGAP (public establishment) and the University of Ghent (Belgium), funded by EU. The project was about training 6,000 people in the clothing business. "We were encouraging SMEs to take part in this and we succeeded, so, there is a spillover in learning effect from large to small companies with which we are involved with" as underlined by Ms. Benöz.

The TCMA was involved in another large project in the Anatolian region which was organized together with the government authorities. The idea was to bring clothing and

textile manufacturers to Anatolia, where they can be close to the raw material supplies (cotton) and use the cheap labor force in this region.

The TCMA works also in the field of marketing the image of the T/C industry by promoting "Made in Turkey" abroad. The association assists its members in establishing direct contacts with national associations in European countries, who are members of EURATEX. For instance, if there is trade relationship between Turkey and Spain, thee association contacts the Spanish clothing association which organizes the visit – selects local companies for the visit, government authorities to talk to, etc., while the TCMA performs the same function for foreign agents when they come to Turkey.

The TCMA has an office, based in one of the industrial districts of Istanbul - Şirinevler. Its staff consists of 20 researchers but it also work with consultants. It has about one million USD annual budget which is composed of membership fees and funds from international research or marketing projects which the organization undertakes. TCMA does not have offices abroad and it does not work with Turkish Embassies. But, it has direct contacts with EURATEX and it has its representatives at EURATEX Board. As a result, the association is constantly involved in international working committees that discuss issues of clothing and textile exports to major markets.

The ITKIB is the most influential T/C Association in Turkey.[53] The textile and apparel exporters from Istanbul (representing 70 % of the T/C production) are required to become members of ITKIB in order to receive export licenses and quota shares. The ITKIB membership list totaled more than 20,000 firms in 2003, according to the official records of the organization. Important function of ITKIB is to cooperate with other sectoral associations and formulate the strategy line for the development of the T/C

[53] More information about ITKIB could be found at www.itkib.org.

industry in Turkey. Its premises, huge and modern building, are found in the periphery of Istanbul, close to the T/C districts. Its staff consists of around 100 people and the association has more than 10 departments, among which there is a department working on EU issues specifically (trade, competition, R&D, anti-dumping, etc.).

According to the Director General of ITKIB, Mr. Tuncer Ogün, before 1980s, the Turkish companies used to import raw materials and then manufacture and export (10 October 2003, interviewed by the author, Istanbul). The T/C industry was underdeveloped at that time. After 1980, big changes occurred - open market, free economy, and companies could easily trade with foreign partners. Mr. Ogün highlighted that one of the reasons for the fast development of the industry since mid-1980s is the functioning in the economy of business associations, as ITKIB. Its annual budget is over $20 million and its resources come from membership fees, but also from the government budget and research or marketing projects, financed by foreign donors. The status of ITKIB as a public/private allows it to function as a bridge between the Turkish public and private sector. In addition, the ITKIB participates in the organization of International Fairs in Turkey, like the Istanbul Fashion Show in August 2003, which attracted about 40 representatives of international fashion journals to cover the event and promote Istanbul across the globe, or the Turkish Fashion shows abroad, like for example the one in Las Vegas, US (2002) and in New York, US (2003).

The Director General admits that if ITKIB did not exist, the private sector could not reach the government body that easily. ITKIB organizes meetings for sector and government representatives to discuss the problems in the T/C field and solve them. ITKIB has two offices abroad (New York and Brussels), and it cooperates with the

Turkish Embassies. Major task of the ITKIB through these offices is to build a positive image for the Turkish T/C industry and the label "Made in Turkey".

During the 1990s, the Turkish BAs gradually became members of international organizations, such as the IAF and EURATEX, and began to lobby at the international level (with the EU, WTO) and at the national level (state support for business projects in the textile and apparel field). Furthermore, regional level BAs were created during the 1990s, thus expanding the support for domestic T/C SMEs. The most important among them are Denizli Textile and Apparel Exporter's Union (400 apparel and 200 textile firms), Uludağ T/C Exporter's Union (apparel 350, textile 550), Antalya Textile and Raw materials Exporter's Union (100 textile and 100 apparel), South East Anatolia Exporter's Association (60 textile and 40 apparel), Mediterranean Exporter's Association (200 apparel and 200 textile) and the Aegean Exporter's Union (650 textile and 1000 apparel).[54] Their functions are similar to the role that the nationally represented agencies play but they focus more on regional development and cooperation among SMEs in the T/C field, rather than on national promotion of the industry. Programs run by these regional BAs involve vocational training, seminars in marketing, brand-name and design courses, process and technological innovation, visited by members of these associations.

3.4 Turkish reality

3.4.1 Competition through informalization

The majority of the textile and apparel firms in the 1980s were the so-called *ateliers (atölye)*. They employed between 1-9 workers and constituted 99.76 % of all textile and apparel firms (303,000 small companies). There were only 600 firms that employed

[54] The role and functions of these regional branch associations can further be explored through their web sites: www.detkib.org; www.uib.org.tr; www.aib.org.tr; www.gaib.org.tr; www.akib.org.tr; www.egebirlik.org.tr; www.tekstilisveren.org.tr.

between 10-49 employees and only 120 companies had over 50 employees (E. Illyasoglu and L. Duruiz 1991). The *ateliers* provided low, non-unionized labor-intensive production (often undeclared). They operated without regular contracts and concrete obligations and were the first to go bankrupt when demand and prices fluctuate. *Ateliers* largely employed women so there was less pressure on the employer to declare the work because women's work usually ended with marriage. However, women continued to be employed as "housewife" labor (Ana Leander 1997).

The primitive organization of textile and apparel production started to change after 1990. The Turkish apparel sector expanded its employment and the ateliers began to disappear quickly. In fact, the clothing sector was transformed from a web of *ateliers* into a web of small-and-medium sized enterprises, SMEs (between 10-199 workers). In 1990, SMEs constituted 92.6 % of the establishments, employing 60 % of the labor in the apparel sector, and by 1995, they made up 93.1 % of the establishments, employing 69.1 % of the labor. The situation was a bit different in the more capital-intensive Turkish textile industry. In 1985, around 32 % of total establishments were large firms (over 200 employees), which employed 70 % of the labor force. This number grew to 40 % of the total establishments and 75 % of the work force in 1990, but by 1995 had decreased to 38 % of the total textile establishments, employing 68 % of the total textile work force.

Table 6 Size distribution in the Turkish T/C industry (2001)

Category	No.of workers	Percentage	No.of firms	Percentage
1-9	97.105	19.3	41.361	83.9
10-24	67.014	13.32	4.468	9.1
25-49	57.517	11.43	1.672	3.4
50-99	66.861	13.29	962	2.0
100-249	86.020	17.09	565	1.1
250-499	54.589	10.85	159	0.3
500-999	47.790	9.5	72	0.1
1.000-4.999	26.315	5.23	19	0.0
Total:	**503.211**	**100**	**49.278**	**100**

Source: Ministry of Social Affairs and Employment, 2001

The Ministry of Social Affairs and Employment reports that in 2001, there were 250 officially registered large firms that employed 125,000 workers, representing one-quarter of total registered labor force. Moreover, an additional 1,527 medium sized firms employed about 153,000 workers, representing 30.2 % of the registered labor force. As we see from the table above, altogether, large and medium sized enterprises employed 55 % of the registered labor force. Furthermore, the number of *ateliers* (1-9 employees) has decreased substantially from 303,000 in 1985 to only 41,000 in 2001, which is a clear sign of moving out from primitive organization of T/C production.

When one considers the employment data of the Turkish T/C industry and the number of firms, one has to acknowledge the high number of unregistered businesses (Tan, B. 2001:34; Kaya, E.S 2004:1-6). Although unregistered workplaces are common in the textile sector, they constitute a highly prevalent and widespread practice in the garment sector in particular. Therefore, official records of the companies and official figures regarding employment in the sector, as presented above, are far from reflecting the real situation (Kaya, E.S. 2004). For instance, according to the statistics issued by the Ministry of Labor and Social Security, the number of companies operational in the garment and textile sectors amounts to 27,245 at the end of 2003. However, the Undersecretariat of Foreign Trade notes that the number of companies operational in these sectors amounts to nearly 44,000 and the employees in the sector are estimated at 588,821, according to the Ministry of Labor and Social Security; whereas the labor unions and the Turkish BAs estimate the number of enterprises to be even higher, while the number of employees is beyond 3 million workers. Other sources estimate the number of employees at even 5.5 million workers (DEIK 2003: 19).

The fact that different types of labor are used in the sector and the level of unregistered operations is very high signifies a highly differentiating structure of sectorial wages and labor costs. In registered and unionized workplaces, the hourly labor costs are 6-7 times higher than in workplaces that employ children or illegal foreign immigrant workers, as seen from the table below:

Table 7 Average Wages, labor costs and employment structure in the Turkish T/C industry (April 2004, USD)

Workers employed in		Employment and % of total T/C employment *	Average monthly wage	Average labor cost (monthly)	Average labor cost (hourly)
Registered–unionize workplaces(1)	Textile Clothing	90 000 (3 %)	385-407 363-385	695-735 658-695	3.09-3.27 2.93-3.09
Registered-non unionized workplaces (1) Group 1	Textile Clothing	60 000 (2 %)	326-348 304-326	595-633 558-595	2.65-2.82 2.48-2.65
Registered-non unionized workplaces (1) Group 2	Textile Clothing**	90 000 (3 %)	267-296 244-274	487-538 450-500	2.17-2.40 2.00-2.23
Registered-non unionized workplaces only applying "legal minimum wage"(1)		360 000 (12 %)	224	417	1.86
Unregistered /clandestine workplaces (sweatshops in Istanbul) (2) Unregistered/clandestine workplaces (sweatshops outside Istanbul) (2)		2 160 000 (72 %)	259-296 185-222	259-296 185-222	0.87-0.99 0.62-0.74
Unregistered /clandestine workplaces – employing children and/or illegal foreign immigrant workers (2)		240 000 (8 %)	148-185	148-185	0.50-0.62

Source: TEKSIF UNION Research Department, Istanbul.[55]

Note: *total employment estimated at around 3 million (registered+unregistered); **applies to Group 2

Group (1) all the costs and expenses are included in the labor costs (taxes, social security premium, other legal payments, expenses for worker's meals and transportation, etc.); Group (2) legal working time in a month is 225 hours (Turkish Labor Code). In the informal sector, the monthly working time is around 280-320 hours (the calculation is based on 300 hours working time).

The conclusion that drawn from TEKSIF Union estimations of the labor force in the Turkish T/C industry is that 80 % of the workforce is in the shadow economy. The second important observation is that the monthly income of a worker is below the poverty and starvation limit and fails to fulfill the minimum requirements of a four-member family. This is the case even in registered and unionized workplaces.[56] The third

[55] These data are estimations of the Labor Union TEKSIF. As such, they might be opposed by employer's associations or by the central government. One look at the strategy report of the Turkish Clothing Manufacturer's Association (TCMA), which was issued in 2003, entitled "Turkish Clothing Industry: Horizon 2010", however estimates the hourly labor cost at 2.14 USD. The report was presented to major governmental and non-governmental institutions in Turkey and abroad and practically confirms that most of the workers fall in the group of registered non-unionized labor receiving close to the minimum labor wage.

[56] As of March 2004, the official poverty limit is estimated at 1.436.527.000 TRL (about $1.064), which is the minimum cost of living for a 4-member family), while the Starvation limit: 472.618.000 TRL (about $351), which is the minimum cost of food articles necessitated by a 4-member family)
(1 USD = 1.350.000 TRL)

observation is that there are around 100,000 local entities (up to 25 workers each), which at present operate in the Turkish textile and apparel industry illegally.

These observations lead us to conclude that the Turkish T/C industry in 2003 co-exists in a two-tiered system in which there are a large number of mini private "firms" that operate in the shadow economy, employing 80 % of the labor force. Low labor costs, non-unionized, labor intensive production (often undeclared) play the role of shock absorber for an advanced, modern technology intensive, large scale production sector, but also often non-unionized, which operates "in the light".[57]

Any discussion of levels of productivity of the sector is out of scope, since if a local exporter (must be legal by law) wants to be competitive on the international market, it can subcontract the assembly operations to local firms in the shadow economy and focus on quality control and marketing activities.

3.4.2 Competition through labor

The working conditions of the Turkish textile and apparel exporters were studied by TEKSIF and other Turkish labor unions, which have issued reports, explaining the character of the relationship between the employers, labor unions, and the employees.[58] These reports are tied with my own research experience among textile and apparel factories, which are presented below:

- *Voluntary employment*: (the Turkish labor code prescribes general rules on this): most of the firms in the sector are SMEs and they often work as subcontractors to other local medium and large firms that export. For that reason, workforce is hired only when

[57] The situation of the textile and apparel industry was very similar in the 1980s. Similar observations were found by Anna Leander (1997).

[58] Limited number of scholars have reported primitive working conditions in the subcontracting firms in Turkey, see Aktar (1990). In fact, there is insignificant number of unionized T/C firms by TEKSIF (only 13) in Turkey, which are required to receive inspections from labor unions to observe whether the labor code practice is respected in 2003.

orders are placed, and immediately fired when the company fails to receive any orders. According to the TEKSIF report "for this reason, no continuity is available in employment and workers are often forced to change workplace or go unemployed for some periods" (Kaya S.E. 2003). The interesting point is that both legal and illegal firms apply this technique. The reason for the legal firm to fire workers lies not only in the fact that buyers' orders do not arrive regularly, but also because of the governmental incentive which is used. In July 2003, 300 workers (25 % of the labor force) were immediately fired from one of the famous and prosperous Istanbul textile firms, interviewed by the author, in order to use a subsidy in September 2003, given by the government, when new workers are hired. In fact, after interviews with firms it was found that this practice is common and the local firm frequently fires and then hires again the same workers in order to use the state incentive and increase its production capacity when there is a large order from a buyer. Thus, money on training is spared and governmental subsidies utilized.

The duration of the working month in the illegal subcontracting firms is far beyond the limits stipulated by the labor code (300-320 hours per month, compared to the legal 220-240 hours per month). The Turkish firms, according to the TEKSIF report, frequently neglect the law and the working time could amount to 14-16 hours daily especially in unregistered/clandestine workplaces in periods of intense orders, while workers could work for 6-7 days weekly. However, it should be noted that this is hardly the case in the registered, legally operating enterprises. Workers, working overtime should gain 50 % more than their ordinary wages as it is prescribed by the law.

- *Discrimination*: in general, majority of the workforce are women, whose wages are lower than men's (TEKSIF 2003). We should note also the huge gap between managerial salaries and worker's salaries. If in Istanbul a worker from a prosperous apparel firm receives between $250-$350, the sales manager of the same firm gets $5,000 per month, which corresponds to the Western European standards.

- *Child labor* (ILO conventions apply): No child labor is used in establishments that perform registered operations in Turkey. But since the level of unregistered operations is very high (Table 7 :76 in the thesis), there is a high probability that local unregistered entrepreneurs use child labor in poorer regions. TEKSIF Research Department estimates that 100,000 – 120,000 children are employed by the Turkish garment sector. The quality inspector of a large American retailer, interviewed by the author, confirmed that small illegal subcontractors often use child labor force (11-15 years old) and they find it normal as the children support their families. This is a practice throughout the whole year and not only during school vacations, as quality inspector of international buyer confirmed (Çarapiç Velizar, 19 July 2004, interviewed by the author, Istanbul). The inspector further noted:

> "The big Turkish firms do not let you go to their subcontractors. But I cheat them. I tell them that they should bring me to their subcontractor in order to detect the problem of sewing straight on the spot and not later when the production is finished. Thus, they let me go. When we go there, I see all these miserable places, I see children working (10 year-olds even). I ask, what is this? Is it a kindergarten? They tell me, no, no, no,…. these are pupils, who come for education."

- *Labor Union freedom*: It should be acknowledged that most of the large textile factories have collective bargaining agreements with the employees, facilitated by the role of TTEA. In an interview by the author, TEKSIF's management confirmed that labor unions and textile employer's associations have relatively good relationships, although

the power has always been in the hands of the employers, who have often complained about the lack of international competitiveness because of high worker salaries. However, TEKSIF explained that the situation between the labor unions and the garment producers in Turkey is quite different - there is no relationship with the major garment representative TCMA (TEKSIF president, 29 July 2004, interviewed by the author, Istanbul). The main reason for this is that most of the illegal work in the industry is done by the local garment manufacturers. TEKSIF reports that there are at least 100,000 - 120,000 illegal foreign workers, employed in the garment sector (mainly found in the Istanbul Thrace Free Zone).[59] The majority of these workers are immigrants from various Balkan countries, ex-Russian Republics (especially the Caucasian countries) and Middle Eastern countries. TEKSIF reports that only 3-4 % of the workforce in the Turkish textile and apparel industry are covered by collective bargaining agreements (only 1 % of total employment in the apparel sector). The government has set rules that are too strict for the unionization of the labor force in the T/C industry, which could be an explanation of this phenomenon. The local unions allow only registered employees to benefit from trade union rights and freedoms (ILO conventions No: 87, 98 are ratified by Turkey). Yet, some of the provisions of the above-mentioned code do not correspond to these conventions and bureaucracy hinders the employees from benefiting from trade union rights and freedoms. According to the Trade Unions Code No.2821, the workers have to be currently employed and registered to be able to participate in labor unions or to establish such unions themselves. Moreover, any worker wishing to become a member of a trade union has to sign the membership form in five copies in the presence of a notary

[59] This is one of the newest FTZ, established in 1991. More information, available at http://www.isbas.com.tr/site/english/kurumsal.asp

public and to pay 20 millions TRL (about 15 USD) for the transaction. According to the provisions of the code, workers wishing to resign from a trade union are also liable to conduct this transaction in the presence of a notary public and to pay approximately 45 millions TRL (about 35 USD). Therefore, non-unionization is a large problem, but the availability of large percentage of unregistered employment constitutes the biggest obstacle standing in front of the employees because it absolutely prevents workers from making use of their trade union rights and freedoms.

- *Bad working conditions*: Legally registered exporters have very high safety standards and relatively good working conditions (author's own research and TAKSIF report 2004). The problems, again, come from the second-tier subcontracting firms, which often work in primitive, miserable premises. The control of safety standards by state officials is very limited in the unregistered work places, while large Turkish exporters are often controlled for safety and social standards by their foreign buyers.

Conclusion

This chapter analyzed the development of the Turkish T/C industry and the role of state policy for helping the sector increase its exports and international competitiveness. Firstly, it looked at the ISI period (until 1980), during which the state created vested interests, but the T/C industry was not among the strongest pressure groups and development of the sector was limited. Secondly, it observed the development of the industry and state policy in the post-1983 period. The early 1980s are characterized by radical transformation of Turkish economic policies, pushed by the IMF stabilization program. The Turkish state embraced export-led growth as it encouraged Turkish entrepreneurs to integrate into world markets. The devaluation of the Turkish lira boosted

exports and the specific industrial policies (investment and export incentives, cotton project, free trade zones, industrial districts) established the T/C industry as a leading export sector of the economy. The liberalization of trade with the EU substantially increased the Turkish T/C exports and EU became the major export market. However, this was not the major reason for the development of the Turkish T/C industry, as EU was granting preferential agreements to Mediterranean countries and developing economies, major regional T/C competitors of Turkey. Limited FDI and no major influence by privatization deals on the T/C industry characterized the post-1983 period. In spite of this, the structure of the industry changed significantly as it moved from a primitive organization (web of *ateliers*) in the 1980s to more complex forms of organization (web of SMEs). Thirdly, the chapter investigated the functions and activities of major Turkish Branch associations in the T/C field to find that sectoral actors were well organized and had the capacity to help development of the industry. Finally, the two-tiered system of informalization of the industry was discovered as a factor for improving international competitiveness. The first part of the analysis discussed the functioning of large number of mini private "firms" that operate in the shadow economy with low labor costs, non-unionized, labor-intensive production which play the role of shock absorber for an advanced, modern technology intensive, large scale production sector, but also often non-unionized, which operates legally. The second part of the analysis provided findings from reports by Turkish labor unions and the author's own research, which concluded that the Turkish T/C industry is able to provide cheap labor and compete successfully at the international level due to maintaining working conditions in the industry that are far below the international standards.

Chapter IV. Industrial and Firm Upgrading in Turkey

Introduction

The chapter aims to analyze the indicators that characterize the dependent variable which traces industrial and firm upgrading in Turkey through applying the Unit Value Analysis (UVA) method, based on data from Eurostat's Comext, and utilizing in-depth interviews with firm managers, textile and branch association experts. The *first section* introduces *Sectoral level* analysis which involves a study of unit values of Turkish textile and apparel exports to the EU market between 1983 and 2003. The *second section* presents the *Network level* analysis of linkages between foreign and domestic firms, whereas the *third section* discusses the *Firm level* analysis by including results from a survey, conducted by the author, and three firm case studies. The conclusion summarizes the major findings.

4.1 Sectoral level

4.1.1 Low value added export position in the 1980s

Turkey exported 75 % of its total textile and clothing exports (852 million ECU) in 1983 to the European Community (EC) market. That same year, clothing exports represented 33 % of total T/C exports to this market. Half of Turkey's T/C exports to the EC market came from cotton products, which is a group of primary export commodities. The distribution of value added, according to the Unit Value Analysis and its three dimensions (down-market, middle-market and up-market) is presented on the following page.

Table 8 Unit Value Analysis of EC textile and apparel imports (1983)

Categories	Turkey		
	DM	**MM**	**UpM**
Textile	59%	3.2%	5%
Apparel	17%	13.8%	2%
Total:	**76%**	**17%**	**7%**

Source: Eurostat (1983), Extra-EC import, author's calculations which cover 99.9 % of total EC import of textile and apparel products from Turkey based on 6-digit disaggregated data level; **Note**: the value added has been weighted according to the value weights of the categories that were studied; All textile articles (50 to 59) and all apparel articles (60 to 63) in the trade nomenclature of EC export/import structure have been taken into consideration; DM stands for Down-market, MM for Middle-market and UpM for Up-market value added exports.

The majority of Turkish T/C exports to the EC market in 1983 were concentrated in down-market niches (76 %), while the share of up-market products was only 7 %, leaving a 17 % share for middle-market goods. The textile exports dominate, and their value added is estimated at 59 % in the down-market segment. Therefore, at the beginning of the research analysis, Turkey is characterized as exporter of low value added goods. Moreover, it exports primary textile commodities, which means that in 1983, Turkey took the first step in the industrial upgrading (See Fig.1, Chapter 2: 20 in the thesis).

In early to mid-1980s, the accession of Greece, Spain and Portugal to the European Community restricted the import quotas of textile and apparel goods under the Multi-Fiber-Arrangement (MFA) because the new members had high exporting capacity (Finkel and Sirman, eds. 2000). Then, the Outward-processing traffic regime (OPT) of the EC was implemented. Since 1983, the OPT allowed developing countries, including Bulgaria and Turkey, to export to the EC more than the recommended quotas under the MFA. This was to occur under the specific condition that "*EC firms supply subcontractors from third countries with materials, parts or components to be processed or assembled, and then re-import them into the EC at preferential tariffs*" (Pellegrin, J. 1997). Thus, the OPT regime provided an incentive for the Western European firms to

outsource clothing assembly in the third countries, while at the same time retain the capital intensive textile production within the EC boundary.

Eurostat began tracking OPT exports in 1988, which is the next time point to analyze according to the UVA method. In that same year, Turkey more than doubled its exports of textile and apparel goods to the EC market compared to 1983 (1.9 billion ECU). The apparel exports (60-63 articles) increased substantially, almost fivefold (1.3 billion ECU) compared to five years earlier.

Table 9 Unit Value Analysis of EC textile and apparel imports (1988)

Categories	**Turkey**		
	DM	**MM**	**UpM**
Section A			
Textile (50-59)	21 %	1 %	4.6 %
Apparel (60-63)	15 %	42 %	16.4 %
Total:	**36 %**	**43 %**	**21 %**
Section B			
Textile (50-59)	21 %	1 %	4.6 %
Apparel (60-63)	24 %	42 %	7.4 %
Total:	**45 %**	**43 %**	**12 %**

Source: Eurostat, Comext databases (1988-2001), Extra-EC imports; the author's calculations cover 520 product groups (6-digit disaggregated level) from categories 50-63. The calculations encompass over 90 % of total textile and apparel export (in value). Section B stands for corrected unit values.

Section A indicates the distribution of value added of Turkish textile and apparel exports to the EC market in 1988. However, since assembly of clothing products, under OPT, became important after mid-1980s, there is a need to control exports in terms of share of subcontracting in total clothing exports. Although, they might indicate up-market or middle-market value added of the exports, automatically they shall be considered down-market because OPT exports yield low value added for the local economy.

The local apparel manufacturers, which perform the assembly operations and export under OPT retain only a slight share from the value of the product. This is because domestic firms perform only the labor-intensive operation, while value which accrues from textile inputs, logistics, design, brand and marketing is gained by the foreign

contractor. The value added of OPT exports is biased to be high and medium-market because of the essence of the competitive advantage from this partnership between the foreign and the local firm which benefits the former.[60]

Another criterion, which should be controlled for when applying the UVA methodology in the case of textile and apparel is the high concentration of exports in one or two products which are biased to be low value added despite the fact that the statistics have shown they have a competitive advantage by taking middle and up-market segments. Such low value added products could be T-shirts, vests of cotton, underwear, etc. In the case of Turkey and Bulgaria, two product groups are considered as such within the category of articles of apparel and clothing accessories in 61 category (610910 and 610990) of Eurostat's Comext.

Section B of Table 9 arrives with new estimations based on UVA methodology and the necessary corrections for OPT and concentration in low value added products. In 1988, OPT is found in the category of articles of apparel and clothing accessories (61) and the category of articles of apparel and clothing accessories, not knitted or crocheted (62). But it represents a highly insignificant share of total textile and clothing exports (0.1 %).[61] However, high concentration is found in T-shirts, singlets and other vests of cotton, knitted or crocheted (610910), which takes about 10 % of total value of total apparel exports to the EC market.[62] Therefore, the new 1988 estimates show that Turkey has slightly improved in terms of value added of its exports to the EC market compared to

[60] The EU buyer imports usually expensive textile materials, supplied from an EU textile producer, and gains from the cheap assembly of the product in the peripheral economy. This increases significantly the unit value of the final product exported from the host country.
[61] In general, OPT exports are detected only in apparel goods, mostly found in category 61 and 62.
[62] Experts in the textile industry have indicated that Turkey had a competitive position in the EU market of T-shirts and vests of cotton in the past two decades not because of the high branded products within this group of articles, but due to the very cheap cotton and the high EU import quota for these products (series of interviews by the author, June 2005).

1983. Value added of middle-market exports increased by 26 %, but up-market exports of Turkey increased by only 5 %. Thus, the majority of the textile and apparel exports to the EC market in 1988 are from the down-market segment. Finally, Table 9 indicates substantial decrease of textile exports to the EC market. Turkey was exporting textile primary commodities in 1983 yielding 56 % of value added in down-market segment, while they are estimated at 21 % of total export in the same segment five years later.

4.1.2 Climbing up in the 1990s

Turkey increased its textile and clothing exports to the EC market in 1991 (3 billion ECU), mainly due to the clothing exports which represented 77 % of total exports. The export of primary textile commodities continued to decrease, as seen from value added which they represent in the following Table 10.

Table 10 Unit Value Analysis of EC textile and apparel imports (1991)

Categories	**Turkey**		
	DM	**MM**	**UpM**
Section A			
Textile (50-59)	14.6 %	0.5 %	4 %
Apparel (60-63)	8.4 %	46.5	26 %
Total:	**23 %**	**47 %**	**30 %**
Section B			
Textile (50-59)	14.6 %	0.5 %	4 %
Apparel (60-63)	27.4 %	37.5 %	16 %
Total:	**42 %**	**38 %**	**20 %**

Source: Eurostat COMEXT databases (1988-2001), Extra-EC imports; the author's calculations cover 520 product groups (6-digit disaggregated level) from categories 50-63. The research encompasses over 90 % of total export (in value).

Seen from Table 10, ***Section A*** and ***Section B*** substantially differ after corrections are made for OPT exports and the high concentration of exports in low value added products. The phenomenon of OPT exports have slightly gained importance in the Turkish case in 1991 (4.5 % of total T/C exports), having an impact mainly in products from articles of apparel and clothing accessories, not knitted or crocheted (62). However, product group 610910 represents 10 % of apparel exports (as in 1988). Thus, as seen from the table

above, the Turkish value added of the T/C export structure slightly improved in 1991 compared to 1988 (by 8 percentage points in up-market segment). However, middle-market exports decreased by 5 percentage points. Therefore, in early 1990s, Turkey exported predominantly low value added textile and apparel products to the EU market – 42 % are found in the down-market segment.

In mid-1990s, Turkey further increased its textile and apparel exports to the EC market compared to 1991 (4.3 billion ECU). The textile exports continued to decrease (0.8 billion ECU) at the expense of apparel exports, which comprised 81 % of total textile and apparel exports (3.5 billion ECU). The changes these observations yielded to the value added of the export structure is seen from the following table.

Table 11 Unit Value Analysis of EC textile and apparel imports (1995)

Categories	**Turkey**		
	DM	**MM**	**UpM**
Section A			
Textile (50-59)	8 %	0.8 %	3.8 %
Apparel (60-63)	9 %	32.2 %	46.2 %
Total:	**17 %**	**33 %**	**50 %**
Section B			
Textile (50-59)	8 %	0.8 %	3.8 %
Apparel (60-63)	29 %	21.2 %	37.2 %
Total:	**37 %**	**22 %**	**41 %**

Source: Eurostat, Comext databases (1988-2001), Extra-EC imports; the author's calculations cover 520 product groups (6-digit disaggregated level) from categories 50-63. The research encompasses over 90 % of total export (in value).

OPT exports represented 2.8 % of total exports in 1995. High concentration is found in low value added products (610910 and 610990), which are present with a share of 11 % of total apparel exports and, both exhibit up-market range. After it is corrected for OPT shares (in Article 62) and concentration in low value added exports from the two articles mentioned above, ***Section B*** indicates that Turkey is already very different in the mid-1990s than it was in 1991. The highest concentration of the Turkish T/A exports is in

the up-market segment. In fact, it doubled its share between 1991 and 1995. The down-market segment represents 37 % of the value added of total T/C exports.

Therefore, it could be concluded that Turkey managed to increase substantially the volume and the value added of its textile and apparel exports to the EU market in the 1990s compared to early 1980s.

4.1.3 Upgrading of Turkish exports in the post-1995

The post-1995 period is significant in the history of textile and apparel trade. When ATC entered into force in 1995, textile and clothing activities in some countries were dependent on quotas and non-tariff restrictions. As long as ATC was valid, all the products of textile and clothing were within the scope of the rules of GATT and it was expected that all bilateral quotas on a product should be abolished. With the termination of ATC in 2005, it was anticipated that none of the products in the sector would depend on the quotas. That is how ATC should be considered a solid instrument that ended almost 40 years of discriminatory protection which violated basic principles of the GATT system (Francois J., H. Glismann, Dean Spinanger 2000: 4).

The integration process of MFA into the rules of GATT through ATC was conducted in four steps:

Table 12 Integration of textiles and clothing into GATT

Date	Minimum Volume Integrated (per cent)	Accumulated volume integrated (per cent)	Remaining quota growth rate
01.01.1995	16	16	16
01.01.1998	17	33	25
01.01.2002	18	51	27
01.01.2005	49	100	Full integration

Source: Hildegunn Kyvik Nordås(2004:13)

According to the rules: “Each member should be integrated into the products of GATT 1994 at the rate of at least 16% of its total import product volume of 1990.” (ATC, art. 2.6). Theoretically, before ATC came into force, a member could freely name the

products that should not be dependent on the quotas, but a contradiction arose. In 1990, the USA trade of 30% and the EU trade of 37% of products that were listed, were not subject to any quotas thus creating an opportunity for them to choose the products without quota for integration into the ATC. As a result, the actual liberalization of the EU market in textile and apparel condensed into a period of three years (2002-2004). This rapid liberalization, also called "cliff effect", welcomed a substantial global trade flow increase in textile and apparel in 2003.

It is worth mentioning what has happened with Turkey in 2001, when it witnessed high international competition in textile and apparel trade. Turkey substantially increased its exports in 2001. In fact, the value of its exports doubled between 1995 (4.3 billion ECU) and 2001 (€ 8 billion). The value of apparel exports continued to stand at 80 % of total exports (€ 6.6 billion). However, it seems that international competition affected the distribution of value added of Turkish textile and apparel exports to the EU market in 2001, as observed from the following table:

Table 13 Unit Value Analysis of EC textile and apparel imports (2001)

Categories	**Turkey**		
	DM	**MM**	**UpM**
Section A			
Textile (50-59)	7 %	3 %	1.6 %
Apparel (60-63)	11 %	31 %	46.4 %
Total:	**18 %**	**34 %**	**48 %**
Section B			
Textile (50-59)	7 %	3 %	1.6 %
Apparel (60-63)	28 %	32 %	28.4 %
Total:	**35%**	**35 %**	**30 %**

Source: Eurostat, Comext databases (1988-2001), Extra-EC imports; the author's calculations cover 520 product groups (6-digit disaggregated level) from categories 50-63. The research encompassed over 90 % of total export (in value).

OPT share is insignificant (<0.01 %), but the concentration of article 610910 and article 610990 has increased its share, compared to mid-1990s and it already takes 17 % from total apparel exports and, as before, in the up-market range. ***Section B*** (corrected

estimates) clearly depicts a position of the value added of Turkish textile and apparel exports. Turkey succeeded in exporting for the EU market 30 % up-market, which is 11 % less than what Turkey achieved in 1995. However, Turkey has increased its exports in medium-market goods by 13 % compared to the mid-1990s. Textile exports from Turkey to the EU market substantially decreased in 2001 compared to the exports in the 1980s, which is a sign of shifting from primary commodities exports to full-package apparel exports.

In 2003, Turkish T/C exports to the EU market have continued to rise (€9.5 billion), because of apparel exports which reached 85 % of total exports (€8 billion). The structure of the exports is different compared to what Turkey was exporting to the same market in 1983. For instance, while cotton exports were taking half of the exports in 1983, about half of Turkey's exports to the EU market are in apparel products, knitted, or crocheted two decades later. The value of Turkish textile exports has doubled, while apparel exports increased by circa 3,000 % compared to 1983.

Table 14 Unit Value Analysis of EC textile and apparel imports (2003)

Categories	**Turkey**		
	DM	**MM**	**UpM**
Section A			
Textile (50-59)	3 %	1.5 %	0.8 %
Apparel (60-63)	8 %	19.5 %	67.2 %
Total:	**11 %**	**21 %**	**68 %**
Section B			
Textile (50-59)	3 %	1.5 %	0.8 %
Apparel (60-63)	31 %	14.5 %	49.2 %
Total:	**34%**	**16 %**	**50 %**
Section C			
Textile (50-59)	3 %	1.5 %	0.8 %
Apparel (60-63)	31 %	22.5 %	41.2 %
Total:	**34%**	**24 %**	**42 %**

Source: Eurostat, Comext databases (2003), Extra-EC imports; the author's calculations cover 520 product groups (6-digit disaggregated level) from categories 50-63. The research encompasses over 90 % of total export (in value).

In 2003, OPT is insignificant because full-package production continues to dominate in the Turkish textile and apparel sector. However, the concentration in article 610910 and article 610990 has reached 20 % of total apparel exports. In spite of this, as ***Section B*** from Table 14 shows, Turkey has managed to substantially improve its export position compared to 2001. Half of Turkish textile and apparel exports are made up of up-market segment in the EU market, which is an increase by a spectacular 20 percentage points compared to 2001. The down-market segment has continued to take 1/3 of total exports, which is likely to be a consequence of increased international competitiveness as a result of liberalization of the global trade regime in textiles. Middle-market export is only 16 % of total value added, which leaves the impression that there is a large group of Turkish manufacturers that target low cost products, which co-exists with even larger group of Turkish manufacturers which target high-value added market niches.

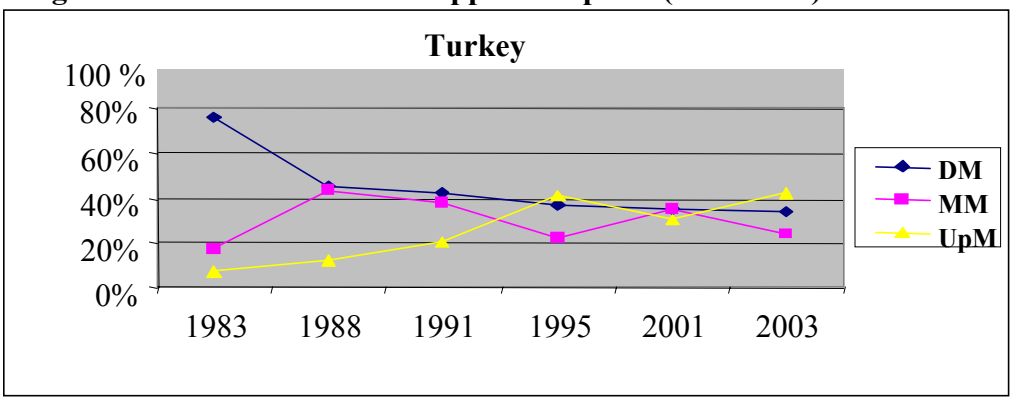
A third adjustment of the UVA methodology was needed, which necessitates the inclusion of ***Section C.*** It applies two additional corrections which reflect contemporary developments of international trade in textile and apparel goods. The first one is related to OPT EC trade and accounts for exports of apparel materials from EU countries to Turkey, which are registered for assembly under OPT, but are not reported as OPT exports from Turkey back to the EU market. The case of Turkey proves no impact from this correction.

The second correction considers the progressive lifting of barriers to trade in textile goods and the WTO membership of China. The first effective removal of textile quota barriers was in 2002 (17 %). The quality level floor has lowered since China's membership to WTO, resulting in increased textile and apparel EU imports in the

liberalized textile trade environment. These two factors significantly impacted the international textile trade and after 2002, price levels were seriously affected.[63] The result is that the average unit values of the EU-extra imports from third countries to EU decreased. Therefore, adjustments have been made for the lath for qualification of unit values into the three dimensional scale: >20 % (Up-market); ±20 % (Middle-market) and <20 % (Down-market).

As a result (See Table 14, ***Section C***), Turkey preserved its concentration in down-market exports in 2003 (34%). The middle-market exports decreased (24 %) compared to 2001 (35 %), but this has happened at the expense of up-market exports from Turkey to the EU market, which increased in 2003 (42%) compared to 2001 (30 %). Therefore, after analyzing the UVA for the period between 1983 and 2003, it can be concluded that the up-market and middle-market exports have increased substantially at the expense of down-market exports, as seen from the following figure:

Fig.7 EU textile and apparel imports (1983-2003)



Source: Eurostat, Comext, author's calculations.

[63] For example, the author estimated the unit values of EU-extra imports of jersey, pullovers and cardigans (product groups 611020 and 611030) between 2001 and 2003 to see how the liberalization of trade and China's entrance to the WTO has affected the unit values of the same product groups of the average EU-extra imports. As a result, I noted a substantial decrease of the unit values of EU-extra imports with variance of 21 % (611020) and 15 % (611030) is registered, respectively between 2001 and 2003.

Starting from low levels in 1983, the up-market exports from Turkey to the EU market progressively increased during the 1990s and maintained a stable level at the threshold of the 21st century. The middle-market exports picked up their pace in 1988 and kept stable levels until 2003. At the same time, the down-market goods, exported from Turkey to the EU market, decreased substantially. In 1983, the value added of down-market goods was 76 %, while twenty years later they make up 34 % of total value added of textile and apparel exports.

The exports and the distribution of value added is generated by firms which fall into particular export role positions, identified by the ladder of industrial upgrading. In addition, the linkages between local and foreign firms, which form the global value chains, is of particular interest when discussing industrial upgrading. Therefore, the aim of the next subsection is to observe upgrading of the T/C industry at the *Network level*.

4.2 Network level

Based on interviews with textile experts, state officials, branch association representatives and firm managers, the author was able to identify the distribution of firms in the Turkish T/C industry, according to the GVC export roles' model. About 5 % of Turkish textile and apparel exporters perform ODM and OBM, while around 60 % of the manufacturers fall in the category of OEM export role and are able to organize the supply of textile inputs, manufacturing and distribution. EPM is conducted by 30 % of the firms, while another 5 % are exporters of primary textile commodities. A graph is developed which clearly identifies the linkages between local firms and their connectedness with foreign firms (*Appendix F*, Turkish Apparel Value Chain: 269).

The raw material suppliers take the first segment of the apparel value chain. In Turkey, these are mainly local producers who exclusively supply the domestic textile industry. In 2003, Turkey was the fourth world producer of wool and top after Australia, China and New Zealand. Turkey was also the fourth largest consumer of wool in the world because of the high demand of the wool-textile industry. It could not be satisfied by domestic production and as a result Turkey began to import large quantities of wool to become the fourth largest net importer of wool after Italy, China and Germany (Cotton and Wool Yearbook 2003).

Cotton is the dominant raw material used by Turkish apparel manufacturers, which explains why Turkey developed comparative advantage in low value added cotton products of T-shirts, singlets and vests (610910 and 610990), as observed from the application of UVA methodology. The value of exports from these product groups increased from 127 million ECU in 1988 to €1.6 billion in 2003. This came as a result of Turkey's substantial increase of cotton-textile production which was brought about by increased demand of local apparel manufacturers. In 1983, the demand for cotton production was low as observed from the low exports of apparel products (Table 8, p.84 of this thesis). In addition, one can contrast production and consumption of cotton products between end of 1980s and a present. In 1988, Turkey produced 2,985 million bales, while in 2003 it produced 4,200 million bales, making it the fifth largest cotton producer in the world after China, India, Pakistan and Brazil. In 1988, Turkey consumed 2,664 million bales, which increased to 6,100 million bales in 2003, thus becoming also the fifth largest global consumer of cotton after China, India, Pakistan and the US (Cotton and Wool Yearbook 2003).

The Turkish intermediary and final textile producers are well equipped with new machinery, technologies and quality certificates. They completely satisfy not only the local market but also the global market as Turkey became the 10th global supplier of textile goods.

The textile producers, working for export, can be divided into three categories: prospective, stagnant and declining. The group of *progressive textile firms* comprises about 60 % of the total textile enterprises. These are firms which used state incentives to import new textile machinery from the beginning of 1990s (spinning, weaving, knitting, finishing) and began to introduce new technologies that enabled quality of production to be increased.

An owner of dying and printing firm, an example of a *progressive firm*, explained that his father created the company in 1941, but he was the one to expand the manufacturing activities in mid-1970s when the firm began work with foreign companies that operated on the local market and exported to France (16 October 2003, interviewed by the author, Istanbul). At that time, 230 employees produced 3 tones per day, while in 2003 the firm employed 148 workers and produced 12 tones per day. This investment, which carried production efficiency, came as a result of the incentives given by the state in expectation of the Customs Union with the EU. In 2003, the firm operated with 50 clients (local apparel firms), which exported 95 % of their products and the owner noted: "The majority of the products that I dye and print are exported to the EU market, which also testifies to the quality of my work". This comment suggested that the destination of exports defines the market segment for which one works. In a Turkish firm exporting to the EU, the products are mostly of medium and high quality. The owner of this Turkish

dyer factory explained that the intense competition in the dyeing and printing subsector in Turkey increased through the 1990s. When the company was formed in the 1970s, it had only six competitors, while at present the local competitors increased to 500. "The high competition, underscored the owner of the dyeing firm, is good for the business, but improving the quality has a limit". That is why, he explained that his firm does not invest anymore as it achieved the necessary technology and know-how capacity.

The group of *stagnant textile firms* represents about 20 % of the local firms. These are Turkish firms which do not posses ISO certificates or buyer's audits and have not been able to establish effective local networks to vertically close the production cycle and manage their links with raw material suppliers. In addition, they have not invested in marketing nor have they improved distribution channels in Turkey and abroad. These factors impede their work and the firms are likely to decrease their production and exports due to the intense international competition because of the liberalization of the global trade regime in textiles.

About 20 % of the Turkish firms are *declining textile firms,* which are characterized by obsolete machinery, lack of capital for investment, and decreasing production and employment through the 1990s. These firms are the first to go bankrupt after the liberalization of global trade or shift their market from export to domestic supplies.

The interviews with Turkish firm managers emphasized that the intra-industry vertical integration of domestic firms creates comparative advantage since the production cycle is totally controlled by the firm itself and it does not depend on other firms in terms of supplies, quality control of manufacturing and delivery on time. As a result, Turkish textile firms have started to integrate clothing in their system of production. Furthermore,

local textile firms rarely use intermediary agents when they work with local clothing manufacturers.

The linkage between local textile and local clothing firms is very strong and built over a long-term period. As a result of the vertical integration of the industry, the clothing producers in Turkey are distributed in the following three market segments: a) high value added companies; b) medium value added value companies; c) low value added companies.[64]

The group of *high value added* clothing firms is represented by Turkish companies, like Vakko, Beymen, Mithat, Altinyildiz and Öztay. These firms comprise 15-20 % of all clothing firms. These large and medium sized firms were successful in the domestic market and as a result, recently, and very aggressively entered the international markets (Western Europe, North America, Central and Eastern Europe) through international marketing strategies, originality of design, quality of textile inputs and skillful labor. In addition, the firms from this group pursue retail strategy to reach the final customer by opening stores in Western Europe (Germany, Italy and Spain), US (New York and San Francisco), Central Europe (Prague, Budapest, Warsaw) and Russia (Moscow). In fact, the Turkish Clothing Manufacturers' Association (TCMA) estimated that around 30 % of their members (400+ firms, which represent 70 % of the Turkish exports) have their own designs and brands for their products offered in the European and US market.

Registering a brand is relatively easy; establishing the brand is a complicated. Moreover, developing a design that meets international customer taste is even harder. Branding and design manufacturing is a process, which most of the Turkish

[64] Turkish firms can combine these market segments, but for simplicity the author shall use these three distinct categories.

manufacturers have begun to explore only after 2000, as underlined by the TCMA Director General (Esin Benöz, 9 October 2003, interviewed by the author, Istanbul). The interviews indicated about 10-15 % of the Turkish apparel exporters fall in the group of *high value added* clothing firms, but they are likely to increase in the near future.

The second group of *medium value added* clothing firms represent about 60%-70% of Turkish clothing exporters. These firms offer full-package production and some of them have just started to learn how to design and market their own brands. Local companies, like APS, Zeynep and Gals Textil, which interviewed by the author, have started as non-branded fashion firms or retailers, which came into existence in the early 1980s as domestic producers to proliferate in mid-1990s when the country began to market one of its most valuable assets: skilled and cheap labor.

Today, Turkey still manufactures garments bearing the labels of Tommy Hilfiger, Liz Claiborne and dozens of other internationally recognized companies. To improve their competitiveness, Turkish producers use special computerized technologies, such as Computer Aided Design (CAD), Computer Aided Manufacture (CAM) and Computer Integrated Manufacture (CIM). These innovations allow for reduction of costs per piece and the development of new strategies, such as quick response or just-in-time. The peculiarity of this group of *medium value added* firms is that they can organize the whole network of activities from the cotton field, to manufacturing and transportation of the final product, which is then exported. However, they have a limited knowledge in marketing and branding and face substantial difficulties to reach the end-customer.

The third category of *low value added* clothing manufacturers consists of about 15 % - 25 % of total. They focus on low-end products (T-shirts, uniforms, simple dresses,

towels) which yield low value added to the local economy. GISAD, which is a trade company that has a network of 200 local firms that export together, is a typical representative of this category. Denizli, one of the major textile centers in Turkey, is well known as a specialized producer of cheap towels for the Western European market and the US. Within this group, one would also find other types of firms which produce and export fake brands. The EU, US and the Eastern market have high demand for cheap products and exactly the price competitiveness is what makes these low value added exporters operate. This is coupled with the growth of Istanbul as a major market of low cost garments since late 1980s when Eastern Europeans and later Russians started to practice the so-called "suitcase trade", the large Saturday market in Istanbul, the *LALELI* market, so ubiquitous in Southeast Europe.

The local clothing manufacturers perform mainly full-package production but they have a network of, on average, eight to twelve local subcontractors which act as buffers (*Appendix E*, Turkish Apparel Value Chain: 269). These local subcontractors are usually small (up to 49 employees) or medium sized firms (50-249 employees), which do not export but work solely for local exporters. The culture of local subcontracting is more or less like "social cooperation" (Bademli 1977, E.M. Cinar, M. Kaytaz and G. Evcimen 1987, 1988, 1991). Most of the local subcontractors operate in the grey economy and are highly dependent on local clothing manufacturers, which export the ready-made final garments. The local subcontractors cannot export because first they have no stable buyer, they are illegal, and they have to receive export certificates by organizations, like ITKIB.[65] Furthermore, intense competition in the local market and the high pressure of the local exporters to bring the prices for manufacturing further down makes the local

[65] The firms have to pay to ITKIB between 0.5 and 1 % of the value of each export deal.

subcontractors more and more dependent on local exporters. That is why local subcontractors themselves frequently use local *ateliers*, which to a great extent perform unregistered work with 10, but sometimes 30 employees.

Sometimes, X employs trade agents to directly link Y with local subcontractors to produce a specific order and later on, establish a permanent network of local subcontractors. This is in the case for firms such as the small trade agent, JUNKERS, or the large trade agent, GISAD. This is the case since the local trade agent has found a foreign buyer; hence market for the local goods. In the case of Turkey, the role of international distributors is very limited since lead firms usually operate directly with large clothing manufacturers. Here is what a foreign quality inspector shared in (Çarapiç Velizar, 20 July 2004, interviewed by the author, Istanbul):

> "When delegations of foreign buyers come to Turkey to inspect new factories, they find large factories where the organization of production, marketing department, designers and other employees work within international standards. However, large Turkish clothing manufacturers often use local subcontractors to compete for low cost production. But, interestingly enough, the large Turkish clothing firms usually manufacture in-house the products, which carry their own brand. It seems that they realize how important is to manufacture "at home" its own product".

All lead buyers that operate on the global market are present in Turkey - Italy (Benetton, Max Mara, Marzotto, Armani, Diesel), Germany (Adidas, Puma, Hugo Boss, Quelle, C&A), Spain (Mango, Zara), US (Nike, Reebok, Kappa, Liz Claiborne, Banana Republic, Tommy Hilfiger, Express, and May Department Stores). Lead firms order full-package products from the Turkish manufacturers and international subcontracting is extremely limited in Turkey, while local subcontracting is well spread.[66]

[66] There are only a few available studies on subcontracting in the Turkish textile and apparel industry. The conclusions come out of author's research, but also based on findings of Mehmet Kaytaz (1994) and Erol Taymaz and Kilicaslan (2002). Kaytaz's research embraced 105 textile firms to conclude that majority of the examined firms have been offering or receiving subcontracting (both, large and SMEs). Most of the subcontracting was in the clothing subsector and the main reason to offer subcontracting was inefficient capacity. Taymaz' and Kilicaslan's work have made the most comprehensive study on local subcontracting

In sum, the linkages between local firms and the low dependency of the sector on foreign supplies, intermediary agents and lead firms is what characterizes the industry. Therefore, the analysis of the apparel value chain yields a case of upgrading for Turkey.

4.3 Firm level

This section first looks at results from survey, conducted by the author, of dependency and upgrading of 44 firms from the Turkish T/C industry. Then, it deals with an in-depth analysis of three case studies of T/C firms.

4.3.1 Survey results

The survey of textile and clothing firms in Turkey was conducted by the author in two distinct periods (October-December, 2002 and July-August, 2003). The largest portion of the firms, which participated in the survey are SMEs (54 %). These are distributed almost equally between textile (41 %) and clothing (39 %) companies, while the rest are vertically integrated firms (they have textile and garment production units). EU is the major market for 64 % of these firms, while Germany is the major export market for 27 % of the firms. A large majority of the firms are export-oriented, since half of them export more than 90 % of their total production, while 20 % export between 60 % and 90 %. A total of 95 % of the firms are private. 89 percentage are owned by Turkish capital, while 4 % are foreign-owned and 7 % are mixed (domestic/foreign investment).

The interviewees, who responded to this survey in person, are managers. Middle management (manager, chief accountant) represents 66 % of all interviewed, while 1/5

among textile firms, covering a panel data on all establishments employing 25+ workers in the period 1988-1997. Their major results: a) local subcontracting is primarily in the knitting and wearing apparel sectors; b) the subcontracting relations in the textile industry seem to be short-term; c) subcontractors tend to produce final products and focus more on advertising than other firms; d) location is very important in establishing subcontracting – subcontracting is growing where firms are located in the same region.

are the owners, followed by representatives of upper management (deputy executive directors or executive directors). Moreover, 75 % in the interviewees have more than eight years of experience in the textile and apparel field. About 2/5 of the respondents have over 14 years of experience, which is a period that encompasses also the 1980s.

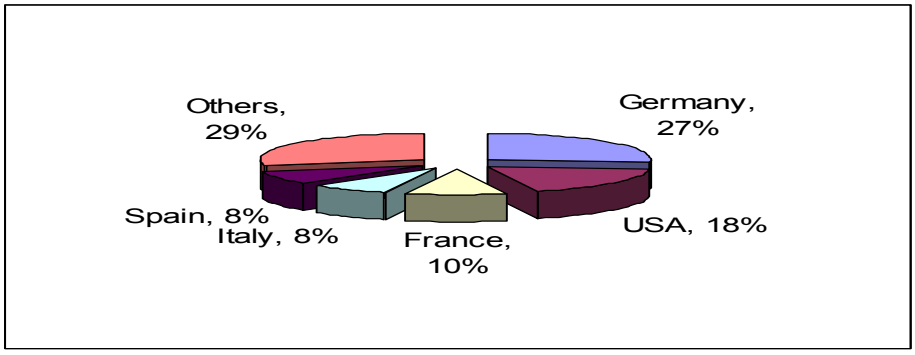
The distribution of the firms in the survey, according to the year of establishment, is similar to the actual age distribution of firms in the Turkish T/C sector. About 1/3 of all firms from the sample were created before 1980, while another 1/3 were created before 1990. About 20 % of the firms were established between 1990 and 1995 and a share of 14 % of the firms from the sample is established after 2000.

a) Dependency of Turkish firms

Major export markets and buyers

The largest export market for Turkish firms from the sample is Germany (27 %), which together with France, Italy and Spain constitute the biggest regional market for Turkish firms – the EU market. The US market is the largest market for only 18 % of the firms from the sample.

Fig.8 Major export markets: Turkey



Source: Author's calculations based on own survey, 2002-2003.

An important factor to understanding the level of firm's dependency on foreign buyers is to estimate what percentage of the total export of the firm is taken by the two

most important buyers. If this share is over 90 %, than the level of dependency is very high because when the dominant buyers suddenly withdraw their orders, then the firm remains out of the market, which might cause bankruptcy. There is high dependency in cases where the total share of exports for the two main buyers is between 60 % and 90 %. In medium dependency, the two main buyers take 30 % to 60 % and for low dependency, the two main buyers are less than 30 % of total share of exports.

Since majority of the Turkish firms from the sample export to the EU market, then EU firms are their major buyers. Turkish firms show a low level of dependency upon the two most important buyers. Only 7 % of the firms from the survey confirm *very high* (>90 %) dependency of the two most important buyers as percentage share of total exports, while 23 % demonstrate *high* dependency. However, every third firm from the sample demonstrates *medium* dependency, whereas 33 % of the firms have *low* dependency on buyers.

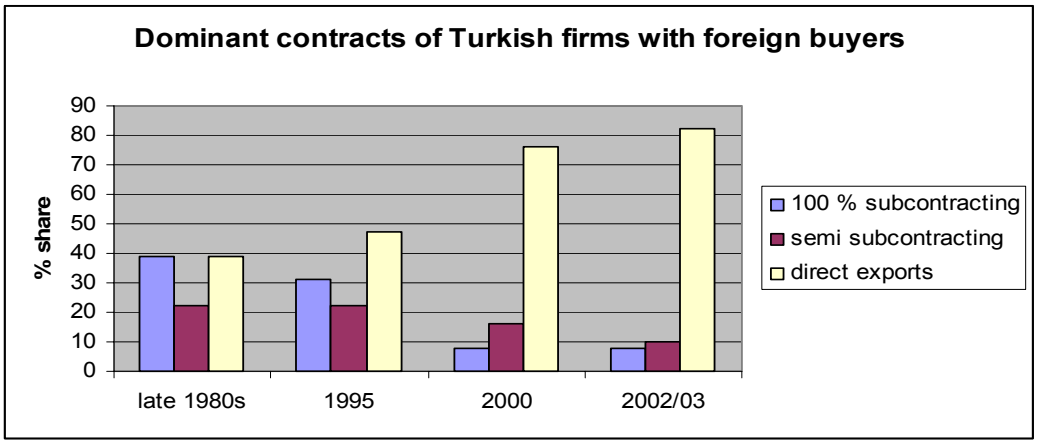
The concentration of exports going to two major buyers does not leave many opportunities for the development of new markets, which is also indicated by the level of concentration in the top export market. The high level of concentration in the top export market corresponds to the lack of diversification of the firm's market portfolio. This limits the firm's development since it is used to particular tastes and preferences of market destination and would be difficult to change its product mix if the firm suddenly needs to re-direct its exports to another market. The results from the survey show *very high* dependency and *high* dependency on the top export market is confirmed by 18% and 42 %, respectively. Almost every one out of three firms has *medium* dependency (29 %), while each tenth firm from the sample has *low* dependency (11%).

It could be concluded that Turkish firms find it easy to diversify the portfolio of their foreign buyers, but they are relatively dependent upon the top export market. It means that they manage to find several important buyers, which focus on particular export markets.

Dominant contracts of firms

Turkish firms were asked about the type of contracts under which they worked between late 1980s and 2002/3. The survey showed the following distribution:

Fig.9



Source: Author's calculations based on own survey, 2002-2003.

Turkish firms have been able to lower the concentration on full-subcontracting and semi-subcontracting from late 1980s to mid 1990s. Moreover, there is an observable shift towards direct exports with 75 % share in the third period (2000) and 82 % share in the last period (2002/03). Direct exports carry more value added for the local firm and suggest more concentration on full-package production. These results convey a picture that is similar to what textile experts describe about subcontracting when they discuss the development of the Turkish T/C industry in the past two decades.

> "In the 1970s and early 1980s, clothing exports from Turkey were very limited and local firms performed only full-subcontracting for foreign companies. In the 1980s, the most important production was that of jeans and there was no product diversification, although local firms began to gradually shift from subcontracting to full-package production in late 1980s. In the 1990s, Turkey completed vertical integration when local textile and local

clothing firms began to cooperate and the companies became real *industrialists*. Since 2000, Turkey is in the phase of creating brands and emphasizing on design. It is the most important phase for the industry, which will guarantee its future international competitiveness". (ITKIB Director General, Ogün Tuncer, 10 October, 2003; Director General of TCMA, Benöz Esin, 9 October 2003, and Koç University professor; Tan Baris, 6 October 2003, interviewed by the author, Istanbul).

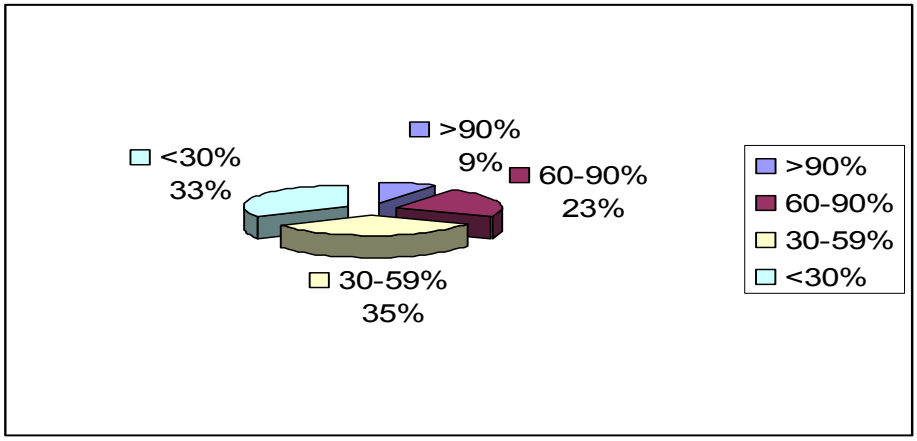
The survey indicates that limited subcontracting is done by Turkish firms for foreign buyers, however local subcontracting is widely spread. This was also confirmed in interviews with large and medium sized companies from the sample. Small firms gravitate toward the larger firms and depend on these orders in order to survive. That is why small firms that subcontract to other local firms often operate on the verge of the shadow economy and are very flexible in terms of prices. They are buffers for the larger firms and are first to go bankrupt in economic unbalance.

Suppliers and place of origin of raw materials/textile inputs

Information about the "dependency on suppliers" is revealed also by the indicator "place of origin". The indicator "dependency on suppliers" is of minor importance because it exemplifies the concentration of orders from particular suppliers. The concentration is rarely the case since suppliers, offering textile inputs (yarn, fabric) for clothing manufacturers or providing raw materials (wool, cotton, silk, etc.) for textile producers are in high competition and dependent upon the buyers (textile or clothing manufacturers). Therefore, such dependency shall not be expected. The second indicator, however, is of greater importance since it identifies the place of origin of the raw materials. On the one hand, it signals whether the domestic market loses as supplier vis-à-vis the foreign market. On the other hand, it shows whether the local textile industry is loosing local firms as clients in case they do not use local textile inputs or raw materials.

Turkish firms from the sample reveal low dependency on suppliers, as far as almost every 7 out of 10 firms has a diversified portfolio of suppliers.

Fig.10 Share of Turkish firms' two most important suppliers



Source: Author's calculations based on own survey, 2002-2003.

In terms of place of origin of the supplies, the survey results confirm that the majority of the raw materials or textile inputs used by Turkish firms are domestic. A total of 77 % of the Turkish firms have indicated that they use local supplies, while only 16 % of the firms import EU supplies and 7 % import from East Asian countries. These results suggest that first, strong local networks between Turkish textile producers and Turkish clothing manufacturers are built and second, full subcontracting seems to be low in the case of Turkey since majority of the textile inputs are not imported.

The role of trade agents

The survey results confirm that local manufacturers in the textile and apparel field primarily do not use trade agents to connect with foreign buyers (valid for only 30 % of the firms) and even less use trade agents to link with suppliers (26 %). However, the trade agents exist and play a role in the Turkish T/C industry. A co-owner and manager of one such trade agent, JUNKER, have been interviewed by the author in order to understand better their role (22 October 2003, Istanbul).

YUNKER is a small trading company, involving 60 employees, which opened for business in Istanbul in late 1980s with only three employees (all co-owners).

"Being global at home" is what describes this firm. Currently, the management focuses on own design and marketing and places orders to local Turkish manufacturers for their export markets of clothing products: About 15 years ago, the firm started with $50,000 and 95 % of its operation was illegal. In 2003, the annual turnover is $2 million and it is functioning only 5 % illegal. How did JUNKER succeed?

Their success lies in building strong partnerships with local apparel manufacturers, while the quality control, design, brand-making and marketing is provided by the firm itself. The firm very often meets its foreign buyers in Textile Fairs and Fashion Shows. "At the beginning - notes one of the owners - it was the *LALELI* market in Istanbul, where we managed to sell a lot of fake branded Turkish garments to suitcase traders, who came from Central and Eastern Europe to visit the biggest garment open market on the Balkans". It was a good business with high profits, which helped the firm stabilize during the 1990s and start thinking long-term. However, the support of TCMA was crucial. In fact, one of the owners of JUNKER was for some time a Board member of TCMA. The training courses that the business association provided for the designers of the firm, as well as the business trips that were organized by the association, helped the company find foreign partners and upgrade. When asked what assistance they expected from the state, the response was "nothing". The owner was firm, "We prefer the state not to be involved in the business at all." He added, "Too much bureaucracy could limit our freedom to do our business" however, he noted, "we cannot do without the support of the state and its specific industrial policy towards promotion of the T/C industry".

The company developed three brands in the last five years and started opening new foreign markets for their own products. They felt that they are small and could not resist

long-term the EU market and that is why they started to think about Central and Eastern Europe. “We are included in the next official business meeting in Prague, organized by TCMA and the state,” said the owner.

The issue of trust, which this company built in its network of local manufacturers, came out in interviews with the owner and the manager of the firm. The trust is based on long-term business model, which proved to be successful in an environment of consistent support by business associations. It was interesting to ask how this small firm survived in the turbulent inflation crises and macroeconomic instabilities through the 1990s. The answer was, “We did it because we were flexible”. However, the owner added, “Now is the time to think also strategically about the future because flexibility is not enough in this tough global competition”.

The future of the firm is prosperous as every next year it hires more employees and its turnover trend is increasing too. The firm does not consider opening its own production facility in the near future; rather it intends to focus on providing services (brand-making, marketing, design, logistics and organization of the production process). It has shops at home and abroad through which it reaches its end-customers.

The majority of the small and medium-sized trade agents in Turkey operate in a manner similar to JUNKERS. They provide value added services and keep a stable network of local producers that manufacture for them. Other trade agents in Turkey act as exclusive representatives of big foreign buyers, like that of GAP.

Another example is Li & Fung, which is a Hong Kong multibillion dollar trade agent, particularly specialized in global trade in textile and clothing, which has its office in Istanbul. Firms, like GAP and Li & Fung arrived in Turkey at the end of 1980s and started

to act not only as trade exporters, but also were directly involved in supply of the raw materials for the Turkish textile firms and textile inputs for the Turkish clothing manufacturers, provided designs, brands and organized the logistics. Ten years later, as learnt from Koç University professor and confirmed by firm manager, the local producers gained the trust of the foreign trade agents, which started to order and export a finished garment, choosing from a catalogue of samples, provided by the Turkish manufacturers (Tan Baris, 6 October 2003, Konyar Levent, 13 October 2003, interviewed by the author, Istanbul).

There are also large Turkish exporters of textile and clothing products, like already mentioned above GISAD, which organize the export of 200+ local manufacturers. The existence of these trade agents has increased the competitiveness of the Turkish T/C industry, as underlined by Tuncer Ogün, Director General of ITKIB (10 October 2003, interviewed by the author). Moreover, the development of mega firms like GISAD, are more efficient in the negotiations with foreign buyers. They are able to negotiate better prices because of the agglomeration effect - high export potential which they can offer. The high volume of exports, however, is not a major criterion to describe development of the local industry. That is why analyzing firm upgrading in the following subsection would contribute to better understanding of the Turkish T/C industry.

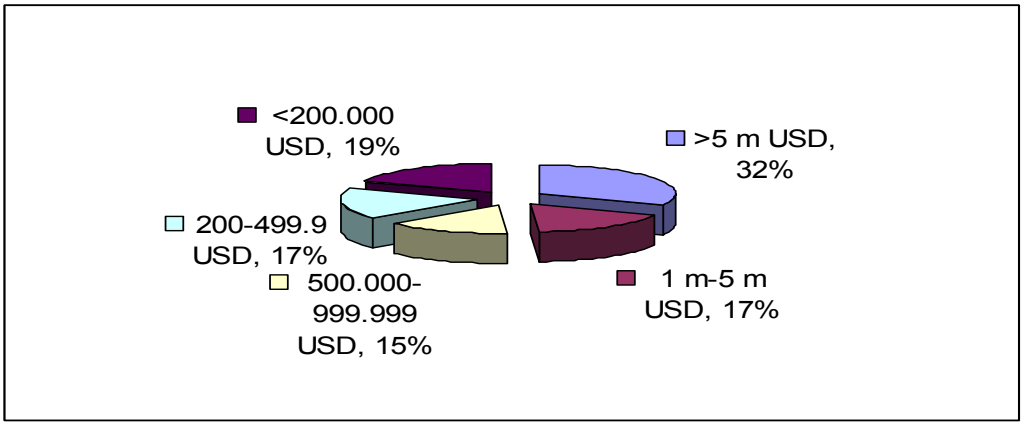
b) Upgrading of Turkish firms

Product and process upgrading

The new challenges of the global economy had a positive impact on Turkish firms since, according to the survey, 93 % of them are very active in developing new products and new production lines in order to respond to global competition. Moreover, only 19 % of the firms have invested less than 200,000 USD and 17 % have invested between

200,000 and 500,000 USD, while every third company has invested more than 5 million USD, which is considered to be high investment compared to local standards. The size of the firms matters since larger firms tend to invest more financial resources.

Fig.11 Share of Turkish Firms' Investment



Source: Author's calculations based on own survey, 2002-2003.

About 60 % of the Turkish firms in the survey have declared investments in new machinery and technology, while 22 % have indicated investments primarily in new buildings or reconstruction of old ones. Important factor for the high private investments in the T/C sector might be the opening of the EU market with the signing of the Customs Union agreement, which entered into force in 1996. This agreement acted as a catalyst for local private entrepreneurs, who understood that the textile and clothing industry has a comparative advantage already in the early 1990s.

Functional and organizational upgrading

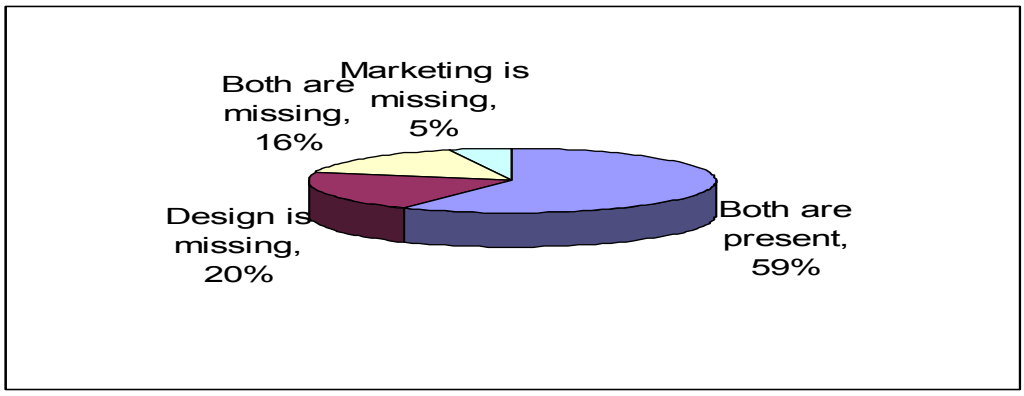
The *functional upgrading* tests the availability of brands, marketing and design departments. Large share (76 %) of the Turkish firms have their own brand. However, as mentioned above already, brand making is a new phenomenon in the Turkish T/C economy, which finds its roots only after the end of 1990s. In 2003, the share of Turkish firms, having their own brand is getting bigger.

> "As a result of the liberalization of textile trade, Turkish firms have gradually realized that there is a big competition in the global market and least developed countries have comparative advantage in labor costs. Therefore, the basic products will be done there, while Turkish manufacturers have to differentiate products and create value added through establishing their own brand". (Director General of TCMA, Benöz Esin, 9 October 2003, interview by author, Istanbul)

The survey indicates that every second Turkish firm has its own shop(s) and 22 % of these firms have their shops at home. This gives signs of growing efforts in retailing by the Turkish exporters, who try to reach directly their end-customers and propose particular concepts that would satisfy customer's taste.

The availability of design and marketing departments reveal important criteria for firm upgrading. While the marketing research offers possibilities for constructing of different competition strategies, the design department is the intellectual product of the firm that is a strong criterion for the firm's long-term vision for development. The research results indicate that most of the Turkish firms have marketing and design departments as the following figure indicates.

Fig.12 Marketing and Design departments in Turkish firms



Source: Author's calculations based on own survey, 2002-2003.

Majority of the firms (60 %) have both departments. This would suggest substantial investments in the long-term development of the companies because these firms target ODM and OBM export role. Moreover, marketing department is present in additional 20

%, while design department is present in additional 5 % of the firms. Both departments are totally missing in 16 % of the firms in the sample, which have limited chances to survive in an environment of intense global competition.

Finally, the *organizational upgrading* is tested by one indicator (ISO certificates or buyer's audits).[67] A total of 62 % of the firms have identified the availability of either ISO certificate/s or buyer's audit.

The following common features characterize the certified companies:

a) Large and medium-sized enterprises with personnel of more than 200 people and more than one production division;

b) Clearly stated export orientation – all companies from the selection except for one – export more than 50% of their production;

c) Export to more than two foreign markets, the two main buyers of each of the enterprises form less than 60% of the total export of the firm;

d) All of the companies have their own registered brand, marketing and design departments and available shops.

The fact that such a significant percentage of Turkish textile and clothing exporters have been certified or have buyer's audit means that majority of the local firms do respond successfully to the challenges of the international competition, as they guarantee quality of production and services, according to internationally recognized standards.

[67] ISO 9000 certificates function within the EU area and could be in the field of quality control, ecology, labor conditions, management, etc. (e.g. ISO 900, ISO 17000, etc.). These certificates are obtained by the firms from authorized scientific laboratories and they increase substantially the confidence of the European buyers. The US buyers and also some European buyers do not consider so much the ISO certificates, but rather prefer to introduce their own annual, but sometimes three year audit certificates (e.g. the American "J.C. Penney" and "May Department", the German "Puma", etc.).

4.3.2 Analysis of three firm case studies

Case One: Bozkurt

KIPAS is a Turkish holding company, which owns 11 firms, specializing in different fields from textiles to energy.[68] In fact, it is one of the top 10 textile industrial groups in Turkey. The holding created a vertically integrated production, which involves spinning, weaving, dyeing, printing and finishing, and garment manufacturing. The history of the holding goes back to 1984, when everything started with a small open-ended spinning mill. In 1997, KIPAS bought a famous Turkish apparel company, called *"Bozkurt"*, to become an industrial group with 4,000+ employees (70 % of the apparel sector), four times more than it did at the end of 1980s. The annual turnover of the firm was approximately $10 million in late 1980s, $16 million in 1995 and it was estimated at $20 million in 2003. The firm has been awarded ISO 9001, ISO 9002, DuPont Lycra Assurance and A.Q.A.P.120 certificates and it has marketing department with 15 salesmen, and the design department is led by a designer from Italy. This signifies functional upgrading of the firm.

The annual investment of *Bozkurt* in the past five years has been in the range $200,000-500,000 which is considered to be low by Turkish standards. The manager explained during the survey interview that the KIPAS Group was among the first to invest heavily in new machines, technology and new buildings at the beginning of the 1990s, when the Turkish textile and apparel industry started to grow significantly. (Assistant General Manager, Karacalý Mehmet, 8 October 2003, interviewed by the author, Istanbul)

[68] For information about the holding group, you may refer to www.kipas.com.tr.

Nowadays, the main investment of the firm is concentrated in new technologies (55 % of total investment) and reconstruction of its factories (25 %), which does not take a lot of financial resources, the manager added. About 70 % of the investments of *Bozkurt* have been made with the help of local bank credits, which the firm did not have a problem attaining, while the rest came from profit reinvestment.

KIPAS built its textile factory in the Asian part of Turkey because of the proximity to raw materials, while its clothing firm, *Bozkurt*, is established in Yenibosna, one of Istanbul's textile districts, in order to benefit from the proximity to other local subcontractors.

During interviews with the management of the company, it became clear that the products of the company are competitive because the focus is on providing the best quality and services to the buyer by learning from partnerships with foreign firms.

In late 1980s, the clothing production of KIPAS was still conducted under full- and semi-subcontracting with foreign partners. This was the time when local manufacturers were learning how to produce with the western quality and standards and offer competitive prices. Afterwards, in the mid-1990s, KIPAS started working on their own. "It is our strategy to vertically close the circle of production, which helps us a lot, when competing for foreign buyers", said the manager. The quality assurance accreditation, received from buyers for which the firm manufactures full-package products, such as Marks & Spencer, Arcadia, Debenhams, Du-Pont, Woolworths, Littlewoods and TSE, proves that the company indeed followed its objectives by achieving organizational upgrading.

When KIPAS bought *Bozkurt*, it inherited strong reputation at the domestic market of a clothing firm with a tradition that goes back to 1954.[69] Some of the most famous buyers nowadays for the firm are GAP, Banana Republic, Mexx, DIM, Lindex, Woolrich and Old Navy, which are all upper-medium customers The company exports 99 % of its products. The foreign buyers from EU and the US take 50 % each from its exports. The Turkish firm managed to learn from its more experienced Western partners, as management confirmed, through the activities of TCMA, which helped with training of the personnel, introduction of new technologies and expertise and encouragement for participation in International Fashion Shows, organized by the ITKIB.

Bozkurt performs subcontracting on an extensive basis with local manufacturers. In fact, around *Bozkurt*, several small local manufacturers gravitate. They take orders from the firm when its production capacity is limited or in case when there are specific operations to be done for small series of production. *Bozkurt* has a group of quality inspectors that supervise the work of the small companies on a daily basis. In this way, confirms the manager, the firm is efficient and is able to produce about 5 million pieces annually, thus making it one of the largest producers in Turkey.

Bozkurt indicates medium dependency (30-60 % share) on its two most important foreign buyers. The firm has a five years experience with its most important buyers, which speaks of certain trust that it built with foreign partners and limited dependency since the major buyers do not take majority of the firm's exports. It may use trade agents to link with new buyers, but it is not dependent on foreign supplies because over 80 % of its supplies come from the domestic market. *Bozkurt* organizes full-package production, which means that it finances its raw material supplies, organizes its own textile and

[69] KIPAS Group bought Bozkurt from Koç Holding A.Ş.

clothing production and the logistics for the export, which is an indicator for process upgrading. Obviously, the firm benefits from the vertical firm strategy of its holding company. However, the firm still counts on brands and designs, provided by the foreign buyers, when it exports, although it has its own marketing and design departments. The firm does not have its own shops but it has its own brand, which is solely for the domestic market. “It is a totally different project to sell our own brand abroad and we need more time and experience in order to start such a project”, admits the manager. He further notes, “If you have your own brand for export, you do not depend on the foreign buyer, but we still have not reached that point”.

The company does not feel the support from the state directly, but it claims that the inflation and the fluctuations of the USD-local currency exchange rate have always had an impact on the export activities of the firm, especially in 2003. However, it is very positive about the role of the state in granting incentives for textile machinery import. The firm manager outlined the positive experience with Turkish T/C BAs with which it had experience with training seminars and participation in fashion shows. The best future strategy for the firm is to establish its own brand abroad. From the interviews, it is clear that the executive management has already realized what important steps need to be taken to transfer from full-package production to OBM. The recent development of fashion fabrics (yarn, woven and denim) by KIPAS group seems to be a strong prerequisite for that.

Case Two: Altinyildiz

This is one of the oldest textile companies in Turkey, which was established in 1952 as fabrics manufacturer and exporter. Four decades later, it became a member of Australian Super Fine Wool Growers and Processors, which represents 400 super fine

wool manufacturers from Australia and the world. This guarantees high standards for the firm, coupled with the ISO 9001 certificate, obtained in 1992, which is a sign of organizational upgrading.

As *Bozkurt*, it is a firm from a holding group, called BOYNAR Holding, which consists of one manufacturer (the firm, which is discussed here), one retail store operation firm (34 shops), second retail store operation firm (20 shops), third retail store operation firm (85 shops in whole Turkey and Turkic Republics), Sales and Marketing firms with offices in the US (New York) and in Germany (Frankfurt). In addition, the holding is represented by 15 agencies worldwide.

In 2003, when the firm was interviewed, the total number of employees of *Altinyildiz* was 1,400 and it has substantially decreased by 20 % from 2000 and by 30 % from the mid-1990s and late 1980s. The reason for the decrease of the number of its own employees is the expansion of the subcontracting work with local companies, located around Istanbul, explained the Director for Subcontracting production, Ismail Morçul. (26 July 2004, interviewed by the author, Istanbul)

The range of activities within the textile industry involves: spinning, weaving, dyeing, finishing. Moreover, it started apparel production (skirts, pants, overcoats, suits, etc.) in 1995, thus becoming a vertically integrated textile and apparel manufacturer with a location in Yenibosna (Istanbul's cluster). The export of the firm in 2003 is distributed as follows: 56 % to Europe, 39 % to North America, 4 % to Far East and 1 % to the Turkish FTZs.

The first impression from the interviews with the firm's export managers and the export director was their strong mission statements and strategy for the future (Pelin

Kolsarýcý and Aydin Yunus, 14-16 October 2003, interviewed by the author, Istanbul). "Flexibility of doing business and establishment of long-term partnership with the customers is what we are after", they said. They also noted that the success as a quality fabrics producer and branded apparel manufacturer, known also abroad, did not come immediately.

In the period 1971-1991, due to the personal contacts of managers of the company, partnerships with Italian firms, like Corsini, Blazin, Zegna, Pancaldi, Lino Banfi were established and, as a result, technical and design know-how obtained. In addition, Altinyildiz signed a technical know-how agreement with the German Kurt Salmon Associates in 1991. New investment in machinery and IT systems was made in mid-1990s and other know-how contracts were signed in 1995 with the textile firm from Group Forall (Italy) and the textile/clothing manufacturer Ermenegildo Zegna (Italy) in 1997, which speaks of process upgrading. The technical management confirmed in a number of interviews that they learnt a lot from their foreign partners, especially when they exchanged visits with experts from Italian apparel firms. This supports GVC scholars' claims that learning from lead firms is an important factor that influences firm upgrading.

Altinyildiz has only performed direct exports, first as fabrics producer and then as apparel exporter. It subcontracts work to more than 20 local manufacturers, with whom the firm built long-term partnership for more than 10 years. "The trust – confirms the assistant director for apparel production - helps a lot in performing quick production operations to respond in time to buyer's demands". Since *Altinyildiz* produces for high quality market, it has opened a whole control unit, which involves a group of quality

control experts that supervise on a daily basis what is produced for *Altinyildiz* by the group of local subcontractors.

The turnover trend of the firm during the 1990s and until 2003 is stable (over $10 million USD) and the dependency from the two most important foreign buyers is medium (30%-60%). The firm does not use trade agents to work with foreign buyers or suppliers because it has its own offices abroad. However, there are cases, when it works with exclusive agents of foreign buyers, such as Ann Taylor.

The annual investment of the firm in the past decade is low (200,000-500,000 USD) but in 2002 it has made a significant investment in new machinery and technology, estimated at about 2 million USD. "We did it because of the high international competition, which requires that we invest in quality production", as underlined by the export manager of the firm.

The firm has mainly used local bank credits in order to finance its investment program and does not find any problem in obtaining long-term investment credits from local banks.

Since the firm produces for high quality, the supply of raw materials (especially wool, silk and linen) is usually imported by *Altinyildiz* but sometimes, the supplier may be pointed out by the foreign buyer, while the cotton supply is organized totally by the firm itself. However, it is *Altinyildiz*, which has the direct contact with the foreign and local suppliers and it is not dependent at all on foreign or local suppliers since the managers of the firm claim "We know the suppliers well and we have many opportunities to purchase abroad and at home". This is relevant for the raw material supplies, whereas over 70 per cent of the textile fabrics for the garment production are supplied from inside production

because *Altinyildiz* fabric is very famous not only in Turkey but also abroad. The rest comes from Turkey too, because, as it was noted in the interviews, "the quality and the price of textile inputs are attractive, and we believe in our local business partnerships" (Altinyildiz Export Director, Aydin Yunus, 27 July 2004, interviewed by the author, Istanbul).

The company started to think long-term how to respond to high competition in the global economy by creating two brands – collections for men and women (FABRICA for young people and NETWORK for higher class customers) at the end of 1990s, thus achieving functional and product upgrading. The success of the brands came suddenly first in Turkey and later on, since 2002, the firm began to export production under its own brand to Europe and the US.

The brand division of the firm involves seven experts and the brand manager has fifteen years of experience in the International Fashion business as a model. (Altinyildiz Brand Manager, Eysan Ozhim, 26 July 2004, interviewed by the author, Istanbul)

The brand manager managed to transform her experience from London, Paris and Milan runways to become the Women's Face of the NETWORK collection, which generated huge success on the local market due to substantial marketing and advertising.[70] Moreover, the brand manager attracted a famous French male model to become the Men's Face of the NETWORK autumn/winter collection and not surprisingly, the firm launched a successful Fashion Show in Istanbul in August 2003. In fact, when the firm began to design its own clothes at the end of 1990s it appointed an Italian designer with a high profile (a former designer of Giorgio Armani). The Turkish designers of *Altinyildiz*

[70] While in Istanbul, the author witnessed every major square in Istanbul having billboard with this brand.

managed to learn a lot from their Italian colleague and after he left in 2003, the design department of the firm transformed all the experience into practice.

"Now, we are thinking of expanding the brand in the West and develop new brand concepts, which would attract the international customer", underlined *Altinyildiz* Brand manager. Moreover, due to the development of international brands, the firm's Marketing and Sales Department, which employs seven people, confirmed that retailing gradually became very important for the firm. "Part of the business is the shops and that is why we try to reach the end customer in Turkey, but also abroad through our own shops" (*Altinyildiz* Merchandizing Manager, 27 July 2004, interviewed by the author, Istanbul). By the end of 2003, the firm had already established three own stores abroad - in Spain, Saudi Arabia and Czech Republic.

Among the main foreign buyers of the firm in focus we recognize US buyers, like Ann Taylor, Loft and Soft, May Department, Nordstrom, Casual Corner, Ralph Lauren, Banana Republic and EU buyers, like Crombie (UK) and Rilaschente (Italy), etc. These are quality customers in the upper-medium range. "We want to continue to grow in exports, but also we have potential to grow in terms of quality customer's niches", confirmed the export manager of the firm.

The top management of *Altinyildiz* foresees the interventionist role of the state as minimal because "the private initiatives have to be leading", as one of the managers noted. However, the management noted that the state support is inevitable in raising international competitiveness of the Turkish T/C industry by exchange rate policy and settlement of the working conditions, incentives for textile machinery imports and the establishment of industrial districts. The firm was very positive about the support received

from local branch associations in the T/C field. In fact, *Altinyildiz* is a member of the TCMA and TTEA and has benefited a lot from the activities of these branch associations. For instance, it has received training for the personnel and expert visits, but also took part in International Trade Fairs. Lobby at the international level and promotion of "Made in Turkey" by the branch associations, ITKIB and the state is seen as the most valuable asset by the Brand manager and the Export manager of *Altinyildiz*.

Case three: Sezer Tekstil

This is a medium sized manufacturing company, producing jackets and coats. It is 100 % privately and owned by a Turkish businessmen. The firm started business in 1988 and at the beginning it had five employees, which progressively increased to 200 in 1995 and 280 in 2002. The minimum salary within the firm is $300 and the annual turnover of the company constantly grew in order to reach an impressive $10.5 million in 2002. The firm has only one production unit, which is based in the Yenibosna textile district of Istanbul and the owner noted that it is strategically located there because there are many manufacturers around to whom *Sezer Tekstil* (henceforth called *Sezer*) can subcontract to as needed (*Sezer's* owner, Halil Sezer, 18 October 2003, interviewed by the author, Istanbul). The company works permanently with 10 local subcontractors, some of them are very small (up to 10 workers), while others are larger (up to 100 workers). Thus, *Sezer* is more flexible on the market. However, for some big buyers, like Marco Polo, the local firm cannot use subcontractors because the foreign buyer requires highly qualitative production, thus a strong control of production is necessary, which could be performed only in-house.

The firm has invested about 5 million USD since 1990 in acquiring new factory building in Istanbul and new French CAD and CAM system and German JUKY sewing

and cutting equipment. The firm has obtained local credit to finance its long-term investment, thus achieving product and process upgrading.

Sezer is export-oriented since the firm has always exported about 80 % of its production and there are several markets that equally take about 20 % share of its export, namely Germany, Italy, Spain, UK and Holland. It used to do subcontracting work for foreign buyers between 1990 and 2000. This was necessary because they needed to learn about the market and the prices, strategies of big buyers, and customer needs. However, *Sezer* recognized the need for developing its own brand in 1995. But it was not until 2001, when the firm managed to start its full-package production and use its own brand, thus gaining functional upgrading. The firm waited for so long because "The most difficult in this business is to win the trust of a foreign buyer, who could secure a good market for your products," clarified the owner. Moreover, *Sezer* also invested in attracting Italian designer for its clothing collections in 2002, thus taking a further step in upgrading by offering its own designs.

The dependence of *Sezer* upon its two main buyers is very low (<30 % of total exports). But, the firm relies on trade agents to find new buyers. "We cannot do without the agents," explains the owner, "because we are a medium sized firm and we can hardly enter into direct negotiation with big buyers". The reason for the difficulty which *Sezer* finds in attracting new buyers is also the strategy of the firm to target upper-middle customers, the hardest to reach.

Sezer is not dependent on foreign supplies since about 70 % of total textile input come from the domestic market and what is more important, the firm organizes the supply of its own raw materials. "We have many alternatives for supply of textile input," explained the

owner. This is also obvious from the fact that the share of the firm's two most important suppliers is less than 30 % of total supplies. The firm finances not only its textile input, but also offers its own designs and organizes the logistics. There is also a built trust between *Sezer* and its suppliers since they work together for over 10 years and there is no intermediary agent between them.

When asked about the support of state authorities for the export activities of the firm, the owner responded that the state is in favor of large enterprises and he does not expect anything different from the state except to provide good macroeconomic climate for Turkey (i.e. stable exchange rates, low inflation). However, when asked about the role of branch associations, Mr. Sezer was explicit about their role because he also took an active part in the discussions for the future of the textile industry in Turkey, organized by TCMA. The owner explained that his company directly benefited from employees training and participation in trade shows and fairs (in USA and Russia), organized by ITKIB. Thus, obviously, he did not know that actually majority of the finances of ITKIB are sponsored by the state. Moreover, he clarified ITKIB's policy to encourage Turkish manufacturers to undertake their own designs and brands had an impact on him as well, which is another reason to clarify that the state support is not missing. TCMA policy, Mr. Sezer explained, is similar to ITKIB, but they focus more on building visions, benchmarking and bringing local businessmen together, which are important for the industry as a whole. The firm plans to move to the Russian market with its own design and branded product. Moreover, Mr. Sezer, has recently appointed his representative to offer *Sezer* products on the Russian market, which, as the owner proclaims, has strong potential in the future.

Conclusion

This chapter presented industrial and firm upgrading for the case of Turkey between 1983 and 2003. Starting from low levels in 1983, the up-market exports progressively increased during the 1990s and make up 42 % of value added in 2003. The middle-market exports gained pace in 1988 and kept stable level until 2003 (24 %), whereas the down-market exports to the EU market decreased substantially. In 1983, the value added of down-market goods was 76 %, while in 2003 they take 34 % of total value added of Turkish T/C exports.

The signs of industrial upgrading, and especially low levels of dependency of the Turkish firms have also been confirmed at the networks and firm level. A major feature of the Turkish clothing and textile firms is their focus on direct exports, which yield high value added for the local economy. The author's survey found that the Turkish T/C industry is not dependent on the imports of raw material supplies and the availability of marketing and design departments in majority of the Turkish firms suggest wide spread use of marketing strategies and ability of local textile and clothing firms to offer their own designs. Moreover, large proportion of the Turkish firms has already realized the necessity to create their own brands, which is widely promoted by local BAs. Turkish firms try to establish their brands in the local, but also in the international market. It is found that some Turkish firms already practice retailing by reaching the end-customers through their own or licensed shops, based at home and abroad. This is a feature of T/C firms from developed economies, which shows certain form of functional upgrading of Turkish firms.

The investments in the sector in machinery and new technologies are predominantly medium and high and they come primarily from Turkish entrepreneurs. Majority of the

large Turkish exporters are either ISO certified or have buyer's audits, which is a guarantee for the quality of production, management and delivery times. The majority of the firms have medium or lower dependence from the two most important buyers. The concentration in the top export market is usually high, which is not a substantial bottleneck for the local firms. The majority of the local trade agents in Turkey does not perform standard operation – working as intermediaries between local and foreign entrepreneurs - but rather focus on providing services (organizing production, offering brands, designs, marketing strategies and logistics). Moreover, some trade companies operate as mega companies, by exporting products of 200 or more local firms, thus reaching better negotiation deals for local firms from foreign or local suppliers and foreign buyers. This helps to increase the competitiveness of local firms that target cheap markets. Still, other trade agents operate as exclusive representatives of big firms (e.g. GAP and Li & Fung). Large percentage of the textile firms are in the range of prospective exporters, while majority of the clothing firms fall in the range of medium value added companies. The linkage between local textile and local clothing companies is strong and the role of foreign firms and trade agents as contractors for subcontracting work is very limited. Moreover, the analysis of three firm case studies in this chapter reveals that the power in the value chain, organized by lead firms, is not in the hands of foreign buyers. The three firm studies have shown low levels of dependency and high levels of upgrading, despite the increased global competition in textile and clothing trade as a result of the expectation for the lifting of trade barriers on 1 January 2005.

Chapter V. Bulgarian Textile and Apparel Industry

Introduction

"Bulgaria's textile and apparel industry is at the beginning of the developmental cycle at the threshold of the 21st century" (NEII 2001: 57). This is the conclusion of a report, prepared by international consultants that evaluated the opportunities for investment in the country. The Bulgarian T/C industry has been brought back to where it was 100 years ago. The difference is that a century ago, the Bulgarian government was more attentive to the needs of the development of the industry. The reasons are explored in this chapter. The *first section* emphasizes the role of the T/C industry and state policy during socialism and the early stages of the transition to a market economy. The *second section* explains development of the industry and state policy after 1995 by focusing on general and specific measures the state took to develop the industry. The *third section* introduces the functions and activities of the major branch associations in the Turkish T/C industry, while the *fourth section* examines the informal nature of the sector and labor issues which induced international competitiveness of the domestic T/C industry. The conclusion summarizes the major findings.

5.1 Initial conditions

The development of modern T/C industry in Bulgaria began in the late XIX century with the issue of the incentive law for the local industry (State Gazette, No.22, 28 January 1895).[71] The law addressed several industries, among which was the yarn, fabric, and knitting industry (art.2a). This protectionist law gave an initial push to the development

[71] The Bulgarian textile production began in 1836, when Dobri Zhelyazkov opened a factory in Sliven (Southwest Bulgaria) with a contract for three years, obtained from the Sultan to produce fabrics for the uniforms of the Ottoman soldiers. This historical fact has transformed the Sliven region in one of the most important textile regions in Bulgaria.

of the infant Bulgarian textile industry one century after the beginning of the first industrial revolution in Europe. When the protectionist law was introduced, the Bulgarian factories (not only, but predominantly textile) were 130 of which 70 were large. Two decades later (in 1940), the number of Bulgarian textile factories increased fivefold to reach 349 of which 169 were state-owned (Textile Industry journal, October 1994: 15)

Capitalist production in Bulgaria ended on 23 December 1947 when all private enterprises were nationalized. The role of the state in the economic, political and social life dramatically changed. In 1951, the Ministry of Light Industry was created and one of its responsibilities was to oversee the textile industry.[72] Then, for a period of 12 years, several Ministerial institutions and committees, which dealt with the whole textile industry were created, dismantled, and re-created again. The management of the industry was even decentralized to the regional level during the period between 1960 and 1963. All these experiments postponed the development of the textile industry, claimed by Zlatanov (1984: 256) and Damyanov, G. and Kisyova, S. (1982).

Heavy industry was priority for the socialist government and the first two decades of socialist government rule created a full-cycle of chemical production which served as main supplier of artificial fibers for domestic textile factories (polyamide fibres and silk, polyester fibres and silk, polyacrilenitrile fibres, viscose fibres and silk). This also instigated the development of ten subsectors of the Bulgarian textile industry (two for primary manufacturing of cotton, linen and hemp, two for the cotton industry, two for the wool industry, one for the linen and hemp industry, two for the silk industry and one for the knitting production). (Shapkarev and Lyubikov 1980: 273-281)

[72] Regulation No.480 from 20.IX.1951, issued by the national assembly periodical, vol.76 from 21.IX.1951.

Vertical integration of local textile production started sometime in the 1950s, when the textile *combinati*[73] were created (Tzochev and Georgiev 1961; Damyanov and Kisyova 1982: 105-109).[74] By 1980, the integration had been fully completed with the following structure: 127 textile and knitting firms with 127,530 employees (1000+ per firm on average) and 46 clothing companies with 64,448 employees (1400+ per firm on average) (Annual Statistical Bulletin 1990: 141-143). The reason for the vertical integration of the Bulgarian state T/C enterprises was the Fordist method of mass production, which spread among economies during the 1960s and 1970s.[75]

The large state-owned enterprise base in Bulgaria, especially in the clothing sector, is strikingly different in the 1980s compared to Turkey, where large majority of the clothing firms were *ateliers* (9-10 workers).

This industrial structure, however, came as a result of the increased demand for exports to the COMECON market in the form of exports of textile yarn, fabrics and ready-made garments in massive quantities. Bulgaria exported textile and apparel goods to the socialist economies (Soviet Union being the most important trade partner) between

[73] "Combinati" were called the textile firms in the socialist period, which integrated 3-5 proximate, formerly private owned, but nationalized textile companies into one factory.

[74] First outcomes and methods of integration of state textile enterprises were reported in early 1960s. The private wool textile factory Andonov-Mihailov AD was one of the first that has been nationalized to receive the name State Industrial Enterprise "Georgi Dimitrov". It was enlarged with other four smaller textile factories in the town of Sliven in 1953 to become the largest wool textile conglomerate in the country. In the apparel sector, there was conglomeration too. Clothing Factory Vitosha in Sofia (one of the biggest in the country in the 1980s) has started from a small factory in 1947 with 15 employees, which was enlarged for the first time in 1962 with other small production units. New buildings were constructed in 1969. The clothing factory has produced men suits and shirts, women overcoats, men and women jackets, women trousers, etc. The factory started to use western designs from 1982. The major markets in the 1980s have been USSR, France, Federal Republic of Germany and Austria.

[75] Vertical integration of the textile firms was found beneficial already in 1850, when Italian textile firms from Prato started to integrate spinning, weaving, dyeing, printing and finishing process into one industrial enterprise (Museo di Tessuto, Prato). As far as the clothing firms are concerned, vertical integration was also seen as beneficial before 1980 because it improves planning and efficiency. However, it was not any more the case since early 1980s when the post-Fordist flexibilization of production emerged as industrial paradigm. Ch. Sables and M. Piore, 1984 first published articles about this phenomenon, observed in Italy, called the Third Italy model, which described an integration of apparel factories that specialize in certain production functions to reach higher efficiency.

70 % and 75 % on annual average, while the economies from the European Economic Community took 8 %-15 % in the 1970s and 1980s (Annual Statistical Bulletin 1990: 318). In 1980, one of the most exported commodities from Bulgaria was cotton fabrics (35 million meters) and the main markets were Yugoslavia with 21 % and the USSR with 16 %. The main capitalist markets for the same commodity were Switzerland with 5.8 % and the Federal Republic of Germany (FRG) with 3.2 %. In 1980, the cotton and wool clothing products were also among the most exported commodities to the USSR (71 % of total exports) and to the FRG (7.2 %).[76]

In 1980, Bulgaria was a developed industrial economy of which total industrial exports stood at 92.7 %, while agriculture exports took only 4 % of total exports. Bulgaria was a net exporter of textile and apparel products to the world with a modest share of 3.3 % of total exports (in value), making it the sixth largest BG export. The three leading export sectors of the economy were the machine building, electro techniques and electronics (44 % export share), the chemical and rubber sector (8.2 %) and the agro-food industry (19.3 %) (Annual Statistical Bulletin 1990: 313).

Despite the low contribution of the T/C industry to the GDP, in 1982, the Bulgarian T/C sector, due to its labor-intensive character, employed 14.2 % of the total industrial workers. In the same year, the number of enterprises represented about 30 % of the enterprises within the industrial sector, and accounted for more than 500 workers (1990: 141). Only the machine building, the electro techniques and the electronics sector outpaced the textile and apparel sector, representing 27 % of employment in the industrial sector (1990: 143). The salaries in the textile and apparel industries in the 1970s and the

[76] During the socialist period a priority was given for trade within the COMECON market, which is explicit with the way the firms called the markets - first (socialist economies) and second (capitalist economies) direction.

1980s were the lowest in the industrial sector. Annual gross labor wages stood at 1,004 USD for the textile and 986 USD annual gross labor wages for the clothing sector in 1980. Therefore, work in the textile and clothing sector was not desirable; only the leather and footwear sector has registered lower annual labor wages of 976 USD in 1980.

Bulgaria did not specialize in the textile and apparel production activity, clearly observed in comparisons with specialization coefficients for other economies from the socialist camp. For instance, according to own calculations from the Annual Statistical Bulletin (1977: 59-61) in the period between 1961 and 1975, in terms of annual output growth in the textile and apparel sector compared to the total annual industrial output growth, Bulgaria was worse off than Hungary, GDR, Poland, USSR, Czechoslovakia, Romania, Cuba and the People's Republic of Mongolia.[77]

Between 1960 and 1986, Czechoslovakia, Poland, Hungary and GDR also beat Bulgaria in terms of exports of clothing and knitting (Annual Statistical Bulletin 1988: 100-404). However, by the mid-1980s, the value of Bulgarian clothing and knitting exports increased by 470 % and 2,200%, respectively, compared to its exports in 1960. This is because a comprehensive modernization program, introduced in mid-1970s, brought new machinery and equipment to Bulgaria, imported from Poland, the GDR and West Germany (1999). Moreover, during the period between 1962 and 1981 (predominantly after 1975), Bulgaria purchased around 160 license agreements, which were introducedin the technological production of Bulgarian T/C firms.

Bulgaria has also been exporter of licenses among which was the license for production of yarns under the method "PRENOMIT". The "PRENOMIT" machine has been developed by the Bulgarian textile engineer Georgi Mitov and the license has been

[77] Romania is the ultimate leader for this period.

sold to Gemil & Dunsmor UK in 1974 and then to Federal Republic of Germany in 1979 to Saurer-Alma. Already in 1983, there were 50 countries which used the "PRENOMIT" machine for production of effective yarns.

In late 1970s, other investments were made in environmentally friendly technology in some Bulgarian factories, such as the world famous "Prato" and new "Clean Star" technologies of the foreign firm Temafa. In these terms, Bulgarian firms followed western trends of production activities (Georgi Genev 1980: 435).

As a result of increased investments, by 1981, 58 % of the textile machines were under ten years old, 28 % of the machines were 10 to 20 years old and 19 % were more than 20 years old. Therefore, about 3/5 of the textile machinery equipment in the Bulgarian factories were renovated in early 1980s.

The state investments continued into the 1980s, as seen from the next table.

Table 15 State capital investments in Bulgaria (1977-1988) in 000 USD

Periods	1977-1980	1981-1984	1985-1988
	1	2	3
Total investment for the Bulgarian industrial sector	5 360 232	6 960 000	9 325 905
Textile	143 761	153 090	232 828
Apparel	13 405	30 260	61 671
Total investment in TA	157 166	183 350	294 499
Trend	100	114	147
Share of TA investment (I) as % of total investment	2.93 %	2.63 %	3.16 %

***Source**:* Author's calculations, "Centralno statistichesko upravlenie"(Central Statistical Unit), 1990, National Statistical Institute, pp. 178-183; *the investments include: building works, machinery and instruments, scientific research, other expenditure. Official exchange rate of the Bulgarian People's Bank – 2 Bulgarian leva=1 USD.

In the period 1981-1984 (2nd column), Bulgaria invested 153 million USD in the textile sector, which is 6 % increase over the preceding period, while in the final period (3rd column) investments continued to increase by 34 %, compared to the preceding period. The apparel sector saw a 56 % increase in investment during the second period

and added a spectacular 50 % in the final period. Apart from enlarging the production facilities, the clothing sector imported 277,980 sewing machines during the period 1980-1988 (95 % imported from Poland and USSR), according to the Annual Statistical Bulletin (1990: 340). As far as the textile sector is concerned, the last renewal before socialism collapsed (1986-1988) reports import of textile machinery at the amount of $138.1 million. According to the Annual Statistical Bulletin (1989: 27-33) about 25 % from the value of this import had been from Western countries (FRG, Switzerland, Italy, France and Japan).

The New Economic Mechanism (NEM) initiated in 1980 lies behind the investment boom in the 1980s. The goals of NEM included updating the technical infrastructure of the Bulgarian industry to improve the quality, to increase the Bulgarian exports to the West, and to raise hard-currency income (Shalom Krispin 1980: 58). NEM also involved regulatory measures by the government to help local firms link with Western firms in order to increase exports to the West. For instance, a JV law (Decree 535) aimed at attracting technology and investment, was promulgated in 1980.

NEM, however, was not as benevolent for the T/C industry, as it was for other industries in terms of investment. As Table 15 (previous page) shows, state investment in the T/C industry stood at a small share of 2.9 % (on average) from total industrial investment in the period 1977-1988. The statistical report also confirms that the T/C industry obtained a much smaller amount of investment compared to other industrial sectors. In terms of state capital investment, out of 16 industries, T/C took 10th position in the period 1981-1985 and reached only 9th position in the coming 1986-1989 period. The biggest state investments were in the priority sectors: machine building and metal

manufacturing sector (23 %), energy sector (17 %) and the chemical and petrol industry (9.7 %) in the period 1981-1985, while in the second period (1986-1989), the sectors that most benefited from investment were energy (19.6 %), machine building and metal manufacturing (19.5 %), electro techniques and electronics (11.3 %), and the chemical and petrol (10.7%).

As already discussed, despite the low capital investments in the T/C industry compared to other sectors, the investments managed to renew large parts of the technological infrastructure.

The NEM policy was very powerful in generating some other very important conditions for the development of the Bulgarian T/C industry. In 1989, one public official from the Ministry of Light Industry outlined the new boundaries concerning planning and operation of NEM (Donkov 1980: 195-197). The main feature of this new economic approach was the possibility to plan from the bottom up. More specifically, NEM gave the state enterprise management the right to change or ask for change of the planned compulsory norms for production, in case there is an offsetting development during the course of the work. The whole production and financial plan, according to NEM, had to be prepared by the state enterprise management. This involved planning for output quantity, maintenance of the machinery, salaries, labor productivity, capital investments, turnover tax, and turnover speed of circulation (Donkov 1980: 4-5). Therefore, through NEM, the enterprises received more freedom from the central and state branch power to apply investment policy and organize the functioning of the enterprises.

In early 1980s, the state enterprise management also received the right to negotiate for the supply of inputs and placement of the ready-made products. Moreover, NEM,

according to the deputy minister of the Ministry of Light Industry, instigated the development of a socialist economy in which every entity had its own responsibility for the decisions made (Vassileva 1980: 195-197).

This led to more freedom and more possibilities for local state enterprises to learn how markets operate by entering into direct partnerships with foreign and local suppliers, negotiations for price and quantities were made by the firms' managers; marketing and promotion; and organization of the production process were led by the enterprise specialists, who knew the needs of the firm better than the state.

There was indeed a foundation which needed to be improved upon. In late 1970s, Bulgarian clothing companies had secured the USSR market within COMECON. But, this was a market for mass production and there was no need to differentiate products. The design of the clothes and the colors were significantly different from Western Europe.[78] Therefore, the Bulgarian firms that could not meet the quality standards of the European market worked under subcontracting partnership with Western firms, which proved to be a good strategy to learn about Western markets.

This strategy began to bear fruit. In 1981, several local firms increased their number of available designs. For instance, one firm from the small town of Dupnitza prepared 40 new designs for the domestic market, 21 for USSR market and 40 for Western Europe (Paris, Basel, Cologne, and Vienna). Additional 250 models were prepared for the following firms – Weil (France), Nadya (Italy), and Yutex (Canada)(Textile industry journal 1981: 467-469).

[78] Damyanov (1980: 101) and Shalom Krispin (1980: 58) found that the main problems why quality and designs of Bulgarian knitting and apparel articles are dissatisfactory is because there is no research on customer demand. In addition, Marin Karaboikov (1980: 83-84) reported of problems in presentation of textile and apparel articles, advertisements and information materials abroad.

Another factory, Georgi Genev, reported in 1982, that they were ready to open a new production unit for underwear and the main customer would be the popular "Irma Ladus" from FRG. Moreover, solid partnerships had been established with foreign clients from FRG, Sweden, Norway, and Finland (Tomov 1981: 229). The "Marek" factory in Central West Bulgaria introduced technologies from FRG, Italy and France in order to increase labor productivity, while Lilyana Dimitrova, an apparel factory, installed new machinery and technologies from FRG (Pfaff, Trofix, Franz Muller) and Italy (Monti).

Bakalova and Yurukova (1983: 63) reported that in the apparel sector, the cooperation between Bulgarian and Western European firms continued to develop. In 1983, Bulgarian SOEs purchased several license agreements with Adolf Ahlers, Triumpf, Lincron for production of jeans, men's shirts, men's trousers. In addition, the authors report that due to the successful cooperation of Bulgarian with French firms, like Biderman and Weil, there was a marked increase in product quality by 1983. In the field of design of collections, Bulgarian apparel firms reached a cooperation agreement with the French firm Pierre Cardin and the Italian firm Miriame Grassi (1983: 64). Another large success came in 1984 at the annual International Textile Fair in Plovdiv. SIA RILA (a professional association for the clothing branch) presented 2,700 design models, representing a 96 % increase in new designs to the collection from the previous year. SIA RUEN (another professional association) for the knitting sector, showed at the Fair 80% renewal of its collections (Topalov 1984: 52).

Bulgarian apparel firms during the 1980s worked with the Western German "Laurel" and with the Italian "Mondi" (brands, such as Mondi, Bruestle, Braun, Chris, Patrizia S), which were among the best clothing manufacturers at that time. Moreover, Bulgarian

designers started to visit and train at international fashion houses in Paris, Milano and London to learn from their colleagues and transfer that knowledge to the Bulgarian apparel firms. Managers of Bulgarian textile and apparel firms began regular visits to international textile fairs, while in Bulgaria, the annual International Textile Fair in Plovdiv became world famous by the end of the decade.[79]

As a result of the state investment policy, which not only renewed, but also expanded some of the production facilities, the output value in the clothing sector grew by 24 % between 1982 and 1988 , while a mere of 11 % output value growth was registered in the textile and knitting sector. As a whole, however, the value of T/C production as percentage share of total industrial production decreased from 8.2 % to 7.6 %, due to the dominance of the heavy industrial production (Annual Statistical Bulletin 1989: 129).

The Bulgarian T/C industry accounted for 3 % of total exports in the 1980s (based on the annual averages). The EC market accounted for 15 % of the total T/C export, while the Soviet Union market accounted for 75 % (Eurostat, Comext, Foreign Trade of Bulgaria 1989).

If the 1980s could be characterized by fairly equal development of the T/C industry as the economy was under state's rule, the situation changed dramatically in the post-1989 period.[80]

> "1989 came suddenly and surprised the domestic textile industry with the loss of the Soviet Union market. After 1990, most of the SOEs were left without a network of shops because the restitution policy returned many of them to private owners… Although, Bulgaria had experience with the Western European market for years, the export of massive Bulgarian goods to EU countries was troublesome because of limited confidence which this created for Western buyers. That is why subcontracting work with foreign partners was the most suitable form of partnership after 1990. This gave opportunity for the local firms to learn about quality and delivery, but the poor domestic enterprises had limited turnover resources to further develop as they had to pay high interest rates for credits to the local banks". (Vlachov, K., 1994 : 33-34))

[79] These observations came out from interviews by the author with former director of the National Design Center and former managers of SOEs in the 1980s.
[80] The socialist political regime in Bulgaria fell on 10 November 1989.

5.2 State policy in the post-1995

During a period of macroeconomic instability and political turmoil in the early 1990s, the textile and apparel industry managed to become leading export sector of the economy by the mid-1990s, accounting for 15 % of total exports.

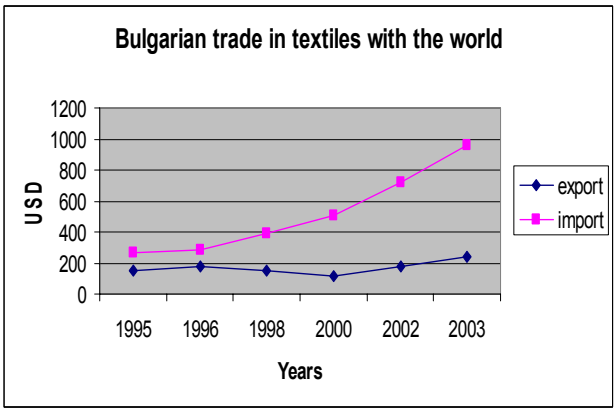
In the 1990s, the Bulgarian government tried to privatize state-owned textile and clothing factories and attempted to encourage private investment from local and foreign entrepreneurs. Both initiatives, though, failed. Moreover, the Bulgarian state progressively withdrew from the sector. By 2003, the state neither owned nor managed any textile or apparel factories. The state did not have a chance to oversee the industry, as it faced difficulties in obtaining information about the domestic T/C industry because firms did not provide specific and accurate data to the National Statistical Institute. In an interview, a textile expert commented "For the state, the sector is in foreign hands and should not be taken care of" (Nikolov Petar, 14 April 2003, interviewed by the author, Sofia). That is the reason why one does not see microeconomic data reports about the development of the T/C firms and their investments conducted by the National Statistical Institute or the Ministry of Economy during this period. The following is an assessment of the influence of general and specific policies that influenced development of the domestic T/C industry.

5.2.1 Integration into world markets

By 1994, there was already a discussion among experts in the Ministry of Economy and managers of enterprises about the "heavy burden" which subcontracting with foreign firms created for the local textile and apparel industry (Vlahov Konstantin, BAKI General Secretary, interview 1995:34). A year later, in an official meeting of textile experts, managers and public officials from the Ministry of Economy, the director of

BAKI, Stefko Kolev, stated the following: "If the state does not help, we might witness all of Bulgaria operating only as an international subcontractor within a few years". In fact, that prediction did not prove wrong when a few years later, over 70 % of domestic T/C firms were engaged in international subcontracting which hindered links between Bulgarian firms and made it difficult for them to embark on firm upgrading.[81] This came about for a variety of reasons. Local textile firms deteriorated because foreign buyers did not use local textile supplies because of international subcontracting, which required that the textile materials be imported from the EU. Thus, the link between local apparel firms and local textile firms was severed in the early 1990s. Local apparel firms also suffered from international subcontracting because these partnerships created limited possibilities for firm upgrading, as foreign buyers required only assembly operations from local firms. Finally, assembly work brings only a small profit for local firms and international subcontracting does not permit local firms to reinvest in upgrading. As a result of the increased interest of foreign firms to outsource production to Eastern Europe, between 1995 and 2003, Bulgaria became a net textile trade importer and a net clothing exporter.

Fig. 13



Source: UN, Comtrade (1995-2003)

Fig.14

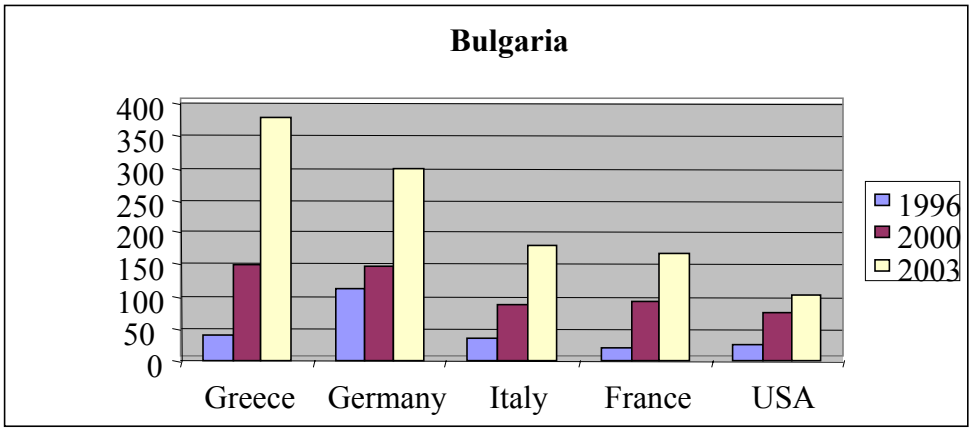
Source: UN, Comtrade (1995-2003)

[81] Experts from the industry claim that 90 % share of total Bulgarian apparel exports are in the form of subcontracting in 2003 (Bulgarian Apparel Strategy, December 2004)

After 1995, a positive correlation emerges between rising imports of textile goods and increasing exports of clothing goods. This is a result of the international subcontracting, which involves import of intermediary textile materials and export of the assembled product. Another observation is the poor performance of the Bulgarian textile exports in comparison with the textile imports, although most of the local textile enterprises focused on exports because they have lost the local market, substituted with textile imports from abroad. Therefore, we might conclude that the trade structure of the Bulgarian T/C sector in the research period differs dramatically from the trade structure in the period 1980-1988 in two main aspects: clothing exports have increased substantially and textile imports have increased substantially.

The Bulgarian T/C industry had been transformed into the leading export sector of the economy. In mid-1990s it accounted for 15 % of export earnings, while by 2003 rose to 23 %.[82] The main export markets of the sector are the EU countries.

Fig.15 Top Five Clothing Markets (in m. USD)



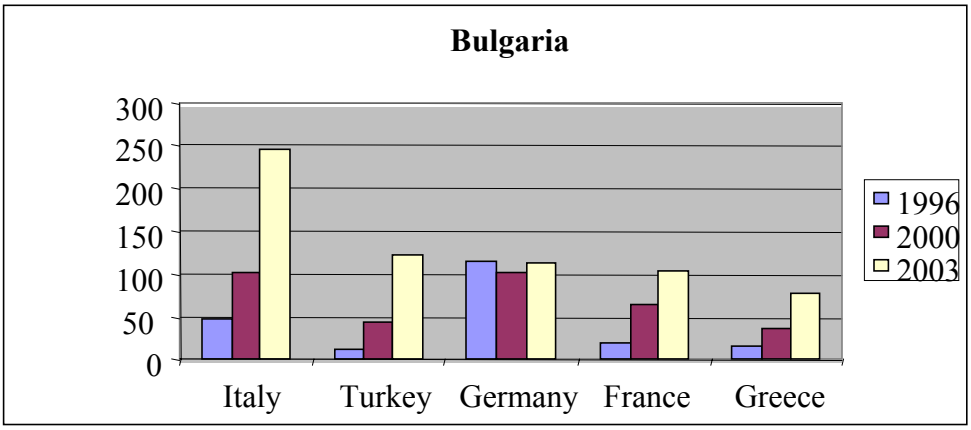
Source: UN, Comtrade, 1996-2003

[82] In 1996, the Bulgarian clothing exports registered 18 % of total export earnings, thus becoming the main export commodity to OECD economies (UN, Comtrade database source, quoted in EBRD Transition Report 1999, Table 9. 1. 1: 179).

The top five export markets of clothing products from Bulgaria identified in the figure above, account for 82 % of total clothing exports in 1996, 78 % of total exports in 2000 and 73 % of total exports in 2003. This speaks to a very high concentration not only on regional level (EU), but also to a very high dependency on buyers from particular countries. Exports increased substantially to all these markets throughout the selected years. However, in the case of Greece, the increase of clothing exports has been spectacular – a ten-fold increase from 1996 to 2003 – replacing Germany as the most important export market.

Bulgaria's top five textile importers account for 75 % of total textile imports in 1996, 68 % of total imports in 2000 and 70 % of total imports in 2003. Italy is Bulgaria's largest textile importer between 1996 and 2003.

Fig.16 Top Five Textile Importers (in m. USD)



Source: UN, Comtrade, 1996-2003

The position of Italy as top textile importer does not necessarily mean that Italian entrepreneurs have registered substantially high interest in the Bulgarian market. The situation is rather different. UK, German or French firm order the fabrics or yarns from an Italian company, which directly supplies the product to the Bulgarian outsource manufacturer (thus, Italy is registered as the importer). The fabric carries the label "Made

in EU", which satisfies the EC's OPT regulation for temporary export. Afterwards, when the Bulgarian firm performs the assembly operation, the final product is re-imported to the EU (the foreign buyer directs the export to a particular destination in the EU).

All major textile importers for Bulgaria have kept a progressively increasing share of textile imports, while Germany kept stable levels. Furthermore, the major textile importers (excluding Turkey) are at the same time among the top five clothing exporters of Bulgaria. Thus, one might assume that international subcontracting has played a major role in the Bulgarian T/C industry because the French or Italian outsource contractor is inclined to use French or Italian textile intermediary goods for assembly operation in Bulgaria.

5.2.2 Exchange rate regime

After 1997, Bulgaria achieved macroeconomic stability due to the Currency Board Arrangement (CBA). However, the CBA constrained the export potential of the T/C industry because between 1998 and 2003, the average annual inflation was higher than the average EU level. Bulgaria's annual average inflation rate is estimated at 6 %, while EU's annual average inflation rate was 1 % between 1997 and 2003 (NSI, ECB). This would mean that the local currency has been depreciated, while at the same time the currency rate was hold artificially (because of the CBA), which decreased the competitiveness of the Bulgarian T/C industry, as the major market is that of the EU.[83] Traditionally, this would mean that the local currency has depreciated, but because of the CBA, the exchange rate did not reflect this depreciation. This decreased the competitiveness of Bulgarian goods in their major market, the EU. Therefore, the local

[83] The national currency was pegged to the DM and later on to the euro, which additionally exacerbated the competitiveness of Bulgarian textile and apparel exports to the European Union market.

firms had to keep export prices low, despite of the increasing prime cost in order to retain their EU buyers.

The CBA and the restrictive macroeconomic policy discouraged private banks to grant loans, especially to SMEs (Bliznashki Valeri, clothing firm manager, 20 March 2003, interviewed by the author, Sofia). The Director of the Branch association of the Knitting Industry (BAKI) confirmed also that only short-term loans for operational turnover were given by private banks and long-term loans were missing from the bank loan's market when the target is SMEs (Kolev Stefko, 11 May 2003, interviewed by the author, Sofia). This came as substantial burden for the T/C industry since SMEs represent above 90 % of all firms in the Bulgarian T/C industry.

5.2.3 Trade liberalization with EU

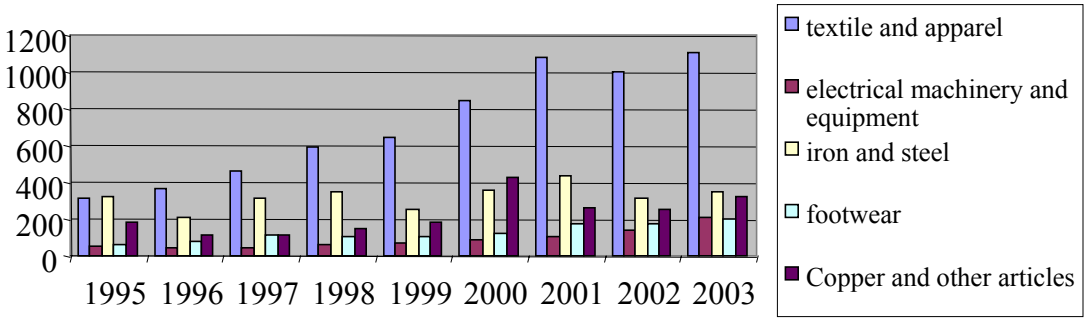
The European Agreement of Association with the EU came into force on 1 February 1995 (State Gazette, N:58 1995). However, the EU lifted the customs duty and quota restrictions for textile and apparel exports from Bulgaria only in January 1998. It was not until two years after that, in January 2000, that the EU lifted another important restriction on Bulgarian producers – the obligation for analysis and testing of every fabric that is temporarily imported from the EU for subcontracting production. Although trade with Bulgaria was liberalized in mid-1990s, the EU continued to protect its manufacturers of textile and clothing until 2000.

Non-tariff barriers to entry to the EU market still exist, since Bulgarian manufacturers can only export to the EU only if they have EUR 1 CERTIFICATE which verifies the Bulgarian origin of the product and respectively all the duty-free quota-free preferences when entering the EU market. Until Bulgaria enters the EU as member, the EUR 1 is

required to be obtained by Bulgarian T/C exporters. In addition, the basic EU regulations and directives in the textile field, as it is in the case of Turkey, were adopted by Bulgaria as part of its preparation to join the EU and adhere to the *acquis communaitaire.* Additional EU measures relating to anti-dumping, protection and levelling measures were also introduced into Bulgarian legislation. These steps have created substantial entry barriers for many textile and especially clothing domestic producers who are far from meeting the new EU standards.

Regardless of these barriers, trade liberalization with the EU has created an upward trend of T/C exports vis-à-vis exports from other sectors of the Bulgarian economy.

Fig.17 Sectoral share of Bulgarian exports to the EU market (in EUR)



Source: Eurostat (1995-2003), author's calculations (the five sectors represent between 50 % and 60 % of total EU exports, on annual average).

An examination of Bulgarian exports to the EU reveals that the textile and apparel sector has been the leading exporter between 1995 and 2003. In fact, the industry has sustained a positive trend (except for 2002) throughout the entire research period and the next largest exporters have been resource-intensive industries, such as the iron and steel industry, followed by the copper industry. Electrical machinery and equipment is one of the more progressive sectors, but its share is only 5.6 % of total exports to the EU in 2003. Another labour-intensive industry, the footwear industry, is also among the major EU exporters from Bulgaria, taking 5.4 % of total EU exports in 2003.

5.2.4 Foreign Direct Investment

Bulgaria began to attract FDI after the moratorium on foreign payment was removed and the state became a member of IMF and started to service its debts (after 1992). But, most (about 80%) of the FDI in the textile and apparel sector was generated after 1998. The major reason for this is the political and macroeconomic stabilization of the economy and the new Law on Foreign Investments,[84] which was passed in 1997 and decreased the barriers for foreign investment in adherence with international standards by equalizing foreign and domestic investment and promulgating 1st, 2nd and 3rd class investors (above €36 million, €20-35 million and €5-20 million, respectively). For all investment classes, central and local authorities provide administrative services which are 1/3 shorter than normal ones. The 3rd class investors receive also information services by the Foreign Investment Agency, InvestBulgaria, such as: economic analysis, sectoral studies, possibilities for partnership and economic advices. For the 2nd class investors this also applies, including support from administrative services for support in obtaining documents that are required by regulations. For the 1st class investors, all these apply, including, obtaining resources for building elements of technical infrastructure that is necessary for the implementation of investment plans. As a result, the distribution of FDI in Bulgaria is the following (next page):

[84] State Gazette issue N.97, of 1997; supplemented, State Gazette issue N.29 of 1998, amended and supplemented, State Gazette issue N.153 of 1998.

Table 16

Foreign Direct Investment in Bulgaria by sectors (USD m)

No	Sector	1998	1999	2000	2001	2002	2003	Jan-Sept 2004	Total by sector
1	Financial activities	63.8	119.1	443.2	114.6	134	441.9	151.5	1468.1
2	Trade and repairs	177.4	124	89.5	117.8	183.2	216.0	372.8	1280.7
3	Telecommunications	23.2	14.1	14.9	236.8	205	178.2	398.9	1071.1
4	Real estate and business activities	0.1	14.7	2.8	22.6	54.7	93.6	150.6	339.1
5	Petroleum, chemical, rubber and plastic products	41	165.2	72.1	-9.5	6.5	22.0	13.1	310.4
6	Metallurgy and metal products	13.2	72.2	17.1	81	-18.9	62.1	78.2	304.9
7	Mineral products (cement, glass,...)	150.6	71.8	7.4	27.7	0.7	34.1	-1.3	291.0
8	Food products	31.5	32.7	11.7	37.4	20.1	48.8	50.3	232.5
9	Textile and clothing	4.4	25.1	27.3	57.7	9.3	76.0	25.9	225.7
10	Wood products, paper	37.3	24.9	38.1	2.9	17	53.6	0.2	174.0
11	Machinebuilding	21.3	18	64.7	13.2	37.6	-12.9	7.0	148.9
12	Hotels and restaurants	26.8	40.5	20.8	17.9	7.9	27.6	5.4	146.9
13	Construction	6.3	6.5	12.7	17.4	29	14.5	35.0	121.4
14	Electricity, gas and water	0	0	18.7	2.4	56.7	34.2	6.9	118.9
15	Electrical eng., electronics, computers and communication equipment	11.5	5.9	28.6	28.2	17.9	-5.3	-10.2	76.7
16	Transport	6.2	-11.7	10.1	5.9	8.1	2.8	22.7	44.1
17	Mining	0	2.7	0	4.9	10.4	4.6	13.1	35.7
18	Leather and leather products	0.7	0	21.2	0.1	0.5	0.1	-2.1	20.5
19	Agriculture, forestry and fishing	0.1	2.4	7.1	0.5	0.9	0.0	6.2	17.2
20	Publishing	0	0.2	0.3	11.8	10.6	3.4	-10.0	16.3
21	Vehicles and other transport equipment	-0.9	1.7	0	5.1	2.2	0.2	-0.3	8.0

Source: InvestBulgaria agency (www.investbg.government.bg), based on reports from the National Statistical Institute.

The T/C industry ranks 9th in terms of FDI in comparison with other sectors of the economy. By 2003, T/C sectors attracted $200 m. (excluding 2004), which represents 3.6 % of total FDI. The low amount of FDI in the T/C is in conformity with the general trend in CEE economies which reveal low direct investment in this labor-intensive industry.

5.2.5 Privatization

When the first questions about privatization in the T/C sector arose in early 1990s, the experts were cautious. Danev (1990: 5-6) outlines the most significant problems that faced the privatization process in Bulgaria: a) almost 100 % of all industry was state property: b) many industries were characterized by monopolies; c) the country had little

private capital; d) there was an in adequate legal system; and e) there was no modern banking system. Milanova and Mladenov (1991: 10) argue that restructuring was going to be difficult primarily because of the monopoly structure of the economy and the fact that the local state-owned enterprises were in poor financial situations and therefore nobody would want to buy them. These factors, along with the unstable macroeconomic and political climate, postponed the privatization of the T/C industry until 1994. Even then, the first cash privatization deals were struck after the SOEs have become highly indebted and unprofitable. The first officially published figures, reported in 1996, are found in the next table:

Table 17 Cash privatization in the Bulgarian Textile and Apparel Industry in USD

Firms	Buyer	Price	% capital share	Overtaken debts	Five year invest-ment plan (in m.USD)
Orphey, Kardzali	Ruen AD	3.333	70	11.5 m	1.0
INA EAD, Sofia	Bulgarlising	333	80	2.6 m	0.023
Vida-style EAD, Vidin	Vida 95	88.000	60	-	0.030
Pioner, EAD, B.Slatina	Pioner Priva	123.333	77	-	0.031
Mizia EAD, Pleven	Mizia 95	76.000	60	-	0.020
Sanitex, Ead Mezdra	Sanitex 95	166.000	45	-	0.120
Druzba Style, Varna	Konteks 95	2.466	60	-	1.700
Vela EAD, Shumen	Vela 96	49.666	60	-	0.013
Marena EAD, Dupnica	Marena-M	333	75	5.6 m	0.013
Rositza EAD, Sevlievo	Rositza 96	1.333	80	1.42 m	0.300
Brilyant EAD, Plovdiv	Brilliant Invest	80.666	78	-	0.040
Pioner, Koinare	Kolektiv	15.666	100	-	0.100
Kateks EAD, Kazanlak	Priteks	170.666	67	0.428 m	-
Fazan EAD, Russe	Fazan 96	156.000	25	-	5.0
Velbazd, Kyustendil	Velbazd-Style	140.000	30	-	-
Etavia, Kyustendil	Sport-Fashion	519	67	0.402 m	0.05

Source: Georgievich, G.(1996: 6); the firms shaded in grey entered the survey of the author.

Most of the SOEs from the T/C sector (92 textile, 43 knitting, and 70 sewing companies) were put in the cash (1994-1996) and later in the mass privatization scheme (1997). Sixteen cash deals were conducted, as seen from the table above, of which the state managed to take a total price of around $1.6 million. The debts of the enterprises, undertaken by the new owners, amounted to $22.5 million, although the debts were disclosed for 6 firms only. The assumption is either that the debts for the 10 other firms

are hidden, or that the firms were not indebted at all. Georgievich (1996: 8) found some of the deals to be ambiguous because they were cheaply sold. Another observation reveals 70 % of the firms were bought by Management-Buy-Outs (MBOs). Only Sport Fashion, Brilliant Invest and Bulgarlising were not among these (Table 17 above).

As far as the mass privatization is concerned, 69 enterprises from the textile and apparel sector were announced in the first wave (State gazette, No.58 from 09.07.1996). It is estimated that 67 % of the capital fund of these enterprises were to be purchased with investment bonds (*Textile and Apparel Journal* 1996: 3). Large privatization investment funds (PIFs) had been formed in order to accumulate the investment bonds of ordinary citizens and bid for the enterprises in the whole economy. PIF "Doverie" bought the most enterprises in the T/C field.[85] It participated in 18 firms. PIF "Petrol" comes second with 14 firms, while "Bulgarian-Holland Fund" comes third with 11 textile firms (Georgi Georgievich 1997: 3-6).

One characteristic of the mass privatization in the T/C sector is the very high number of T/C firms that were split among several PIFs. For instance, "Doverie" purchased 26.92% of Maritzateks, while "Petrol" bought 24.08 %. Viteks-Troyan was bought by two funds, "Bulstrad" (22.66 %) and "Orel Invest" (31.84 %). "AKB Forest" acquired 34 % of Dekoteks-Sliven, while the "Bulgaro-Holland Fund" obtained 22.71 %. Three funds obtained the controlling share of Slitex (Doverie – 22 %, Petrol – 16.97 % and Bulgaria – 11.99 %). In fact, not one PIF acquired a controlling share (51 %) in any one firm. In fact, the largest share for one Fund has been 34 %. There was a hidden state strategy by fixing the highest share at 34 % in each privatization deal. The beneficiaries were

[85] Behind PIF "Doverie" there are: United Bulgarian Bank, State Insurance Institute, Darik Radio, Financial house EVER, Limeks Group commerce, Andema, Kresta consulting. The UBB has promised to give to their enterprise: a) credits for turnover resources; b) guarantees for temporary imports; c) acreditives.

obviously the PIFs, which could obtain with less investment bonds shareholder's power for decision-making in more privatized T/C firms. Thus, the PIF which bid the highest percentage was automatically transformed into the main shareholder, and hence a decision-maker.

The biggest winners from the mass privatization in the T/C sector were PIF "Doverie" who gained the decision making power in 9 firms (it bid on 18), while the Bulgaro-Holland Fund controlled 5 firms (out of 11 bid on) and Petrol with 3 (out of 14).

The role of the PIFs and MBOs was little in helping local firms move up in the global value chain because they offered no investment in new machinery, equipment and technologies to replace the obsolete ones. Only a brief examination of the investment figures for 1996 shows that the T/C industry invested approximately 1 million DM in the textile branch and approximately 0.250 million DM in the clothing branch. If we accept the absurdity that all was spent for new equipment, then it seems that the entire Bulgarian T/C industry managed to buy only 5-6 spinning machines in 1996.

5.2.6 State industrial policy

Incentives

After 1990, firm reinvestment and state capital investment was limited. T/C SOEs were subsidized during the Videnov government (1994-1996) but primarily to covering salaries of workers and as payment of compensations for those workers that were laid off.[86]

After the T/C industry became leading export sector of the economy and a major employer, state officials decided to develop a national strategy plan for its development.

[86] Videnov government applied the subsidizing policy to different sectors of the economy and textile and apparel SOEs were not among the large beneficiaries. Other industrial sectors with strong striking powers, like the mining and the chemical sector were among the most subsidized industries in this period.

As a result, two strategies were proposed, the first in 1996 and the second in 1999. However, there was no impact from these strategies. In fact, the state clearly neglected the sector. Between 1995 and 2003, no specific state SME policy targeted the T/C industry. Nor was there a program for the creation of special T/C districts, clusters, Free Trade Zones or other encouragement of vertical and horizontal integration of the T/C industry through some state incentive programs. There is one exception to this. In its general policies in 2003, the Bulgarian state introduced a duty free entry policy for new machinery exceeding $5 million which was purchased by private firms. This measure did not specifically target the textile industry, as it was not easy, especially for SMEs to meet this target. According to textile experts, the threshold was difficult to meet even by large textile and clothing Bulgarian firms.

A public official from the Ministry of Economy, responsible for the textile sector, shared in an interview that he opposed the policy of the Bulgarian government, which neglected the industry, but he did not have power to argue against governmental passiveness (anonymous interview, 20 April 2003). He further noted that meetings with business representatives proved ineffectual because the state did not want to be involved in issues related to the T/C industry. The official went on to state that, “We do not have money and that is why we can do nothing in Bulgaria”. Another official of the Ministry of Economy contradicted this view by pointing out some of the EU projects in which the state cooperated, such as “FLAG”, which organized vocational training seminars and workshops for managers and workers in the T/C industry. However, these workshops were inefficient because they tried to teach something that the firms already knew. The prediction of both public officials is that everything related to the T/C industry will fade

in the near future with the EU enlargement, referring to the position of Hungary, Poland and Czech Republic in 2003, whose T/C activities started to move east as a result of increased labor costs in their domestic markets.

5.3 Branch associations

State Industrial Associations (SIAs), which acted as the umbrella associations for the state-owned T/C firms, appeared in the 1950s.[87] The seven SIAs were especially important for the textile industry in terms of vertical integration (Zdravko Zlatanov 1984: 254).[88] SIAs engaged in centralized management for planning and supply and distribution. They also undertook the modernization of obsolete machinery, the cooperation and integration of the enterprises, the introduction of a system for repairs, and the development of system to improve labor productivity.

Industrialimport, a state-owned trading company created in 1947, oversaw export promotion and trade contacts of the Bulgarian textile and apparel industry. In the next four decades, this mega agency played a substantial role as a mediator between the foreign clients and the local enterprises by negotiating orders, advertising in foreign markets, participating in international textile and fashion fairs and establishing foreign agencies in the export markets. Each SIA had its own department in *Industrialimport*, thus the decentralizing the management structure according to subsectors and markets. This trade company played a major role in late 1970s and 1980s, when first contacts with Western European clients have been created. Together with the SIAs, *Industrialimport* played a vital role for the modernization and technological renewal of the textile and

[87] The 8th regulation of the Council of Ministers from 23 XII 1947 (State Gazette from 4 Feb. 1948, Vol.27).
[88] Zlatanov Z. (1984). *150 godini Slivenska Tekstilna Promishlenost (150 years Textile industry in Sliven),* Profizdat, Sofia.

apparel factories, the planning activities of the enterprises, contact with foreign buyers and the linkage between local enterprises and the central government in the face of the Ministry of Light Industry.

After the collapse of socialism, the Confederation of the Bulgarian Industry claimed that if Bulgaria is targeting integration with the European economic structures, then the road is only one: fast establishment of private branch associations, which could be united at the Confederation of the Bulgarian industry.[89] The first private branch association appeared at the end of 1991, representing the wool, linen and hemp industry. The goals of the association were to support the modernization efforts of its members, privatization of the enterprises, conduct collective agreements, support the release of credits for the enterprises, attract FDI and finally to propose concepts for development of the industry. Neither of these goals was realized by this and the other six branch associations which appeared after mid-1990s. Limited membership, limited budgets for activities, limited lobbying power compared to other sectors of the economy were among the most important factors that have prevented the Bulgarian T/C BAs to play a crucial role. One striking example was encountered through an interview with the General Secretary of the Branch Association of the Sewing Industry, who confirmed not only the BAs have limited financial resources, but sometimes they do not have simple equipment, like a phone or computer. (Vlaikov Georgi, 12 May 2003, interviewed by the author, Sofia)

The Branch Association of the Wool industry and BAKI are also financially unstable and are one-man show, as only the General Secretary is officially appointed. A more positive example is presented by the Association of Apparel and Textile Exporters

[89] This has been recommended by the Confederation of the Britannic Industry and the Federal Alliance of the German industry, *Textile industry journal*, vol.9, 1991:4-5.

in Bulgaria (AATEB), created in 1997.[90] It maintains a stable membership list of 81 firms in 2003, a staff of a General Secretary and four researchers and office in the downtown Sofia. Moreover, it established successful contacts with EURATEX and provides it with regular Bulgarian T/C reports. Although for microeconomic research, the reports are very limited since firms are not keen on providing information about sensitive indicators, like products, profitability, productivity, exports, technological, product and process innovation. Besides industry reports, AATEB collects data and supplies with marketing research its members, which are predominantly SMEs. AATEB officials indicated that foreign firms operating in Bulgaria also became members of AATEB. The Branch association organizes business trips of their members to foreign countries and guides foreign businessmen who want to establish contacts with Bulgarian entrepreneurs. The AATEB work is an exception, rather than a rule in the Bulgarian BA life. It functions with support from the Deutsche Gesselschaft für Technische Zusammenarbeit (GTZ), based in Sofia.

The Bulgarian state neither finances the AATEB, nor any other BA in the textile and apparel field. Moreover, the state neglected the problems of the industry and did not consider any of the recommended actions of BAs to introduce measures. For instance, the BAKI director sent a letter to the Ministry of Economy on 7 October 2002 on behalf of BAs and firms which they represent. The BA officials put forward several proposals for consideration, e.g., development of national strategy for the T/C industry; decrease of duties for Bulgarian textile, knitting and clothing products exported to the former Soviet Union countries; tax credit for recovery of the VAT by 30 days and not by 4 months as it

[90] In 2003 AATEB was renamed BAATPE (Bulgarian Association of Apparel and Textile Producers and Exporters.

is usually the case. The sectoral actors also demanded preferential state subsidy for the purchase of raw materials or decrease of duties when there is import of wool, silk, flax, linen; limitation of illegal imports of textile products which do not respect the Bulgarian quality standards, as well as dump the local prices.

The state did not respond to these recommendations, neither did expand the functions of BAs, by granting them the authority to issue licenses, registration and other types of documents. The necessity to give the BAs financial and organizational power by law was not met until end of 2003, which put the private initiative and possibilities for organization of the hundreds, if not thousands of textile and especially clothing firms, to a limit. Individual initiatives by textile experts and textile academics did not attract the attention of the Ministry of Economy during the 1990s and at present. The weakness of BAs in Bulgaria diminished the capacity of sectoral actors for effective intervention for firm upgrading and also limited the state capacity to help development of the sector.

5.4 Bulgarian reality

5.4.1 Competition through informalization

In early 1980s, the T/C industry was represented by 198 SOEs which employed 192,000 workers. The number of enterprises grew to 259 with a total of 203,500 employees in 1988, a couple years before the central planning system collapsed. The number of enterprises increased substantially after mid-1990s when Bulgaria welcomed a truly expanding sector, which eventually became leading export sector of the economy.

Table 18 Number of enterprises and employees (1983-2003)

Sectors	1982	1985	1989	1996	1999	2001	2003
Textile and knitting	127	133	142	---------	--------	700	722
Employees	127.530	120.727	116.499	44.095	33.732	29.730	23.759
Clothing	71	73	91	---------	--------	3.637	3.598
Employees	64.448	59.124	62.181	82.000	95.940	119.805	148.025
Total No. of firms	198	206	233	-------	-------	4.337	4.320
Total employment	191.978	179.851	178.680	126.095	129.672	149.535	166.582
Share of total industrial employment *	14 %	13 %	11 %	15 %	18 %	23 %	25 %

Source: Annual Statistical Bulletin, 1989, p.105 (column 1); National Statistical Institute, 1993, pp.151-152 (column 2, 3); National Statistical Institute, 2000 (Column 4, 5); and National Statistical Institute, Sofia, April 2004, National Classification for Economic Activities (column 6, 7). **Note:** The period 1982-1989 has witnessed only state-owned enterprises and cooperatives. After 1990, thousands of new enterprises emerged, which however, have not been registered by the National statistical institute. *data obtained from WIIW Industrial Database Eastern Europe, which uses data from National statistical institutes across CEE (DB Textiles and textile products).

During the 1990s, the official statistical information is contradictory and hard to develop comparisons of the number of textile and clothing firms and their employees. The reason for that is the high number of firms that operated in the shadow economy.

The number of textile/knitting firms increased about five-fold, while the number of apparel firms registered eighteen-fold growth between 1989 and 2003. The most remarkable growth of new textile and clothing firms was registered in late 1990s. Reports by public officials confirm that the number of Bulgarian T/C firms reached 3,892 in 2000, but they suddenly increased by 10 % in 2001 (4,337 firms), and by 2002 the number had grown by 24 % (5,873 firms). (Gaidarova Maria 2003, Panayotova Snejina and Mileva Nedka 2002: 21)

The Ministry of Economy estimated the data based on the National Statistics Institute BULSTAT reports, which register the number of companies dealing with apparel and textile activities. The data, however, has to be viewed cautiously as the statistical source provides information on registration without any distinction of how many of the companies actually carry out the declared scope of activities. Therefore, if the data is

correct, it would transform Bulgaria into the country with the highest number of registered T/C firms per capita (1,350 capita per firm). This, by itself, assumes high interest for domestic entrepreneurs in doing business in this particular sector. However, as already suggested, the figures are dubious.

In order to have a better picture of the situation, let us turn to another source, the official data of the National Social Security Institute (NSSI). NSSI indicates that there were about 1,200 companies specialised in the production of apparel, including leather, as of 2003. This data is again not accurate because there were many firms which still operated in the shadow economy.[91] The phenomenon of the existing grey economy is relevant if one considers the 34 % increase of registered T/C firms between 2000 and 2002. Thousands of firms in the shadow economy preferred to get out "in the light", following the stabilization of the macroeconomic environment and the European integration process in the post-2000. More realistic estimates were given by a number of experts and producers from the sector interviewed for this thesis. They estimated that as of 2003, approximately 2,500 apparel producing companies and approximately 300-350 textile producing firms operated in Bulgaria in 2003. This is about half of the official estimates, shown in the table above.

The high presence of T/C firms in the informal economy during the 1990s would suggest an application of the same logic to employment in the sector. At the end of the 1980s, the T/C labor represented only 11 % of industrial employment, which grew to 25% of industrial employment in 2003. However, this is rather a result of the decline of other industrial sectors in the post-1990 period, then a substantial growth in labor demand

[91] It means that the employer does not sign a contract and does not pay social security for the worker.

of the T/C industry. In fact, for the period between 1982 and 2003, labor engaged in the sector decreased by 13 %.

When the T/C industry became leading sector of the economy in mid-1990s, labor increased. In 1996, according to NSI (2004), T/C employees represented 15 % of the total industrial employment (126,095 officially registered employees), which progressively increased to 23 % in 2001 and to 25 % in 2003 (166,582 employed). Textile experts would add additional 25,000-40,000 more employees which are engaged by SMEs that exist in the grey economy. These employees work part-time (at home), seasonally, or full-time in firms without a labour contract. Therefore, when taking into account the unregistered labor force, the leading export sector of the Bulgarian economy reaches more than 200,000 employees, which is the highest achieved T/C labor in the past two decades.

By 1996, the sector was the largest industrial employer of the economy, outpacing the machinery and equipment sector, the second important industrial employer, which had 35 % of industrial employment in 1989 but decreased to 10 % of industrial employment in 2003 (NSI 1993; WIIW Industrial Database Eastern Europe 2003).

Compared to other Central and Eastern European countries, the Bulgarian T/C industry grew from the smallest T/C employer in the 1980, to the third largest employer in the CEE region in 2003 after Romania (362,100 employees) and Poland (233,400).[92]

5.4.2 Competition through labor

In 2001, a group of experts conducted research among 77 Bulgarian clothing SMEs and made interesting conclusions about the working conditions in Bulgarian apparel

[92] According to the WIIW industrial database, the Czech Republic has 83,000 T/C employees, Croatia has 32,105 employees in 2003, while Hungary has 88,859 employees in 2002 (2003 T/C employment data for Hungary are non-existent).

firms and the character of the relationship between the employers, labor unions and the employees.[93] The research of 62 T/C enterprises by the author in 2002 and 2003 confirmed these observations by using similar questions to those found in the research design of the 2001 group. Discussion of the most important issues related to identifying the working conditions in the enterprises are found below:

- *Voluntary employment*: The Bulgarian labor code prescribes general rules on this. The enterprise workers, according to the 2001 research, have voluntary selected the job of clothing worker. However, the workers respond that they would prefer to take another job with better payment, if any opportunity arises. In many cases, when there is a big order that has to be finished on time, the workers have to stay extra hours. This is inevitable in the clothing sector. In other sectors, extra-hours work could be offered in exchange of extra payment and in conformity with legal set up percentages. In this industry, however, the workers are frequently threatened to do extra-work without extra payment. Moreover, the author's research identified cases in which the workers have been locked in the factory in the nights until the order is finished without extra compensation. The work day is 10 hours long on average, while the overtime hours are usually between 70 and 100 in 6-7 day working week.

- *Discrimination*: the 2001 report did not identify any discrimination in terms of compensation, with the exception of a few cases when the employer a foreigner and discriminated on the basis of gender. This might be the case since the worker's payment is low in each production segment. During the author's own research, it was difficult to

[93] The research has been conducted in the framework of the international project "Worker's rights in the subcontracting chains of the apparel industry" in which 7 NGOs from Asia and Eastern Europe have taken part under the leadership of Women Working Worldwide (UK). The research has been published by the Association "Bulgarian-European partnership", Sofia, 2002. Interviewed: 77 workers, 15 managers, 31 employers. 7 out of the 77 interviewed enterprises have been visited by the research team.

identify racial or gender discrimination from factory visits and employee interviews, who avoided talking about these issues. One interview with a female former executive director of one of the largest Bulgarian knitting firms confirmed sexual harassment in clothing firms (anonymous interview by the author, 10 June 2003, Vidin). The manager said that sexual harassment and threats to the female workers by the foreign employer was daily practice. Since most of the unskilled female workers in the Northeast Bulgaria (the region where my interviewee worked) are from the minority groups (either of Turkish or Roma origin), the repercussion of this treatment by the employer have been even culturally heavier.

- *Child labor*: Bulgaria ratified the ILO Convention No138 in 1980 and the ILO Convention No.182 in 2000, which forbid the use of child labor. The 2001 survey indicates that there are cases when child labor (14-18 year-olds) was used in the Southwest Bulgaria (one of the best performing textile regions of Bulgaria) during school vacations. The parents of these children urged them to contribute to the family budget. The workers have confirmed that the children worked a full time schedule. The author was not able to detect child labor during my interviews in apparel firms across Bulgaria, but indeed, it is possible that one could find them working in small firms that operate in the grey economy during the summer in Southwest Bulgaria and Northeast Bulgaria where minorities and poor regions are found.

- *Labor unions freedom*: The ILO Convention No.87 and No.98, which treat labor union functions, were ratified by Bulgaria in 1959. The 2001 report indicated that in most large and in some SMEs there are labor unions, while in the small enterprises, which represent about 90 % of the labor force, labor unions were missing. Moreover, in those

enterprises that have labor unions, the general situation is that the employers' attitude is very negative towards suggestions by the union leaders, who sometimes are fired for their activities. The interviews of the author yielded the following results. In some of the enterprises, collective agreements exist, but are not frequently updated. None of the interviewed SMEs from my sample had codes of conduct.

They were only found in some of the large textile and apparel firms. In most of cases, the firms have the paper because the annual audits of the US buyers or the ISO certificate agencies require them. These firm codes, however, are simply formal documents, are presented just for prestige, and as such, do not serve the purpose.

A separate labor union for the textile and apparel workers does not exist in Bulgaria. In general, the labor unions have been weak in the textile and apparel sector which explains why protests in this sector in the 1990s were almost non-existent. This is especially ironic, because textile employees suffer more than other sectors in terms of low salaries, unpaid overtime, and uncontracted work, which results in no payment into the state pension and medical plans. In fact, according to my survey results, about half of the enterprises in Bulgaria give the minimum salary (55-110 USD), while 42 % give medium salary (110-150 USD) and only 6 % of the firms give high salary (more than 150 USD) to their workers.

A few publications can provide us with information on the actual situation in terms of the role of labor unions and the results of protests by textile and apparel workers in Bulgaria. Ivanka Laleva, correspondent of daily newspaper *Trud* reported to Clean Clothes Campaign (CCC) about the 1999 protests in South-western Bulgaria, where

many Greek owners opened up production units near the Bulgarian-Greek border.[94] One hundred eighty workers from the Savina factory (production facility in the town of Sandanski and the village of Strumyan), who produced under OPT for Adidas and Nike had tough negotiations to get normal working hours with their Greek owner. Two of the women, who participated in the protests reported the following, according to the CCC report:

> "We had difficult negotiations which involved attempts at intimidating workers; but we succeeded in agreeing on an 8am to 5pm working day with a 30-minute lunch break. However, we did not come to an agreement on the issue of social security and pensions which, according to Bulgarian law, should be based on monthly gross pay. Even now, we are only insured on the basis of a monthly salary of 90 DM. We work under a quota regime and pay depends on fulfilling that quota. We get a maximum of 150 to 200 DM before tax". The second employee at Savina, added that some of the quotas are impossibly high. We brought up the issue with our Greek employers but they invariably answer that the quota is set by Adidas. We suppose that this is not true, because we know of cases where bosses take it upon themselves to change the quotas to suit their own people."

The words of the two employees have been confirmed, continues the CCC report, by the regional chairman of the labor union KT Podkrepa, Dancho Petkov, from Sandanski. He stated, "Some of them are forced to work overtime in order to catch up their colleagues and fulfill their quota. One worker came to me who had managed to make only 25 DM in a period of 17 days. I tried to discuss the matter with the management, but they categorically refuse to discuss the issue."

The daily newspaper, *Standart,* reported on 1 November 2004 that hundreds of women that work in the clothing sector were laid off in southwestern Bulgaria because six firms closed down in 2004. This region has 126 Greek-owned firms which employ 11,078 (90 % of whom are women). These firms provided 1/10 of the wages for the local

[94] http://www.cleanclothes.org/companies/savina99-11.htm

population. The Greek owners closed their production units because the Bulgarian Labor inspection has started to register fines (142 in a short period of time).

The power of foreign enterprise owners of T/C firms in Bulgaria was demonstrated after an article dated 4 March 2003, was published in the daily newspaper *SEGA*. It reported on the intention of Edoardo Miroglio, the director of "Gruppo Miroglio" (the Bulgarian exporter for 2002) to sue a Bulgarian journalist from the daily newspaper, *DUMA*. Miroglio was suing on moral grounds because of two articles written a year earlier, which accused the firm of using chemicals that poisoned the workers and stated that the workers were fired for protesting against the plant. Furthermore, the famous Bulgarian investigation journalist Valya Ahchieva, who broadcast a weekly TV program on malpractice, presented the case of Dewavrin Group on National TV in January 2005. Dewavrin is a well-known 150 years old French textile family company, which built in 2002 a combing plant "Parvomay " with an investment of several million euros. This new textile factory had a dying production unit, which brought Ms. Ahchieva to the town of Kazanlak where the factory was built. The citizens of Kazanlak wrote a letter of complaint to Ahchieva, saying that because of the chemicals, used by the factory the town could "hardly breathe". During the TV report, the journalist interviewed people outside the factory who complained about the poisoned air. The interesting point is that the journalist could not find workers inside the factory, willing to complain. If the poisoned air was felt by the ordinary citizens in the town of Kazanlak, was not this more obvious for the workers in the factory? No doubt, the textile workers were afraid for their job, which explains their reluctance to speak on camera.

These examples illustrated that in Bulgaria, neither workers, nor labor unions, nor journalists feel protected in the hostile triangle of employers-workers-labor unions, exacerbated from the fierce international competition, driven by the global apparel buyers.

- *Bad working conditions*: The research of the group of experts, conducted in 2001, has reported numerous examples of dissatisfactory conditions at the working place like no air-conditioning, high dust concentration, deficient light, poisonous chemicals and bad noise. In the small enterprises, the workers have lunch in their work space, while in the medium or large enterprises, they may have cafeterias. A medical service is missing in the small firms, while in the larger firms one may find one. It has been registered by the 2001 report that 2/3 of the interviewed firms have rented the working space and therefore, have no motivation to invest in the improvement of the working conditions.

The author confirmed most of these observations during visits in the production facilities of Bulgarian T/C firms. The large clothing firms, Vida Style (northwest Bulgaria) and Albena Style (northeast Bulgaria), which have more than 40 years of experience and employ at present more than 1000+ workers, each have good working conditions (separate cafeteria, air conditioning, worker's code of behavior, low dust and standard noise at the working place) and they invested in their own buildings to improve these conditions. However, in smaller firms (up to 50 workers, but sometimes 70-120 employees), the author witnessed the opposite situation. The following story, told by the chief accountant of *Vida Style* from Vidin, would help us understand the situation:

> "We have worked for more than five years very successfully with a Spanish company as their main Bulgarian subcontractor. In 2002, however, they have decided to change their strategy by decreasing substantially the price per piece.[95] We could not accept that because it was below our production price, so they quickly turned to another clothing company in our town, which used to employ part-time and seasonally 50-70 workers. They produced under subcontracting in a rented small production facility. Suddenly, the small firm received the big order and even increased the number of their employees to 200, but continued to keep dissatisfactory working conditions." (10 May 2003, interviewed by the author, Vidin)

How did the small local firm attract the foreign buyer? Why the small firm did not change the working conditions and start to think long-term after the first big order? The Vida Style manager responded, "The foreign firm was after the price and that is the explanation". The local firm could provide that low price only by operating in the grey economy and by squeezing what it could get from the workers (low payment, poor working conditions).[96] "Such firms - concluded the manager of Vida Style - have no chance to survive in the market". These firms exist only short-term and quickly disappear after the foreign buyer re-locates in search of more acceptable price per piece.

Conclusion

This chapter analyzed the development of the Bulgarian T/C industry and the role of state policy in helping the sector increase its exports and international competitiveness. Firstly, the chapter touched upon the period of planned economy, during which the T/C industry was not a priority sector of the economy. Bulgaria created a heavy industrial basis of its economy and the T/C exports were limited and mostly directed to the COMECON countries (above 70-75 % of total exports). The T/C industry grew out of the macroeconomic unbalance and political turmoil of the early 1990s by achieving 15 % of total export in 1995, when the major T/C market became that of the European Union.

[95] The Spanish firm changes its price policy in conformity with the elimination of textile quotas in 2002 (third phase) and the impact of China membership in the WTO. 2002 is the year, when Western European firms started to search for Chinese prices in the Eastern European countries.

[96] The manager of the small firm had powerful links with the local authorities and thus the sanitary, labor and other controls were limited.

Secondly, the chapter looked at the post-1995 when the T/C industry became leading export sector of the economy. Bulgaria became a net textile trade importer and a net clothing exporter. The major reason for that is the high percentage of subcontracting which Bulgarian apparel firms performed for EU buyers. T/C exports in 1995 registered 317 million ECU, whereas in 2003 the industry achieved €1.1 billion. The trade liberalization with the EU, which encouraged outsourcing of production, instigated Bulgarian exports of textile and clothing goods. But, the role of state policy was very limited. Privatization in the T/C industry was very slow and was realized only after mid-1990s when most of the state-owned firms were put into the cash and mass privatization schemes. These methods of privatization did not bring financial resources to the enterprises, which desperately needed to replace obsolete machinery and technology. There was no general and specific industrial policy to affect the T/C industry. Thirdly, the chapter investigated the functions and activities of major Bulgarian BAs in the T/C field to find that sectoral actors were not organized and did not have the capacity to help development of the industry. Finally, the two-tiered system of informalization of the industry was discovered. Small firms that work in the grey economy gravitate around the large and medium-sized firms and are used for subcontracting work. Reports by a research group, journalists and author's own research concluded that the working conditions in the Bulgarian T/C industry are much below the international standard levels. The system of firms that operate in the unofficial economy and the poor working standards generate the survival strategy of Bulgarian T/C exporters by meeting the desire of foreign firms to push the prices further down.

Chapter VI. Industrial and Firm Upgrading in Bulgaria

Introduction

The chapter aims to analyze the indicators that characterize the dependent variable which traces industrial and firm upgrading in Bulgaria. It applies Unit Value Analysis (UVA) method, based on data from Eurostat's Comext, and uses in-depth interviews with firm managers, textile and branch association experts. The *first section* introduces *Sectoral level* analysis which involves a study of unit values of Bulgarian textile and apparel exports to the EU market between 1995 and 2003. The *second section* presents the *Network level* analysis of linkages between foreign and domestic firms, whereas the *third section* discusses the *Firm level* analysis by including results from a survey, conducted by the author, and three firm case studies. The findings are summarized in the conclusion.

6.1 Sectoral level

6.1.1 Low value added export position in 1995

In mid-1990s, Bulgaria exported 60 % of its total textile and apparel exports to the EU market, mainly apparel goods, which constituted 82 % of its EU T/C exports.

Table 19 Unit Value Analysis of EC textile and apparel imports (1995)

Categories	**Bulgaria**		
	DM	**MM**	**UpM**
Section A			
Textile (50-59)	12 %	2 %	0.05 %
Apparel (60-63)	22 %	50 %	13.95 %
Total:	**34 %**	**52 %**	**14 %**
Section B – corrected			
Textile (50-59)	12 %	2 %	0.05 %
Apparel (60-63)	68 %	14 %	3.95 %
Total:	**80 %**	**16 %**	**4 %**

Source: Eurostat, Comext databases (1988-2001), Extra-EC imports; the author's calculations cover 637 product groups (6-digit disaggregated level) from categories 50-63. The research encompasses over 90 % of total export (in value).

The case of Bulgaria, similar to the Turkish case, is controlled for OPT exports and concentration in two low value added articles of T-shirts, vests of cotton, underwear, etc., found in 610910 and 610990 articles. The calculations involve ***Section A*** which indicates the distribution of the value added structure before corrected estimates and ***Section B,*** which presents the actual distribution after the necessary corrections (See Table 19 above).

There is a substantial difference in the results after correction of the estimates because of the influence of OPT, which is defined as down-market despite taking up-market or middle-market segments. In 1995, 33 % of total apparel, not knitted or crocheted (61 article) and 60 % of total apparel, knitted or crocheted (62 article) is in OPT trade. That would comprise half of the total apparel exports, concentrated in OPT. Exports of cotton vests and singlets (610910) represent 14 % of the apparel, not knitted or crocheted and only 3 % of total apparel exports. The UVA shows down-market concentration of the export of this product in 1995, 25 % of it in OPT exports. Therefore, Bulgaria started from unfavorable export position in its integration with the EU economy. A total of 80 % of its textile and apparel exports to the EU market are low value added. Furthermore, Bulgaria in 1995 takes similar position compared to Turkey in 1983 in terms of two factors. First, Bulgaria takes the Export Processing Assembly position in the ladder of industrial upgrading (See Fig.1, *Chapter II*), while Turkey is characterized by exports of primary commodities. These two positions are considered first step in industrial upgrading, but Bulgaria would be considered to have a better starter position compared to Turkey at the initial stage of integration with the EU economy. Second, large majority of

the textile and apparel exports from both economies to the EU market are in low value added products.[97]

6.1.2 Low value added exports in 1996 and 1998

The Bulgarian textile and apparel exports to the EU market increased by 12 % in 1996 and by 45 % in 1998 compared to the first year of research. The apparel exports continued to dominate as they represented 86 % and 89 % of total textile and apparel exports to the EU market, respectively.

Table 20 Unit Value Analysis of EC textile and apparel imports (1996, 1998)

Categories	**1996**			**1998**		
	DM	**MM**	**UpM**	**DM**	**MM**	**UpM**
Section A						
Textile (50-59)	5 %	0.5 %	0 %	0 %	0 %	0 %
Apparel (60-63)	29 %	53.5 %	12 %	58 %	40 %	2 %
Total:	**34 %**	**54 %**	**12 %**	**58 %**	**40 %**	**2 %**
Section B						
Textile (50-59)	5 %	0.5 %	0 %	0 %	0 %	0 %
Apparel (60-63)	60 %	26.5 %	8 %	72 %	27 %	1 %
Total:	**65 %**	**27 %**	**8 %**	**72 %**	**27 %**	**1 %**

Source: Eurostat, Comext databases (1988-2001), Extra-EC imports; the author's calculations cover 637 product groups (6-digit disaggregated level) from categories 50-63. The research encompasses over 90 % of total export (in value).

The OPT exports increased in 1996 compared to one year earlier, as they comprised a stunning 68 % of Bulgaria's total apparel exports to the EU market. About 80 % of all apparel goods, knitted and crocheted (62), that comprise the largest group of exported apparel goods from Bulgaria (3/4 of total exports) were assembled under OPT arrangement. Lack of turnover resources and difficulties to operate with the local banks may explain the low performance of apparel production in Bulgaria. It seems that the macroeconomic instability, as a result of incurring financial crisis in the last quarter of 1996, had a negative impact on the development of textile and apparel exports to the EU

[97] To recall from Chapter 4, 76 % of Turkey's textile and apparel exports are in down-market segment in 1983.

market. However, we observe a similar picture of concentration in down-market products in 1998. On the one hand, in 1998, Bulgarian apparel down-market product exports increased by 7 percent, while up-market product exports decreased by 7 percent compared to two years earlier. Bulgaria continued to do OPT production for EU buyers, as it exported 52 % of its total apparel exports in 1998. The largest group of apparel exports, knitted or crocheted (62) registered half of its exports in OPT.

Exports of cotton vests and undershirts (610910 article) rose in the post-1995 period. Bulgaria has 19 % of its apparel exports, not knitted or crocheted and 5.4 % of total apparel exports from this product group. In 1998, the export of these products represents16 % of the apparel, not knitted or crocheted and 5 % total apparel exports.

There is a slight increase of textile exports to the EU market. Although value of apparel exports to the EU market doubled between 1995 and 1998, textile exports increased only by 18 % for the same period. As a result, textile exports do not have a share in the value added structure in 1998.

To conclude, results obtained from the unit value analysis indicate that Bulgaria continued to export the majority of its textile and apparel goods in the low value added segment and its position is similar to what the country was exporting in 1995. The macroeconomic stability of the economy, achieved due to the Currency Board, introduced in July 1997, did not improve the performance of the domestic textile and apparel industry and its exports to the EU market.

6.1.3 Low value added exports in 2001

At the beginning of the 21st century, Bulgaria established itself as one of the major exporters of textile and apparel goods to the EU market. For the first time in its history, it

registered a record by exporting to the EU market textile and apparel goods exceeding €1 billion. The distribution of value added of these exports still was very limited in the up-market segment.

Table 21 Unit Value Analysis of EC textile and apparel imports (2001)

Categories	**2001**		
	DM	**MM**	**UpM**
Section A			
Textile (50-59)	0.7 %	0.6 %	0.2 %
Apparel (60-63)	29.3 %	64.4 %	4.8 %
Total:	**30 %**	**65 %**	**5 %**
Section B			
Textile (50-59)	0.7 %	0.6 %	0.2 %
Apparel (60-63)	45.3 %	49.4 %	3.8 %
Total:	**46 %**	**50 %**	**4 %**

Source: Eurostat, Comext databases (1988-2001), Extra-EC imports; the author's calculations cover 637 product groups (6-digit disaggregated level) from categories 50-63. The research encompasses over 90 % of total export (in value).

Bulgarian textile exports to the EU market represent only 6.5 % of total T/C exports in 2001. The largest group of exports is that of apparel, knitted or crocheted (62), estimated at 60 % of total T/C export. OPT continued to play an important role, although declining, as it took 33 % of total apparel export and only 29 % of total apparel export from article 61.

Why did OPT exports from Bulgaria decline? Since 1 January 1998, the trade of textile and apparel goods between EU and Bulgaria was liberalized, in accordance with the Free Trade Agreement (FTA). As a result, there was an elimination of the benefits for the EU buyers. Even if the EU buyers continued to subcontract to Bulgarian firms, they stopped receiving a variance on the duties of the assembled production. Hence, the incentive for the EU buyers or the Bulgarian firms to officially register their OPT exports came to an end in 1998. Due to the requirement of the EU's FTA, however, Bulgarian exports needed to comply with the EU's rules of origin, which were hard for Bulgarian

textile and apparel firms to meet.[98] Thus, many Bulgarian firms continued to export under OPT and register their exports under OPT (the rules of origin do not apply because the textile materials have EU origin). But, other Bulgarian enterprises managed to export without officially registering their export as OPT, and continued to work under subcontracting with EU buyers. That is why there is still a high OPT share, estimated at 33 % of total export share in 2001. But, this does not reflect the actual size of OPT trade because there is a large group of Bulgarian manufacturers, who work under international subcontracting agreements but do not register the export as OPT in the EU customs documentation.

6.1.4 Low value added exports sustained in 2003

In 2003, Bulgaria exported textile and apparel estimated at €1.1 billion to the EU market. The apparel exports, knitted or crocheted (62) represented 65 % of total exports. The distribution of the value added structure is as follows:

Table 22 UVA of EC textile and apparel imports (2003)

Categories	**2003**		
	DM	**MM**	**UpM**
Section A			
Textile (50-59)	0 %	0 %	0 %
Apparel (60-63)	9 %	40 %	51 %
Total:	**9 %**	**40 %**	**51 %**
Section B			
Textile (50-59)	0 %	0 %	0 %
Apparel (60-63)	23 %	34 %	43 %
Total:	**23 %**	**34 %**	**43 %**
Section C			
Textile (50-69)	0 %	0 %	0 %
Apparel (60-63)	40 %	47 %	13 %
Total:	**40 %**	**47 %**	**13 %**

Source: Eurostat, Comext databases (2003), Extra-EC imports; the author's calculations cover 637 product groups (6-digit disaggregated level) from categories 50-63. The research encompasses over 90 % of total export (in value).

[98] In this respect, there was an obligation to fulfill hundreds of pages of the EU's customs documentation in order to prove the rules of origin. This was coupled with problems at the EU border to prove the origin, which resulted in non-EU border entry of the Bulgarian T/C goods.

Unit value estimates are presented in ***Section A***. In terms value added distribution, Bulgaria improved considerably compared to previous years. However, concentration in article 610910 and article 610990 increased in 2003 as the statistics reports that they have a quarter share of article 61 and 3.5 % share of total apparel exports. In addition, Bulgarian firms continued to register OPT imports through 2003. Only 6 % of total apparel exports (not knitted and crocheted) and 20 % of total apparel exports (knitted and crocheted) are reported as OPT exports. The two criteria have corrected the UV estimates, outlined in ***Section B.***

As in the case of Turkey, ***Section C*** is also applied for the case of Bulgaria**.** It uses two additional corrections. The first one is related to OPT EC trade, which was not relevant in the case of Turkey, but is highly suitable in the case of Bulgaria. Bulgarian firms continued to do subcontracting work for foreign firms, however, the information tracking this, began to disappear from the statistical reports after 2002.

The reason for that is the duty free and quota free EC imports from Bulgaria to the EU market, which used to encourage EU buyers to trade in OPT before 1998, as it gave preferential access to the EU market. Since barriers to trade were removed after 1998, Bulgarian goods started to freely circulate within the common market. Hence, EU buyers (mainly from Greece, as the statistics shows) continued to register their OPT exports to Bulgaria, but Bulgarian firms discontinued (especially after 2002) to fill-in documents for OPT trade when they exported goods to the EU market assembled under OPT.

As a result, the EU OPT export to Bulgaria increased, but the EU OPT export from Bulgaria decreased substantially. A comparison between OPT trade of Bulgaria and the

EU between 1995 and 2003 confirm these findings, especially true in the case of apparel goods, not knitted or crocheted (article 61).

Table 23 EC apparel trade with Bulgaria (1995/2003*)*

Trade	Article	Total	OPT	%
1995				
EC import				
	61	63.3	28.8	45 %
	62	188.5	149.4	79 %
EC export				
	61	33.2	23.7	72 %
	62	26	13	50 %
2003				
EC import				
	61	246	14	5.7 %
	62	718	144	20 %
EC export				
	61	234	171.6	73 %
	62	94	24.5	26 %

Source: Eurostat, Comext (1995, 2003), author's calculations.

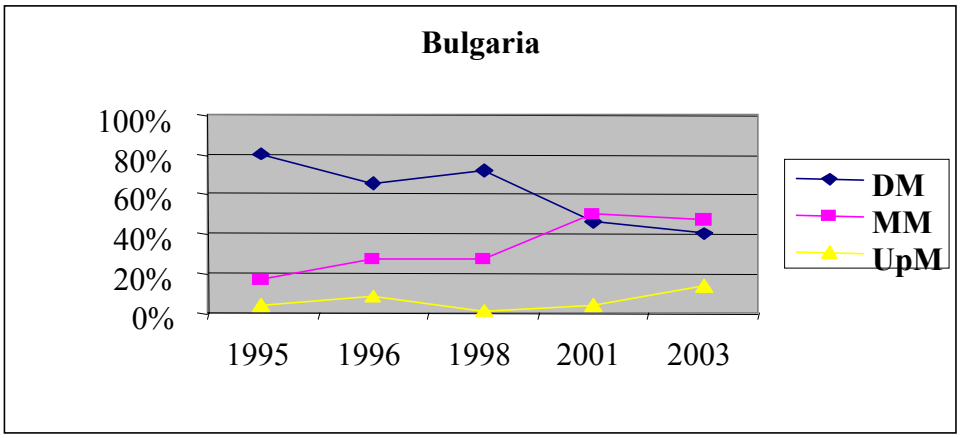
According to the table, in 1995, registered OPT export from EU to Bulgaria represented 72 % of total exports in article 61 and the share was preserved in 2003 (73 %). It is important to note, however, that the registered value of OPT exports of apparel products for assembly in Bulgaria in article 61 increased substantially. According to Eurostat, in 1995, EC exports from Bulgaria for OPT have been estimated at 23.7 million ECU, while in 2003, they have reached a value of €171.6 million. At the same time, although the value of goods which EU exported to Bulgaria for assembly under OPT increased, the value of OPT EU import from Bulgaria (article 61) decreased between 1995 (28.8 million ECU) and 2003 (€14 million).[99] How could Bulgaria import goods for OPT assembly in 2003, estimated at €171.6 million (article 61), while exports of assembled goods to the EU market under OPT be valued at 14 m. EUR (article 61)? This discrepancy in the statistical report is considered and adjusted accordingly through ***Section C***, which takes into account the exports of apparel intermediary goods from EU

[99] To recall, this is the EU import, which Bulgarian firms register as OPT goods.

countries to Bulgaria, which are registered for assembly under OPT, but are not reported as OPT exports. There is also another adjustment, already applied in the Turkish case, related to the increase lath for qualification of unit values into the three dimensional scale: >20 % (up-market); ±20 % (middle-market) and <20 % (down-market). As a result, Bulgaria preserved its high concentration in down-market exports in 2003 (40%). The up-market exports only slightly increased compared to 2001 and account for 13 % of the value added, while the middle-market goods slightly decreased and represent 47 % of value added of exports from Bulgaria to the EU market.

Therefore, after analyzing the UVA for the period between 1995 and 2003, it may be concluded that the middle-market and down-market exports stay high.

Fig.18 EU textile and apparel imports (1995-2003)



Source: Eurostat, Comext, author's calculations.

Bulgaria has only slightly improved at the end of the research period compared to the initial point. Between 1995 and 2003, the down-market textile and apparel goods from Bulgaria to the EU market decreased by 40 %, but the up-market exports increased only by 9 %. Moreover, Bulgaria exported many clothing goods under OPT. Finally, Bulgaria registered a substantial decrease of its textile export as percentage of total exports to the EU as a result of the deterioration of the domestic textile industry.

6.2 Network level

Based on interviews with textile experts, state officials, branch association representatives and firm managers, the author was able to identify the distribution of firms in the Turkish T/C industry, according to the GVC export roles' model. A very insignificant number of firms (1 % of total T/C exporters) perform ODM and OBM in Bulgaria, while about 9%-19 % are in OEM and thus able to organize the supply of textile inputs or raw materials, manufacturing and distribution. Subcontracting is done by majority of the firms in Bulgaria (75%-85 %), while the rest of the firms are exporting primary textile commodities (5 %). A graph clearly identifies the linkages between local firms and their connectedness with foreign firms (*Appendix G*, Bulgarian Apparel Value Chain: 270).

The raw materials (cotton, silk, wool, linen and hemp) are supplied from abroad, which makes it difficult for the Bulgarian textile producers to organize the imports and pay in hard currency. That is why, frequently, the textile firms look for local or foreign trade agents to help them connect to foreign suppliers and organize the import. The increasing import of raw materials, as a result of the substantial decrease of domestic supplies since early 1990s and the commissions paid to the agents has raised the price of the Bulgarian textile product.[100]

Bulgaria does not have cotton fields and the local supply of wool is also limited, hence before 1990, the registered textile imports were predominantly raw materials (cotton and wool).

[100] For instance, a group of professors, executive director of textile enterprise and branch association expert confirm in report delivered to the Ministry of Economy in April 2005 that the domestic supply of wool has totally satisfied the local textile production as 36.158 tones of wool have been delivered in 1984 compared to 6,000 tones in 2003. The experts underline the importance of imports of supplies for the textile industry, especially of cotton from the Soviet Union

In the 1980s, Bulgaria imported about 70,000 tons of cotton and 1,150 tons of wool annually. The most important cotton importer was USSR with 75 % and Egypt with 5 % share from total cotton imports, while Australia and Mongolia have been the most important wool importers between 60%-80 % share for the first and 5 %- 30 % share for the second one, depending on the year (Annual Statistical Bulletin 1990: 339).

Russia has been an important cotton importer since the 1970s when Bulgaria bartered a deal of textile and clothing export in exchange for imports of petrol and cotton.[101] After 1990, the situation with limited raw materials worsened because there was no large state trade agent, like *Industrialimport*, to organize large orders of raw material supplies and the economic relationship with the former Soviet Union block came to a limit (Yanev Boyan, 13 April 2003, interviewed by the author, Sofia).

In fact, the local demand of apparel producers substantially decreased by the end of 1990s. As a result, local textile firms could not compete on the local market, but began to look for buyers abroad. The Bulgarian textile industry became detached from the Bulgarian clothing industry, especially after 1997 because the majority of Bulgarian clothing manufacturers concentrated on international subcontracting (OPT) manufacturing and full-or semi-subcontracting with US buyers.

The Bulgarian textile producers, working for export, can be divided into three categories: prospective, stagnant and declining.

The group of *prospective textile firms* comprises 20 % of all textile and knitwear firms. These are former State-Owned-Enterprises (SOEs) which have received substantial

[101] Interviews with Lyubka Aleksieva, 23 April 2003, Sofia, former public official at the Ministry of Light industry in the period 1975-1987; Konstantin Vlachov, 20 May 2003, Sofia, former expert at the Ministry of the Economy between 1992 and 1999) and Boyan Yanev 23 April 2003, Sofia, former General Director of "Pamukoteks".

investment by foreign firms that enabled outdated machinery (spinning, weaving, finishing) to be replaced, new technologies to be introduced and quality of production to be increased (AATEB representative, 20 April 2002, interviewed by the author, Sofia). Miroglio Bulgaria AD, the Bulgarian subsidiary of Miroglio SpA Italy, is such an example. It is one of the largest textile groups in Europe with 7,000 direct employees and €750 million of annual revenues.[102] In 1998, the firm began intensive program of investments in Bulgaria for a vertically integrated production. By 2003, Miroglio has invested $153 million in five production units: a) dyeing-printing factory in Elin Pelin (Sofia region) for production of printed fabrics in viscose, cotton and polyester;[103] b) wool factory in Sliven for spinning, weaving, dyeing and finishing of wool and wool blends fabrics;[104] c)weaving factory in Sliven of viscose and polyester fabrics; d) spinning-twisting factory in Nova Zagora and e) factory for production of knitting yarn (Raumer Bulgaria), JV with "Raumer Italia". The five units, fully owned by foreign capital, employ about 1,700 people (7 % of total textile employment in Bulgaria).

Another example of a *progressive textile firm* is Coats Bulgaria, Sofia, which is the Bulgarian subsidiary of Coats PLC – London, UK, the largest manufacturer and distributor of sewing and embroidery threads (industrial and home use), hand-knitting and consumer craft products and second largest producer of zippers.[105] Coats Bulgaria

[102] This company has been announced "Exporter for 2002" by the Bulgarian Ministry of Economy. For more information about the company, visit their web site: www.gruppomiroglio.com/tessile. Information for the investment of the company is obtained from "*Bulgaria, Textile and Apparel: Opportunities for Investment",* prepared by the Bulgarian Foreign Investment Agency and issued in May 2002; additional information is found in Bulgaria Fact sheet 2004: Textile and Clothing sector, source: Invest Bulgaria Agency, formerly known as Bulgarian Foreign Investment Agency, www.investbg.government.bg.

[103] Greenfield investment award by InvestBulgaria Agency in the year 2000

[104] This company, formerly known as Slitex AD from Sliven has been interviewed for the purposes of the research. It was completely renewed in installation and machinery.

[105] J&P COATS Ltd. from Glasgow has been present in Bulgaria before 1945. Joint Venture "Bulgaria" has been created between the UK firm and the Bulgarian firm "Bratya Stainovi" for the production of embroidery threads in 1930 with a capital of 20 million leva. The chairman of the management council was

was established in 1993 as a distribution centre and its wait-and-see policy came to an end in 2002, when the company began local production. In October 2003, it made a Green Field Investment (GFI) in a new production facility for $3 million. It has only 69 employees and the annual turnover for 2003 has been estimated at €4.4 million. They have a development strategy, which aims at expanding current capacity with the investment in new machinery in 2004.

Not only large companies, but also smaller knitting companies invested in Bulgaria. For instance, a Greek-American investor came in Bulgaria in 1992 to create *Pangaea*, a company with its own production facility in Sofia, when foreign investment in the T/C industry was non-existent at that time. Over the next eleven years, it became one of the major exporters of knitwear to Europe and to the US. Moreover, knitwear produced by Pangaea with the "Made in Bulgaria" can be found in many retail catalogues, like Express, Karstadt, Quelle, Neckermann, C&A, which are among the top European retail firms.[106]

The group of *stagnant textile exporters* is represented by 20 % of all textile firms in Bulgaria. These are primarily all those former state-owned enterprises, which were transferred into private hands in the 1990s and could not manage to improve their position on the market. After loosing the Soviet Union market, these firms managed to replace it with the Western markets, but it is very difficult to improve their position without investment from abroad. Vratitza Ltd, one of the largest Bulgarian cotton textile companies benefited in the 1990s from the vertically integrated production cycle of the

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the Bulgarian entrepreneur. The JV has been credited by the UK firm, which sometimes overpassed the amount of 100 million leva per year. On 23.12.1947, the nationalization sweeps the firm and Coats had to leave the country. They came back to Bulgaria after 1989 but the Bulgarian state did not meet their restitution claims. After mid-1990s, the Bulgarian Investment Fund "Doverie" purchased 30 % of the factory, while privatization fund "Petrol" bought another 17.52 % (Textile journal 1991: 10-11).

[106] For more information about the company, please visit www. http://www.pangaea.bg

firm, inherited from the socialist period.[107] Spinning, weaving, finishing, printing and sewing close the technological cycle, coupled with purchase of ISO certificate, often required by European foreign buyers. However, Vratitza Ltd, as well as other similar Bulgarian textile producers find difficulties in meeting their production capacity and addressing the new market situation.

Finally, the *declining textile exporters* comprise 60 % of the textile/knitwear factories. Such examples are Maritzatex and especially Galatex, which are both large formerly state-owned cotton textile firms. They inherited obsolete machinery, did not have capital to reinvest after privatization and the new owners, MBO, in the case of Maritza and restitution in the case of Galatex had to substantially decrease production and employment. Another example of declining activity is *RUEN*. This is a knitwear company (the umbrella firm of four privatized enterprises), once major supplier for the lead German firm, PUMA, best performing Bulgaria firm in the 1990s and export leader in 2001, which was liquidated in 2003.[108]

The clothing firms, as in the case of Turkey, are distributed in three types: a) high added value companies; b) medium added value companies; a) low added value companies. An insignificant number of the clothing exporters (about 1-2 %) are concentrated in the niche of *high value added companies*. These are either Fashion Houses which design and prepare small collections that are presented for the Spring/Summer and Autumn/Winter season (e.g. Jeni Style, Fashion House "Tani")[109] or firms, like Rila Style, well known fashion house in the socialist period, which nowadays,

[107] More information about Vratitza factory available at www.vratitza.com
[108] The case of *RUEN* is a good example for an outcome created because of generated high dependency by the foreign big buyer. In-depth analysis of this case will follow in subsequent subsection.
[109] For more information, go to www.tanifashion.com/companyinfo.htm; www.rila-style.com; www.jenistyle.com.

thanks to French investment, designs its own collections with their own brand names, partially manufactures its own products (mostly subcontracts to other Bulgarian firms) and presents its collections on international podiums (e.g. Prêt à Porter Paris), while on national podiums it receives top Fashion prizes.

A comparatively higher number of clothing exporters (about 20%-30%) are concentrated in the *medium value added* segment. These firms offer organization of full-package production, but frequently receive subcontracting orders for assembly production from big buyers, like Zara (Spain), Benetton (Italy), Quelle (Germany), C&A (Germany), Max Mara (Italy), Puma (Germany), Mango (Spain), Steilman (Germany), Esprit (Germany), Marzotto (Italy), Armani (Italy), Hugo Boss (Germany), Cortefiel (Spain), Triumph (Switzerland), Diesel (Italy), which are among the top European clothing firms.

Some other firms in this segment, like Albena Style and Ropotamo, are formerly SOEs, which were privatized in mid-1990s and transformed into private firms through MBO or the mass privatization scheme. These firms rely on their old management staff, which established contacts with Western European firms in late 1970s and the firms' good reputation on the European market, created in the 1980s. Other firms with local capital (Alfa 71, Brilliant Invest) and foreign capital ($19 million German investment by Rollmann in Pirin Tex) managed to grow in the 1990s and become the leading exporters, working for the big European buyers. The typical characteristics for these medium value added companies are that they have the capacity to offer design; help with the marketing; and offer their own brand and logistics. But they are often pressured by the big buyers to focus on assembly production. In addition, they are asked to provide more capacity at

lower prices, which these firms can only offer by subcontracting work to other small Bulgarian companies.

These other small companies, sometimes 15-20 firms clustered around the medium value added company, represent around 70 %-75 % of all clothing firms in Bulgaria, and are *low value added* exporters. These firms, which usually employ 30-99 employees, are exclusively focused on assembly production and their upgrading reaches only the standard required for quality production. Activities such as designing, marketing, branding, and utilizing sophisticated technology (CAD, CAM systems) are totally missing. The organization of production, and therefore labor productivity, in these enterprises is limited.

The foreign buyers and trade agents play a role in Bulgaria. Sometimes foreign buyers totally control the value chain by arranging for the textile inputs from Bulgarian textile producers for the Bulgarian clothing firm from which they order OPT assembly of apparel goods. Thus, the foreign firm has minimized the direct contact between local textile and local clothing firms. In other cases, it is a Bulgarian trade agent which arranges subcontracting to other local clothing firms for foreign buyers. Many SMEs and some large firms (1000+ workers), such as Vida Style, Albena Style, Druzba Style, work as subcontractors and when the order is too big or there is a need for flexible operation (small series production), the large firms subcontract again to smaller firms. In addition, many of these subcontractors are actually operating illegally in order to keep up with competitive prices. That is why large clothing manufacturers prefer to keep a permanent linkage with a satellite of 20-30 small firms and to supervise their work on a daily basis. It is not only ready-wear firms but also trade agents (mostly foreign trade agents) that

work directly with legal or illegal small subcontractors. Ready-wear firms are contacted by trade agents, distributors or directly by lead firms. The common feature of lead firms (retailers, branded apparel manufacturers or marketers) in Bulgaria is that they control the value chain. The power of the Bulgarian clothing firms is very limited since there is very high local competition. Moreover, local firms have limited knowledge of how to perform full-package production, create the designs and present their own brand to the Bulgarian and the foreign market. The power of local clothing manufacturers is also undermined by the operation of trade agents and distributors, who hold the contacts with foreign retailers and marketers. With the exception of *RUEN*, before it was liquidated, and Rila Style, which directly work with PUMA and MANGO, Bulgarian clothing firms hardly have a direct contact with lead firms without the interference of foreign trade agents or distributors.

6.3 Firm level

This section looks at results from survey, conducted by the author, of dependency and upgrading of 62 firms from the Bulgarian T/C industry, followed afterwards by an in-depth analysis of three firm case studies.

6.3.1 Survey results

The survey among textile and clothing firms in Bulgaria was conducted by the author during two distinct periods (April-May 2003 and June-July 2004). Majority of the firms interviewed were SMEs (70 %). These are primarily clothing companies (61 %) and their major regional market is that of the European Union (81 %), while Germany is their major export market (37 %). A large majority of the firms are export-oriented as 96% export more that 60% of their production. 87 % of the firms are privately owned and 85

% are owned by local investors, while 5 % are foreign-owned and 10 % are mixed (domestic/foreign investment).

The interviewees, interviewed in person, are all managers. The middle management (manager, chief accountant) represents 60 % of all interviewees, while 1/5 are firm owners and the others are deputy executive directors or executive directors. About 2/5 of the respondents have more than 14 years of experience and 83 % have more than 8 years experience, therefore the Bulgarian sample consists of persons with high experience in the T/C business.

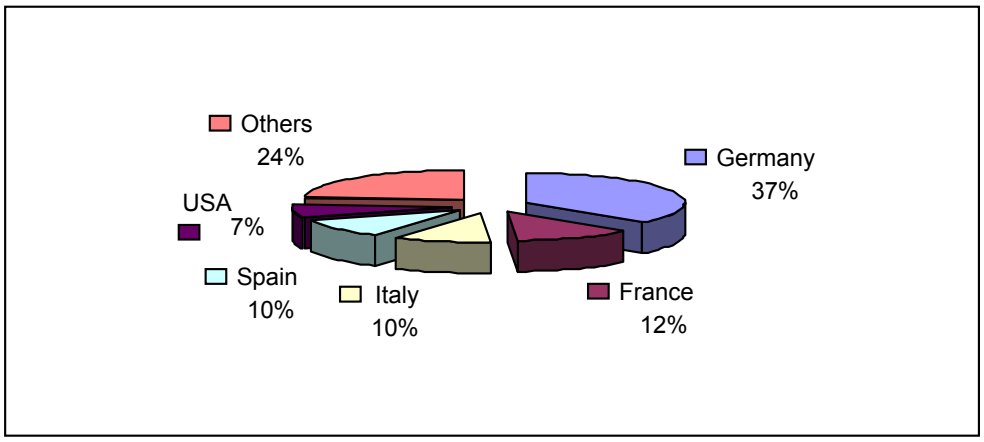
The distribution of the firms in the survey is similar to the actual distribution of firms in the Bulgarian T/C sector. 33 percentage of the interviewed firms were established before 1990, while almost every second firm (46 %) in the survey started between 1990 and 1995. Newcomers to the market (those created after 1995) represent 21 % of the interviewees.

a) Dependency of Bulgarian firms

Major export markets and buyers

As already mentioned above, the biggest export market for Bulgarian T/C firms in the survey is that of Germany (37 %), followed by other EU countries.

Fig.19 Major Export Market: Bulgaria



Source: Author's calculations based on own survey, 2003-2004.

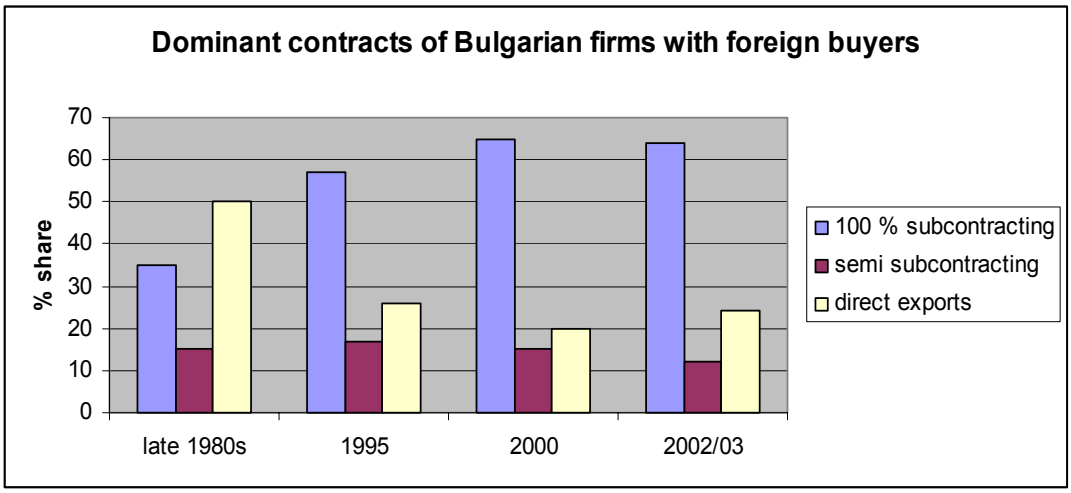
The survey shows a total of 25 % of the firms are *very highly* dependent on the two most important buyers, while 35 % of the interviewed firms are *highly* dependent on their two main buyers. These two combined represent 6 out of every 10 firms. *Medium* dependency is observed in almost 30 % of the firms, while low dependency is found in only 1 out of every 10 firms.

We can also ascertain dependency of Bulgarian firms on their top export market. *Very high* concentration is observed in 15 % of the firms, while there is *high* concentration in 41 % of the local firms. These two combined represent again 6 out of 10 companies. Furthermore, about 30 % of the Bulgarian firms indicate between 40 % and 60 % (*medium*) concentration in the top export market and only 15 % of the firms have *low* concentration on their top market. Therefore, local firms find it difficult to diversify their portfolios of buyers and export markets.

Dominant contracts of firms

The more the firm is concentrated on full-subcontracting or semi-subcontracting, the lower the chance for firm's upgrading, hence higher dependency and limited opportunities for learning for the local firm. There is a trend of full-subcontracting of Bulgarian firms for foreign buyers, performed between the end of 1980s and 2003.

Fig.20



Source: Author's calculations based on own survey, 2003-2004.

Bulgarian firms in the sample were mainly direct exporters in late 1980s, although full subcontracting and semi-subcontracting was also present at that point.[110] This is likely due to the large percentage of exports to the Soviet Union market as % share of total Bulgarian T/C exports. Throughout the 1980s, Bulgarian firms exported directly to Soviet Union markets, whereas production for European Community markets was subcontracted, with the design and brand provided by the Western partner (Boyan Yanev, 15 April 2003, interviewed by the author, Sofia). In 1995, there is a sudden shift towards full-subcontracting as percentage of total exports, which led to an increase in exports to

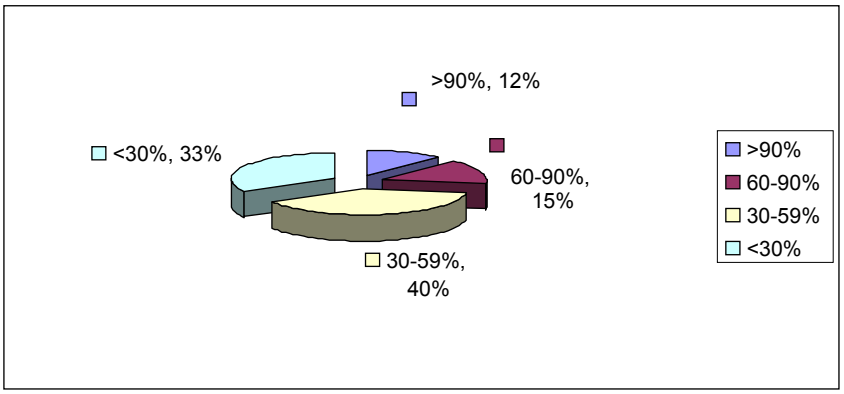
[110] This is confirmed in interviews with managers of Bulgarian T/C enterprises. Among them also underlined by Stefan Kolev, executive director of RUEN, in interview from 11 May 2003, who clarified that full subcontracting is usually performed by clothing firms, while textile and knitting firms perform semi- subcontracting.

the European Community over other regional markets. The trend of full-subcontracting is preserved throughout the following two periods (2000 and 2003), as over 60 % of the firms did mainly work on full-subcontracting basis with foreign firms. This confirms the general opinion of managers in the sector, who, when asked, claim that the largest percentage of the local firms that export to the EU market work under full-subcontracting, although not registered in the customs documentation.[111]

Suppliers and place of origin of raw materials/textile inputs

Majority of the Bulgarian firms are not dependent upon suppliers because a total of 73 % of the local firms have indicated that they have low (<30 %) and medium (30%-60 %) dependence upon the two most important suppliers, as seen from the next figure.

Fig 21 Share of Bulgarian firms' two most important suppliers



Source: Auhor's calculations based on own survey, 2003-2004.

Regarding the supplies' place of origin, little more than half of the firms (53 %) rely on EU suppliers, while 17 % of the firms look for supplies in Turkey and 9 % in East Asia. Only 15 % of the firms use primarily domestic supplies, which does not assist in the development of the local textile industry.

[111] This is confirmed by interviews with a group of managers of Bulgarian firms, who gathered for a seminar in Hisarya (Bulgaria) between 9-12 October 2003, organized by the Bulgarian association of textile and apparel exporters. This came out also as a result of numerous conversations with managers of clothing enterprises.

The textile inputs (fabrics and yarns) are supplied primarily from the EU. This corresponds with the presence of a high share of full-subcontracting performed by local clothing manufacturers for EU buyers as the unit value analysis has already shown. Since the supplies arrive in Bulgaria as part of the subcontracting contract, it is not the local firm which signs the deal with the supplier and organizes the delivery, but the foreign buyer. For instance, Greek firms, which established many clothing firms in Southwest Bulgaria, organize the import of textile inputs from neighboring Greece, perform full-subcontracting in Bulgaria and re-export to the EU market. A number of interviews with textile experts have revealed that Bulgarian clothing firms in Southwest Bulgaria worked predominantly on subcontracting basis in 2003. Greek firms came to Bulgaria in mid-1990s, while after 2000, Turkish firms began to do the same in order to use Bulgaria's unfulfilled apparel quotas for the US market (Stefko Kolev, *RUEN* executive director, 11 May 2003, interviewed by the author, Sofia). It is likely that this is the reason why 17 % of the local firms report import of textile inputs and raw materials from Turkey.

The role of trade agents

There is less dependency of the local firm in case it is able to work directly with suppliers and buyers because it evades granting commission to the trade agent and creates a possibility for direct backward (with local firms) and forward (with foreign firms) linkages, which increases the chances for the local firm to be competitive on the market.

The survey shows that large percentage (66 %) of the Bulgarian firms use trade agents to work with foreign buyers, while 40 % of the Bulgarian firms use trade agents to work with foreign suppliers.

Why do trade agents play such an important role in Bulgaria? The answer to this question was explored by interviews with trade agents in Bulgaria.[112] Some of these agencies employ 4-10 people with an annual turnover of around $250,000 (e.g. Vikitex, Express Intellect), while others (Astra Commerce, NTC and TVS) have more than 10 employees and have an annual turnover of about $1 million. Most of the trade agents in Bulgaria are private agents, who work for themselves and at the same time represent foreign firms (e.g. TVS is representative of famous French firm, NTC of several German firms). The trade agents mainly work as importers of raw materials (wool, cotton, silk, flax and linen) for the local textile industry or as importers of textile fabrics and yarns for the clothing industry. They are engaged with foreign retailers, marketers or branded manufacturers, who subcontract sewing work to local Bulgarian firms. One common feature of the agencies that were interviewed is that they started work in the early 1990s and they have managers with over 20-30 years of experience in the textile business. In addition, all of these managers are former employees of former state trade agent, *Industrialimport*.

One interviewee said that the managers left the state agency with their contacts and became rich in no time due to the contacts they have with foreign buyers. Finally, the trade agents work with a satellite of, on average, 100 local firms from all over the country. Their commission varies between 5 % and 10 % from the deal, depending on the volume of the orders. According to the trade agents, large percentage of the Bulgarian clothing firms operates under full-subcontracting and their major problem is to find market for direct exports (full-package goods). Moreover, local firms do not have direct

[112] The author interviewed five trade agents (Express Intellect, Astra Commerce, Vikitex, NTC and TVS) between 20 and 29 April 2004, Sofia.

links with foreign buyers because it is very difficult to establish such. That is why trade agents, especially those that have over 20 years of experience with foreign buyers, have played and continue to play important role in the Bulgarian T/C industry. According to the trade agents, there is another reason for Bulgarian firms not to be able to find vital foreign partners, "It is the highly competitive environment in which there are almost no rules".[113]

The trade agents interviewed import raw materials/textile inputs from the EU, but also from Turkey, the Far East and Australia. Moreover, they often operate directly with foreign buyers from Italy, Turkey, Germany and France, which came to Bulgaria to manufacture under subcontracting solely for export to the EU market. The trade agents stressed that all their Bulgarian partners ask for postponement in payment and it is especially difficult to work with the large Bulgarian clothing firms, whose management often negotiates for the percentage of the commission. This confirms the presumption that the bigger the firm, the better its negotiating power. Furthermore, the trade agents shared that competition in the Bulgarian market has increased substantially with the entrance of large foreign investors. For instance, the French firm "Dewavren" from Parvomai (wool textile producer) invested in Bulgaria in 2001 and within two years, managed to win the bid to supply the local large factory of Slitex (Italian investment from Miroglio). This let to the collapse of Velbyzd, a local wool textile producer, which was once the biggest in the Balkans.

[113] Several large Bulgarian clothing firms (400+ employees) worked for the French army. The French contractor did not pay for the order and returned the goods. The result was that the Bulgarian firms quickly went bankrupt. Through such negative examples, the trade agents justify their existence on the Bulgarian market by facilitating the contact between locals and foreigners and building trust between buyers and suppliers (story told by trade agent representative of Express Intellect, 21 April 2004, Sofia).

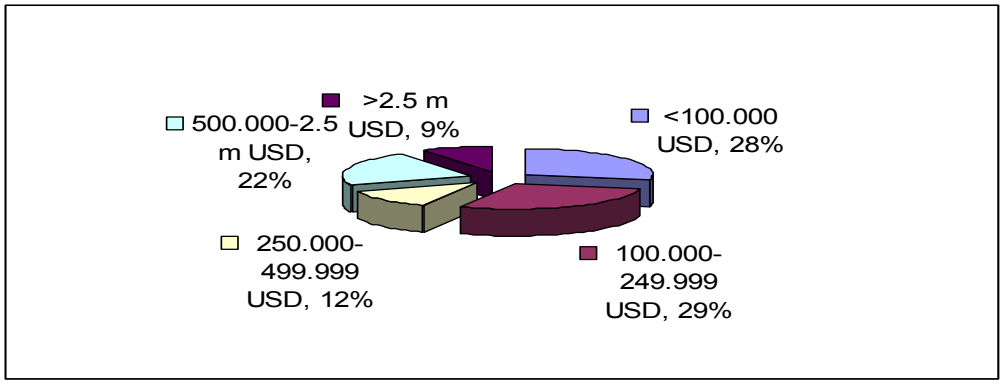
In sum, managers' contacts of current trade agents with foreign buyers before 1990 have given them a chance to maintain these relationships and become inevitable partners in the linkage between local and foreign firms. This, however, represents a burden for local entrepreneurs who have to pay commissions and rely on these trade agents.

b) Upgrading of Bulgarian firms

Product and process upgrading

About 40 % of the firms in the survey declare that they have not developed a new product line to keep up with the challenges of the new competition. In terms of investment (technology and know-how, machinery and equipment, reconstruction of buildings or new buildings), the firms are also weak since a majority of the firms (57 %) have invested less than to $250,000 since 1990. Moreover, 30 % of the firms from the survey have invested less than $100,000. Only 9 % of the firms have invested over $2.5 million, although 30 % of the firms from the sample are large, thus opportunities for product and process upgrading should have been higher.

Fig. 22 Share of Bulgarian Firms' Investment



Source: Author's calculations based on own survey, 2003-2004.

What could be the reason for low investment by the Bulgarian T/C companies? The restrictive bank credit policy, a result of the bank crisis in 1996/1997, is likely to be a

reason for that. The interviews with firms from the survey disconfirmed this. Half of the Bulgarian small firms invested through local bank credits, while the other half reinvested their profit into the company. A few local firms have benefited from the EU's PHARE program to encourage technology transfer from foreign companies. As far as the large firms are concerned, large majority of them have used local bank credits. Some of them (such as Galatex, Maritzatex, and Vida Style) fully financed their investment with bank loans, while others (Ruen and Druzba Style) used bank loans for 70 % of their investment from bank credits, like (clothing firm), while still others (Albena Style, Rila Style, Kateks and Rositza) only received between 30 % and 50 % of their investment from local bank credits. Therefore, the majority of the interviewed local firms, especially in clothing, which necessitate lower investments, have used local bank credits in order to finance their long-term investments. Interviews with a group of 30 clothing firms, members of the Bulgarian association of exporters of textile and clothing, confirmed that they have a preference for local bank credits only after they receive support from state and branch associations for their marketing research for foreign markets, incentives for direct export and tax incentives for import of textile machinery.[114]

Functional and organizational upgrading

A relatively large share of companies in the survey declared the ownership of brands (56 %). It is another matter, however, whether the brand is established on the market. For example, the executive director of *RUEN* shared that the name of his company is well known in the foreign market, but not as a brand of clothing, but rather as a respected

[114] Survey results from a questionnaire that was distributed by the author in a seminar, organized by the Association of Bulgarian Textile and Apparel Exporters, 31 May 2003, Hisarya, Bulgaria.

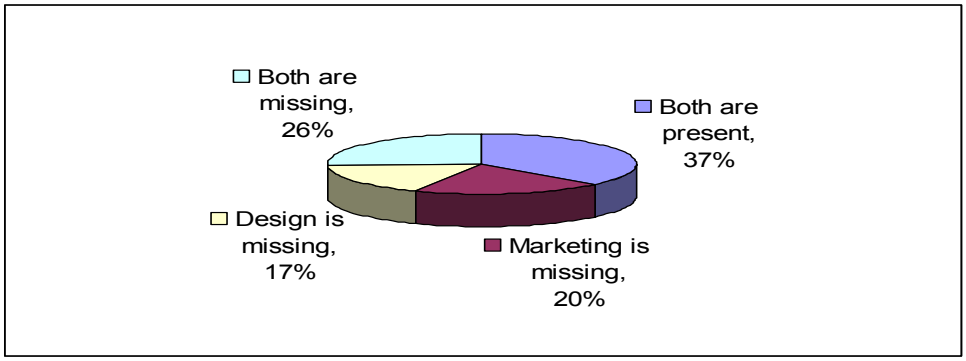
manufacturer of knitting products. He stated that this is because, "It costs a lot of money in advertising to establish a brand".

Branding is a concept still not well developed in Bulgaria, commented in an interview, Martin Kozhuharov, Brand manager of Rila Style, the firm which received a Bulgarian award for its brand (Ulpia Serdika) in 2003 (26 May 2003, interviewed by the author, Sofia). There are few traditions for clothing branding in Bulgaria and, thus there are good experts in this field, confirms Mr. Kozhuharov. Many people in Bulgaria started in the clothing business under subcontracting because they only had to buy equipment and sewing workers and the return on the investment took only 3 months. The creation and establishment of brand requires at least three years. Rila Style, for instance, recognized the need for a brand in 1996 after its first prêt-a-porte in Paris and three brands were created (Gets, Thema and Batibaleno). Rila Style did it because the management believed that firms that offer intellectual product will be successful in the future. The brand manager stated that Bulgarian firms need to start branding or, "…many local clothing firms will collapse as a result of the high competition from China".

Furthermore, Mr. Kozhuharov explained that it is also very difficult for local firms to establish their own shops at home and abroad as Rila Style did. Large clothing firms with their own retail chains in Bulgaria are simply missing. Firms, like Rila Style are rare in Bulgaria as only 4 % from the survey indicate that they have shops at home and abroad, though 40 % of the firms from the sample indicate that they have shops in the domestic market.

The results from the survey show that majority of the Bulgarian companies face also difficulties with organizing their own marketing and design activities.

Fig.23 Marketing and Design departments in Bulgarian firms



Source: Author's calculations based on own survey, 2003-2004.

Only 37 % of the firms have both departments, while every fourth company has only one or the other. Other 37 % do not have either the marketing or the design department. This demonstrates that many Bulgarian firms do not have competitive strategies and miss a long-term vision because ODM and OBM production is considered to be the highest step in T/C firm's development.

The organizational upgrading is tested only with one indicator. It identifies whether the firms have ISO standards or firm audits. In the case of Bulgaria only 34 % have shown such. Official figures from 2001 show that only 2 firms in Bulgaria have received certificate ISO 9002, while 11 have received ISO 9001.[115] Three years later (August 2004) a total of 32 apparel producers (including knitwear) and 11 textile producers have been successfully ISO-standards certified, which represents an insignificant share of total exporters (Sector Development Strategy of Bulgaria 2004: 27).

The following common features characterize the certified companies:

a) Large enterprises with personnel of more than 250 people and more than one production division;

[115] Official figures provided from a research of the Bulgarian association of apparel and textile exporters (2001).

b) Clearly stated export orientation – all companies but one export more than 95% of their production;

c) Export to more than one foreign market, the two main buyers of each of the enterprises form less than 60% of the total turnover of the respective company;

d) All of the companies have their own registered brand.

The fact that so insignificant percentage of Bulgarian textile and clothing firms have been certified means that majority of the local firms do not respond successfully to the challenges of the international competition. These certificates are especially needed for Bulgaria since its major buyers are EU retailers which require ISO certificates to be provided to guarantee production quality.

6.3.2 Analysis of three firm case studies

Case one: Druzba Style

This clothing company, established in 1957, became one of the leading Bulgarian clothing exporters. "Druzba Style" (henceforth called *Druzba*) began producing apparel (men's and women's clothing) for the internal market. By early 1970, *Druzba* began to export to the Soviet Union market 76 % of its total production. The internal market absorbed 18 % of total production, while the remaining 6 % of apparel production was exported to the Western market. At that time the entire Bulgarian T/C industry was oriented towards the Soviet Union (75 %),[116] which provided an unrestricted market for direct exports and no competition under the CMEA regulation. Thus, Bulgarian clothing

[116] 15 percent were sold to Western Europe, Canada and US and the rest 10 % to the domestic market (Strategy for the development of the Textile, Knitwear and Clothing Industry in Bulgaria, 1999).

companies, including *Druzba*, had experienced personnel in sewing, yet they neither needed to differentiate product, nor did they feel the need to increase efficiency, when exporting to the East (Vlaikov Georgi, 12 May 2003, interviewed by the author, Sofia). The designs of these clothes and the colors that were used were significantly different from those in Western Europe and their products did not meet the quality standards of the European market. Still, *Druzba* and other Bulgarian clothing companies established partnerships with western companies as well, but mainly through subcontracting. Through this scheme, the design and brand, quality textile fabrics, technology and skills were imported from the west.[117]

Druzba became the third most important clothing entity in the "RILA" system, which is the state umbrella organization of knitting factories.[118] It exported to Western Germany, Belgium, Austria, Libya and later on the UK, Canada and France. In the 1980s, new markets were explored in Italy, Holland, Finland and the US. The target of the factory in the 1980s was to diversify its clothing products (in addition to men's and women's suits, they started to produce light men's and women's coats, jackets, and bathing suits). Similar to other Bulgarian factories, *Druzba* opened seven production units that were established in the villages and two small towns close to Varna, where the company was located. In the 1980s, major companies from the west, such as "Yuteks", "Quinswear", "Morvil" and

[117] The company experienced three periods of reconstruction and modernization of the production 1957-1960, 1961-1969, 1970-1975 and 1987-1989. The period before the last one is related to the transfer of technology and know-how from Western Germany for subcontracting production. For example, new European table for heights was introduced in compliance with the age characteristic and weight. New equipment was purchased from "Hofman" and "Texima". After 1976, new automatic machinery, specialized in the production sections of wearing apparel, was purchased. According to this new equipment, new organization and technology of production was initiated. In the 1980s, new complex system for quality control was introduced and the company introduced designer system for model and construction, and production line for men coats. 114 sewing machines were imported from Western Germany and by the end of 1980s, the ironing technological lines were equipped with new machines.

[118] Other major clothing and knitting export companies from this period, which i have interviewed for this thesis, were Rositza (Sevlievo), Vida (Vidin), Orphey (Kardjali), etc., and from the textile producers were Kateks (Kazanlyk), Maritzatex (Plovdiv), Galatex (Varna), etc.

"Style-Kraft" from Canada, "Alexanders" from US, and "Sepala" and "Halonen" from Finland started to trade with *Druzba*. These linkages were usually subcontracting arrangements and the equipment, imported from the west, was paid for under this partnership (State archives, Varna, historical report on "Druzba Style", March 1982).

The Bulgarian government promulgated a Joint Venture (JV) Law (Decree 535, 1980) to attract Western technology and investment but *Druzba* did not take advantage of this. Or more accurately, the foreign companies were not interested in entering partnerships with Bulgarian firms, in general.[119]

Why there was no interest in JV agreements? In early 1980s, OPT trade of the European Community in textile and clothing with third countries began. OPT gave incentives to EC companies to establish subcontracting partnerships with companies from the Central and Eastern European region, including Bulgaria. Thus, foreign companies preferred to embrace non-equity forms of control, instead of direct investments under the Bulgarian Decree 535, because of fewer investment risks and more flexibility to move quickly to other countries with a cheaper labor force.

The economic recession of 1989, the year of the Bulgarian democratic revolution, affected negatively the factory. Production decreased, labor and technological discipline deteriorated, which had an impact also on the control and quality of production. In addition, Loukanov government announced moratorium on the payment of external debts in March 1990 - inflation hit the economy and interest rates jumped. In May 1990, there was a meeting of the firm's management board, which decided that the factory should depart from "RILA" and form a new state enterprise. This was the case in all companies

[119] The decree was not used in eight other large Bulgarian ex-SOEs exporters, interviewed by the author in the period April-July 2003.

from the T/C field. In fact, the Ministry of Light Industry had been dismantled two years earlier (in 1988), paving the way for the abolishment of all seven state BAs in 1990.

The transformation of *Druzba* in August 1990 was accepted fairly well by the labor unions. However, salaries remained low, which led to the first factory strike in 1990. Still, the macroeconomic shock and the abolishment of the BAs were not the only harmful influences on the sector. After 1990, the Bulgarian T/C industry lost its major client – the Soviet Union and quick reorientation to the Western market was needed. *Druzba* was not an exception in this case and western markets absorbed 90 % of the firm's production. The entire production of *Druzba* in 1990 came down to 800-900,000 clothing items, compared to 1,200,000 in 1987. The company worked with 13 foreign buyers in 1990 and exported to the EU, Canada and the US market. By 1992, about half of *Druzba* production was under international subcontracting. The former Soviet Union market was completely closed and management began looking for new markets and new buyers, which increased to 30 in 1992. The *Druzba* case was unusual because not all managing directors in Bulgarian T/C firms had the chance to communicate directly, as *Druzba* did, with their Western partners before 1990. This role was usually conducted by the state BAs. When the associations were destroyed, the channels with the foreign firms from the west automatically disappeared. After 1990, the SOEs faced difficulties in finding foreign clients and had to contact former employees of the BAs, who began to operate as private trade agents in exchange for high commissions.

In 1993, *Druzba* became the largest Bulgarian clothing exporter and worked to full capacity, earning a profit of $330,000. The biggest buyers came from Germany and Denmark.

In 1994, a procedure for privatization of the factory was opened. At the time, the firm worked with 20 European and 5 US companies and these contracts accounted for 96 % (3/4 of which was in subcontracting) of total production. The procedure for privatization of the company took two years and it finished on September 16, 1996, when an MBO purchased 60 % of the capital.

In-depth interviews (May-June 2003) were conducted with a manager from *Druzba* to examine the recent developments in the company. In 2003, it is one of the top ten exporters of Bulgaria with an average annual turnover for the last decade with over $5 million. Almost all of its production (99 %) goes for export. The biggest markets are France (30 %), US (25 %), and Germany (10 %). The firm has neither a garment collection nor its own brand, which is why it does not need separate marketing department, the manager explained. Hence, there is a limit in functional upgrading. "We also do not need ISO certificate," he continued, "because we intend to focus our work on the US buyers, who rely on internal audits". Therefore, the firm did not recognize the need for organizational upgrading. This, together with the high dependency of the firm from its two most important foreign buyers (60-90 % of the orders) demonstrates inflexibility of the firm on the global market. Moreover, the future of the company is unclear because since 1996, it has produced on full- (40-45 %) and semi-subcontracting basis (55-60 %). In fact, the firm specialized in working under full- and semi-subcontracting because of the flexibility of approximately 30 firms that operate near *Druzba* and take orders. The manager admitted that most of the local small firms *Druzba* uses as subcontractors work in the shadow economy because they offer very low price for the labor-intensive work they perform. "In many cases we do not tell the foreign buyer

that we have a satellite of subcontracting firms," explains the manager, "because we do not want to loose the foreign buyers' trust in our quality of production". In fact, the manager explained that *Druzba* controls what is produced for the firm outside by sending quality control inspectors to supervise the work of the local subcontractors.

"It is not that we cannot do the full-package production", claimed the manager. An example was given of a foreign buyer, who came with a ready-made suit and ordered 10,000 pieces. The manager explained that *Druzba* supplied the textile fabrics, the design, cut-make-trim operations, and shipped the production overseas. The manager said that what is stopping *Druzba* from doing direct exports is the lack of turnover resources. On the one hand, this statement is surprising since *Druzba* has managed to obtain short-term, but also long-term loans, which is more difficult to get from local banks. Due to the loans, it was able to finance 70 % of the $2 million in machinery and technology in the past five years. Thus, it targeted process upgrading. On the other hand, the example given by the manager is just a sporadic case of an individual buyer. Organizing the production for the local firm is not as important as getting a stable buyer or a market with its own product on a long-term basis.

Druzba is far from making its own designs, offering its own brand, and using its own marketing channels to reach the buyer. This conclusion is alarming if we consider the highly competitive environment of global apparel trade, where competition is fierce. This failure of *Druzba*, a company with a long history, to meet the new challenges of the market, came as a result of the long-standing subcontracting partnership with foreign clients (mainly EU, but also US firms). The buyers have always provided their design, brand and marketing strategies, and demanded their local partner to perform the labor-

intensive operations only. In addition, *Druzba* indicated no support from any state institutions or branch associations for its export activities and the future development of the company is under threat.

Case two: RUEN

This company has a 40 year history. In the past, it used to manage 25 Bulgarian state knitting companies, as it played a role of state BA. After 1989, all firms in the RUEN system became separate *de jure,* but *de facto RUEN* continued to play its major role as a trade agent - providing export deals of Bulgarian knitting firms. In 1994, *RUEN* was privatized through MBO. Before the privatization, *RUEN* worked only as a trade agent. After the privatization, having also acquired four manufacturing companies, the management decided to create its own production of knitting articles for sport and leisure.

As stated earlier in the thesis, foreign buyers easily recognized the name of the company and that is why it was kept after the privatization of the firm. The company performed well in the 1990s and became one of the leading export firms and employers in the sector with 1000+ workers. After the MBO, the controlling shares were in the hands of the current executive director, Stefko Kolev, whom I have interviewed (21 April 2003, Sofia). He is manager from the old elite, who started his career in the sector in 1976 when he joined the knitting section team of the biggest state-owned trade company *Industrialimport*. In 1980, he was transferred to the West German office of the trade agent where he managed to establish contacts with German buyers, including PUMA. In fact, the German leader became the leading Western partner for *RUEN*.

Before the privatization, the export of *RUEN* was 3 million DM, which increased over ten-fold six years later. *RUEN* built traditional links with PUMA through a license contract, signed in 1994. Other foreign, but much smaller, buyers for *RUEN* include

REEBOK (Germany), CANDA (Germany), QUELLE (Germany), and SHIESSER (Germany). The foreign buyers demonstrate that the top export market for *RUEN* is Germany (over 90 % of total export). This is a very high concentration in the top market, which indicates a form of high dependency. The local market absorbs only 9 % of the production, while Spain and Italy have less than 1 % share together. It should be noted that the dependency of *RUEN* from foreign buyers is very high since only PUMA ordered over 80 % of total production. Combined with the second major buyer of *RUEN*, I found that *RUEN* has concentrated over 90 % of its exports in the hands of only two Western buyers. The firm is also highly dependent on the use of trade agents, based in Germany, who facilitate the work of the firm with German buyers.

The share of direct exports of the firm is very high, as subcontracting is done only for 25 % of its exports. However, we have to bear in mind that in general there is far less subcontracting in the knitting sector compared to the apparel sector. Therefore, the low percentage of subcontracting can not be used as criteria here to judge for dependency.

Textile supplies of the company come predominantly from the Turkish market (55 % share of total supplies). According to the executive director, the Turkish firms offer high quality and competitive prices. Otherwise, the firm purchases its supplies from Bulgaria (25%) and the EU (20%). In fact, the firm is highly dependent on imports, as far as 75 % of total supplies come from abroad.

RUEN has design and marketing departments and its own brand “Prima”, registered in the Bulgarian market. In addition, it opened a local chain of shops in 2000. It has also textile certificate “ECOTEX”, while PUMA conducts internal audits on annual basis. The firm invested in the range of $500,000 USD-2.5 million USD since 1994 in machines (85

%) and new production facilities (15 %). The investment came from local bank credits (50 %) and reinvestment of the profit (50 %). Therefore, the firm managed to achieve product, process, functional and organizational upgrading.

RUEN seems a success story. Building on traditional contacts with a big buyer, investing in machines, having their own brand and local chain of shops are strong criteria for success. However, it registered decreasing turnover trend in the past decade - in the late 1990s, it was over $10 million, while in 2002 it was down to approximately $1-2.5 million USD.

In fact, the company entered into a period of liquidation on 23 February 2003 because it could not settle payments on its bank loans. The reasons according to the report of the liquidator are the following:[120]

a) In 2001, the firm organized for the first time full-subcontracting production of sneakers for PUMA. The Bulgarian manufacturer incurred loss of 350,000 USD because of low quality of production led to them being returned.
b) *RUEN* lost $2.5 million from exchange rate between 1998 and 2002 because it paid for the import of textile inputs in USD but exported the product in EUR.
c) *RUEN* lost $1.25 million on an annual basis from interest rates and leasing payments.
d) International competition increased substantially and while the price of knitting products remained the same, the costs for production (electricity, water, transportation) increased.

[120] Report, written by Ivo Velchevski (liquidator), presented at the Sofia District Court in April 2003.

The most significant reason for *RUEN* liquidation, not mentioned in the liquidator's report, was that PUMA suddenly withdrew from *RUEN* in 2002 to find a new large manufacturer in China. The Bulgarian firm had no choice but to decrease its employment and production. A series of interviews with Kalina Nincheva, the Distribution director of the company, revealed that *RUEN* participated in trade fairs and attempted to attract other global leaders such as HUGO BOSS (April-August 2003, interviewed by the author, Sofia). However, it could not cope due to lack of experience and no support by any Branch association or state authority. Based on their high dependency on their most important foreign buyer, *RUEN* collapsed.

Why, after having links with a global leader and good channels with the German market, could *RUEN* not translate that experience into a learning process that would allow it to escape dependency by diversifying its customer base?

The reasons vary. *RUEN* demonstrated high inflexibility and huge gaps in its learning curve. For instance, the trade department included 25 employees, who worked in the Sofia office of the firm. There were some intermittent ideas in the 1990s to appoint official representatives of *RUEN* in UK and Germany but these attempts failed. Another striking example of inflexibility was that, as a multi-million firm, *RUEN* did not have a marketing expert at its headquarters but counted on the limited experience in this area of an engineer, who was responsible for the marketing channels of the firm. Needless to say, research on foreign markets and exploration of potentials for entering new production niches was completely absent. PUMA's orders were seen by *RUEN*'s management as though they would exist forever.

The lead German firms did not give *RUEN* an alternative. The distribution manager of *RUEN* shared in an interview that the executive director of *RUEN* managed to create Textillogistic in Botevgrad (town close to the capital) in 1999 as a JV between *RUEN* and C&A (50 % to 50 % ownership). This new firm established itself on the market very quickly as a quality control and logistical services firm. It had a number of top quality experts who traveled around Bulgaria to inspect clothing products before they come to the quality control centre in Botevgrad to be exported.

Due to Textillogistic, says the distribution manager, who used to be one of the quality control inspectors in late 1990s, no goods were returned from Germany. Moreover, C&A improved substantially, according to *RUEN*'s manager, their subcontracting work with a group of 12 Bulgarian enterprises. However, although successful, Textillogistic was totally dependent on the orders of C&A. Eventually, *RUEN* was forced to sell Textillogistic to its German partner in 2001.

As far as the role of the state is concerned, neither the distribution manager, nor the executive director underlined any special policy that helped *RUEN*'s export activities. "We expect nothing from the state!" – said the director. This sounds paradoxical if we consider that the executive director of *RUEN* was also the chairman of the Branch Association of the Knitting Industry.

Case three: VIDA STYLE

Created in 1962, *VIDA STYLE* (henceforth called *VIDA*) was one of the first socialist clothing firms for production of men and children shirts, women blouses and dresses, trousers and men's ties and had 400 employees. Three decades later, it was privatized with MBO, and managers took 94 % of the ownership, while the state retained the rest.

In 1995, when the firm was privatized, the number of employees was 1,400 and it increased to 1,760 employees in 1998. The demand for labor was primarily due to the increase of orders under full-subcontracting from foreign buyers. In 1995, the firm used to export under full-subcontracting about 35 % of its total exports, while seven years later it exported under full subcontracting majority of its products (96 % of total export). In fact, the firm's subcontracting strategy carried it to the tenth position in the top exporters list of Bulgarian clothing firms in 2001. Not surprisingly, the turnover of the firm increased substantially since 1995 when it was up to $5 million, while in the post-privatization period, it was constantly over $7 million on annual average, except for the final year (2003), which indicated substantial decrease of exports and gloomy prospects for the firm.

VIDA started work with western buyers in 1965 by exporting nylon shirts for Tonofolmari (Western Germany). Only two years later, the foreign buyer became more confident in *VIDA's* manufacturing potential and started to order cotton shirts, until 1974 when the foreign partner went bankrupt. In the 1970s, *VIDA* entered the RILA management system and began exporting to the Soviet Union market. About 30% of total production went to this market, 20% was kept for the domestic market, while 50% was exported to the West.

Since 1978, *VIDA* has partnered with a number of large foreign buyers from Western European countries, like Brambia Cagros (France), Sepala and Paloyoki (Finland), Kurtals and Francle (UK), Replay and Milord (Canada), Quelle and Ruduick(Germany), Regent (Denmark), Carlsteins and Strong (Sweden), and Tommy Hilfiger (USA) (State Archives, Vidin, fond 783, file 7, unit 69).

In fact, between 1981 and 1984, the firm's export for the Western markets stood between 40 % - 48 % of total exports (State archives, Vidin, Fond 783, File 6, unit.No.56). However, the interest in the Western markets increased substantially after mid-1980s as RILA management ordered that *VIDA* visit exhibitions in Paris, Vienna, Thessalonica, Budapest, Bucharest, Milano, Burno, Laipzig, Tripoli, Bagdad and Beijing.[121] The exhibitions were successful and between 1985 and 1990 they helped built the necessary contacts wih the West and firm's exports accounted for between 60 % and 80 % of total exports, especially in late 1980s (State archives, Vidin, Fond 783, file 7, unit 45).

New production units were established in the nearby villages, and small towns, like Rakitnica, Novo selo, Kula, Archar, Kalenik in order to satisfy the orders of foreign buyers. Not only the exhibitions, but also the state subsidy of the export prices in the 1980s made *VIDA*'s clothing prices very attractive and competitive on the world market. Moreover, the subsidy was paid immediately the day after the export without preliminary check ups, which additionally encouraged firms to export. The export subsidies granted Bulgarian firms the unprecedented chance to establish themselves on the foreign Western markets as manufacturers of clothing products in the 1980s.

In 1990s, *VIDA* worked with Bulgarian textile firms, like Galatex (Varna), Maritzatex (Plovdiv), Mak (Gabrovo), which were its main suppliers of textile inputs. The textile firms bought cotton in hard currency, but sold it to *VIDA* in national currency. *VIDA* sold their goods abroad for hard currency and in the triangle of local textile firm-local apparel manufacturer-foreign buyers, local textile firms suffered because of the flexible exchange

[121] In a letter, the director of RILA instructs the VIDA management to prepare visits of exhibitions between 17.12.1986 and 10.09.1988 (State archives, Fond 783, file 7, unit.119).

rates. The cost of the Bulgarian textile products gradually increased throughout the 1990s and *VIDA* had to re-orient to foreign textile firms' supplies. The difficulty in organizing the import of textile inputs forced *VIDA* to turn to full-subcontracting after 1997. This eventually led to deterioration of *VIDA*, huge decrease of turnover and ultimately lay offs in 2003.

What carried the firm to this end? First, the investment of the firm did not increase from the socialist period, $500-600,000 annually, which indicates medium process upgrading. During the 1990s, the firm used long-term bank loans in order to invest in machinery and equipment. However, the firm became highly dependent on trade agents and foreign buyers in late 1990s. Although, the management was in constant contact with foreign buyers during their four decades of experience, they could not secure orders from big foreign buyers but had to rely on intermediary agencies, like *Rila Style* and Balkantrading (Bulgaria), Inatex (USA) and Altex (Spain), who worked for generous commissions. This created a dependency position of the firm, which was further intensified with the total dependence of textile supplies from abroad, ordered by the foreign subcontractors after 1997. Thus, *VIDA* lost its links with local textile firms and the chance to organize its own production and export directly.

As learnt from interview with the chief accountant (7 May 2003, Vidin), *VIDA* operated with two strong buyers in the past five years, which created another form of high dependence. For instance, the firm's US buyer took 55 % of total exports, while the firm's Spanish buyer took 17 % of total exports. *VIDA* management complained about the constant push downwards of the unit prices of their products and how competitive the international market is. Moreover, the management indicated a significant problem that

was regularly encountered with foreign buyers. Except the British firms, the foreign buyers did not pay the final installment from the deal. They always found some problem. For instance, explains the chief accountant "We have worked with a German firm for over 20 years and finally they did not pay us 17,000 DM, while another Italian firm did not pay us 20,000 DM and even did not give a simple explanation".

The firm is not only highly dependent on foreign buyers and trade agents, but it is also not investing in long-term programs for upgrading. The firm has a functioning design department with 15 employed designers. However, as the management clarified, *VIDA* has never designed its own product, but used its designers to accommodate the designs of the foreign buyers to the particular product under full-subcontracting, thus production and functional upgrading is missing. Furthermore, *VIDA* does not have ISO certificate, and as underlined by the management "We do not need it because our clients do not require it". Therefore, the firm did not recognize the need for functional upgrading.

The firm's subcontracting strategy, which carried *VIDA* to high dependence on buyers and intermediary agents and a lack of functional upgrading (no certificates and design) also let the company to a substantial downward trajectory. Lack of marketing strategies further pictured gloomy future for the firm, especially with the following principle of *VIDA*'s management: *"We want the clients to search for us, and not us running after them"*. The firm never expected anything from the state. The management lost confidence in the BAs as well because they did not provide substantial information or as noted, "They explain to us new laws, which we can easily find in the State Gazette". That explains why the firm is not a member of any specialized clothing BA.

Conclusion

This chapter presented industrial and firm upgrading for the case of the Bulgarian textile and clothing industry between 1995 and 2003. Between the beginning and the end of the research period, the down-market goods from Bulgaria to the EU market decreased by 40 %, while the up-market exports increased by only 9 percentage points at the end period of research.

The low level of industrial upgrading and high levels of dependency of the Bulgarian firms have also been confirmed at the networks and firm level. Major feature of the Bulgarian T/C firms is their focus on full-and-semi subcontracting exports, which yield low value added for the local economy. A large proportion of the local firms use foreign supplies (raw materials or textile inputs), which means that the Bulgarian T/C industry is dependent on their imports. Missing or inadequate marketing and design departments in a majority of the Bulgarian firms is an indicator for low opportunities for developing marketing strategies and approach of the clients with own design. Moreover, a large proportion of the Bulgarian firms have realized the necessity to create their own brands, but have not established one.

The investments in the sector in machinery and new technologies are low and they come primarily from foreign companies, which entered the textile and knitting sectors. The number of ISO certified companies is very low, although the major market of Bulgarian T/C firms is the European Union, which requires ISO certification. The dependence on the two most important buyers and the concentration in the top export market is usually high, which indicates that Bulgarian firms find it difficult to diversify the portfolio of their clients. Moreover, this is also observable from the high importance of the role of trade agents in the sector, which act as middleman between foreign and

local firms. A large percentage of the Bulgarian textile and knitting firms are failing, while most Bulgarian clothing firms export low value added products. The linkage between local textile and local clothing companies is interrupted and the role of foreign firms as contractors and trade agents is very important. Moreover, the foreign buyers of clothing that operate in the Bulgarian market are very mobile and the power in the value chain of lead firms (branded apparel manufacturers, marketers and retailers) is totally in foreign hands because of the high dependence and low upgrading of domestic firms. This is coupled with the high competition among local firms for foreign buyers and the intensified global competition in textile and clothing trade. Three in-depth firm case studies revealed high levels of dependency and low levels of upgrading, thus confirming the survey results.

Chapter VII. Results from Multivariate Analysis

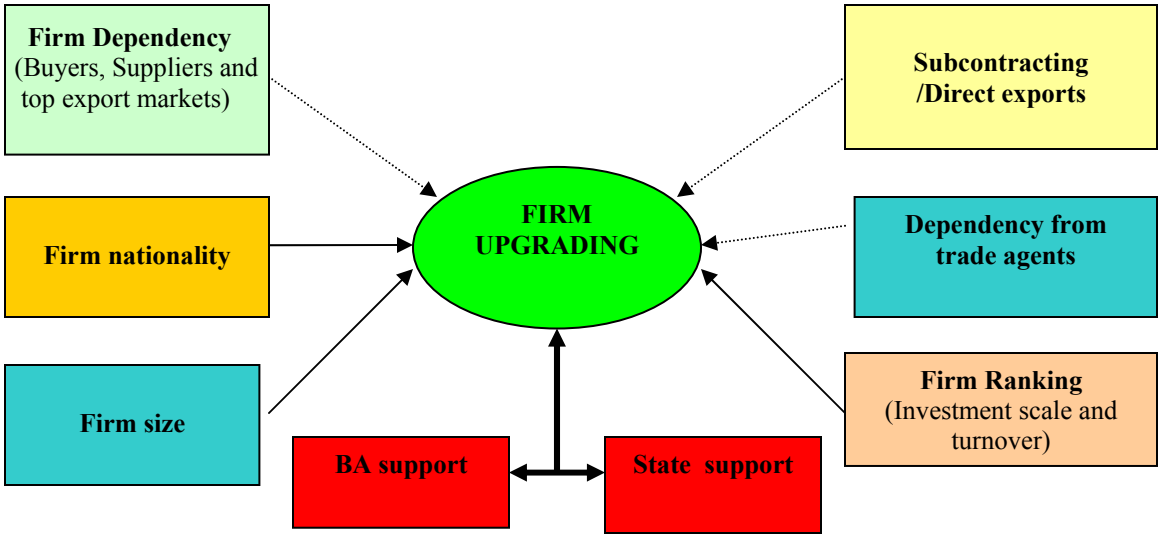
Introduction

The previous four chapters analyzed development of the textile and clothing industry in Turkey and Bulgaria. General and specific policies of the state have been supportive of the development of the Turkish T/C industry which was not the case in Bulgaria. Furthermore, the role of branch associations was found to be important in Turkey and not relevant in Bulgaria. Unit Value Analysis of exports to the EU market revealed that Bulgaria performed worse compared to Turkey. The same was valid when networks and firm level analyses were introduced. Particularly significant to mention is the high dependency of Bulgarian firms upon the two most important buyers, the high share of full subcontracting, performed by Bulgarian firms, the high imports of supplies and the use of trade agents to connect with foreign buyers compared to Turkish firms which perform much better and show comparatively lower dependency ranges for the same criteria (*Appendix H*, Comparison of Firm Dependency in Turkey and Bulgaria: 271). Turkish firms are also better compared to Bulgarian firms in terms of product, process, functional and organizational upgrading (*Appendix I*, Comparison of Firm Upgrading in Turkey and Bulgaria: 272).

This chapter attempts to analyze the factors which influenced upgrading of T/C firms in Turkey and Bulgaria through the application of multivariate analysis. The *first section* demonstrates a conceptual framework that offers the hypotheses that shall be tested and justifies the comparison of the two firm samples. The *second section* provides empirical application of the comparison between the textile and apparel firms in Bulgaria and Turkey. The conclusion summarizes.

7.1 Application of the multivariate analysis

Fig.24 Conceptual Framework for Firm Upgrading



Source: Author's construction

The figure above presents the application of the multivariate analysis, which is based on the hypotheses already stated in *Chapter II*. The *first* variable to be tested is Branch and State support (B&S support). The hypothesis claims that firms that have received support from the state and business associations for their export activities, are very likely to have upgraded more in terms of availability of own shops (in the local and international market), own certificates (ISO or buyer's audits), own brands, and have marketing/design department or both. One would expect that B&S support in the case of Bulgaria to be irrelevant for firm upgrading compared to the Turkish case where it is highly relevant. The *second* variable is related to levels of dependency on foreign buyers, suppliers, and concentration in the top export market claiming that the less dependent the firm is the more upgraded it is. The *third* variable tests whether upgrading is relevant to firms which have more direct exports, while those firms which perform subcontracting

exports are comparatively less upgraded. The *fourth* variable reveals the importance of firm nationality. It is expected that foreign ownership (full or partial) is likely to help upgrading. The *fifth* variable would test whether the less dependent the firm is on trade agents, the more upgraded it is, while the *sixth* would trace whether the firm is more upgraded if it has high level of investment in machinery, know-how and technology and it operates with a high turnover. Finally, the *seventh* variable to be tested is releated to the hypothesis that claims that the larger the firm, the more upgraded it is.

7.1.1 Justification for the comparison of the two samples

The justification of the comparison between the Bulgarian and the Turkish sample of firms is necessary in order to be able to judge: a) whether the samples correspond with the national T/C industrial structure; b) whether the two samples are comparable in terms of the variables used; and c) whether they respond to the research objectives.

Table 24 Comparison of the two firm samples

Variable	Categories	Bulgaria	Turkey
No. of respondents		62 %	44 %
Firm size	a) Small (1-49 employees)	18 %	20 %
	b) Medium (50-249)	52 %	37 %
	c) Large (over 250)	30 %	43 %
Subsector	a) Capital-intensive (textile, knitting, dyeing)	34 %	41 %
	b) Labor intensive (clothing)	61 %	39 %
	c) vertically integrated	5 %	20 %
Major regional market	EU	81 %	64 %
	USA	9 %	18 %
	Others (CEE, Arab world, etc.)	10 %	18 %
Biggest export markets	Germany	37 %	27 %
	France	12 %	10 %
	Italy	10 %	8 %
	Spain	10 %	8 %
	USA	7 %	18 %
	Others	24 %	29 %
Ownership	Private	87 %	95 %
	State	0 %	0 %
	Mixed	13 %	5 %
Firm nationality	100 % local	85 %	89 %
	100 % foreign	5 %	4 %
	mixed	10 %	7 %

Firm establishment	Before 1980 Before 1990 Before 1995 Before 2000 Before 2002/03	30 % 3 % 46 % 14 % 7 %	32 % 33 % 21 % 9 % 5 %
Type of business	Manufacturer Trader	100 % 0 %	84 % 16 %
Firm export share of total production	<30 % 30-59 % 60-90 % >90 %	4 % 0 % 20 % 76 %	7 % 23 % 20 % 50 %
Firm export trend since 1990	Decreasing Constant Increasing	6 % 50 % 44 %	3 % 46 % 51 %

Source: Author's survey database

Majority of the firms that entered the two samples are medium and large sized (Bulgaria - 82 %, while for Turkey – 80 %), which corresponds also to the structure of the exporters and to one of the major research objectives (to observe not the producers, but the exporters). Small firms (1-49 employees) also export and this is taken into account as they represent 18 % in the Bulgarian sample and 20 % of the firms in the Turkish sample.

The large share of firms in the Bulgarian sample are specialized in labor intensive activities (clothing), representing 61 % of all studied firms, while in the Turkish case the representatives of the same group have 39 % share. However, looking at the group of vertically integrated firms (those firms, which have full production cycle, hence including clothing production), one finds a similarity in both cases (second row in Table 24). Thus, we find 66 % representation in the Bulgarian sample (clothing firms + vertically integrated firms) and 59 % share in the Turkish sample. The comparatively higher share of solely capital-intensive exporters in the Turkish sample could be justified by the fact that Turkey is, except large clothing exporter, also large textile exporter, while Bulgaria is only large clothing exporter.

An important indicator, which directly links to the research objective, is the share of firms whose main regional export market is that of the European Union. 81 percentage of the Bulgarian firms in the sample have declared EU as their major market, while the same market is dominant for 64 % of the Turkish firms from the sample.[122] Moreover, Germany has been the main export destination for the firms in both samples. There are 37 % of the Bulgarian firms from the sample, which have indicated this market (in 2003, it is the second important clothing export market after Greece), while in the case of the Turkish firms one finds 27 % share, which accords with the national figures. Moreover, Italy and France, which are one of the top five export markets for Bulgarian and Turkish T/C products, also find their place as important market for the firms in both samples.

Majority of the firms in the two samples are private (87 % in Bulgaria and 95 % in Turkey), which conforms with the ownership structure of the industry in both countries. The two samples harmonize with the national data also in terms of firm nationality, as 85 % of the firms in the Bulgarian sample and 89 % of the firms in the Turkish sample are with 100 % local capital, whereas only 5 % (in Bulgaria) and 4 % (in Turkey) are with 100 % foreign capital and the remaining are with mixed (local/foreign) ownership.

Every third firm in both samples has been established before 1980, which gives us a chance not to discriminate in terms of old (pre-1990) and new firms (post-1990) in the two samples. Moreover, there exists a very similar structure of periods of establishment in both cases. In the case of Turkey, most of the firms have been registered until 1995 (86 % of all firms), which is similar to the growth of registered firms and realization of the export potential in the mid-1980s and early 1990s. Only 3 % of the firms in the Bulgarian

[122] The national statistics indicate total export share of Bulgarian T/C to the EU market estimated between 75 %-80 %, while for Turkey it varies between 60%-75 % of total Turkish T/C exports between 1995 and 2003.

sample have been registered before 1990, which corresponds to the national data that shows few new firms to have been registered in the socialist economy of the 1980s. Almost half of the firms (46 %) in the Bulgarian sample have been registered in the period 1990-1995 when, in fact, the private initiative mushroomed and hundreds of new private establishments entered the local market. Therefore, before 1995, the Bulgarian sample witnesses 79 % of the firms' establishments, while in the case of Turkey, the share is estimated at 86 %.

One hundred percent of the interviewed firms in the Bulgarian sample are manufacturers. In Turkey, the group of manufacturers is measured at 84 %, while the rest comprises the group of traders. The difference in both cases is due to the Turkish phenomenon of existing local trade agents, which organize the manufacturing process by fully subcontracting the work to local Turkish manufacturers. Thus, the local trade agent acts as exporter, and does not necessarily own production facilities, rather concentrates on marketing activities and quality control.

Finally, let us concentrate on the transnationalization component. It justifies the export orientation of the firms in the two samples. Only 4 % of the Bulgarian firms and 7 % of the Turkish firms indicate that their production for export is lower than 30 % of their total production. In fact, 20 % of the Bulgarian firms and the Turkish firms from the sample have a concentration of the export production between 60 % and 90 % of total production, while a remarkable 76 % of the Bulgarian firms and half of the Turkish firms indicate that over 90 % of the their total production is for export. In fact, 96 % of the Bulgarian firms concentrate in the range beyond 60 % of production for export, while in the case of Turkey it is slightly less, estimated at 70 %, but adding another share of 23 %

of all firms, which have 30-60 % of their production for export. In addition, the indicator firm export trend points that 94 % of the Bulgarian firms have either constant or increasing export share, while the Turkish firms attest a slightly higher constant and increasing export share, estimated at 97 % of all firms that fall in these two groups since 1990. The two final indicators help us understand that the level of transnationalization of Bulgarian and Turkish firms in the two samples is very high, which corresponds to the general trend of export firms from these two countries and to the research objectives.

Based on the analysis, it is concluded that the two samples correspond to the firms' national characteristics, the two samples are comparable in terms of the variables used and the construction of the two samples is coherent with the research objectives. Therefore, the results from the two samples shall be deemed representative for the Bulgarian and the Turkish case studies.

7.2 Tested multivariate results with statistical processing

7.2.1 Inter-correlation analysis of variables

Background variables

In the case of Bulgaria, *firm size* has shown strong positive correlation with firm's turnover (r=.67**)[123], investment (r=.66**), presence of certificates (r=.55**) and availability of marketing and design departments (r=.61**). Therefore, the larger the Bulgarian firm, the higher turnover and investment it has. There is also higher probability that the larger the firm is, the more chance there is that it has certificates, marketing and design departments. Firm size has strong negative correlation with the year of

[123] ** stands for significance level at p<0.01, while * for significance level at p<0.05 throughout the paper.

establishment (*r*=-.59**), which indicates that the larger the firm, the higher the chance to have been established before 1990.

In the case of Turkey, firm size has strong positive correlation with turnover (*r*=.68**), availability of marketing and design departments (*r*=.62**), own brands (*r*=.66**) and own shops (*r*=.40**). Therefore, the larger the firm the higher the possibility to find marketing and design departments, brands and own shops, besides the high turnover.

Another background variable is the *year of establishment*. In the Bulgarian case, it shows strong negative correlation not only with the firm's size, as indicated above, but also with the firm's turnover (*r*=-.64**), investment (*r*=-.58**) and presence of certificates (*r*=-.67**). Therefore, the longer the firm existed, the better the chances to have high turnover, investment and presence of certificates. In the case of Turkey, the same variable does not have any statistical significance.

Third background variable is the *average salary of workers*, which in the case of Bulgaria has strong positive association with employment trend (*r*=.41**), while in the case of Turkey, it has strong positive association with the dominant firm's contracts for 2000 (*r*=.45**) and for 2002/03 year (*r*=.46**). The final outcome means that the firms which pay more to their workers are usually those which perform direct exports.

Dependency & Upgrading variables

In the case of Bulgaria, rank of investments has significant and strong positive correlation with availability of departments (*r*=.46**), certificates (*r*=.52**) and dominant firm's contracts for year 1995 (*r*=.51**) and for year 2000 (*r*=.43**). There is also a very strong positive correlation between firm's own brand and development of a new product (*r*=.68**), as well as the firm's attitude towards branch support is positively

correlated with the firm's attitude towards state support (*r*=.45**). The strongest positive correlations in the Bulgarian sample are registered between dominant firm's contracts in 2002, compared to firm's contracts in year 2000 (*r*=.96**), year 1995 (*r*=.80**) and late 1980s (*r*=.65**). The strongest negative correlations (already mentioned) are between firm size and presence of certificates (*r*=-.67**).

In the case of Turkey, rank of investment is highly correlated with turnover (*r*=.56**). There is a high positive correlation also between dependency on the top export market and the share of the two most important buyers (*r*=.51**). Therefore, the firms which have high dependency (>90 % export share) on the top market are usually the ones which have high dependency on the two most important buyers (>90% share). State support is positively correlated with presence of certificates (*r*=.40**). The highest positive correlation is found between dominant firm's contracts in 2002/03 and firm's contracts for 2000 (*r*=.90**). The highest negative correlation in the case of Turkey is found between place of own shop and investment in new machinery and technology (*r*=-.59**), which means that it is highly probable that those firms which have invested more in machinery and technology, have also started their own shop at home.

Attitude towards B&S support

In the case of Bulgaria, there is significant and strong positive correlation between the state and the branch support (r=.45**) and between branch support and firm's turnover trend (*r*=.38**). Lower significance but strong positive correlation is found between branch support and place of own shop (*r*=.45*), share of two most important suppliers (*r*=.36*), while moderate association is observable with firm's own brand (*r*=.28*) and average salary (*r*=.27*). Lower significance, but strong negative correlation is found

between state support and average salary (r=-.31*), while it has moderate correlation with firm export share (r=.-27*).

In the case of Turkey, there is significant and strong positive correlation between presence of certificates and firm's attitude towards state support (r=.40**). Less significance, but strong positive correlation is observed between firm's attitude towards state support and firm export trend (r=.38*), share of the two most important suppliers (r=.37*), use of trade agents for buyers (r=.32*) and trade agents for suppliers (r=.31*). As far as the variable branch support is concerned, it is highly correlated with dependency on two most important clients (r=.44*) and concentration in the top export market (r=.38*). Finally, the answers of the Turkish firms indicate a strong positive correlation, though with less significance compared to the Bulgarian case, between firm's attitude towards the state and the branch support (r=.37*).

7.2.2 Creation of new indexes and dummy variables

B&S support index

An index composed of the variables branch and state support was created through factor analysis.[124] The index, called Branch & State support measures the attitude of firms towards institutional support. The categories of the two original variables were five (very negative, negative, neutral, positive, very positive), which were recoded into three categories (negative, neutral and positive). The new index is called B&S support.

[124] Crombach's alpha in the case of Turkey is estimated at 0.53, while in the case of Bulgaria it is 0.62. The integration of the two variables (branch support and state support) is natural since firm's development benefits from both actors at the same time. The number of the categories of the two variables is kept.

Trade agent's dependency index

The factor analysis for the two variables, which measure dependency from trade agents (in terms of firm's contact with buyers and suppliers, respectively payment of commission) explains significant percentage of the variance of the component which is identified as trade agent's dependency.

Table 25 Factor loadings for the relationship between trade agents

	Bulgaria	Turkey
Trade agents for buyers	.76	.81
Trade agents for suppliers	.76	.81
Variance	57 %	65 %
Cronbach's Alpha	.25	.47

For the case of Bulgaria, the factor loading explains 57 %, while for the case of Turkey it is slightly better as it catches 65 % of the variance.[125] The factor loading for the Bulgarian case shows r=.76**, while for the Turkish case r= .81**[126]. Therefore, all the necessary conditions are present, which allow the creation of an index called *trade agent's dependency* from the two variables (Cronbach's alpha for Bulgaria is .25, while for Turkey it is .47)[127]. The Univariate analysis of variance has yielded the following result: T (3, 98)=35.4** (Adjusted R squared =.52).

Firm Upgrading

The factor analysis for the four variables of upgrading, which take the same nominal categories and measure certain form of upgrading explains 42 % of the variance in the case of Bulgaria, while for the case of Turkey it explains a variance of 55 %:

[125] A relationship is assumed between the following variables: dependency from trade agents that connect the firm with buyers and the dependency from trade agents that connect the firm with suppliers. That is why we have used Oblimen.

[126] The eigenvalue in the case of Bulgaria is 1.14, while for the case of Turkey it is 1.30; **strong correlation.

[127] Although Cronbach's alpha should be at least .50 in order to allow combination of variables, we have to bear in mind that the sample is comparatively small (62 respondents for Bulgaria and 44 for Turkey), which would justify our low alpha, especially in the case of Bulgaria. However, the results from the factor analysis show that the two variables explain one and the same thing.

Table 26 Factor loadings for firm upgrading

	Bulgaria	Turkey
Firm own brand	.61	.91
Firm own shop	.71	.66
Presence of certificates (European ISO, US buyer's audits)	.51	.25
Recoded presence of department	.73	.75
% of variance	41.8	47.2
Cronbach's Alpha	.51	.55

Extraction Method: Principal Component Analysis.[128]

The table demonstrates that the four variables within the component upgrading measure the same thing in both cases. The highest result in the case of Bulgaria is reached by the recoded variable presence of departments,[129] while in the case of Turkey it is firm's own brand. All the other variables are strongly associated with each other, except in the case of Turkey, when the variable presence of certificates is considered (.25).[130] However, included is the variable in the common index for the purpose of the comparative analysis, which will hold the same analysis of indexes in the case of Bulgaria and Turkey. As far as all conditions were met, an index called firm upgrading was created, which encompasses four variables that measure upgrading: shops, brands, presence of certificates, and presence of department.

Firm dependency indexes

Factor analysis was run for five variables in order to measure firms' dependency. These are dependency from clients and suppliers, concentration in the top export market,

[128] In the case of Turkey, when the var presence of certificates is excluded, the Alpha Cronbach increases to .704, while the variance equals 65 %. However, the comparison between Bulgaria and Turkey requires that we use the same variables in the indexes, although higher regression coefficients could be expected in the case of Turkey if we exclude 1 variable.

[129] The firms were asked the question what kind of departments they have and the answers were distributed in four categories, namely no departments, marketing department, design department, or both departments. In order to include this, obviously upgrading variable into the common list of upgrading variables, which had two answers (no or yes), the ordinal variable "departments" was recoded into: no departments or one or both of the departments;

[130] The maximum is 1.

rank of investment and rank of turnover. The factor analysis for the five variables has shown two component factors, as seen from the table below.

Table 27 Pattern matrix of dependency and ranking

	Bulgaria		Turkey	
	Dependency	**Ranking**	**Dependency**	**Ranking**
1. Share of the two most important clients of total export	.83	.15	.87	-.02
2. Share of firm two most important suppliers of total supplies	.77	-.10	.76	-.06
3. Dependency of concentration in the top export market	.65	-.06	.74	.10
4. Rank of the investments	.01	-.90	-.17	.93
5. Rank of Turnover	.00	-.90	.21	.85

Extraction Method: Principal Component Analysis. Rotation Method: Oblimin with Kaiser Normalization.
a. Rotation converged in 5 iterations; b. Firm origin = Bulgaria, Turkey

By the application of factor analysis, one finds a similarity in the case of Bulgaria and Turkey when the five variables are taken into consideration. Both cases suggest that two indexes should be used. The first involves the first three variables, while the second involves the last two variables, which required separate factor analysis for the two groups of variables.

Table 28 Firm dependency matrix

	Bulgaria	**Turkey**
Share of the two most important clients of total export	.79	.87
Share of firm two most important suppliers of total supplies	.77	.75
Dependency of concentration in the top export market	.69	.75
% of variance	56.7	62.5
Cronbach's Alpha	.62	.70

Extraction Method: Principal Component Analysis; a)1components extracted; b)Firm origin = Bulgaria, Turkey

As one sees from the table, the percentage of variance and Cronbach's Alpha is very high in both cases. Thus, the index firms dependency is created which embraces three variables - dependency on clients, suppliers and concentration on the top market.

Table 29 Firm ranking matrix

	Bulgaria	Turkey
Turnover	.91	.88
Investment scale	.91	.88
% of variance	82.49	78.00
Cronbach's Alpha	.78	.71

Extraction Method: Principal Component Analysis.
a. 1 components extracted ; b. Firm origin = Bulgaria, Turkey

As a result of analysis, firm ranking index is created as a composition of two variables - rank of investment and rank of turnover.

Dummy variables for firm size

The dummy variables for firm size were created in order to test whether there is large difference in what firms from the sample answer depending on their size. For this reason, medium sized firms are used as a reference category. The assumption is that there could be great divergence of the answers of small and large firms.

Dummy variables for dominant contracts in the last period

The dummy variables were created in order to test whether there is large difference between firms' responses in terms of the type of contracts, which they use when they operate with foreign firms. The reference category is semi-subcontracting, as large differences are expected between firms which are using 100% subcontracting contracts and firms which are using direct exports.

7.2.3. Regression models of variables and indexes

Table 30 Regression of upgrading index used as dependent variable

Model	Variables	Adjusted R^2	t	Beta
1	Branch and State support index	.17	3.40	.43**
2	Branch and State support index	.28	3.00	.36**
	Firm Ranking index		2.86	.35**
3	Branch and State support index	.35	2.71	.32**
	Firm Ranking index		3.43	.40**
	Firm's nationality		2.49	.29*

Note: *p**<.05; ***p* <.01; the Bulgarian and the Turkish samples have been weighted for firm size; stepwise method is applied; NB: only significant results have been included in the table; author's calculations.

The table presents three models, which demonstrate the regression results of variables and indexes. The dependent variable is the upgrading index, which involves four variables, namely: availability of shops, brands, marketing and design departments and certificates or buyer's audits. The independent variables in this model are branch and state support index, firm ranking index, firm's nationality, firm's dependency index (clients, suppliers, concentration in the top export market), trade agent's index (dependence on agents for buyers and suppliers) and subcontracting/direct exports dummy variables. The results of this regression show, observed in Model 3, which yields the highest prediction (Adjusted R^2=.35) that branch and state support stays significantly positively associated with the upgrading index (Beta=.32**). Firm Ranking index has even higher regression coefficient in Model 3, compared to Model 2. This is due to the third variable that entered Model 3, called firm nationality, which is less significant, but has strong positive association with the upgrading index. Model 3 indicates that if the firm nationality is mixed (local/foreign ownership), the investment scale and the turnover is very high, and the firm has been supported by branch associations and state institutions for its export activities, then it is very likely that the firm is an upgraded one. Moreover, the most important independent variable, when the stepwise method of regression analysis is applied , is branch and state support. This would indicate that firm upgrading has been highly influenced by state and branch support.

Small firm dummy variable

Entered through the stepwise regression method, the same independent variables were controlled for small firms from the sample to produce the following result:

Table 31 Regression of upgrading index with control for small firms

Model	Variables	Adjusted R^2	t	Beta
1	Small firms Dummy variable	.29	-4.69	-.55**
2	Small firms Dummy variable	.40	-.44	-.49**
	Branch and State support index		3.13	.35**
3	Small firms Dummy variable	.42	-3.63	-.42**
	Branch and State support index		1.9	.32**
	Firm Ranking index		.7	.20†
4	Small firms Dummy variable	.46	-3.60	-.41**
	Branch and State support index		1.89	.22†
	Firm Ranking index		2.36	.28*
	Trade Agents index		2.06	.24*

Note: †p<.10; p*<.05; **p <.01; the Bulgarian and the Turkish samples have been weighted for firm size; NB: only significant results have been included in the table; author's calculations.

The dummy variable for small firms is negatively and strongly associated with the upgrading index. This would indicate that the small textile and apparel exporters are likely not to be upgraded as much as medium and large sized exporters. Still, if they are upgraded, then the state and branch support index, when only small firms are considered, is highly significant and strongly positively associated with the upgrading index in Model 2. This would mean that B&S support for small firms has also been relevant for firm's upgrading. However, the B&S index becomes less significant and moderately associated with the upgrading index when two other indexes are entered in the multivariate analysis, namely Firm Ranking index and Trade Agents index (Model 4). This would mean that small firms are influenced more by the investment and turnover and their less dependence on trade agents (for buyers and suppliers), rather then influenced by the support of BAs and the State.

Large firm dummy variable

The same regression method has been applied in regression test, but when controlled for large firms from the sample. The dependent variable is again the upgrading index.

Table 32 Regression of upgrading index with control for large firms

Model	Variables	Adjusted R^2	t	Beta
1	Branch and State support index	.17	3.40	.43**
2	Branch and State support index	.29	3.19	.38**
	Dummy variable for large firms		2.99	.36**
3	Branch and State support index	.36	2.93	.34**
	Dummy variable for large firms		3.66	.42**
	Firm's nationality		2.65	.31**

Note: *p**<.05; ***p* <.01; the Bulgarian and the Turkish samples have been weighted for firm size; NB: only significant results have been included in the table.

In Model 3, branch and state support stays highly significant and observed is a very strong and positive association with the upgrading index. The dummy variable for the large firms is also highly significant and strongly and positively associated with the upgrading index. The same is true for firm's nationality. The whole Model 3 yields very high prediction in 36 % of the cases. As a result of the regression analysis, it can be concluded: first, large firm exporters are likely to be more upgraded compared to small and medium sized exporters; second, the firm is upgraded in case if it has a mixed ownership (local/foreign), which means the foreign capital has become localized and not so easy to relocate; and third, branch and state support index stay as a very important independent variable from Model 1 to Model 3, which means that it has highly influenced upgrading of the large firms in Turkey and Bulgaria. Finally, it is tested whether firm dependency (clients, suppliers and concentration in the top export market) has a relationship with firm upgrading index (availability of brands, certificates, shops, and marketing and design departments). The results have yielded not a very high prediction (Adjusted R^2= 0.06), but a moderate regression coefficient (Beta=.28) and significant relationship (p=0.04). This means that the less the Turkish and Bulgarian export firms are dependent on buyers, suppliers and concentration in the top market, the more they are upgraded.

Separate regression models for Bulgaria and Turkey

This subsection uses regression analysis applied to separate models for the case of Bulgaria and Turkey. The pursuit is to test which of the independent variables (used in all our previous models) have an impact on the upgrading index.

Table 33 Separate regression models for Bulgaria and Turkey

Model	Variables	Adjusted R^2	T Value	Beta
Bulgaria				
	Firm's nationality	.12	1.78	.42†
Turkey				
1.	Dummy variable for small firms	.26	-3.57	-.53**
2.	Dummy variable for small firms	.35	-2.94	-.43**
	Branch and state support index		2.38	.35**
3.	Dummy variable for small firms	.39	-2.81	-.40**
	Branch and state support index		2.16	.31 *
	Dummy variable for direct export		1.73	.24†

Note: †p<.10; p*<.05; **p <.01; the Bulgarian and the Turkish samples have been weighted for firm size; NB: only the significant results are presented in the table.

In the Turkish case (Model 3), the small firm dummy variable has negative and strong association with the upgrading index. This would indicate that small firms in Turkey are not likely to be upgraded vis-à-vis large and medium sized firms. The branch and state support index stays highly positive and strongly associated with the upgrading index. Finally, the dummy variable for direct export is moderately associated with the upgrading index, although it stays less significant. As far as the Bulgarian case is concerned, only firm nationality has a high regression coefficient (B=.42) and it shows strong association with the upgrading index. In fact, this is the only significant independent variable. The test shows that those Bulgarian firms are upgraded, which are partially or fully owned by foreign companies and there is no impact of the firm size.

Conclusion

The chapter applied multivariate analysis in order to show differences in upgrading of textile and apparel Bulgarian and Turkish firms and tested the influence of seven variables that affect firm upgrading. The major finding of the study is that branch and state support index was validated in terms of being the most influential factor for firm upgrading in Bulgaria and Turkey (H1). Firm nationality (H4) has been validated as well, which is also true for the firm ranking index (H6) and firm size (H7). The regression models did not score high related to (H2) in terms of dependency index (buyers, suppliers and concentration on top export market) and in terms of relationship between type of exports (subcontracting or direct exports) and firm upgrading (H3). Finally, the relationship between trade agent index (H5) and firm upgrading was not validated as well.

Chapter VIII. Conclusion

The main focus of this chapter is to give a comparative overview adn derive the major conclusions of the dissertation. The *first section* summarizes the empirical findings of the comparison between Turkey and Bulgaria of state and branch associations' role for helping the industry and firms to achieve upgrading. The *second section* comes back to theoretical framework of the thesis to discuss the new analytical interpretation through the prism of the empirical findings. The *third section* discusses the recent situation of the textile and clothing industry in Turkey and Bulgaria and the importance of the subject area and its relevance to contemporary scholarly work.

8.1 Comparative overview

8.1.1 Similar starting positions, different outcomes

The thesis observed two developing economies from the European periphery which are *late-comers* in the process of integration with global markets. It set the background of the two cases by discussing development of the T/C industry in Turkey between 1983 and 2003 (*Chapter III*) and in Bulgaria between 1995 and 2003 (*Chapter V*). It investigated the challenges faced before and during the industry became leading export sector of the economy. Several general and specific industrial policies that have direct and circumstantial impact on industrial and firm upgrading were regarded.

In *Turkey*, it was concluded that the ISI policy managed to create groups of private interests, which benefited from high domestic protectionism. The apparel sector, however, was given scarce attention and was marginalized during the ISI period compared to other sectors. The fact that it was not a priority sector meant that it was not protected, not subsidized, and no foreign investment was promoted. The disinterest of

Turkish policy-makers was such that they even did not bother to statistically register the sector. There was scant information about the production capacity, productivity and the like.

In the post-1983 period, the Turkish state embraced the export-led growth model. The liberalization of trade with the EU played a key role in boosting exports, but was not crucial for helping upgrading of the exports. The T/C industry benefited from devaluation of the Turkish lira and specific industrial policy in the field of investment and export incentives, cotton project for domestic supply of raw materials, FTZs and Industrial Districts. This stabilized the T/C industry as a leading export sector of the economy. The clothing sector, the driving engine of the industry, was transformed from a web of *ateliers* (in the 1980s) into a web of SMEs (in the 1990s). Furthermore, the Turkish T/C industry was allowed by the state to co-exist in a two-tiered system where it benefited from informalization of the economy and cheap labor force, thus sustaining its international competitiveness.

In *Bulgaria*, a serious modernization program was introduced after mid-1970. A fair amount of new machinery and equipment was installed. The state initiated the NEM which explains the investment boom for the last decade of socialism. The domestic T/C industry, however, was not among the export leaders and priority sectors of the economy as much as the heavy industries.

The turning point for Bulgaria was 1995 when the T/C exports jumped to quarter of total exports, thus transforming the industry into a leading export sector of the economy. This coincided with the liberalization of the EU market related to the Association Agreement signed between Bulgaria and the EU. This liberalization, however,

encouraged OPT trade, which yielded low value added for the local economy. The sector became one of the EU's top clothing importers, but this did not change the role of the state. Privatization in the T/C industry was very slow and unsuccessful. The major source of FDI in the sector came only after 1998 and it kept modest levels. The exchange rate regime did not favour Bulgarian T/C exporters and the state did not offer specific industrial policy. As in the case of Turkey, the Bulgarian T/C industry was also allowed by the state to benefit from the informal economy and cheap labor force which, however, only helped the local firms maintain their survival strategy and continue to be engaged in subcontracting with foreign firms.

Industrial and firm upgrading in Turkey (*Chapter IV*) and in Bulgaria (*Chapter V*) was further investigated. The *Sectoral* level analysis traced upgrading of the T/C exports of Turkey (1983-2003) and Bulgaria (1995-2003) to the EU market in order to see how much value added is retained within the local economy. The analysis found that the T/C exports of these two neighboring countries were predominantly concentrated in down-market niches at the beginning of the research period, while the two cases differed at the end of the research period. In particular, Bulgaria managed to decrease by half its down-market exports to the EU market, but the up-market products still took only insignificant share of the total value added. In the case of Turkey, where the down-market exports were also decreased by half, a substantial increase of the share of value added of up-market goods exported to the EU market was observed.

The *Network* level analysis concluded that Turkey managed to climb-up from primary commodities export role to original equipment manufacturing role, while Bulgaria maintained its position of assembly export role. More particularly, it was found that

around 60 % of Turkish textile manufacturers fall in the category of *progressive firms*, while 60 % of the clothing manufacturers fall in the category of *medium value added firms*. This is quite different compared to the Bulgarian case where the majority of textile firms are declining (60 %) and large majority of the clothing firms are *low value added firms* (70 %).

Raw material suppliers are mainly local producers which exclusively supply the domestic textile industry in Turkey. And local demand is satisfied by importing raw materials and textile input, but the sector is not dependent on these imports. This is contrary to the case of Bulgaria, which continuously imported large majority of its raw material inputs since the early 1990s. This is the result of decreased production of raw material supplies in Bulgaria as well as of concentration of Bulgarian clothing manufacturers on subcontracting partnerships with EU and US buyers which exclude domestic raw material supplies and textile inputs. Hence, it was concluded that opportunities for upgrading in the Turkish case are higher because of the possibility for local firms to organize full-package production, whereas opportunities of upgrading in the Bulgarian case are limited because of the concentration of majority of local apparel producers on OPT manufacturing and the dependency from imports of raw materials.

Furthermore, the Turkish intermediary and final textile producers are well equipped with first-hand machinery, new technologies and quality certificates and they completely satisfy not only the local market, but also the global market as Turkey became the 10th global supplier of textile goods in 2003. On the opposite side are the domestic textile producers in Bulgaria which have substantially decreased their production capacity as a

result of subcontracting partnership of local clothing firms with EU buyers which decreased demand for local textile inputs.

The role of international distributors is very limited in the case of Turkey since lead firms usually operate directly with large Turkish clothing manufacturers, while the role of local trade agents is in the form of providing high value added services (marketing, design, branding) and organizing production and exports of the Turkish products, whereas in Bulgaria, foreign buyers and trade agents successfully interrupted the direct link between local/foreign textile and local apparel manufacturers. They extract substantial profits from trade deals, thus putting local firms in higher dependency positions.

Leading EU and US buyers exist in Turkey and Bulgaria. They order full-package products from Turkish manufacturers and international subcontracting is extremely limited, whereas in Bulgaria, lead firms and foreign firms are mainly engaged in international subcontracting and direct exports of full-package products are limited.

The analyses at the *Sectoral* and *Network* level, which showed substantial differences in terms of upgrading and dependency, were further supported by analysis at the *Firm* level. A survey, conducted by the author, based on evaluation of a set of dependency indicators (export markets and buyers, suppliers and origin of supplies, trade agents and dominant contracts), demonstrated that Bulgarian T/C firms have higher dependency compared to Turkish T/C firms. Most importantly, Turkish firms outperform Bulgarian firms in terms of upgrading at product, process, functional, and organizational level.

Characteristic of Bulgarian T/C firms is low investment for machinery, technology and new buildings; lack of ISO certificates and buyer's audits; and prevalence of

international subcontracting. Furthermore, low levels of upgrading are also indicated by the fact that Bulgarian firms do not own their own brands due to lack of marketing and design departments and do not own shops where to reach the end-customer.

Characteristic of the Turkish T/C firms is high investment in machinery, technology and new buildings; availability of ISO certificates and buyer's audits; and prevalence of direct exports, which yield high value added for the local economy. High upgrading is indicated by brand ownership, which is a direct result of the availability of marketing and design departments in the majority of Turkish firms and ownership of shops at home. The Turkish firms also started to reach the end-customer through shops abroad. In-depth analysis of altogether six firm cases (three in each country), reached similar findings, namely that there is great divergence in dependency and upgrading of firms when we compare Bulgaria and Turkey.

8.2 Sectoral analysis and its revision

The Turkish case complies with *Sectoral Analysis* prediction that the state finds it easy to develop its leading export sector because of the light profile of that sector. However, the prediction is not validated in the case of Bulgaria where the state failed to make use of the favorable position for upgrading its leading export sector.

This thesis claimed in *Chapter II* that state's efficiency in helping upgrading of the leading export sector is determined by its role in strengthening the capacity of sectoral actors, like branch associations, which in return empowers state capacity to support the sector. It was argued that *state-sector interaction*, which results in cooperation, intervention and support of the sector over extended period of time, influences upgrading at sectoral, networks and firm level, used as indicators for local development.

As a result of the high international competition in this buyer-driven industry, firms from developed economies enter the peripheral economies and tend to make dependent local firms. If the state or the sectoral agents do not help local firms to *lock-out* of dependency position, then the domestic sector is transformed into a transnational light with a limited chance for upgrading. If the state or sectoral agents do manage to relief local firms from dependency, then we have a national light sector profile and opportunities for upgrading do exist.

This argument is borrowed from Bela Greskovits' analytical framework, called transnational sectoral analysis (2002, 2003).[131] The scholar makes a distinction between transnational light sector versus national light sector to explain the impact on state capacity. For Greskovits, if the leading sector is transnational light (the control of the industry is in transnational hands), then there is low stateness. Consequently, it is more difficult for the state to bargain for development with transnational actors; the state is weak and dependent because development "is trapped by cross-border hyper mobility" (Greskovits 2003: 22). If the leading sector is national light, then Greskovits predicts that it is easier to bargain for restructuring of the industry because the control is in national hands and "the state is capable of helping development".

This thesis asserts that the profile of transnational and national light leading sector is shaped by the *state-sector interaction*. Qualitative analysis touched upon the case of Turkey (*Chapter III*), which has nurtured a national light sector, while *Chapter V* elaborated on the case of Bulgaria which developed a transnational light sector. The state and the sectoral actors cooperate, intervene and support the industry over extended period

[131] Greskovits (2002, 2003) has elaborated on the following inquiry: "how sectors shape the developmental prospects of states" in the new context of the post-socialist transformation.

of time in Turkey, generating *high* SSAB and this is what conveyed *Ascending Local Development* (local upgrading). The low level of cooperation, intervention and support is characterized by *low* SSAB in Bulgaria, which carried *Descending Local Development*.

This finding was proved also quantitatively through *Chapter VII* which embarked on analysis of a group of variables, hypothesized to have an impact on firm upgrading. According to the results, branch and state support was validated in terms of being the most influential factor for firm upgrading in Bulgaria and Turkey. Firm nationality (H4) and firm size (H7) were validated as well, thus confirming Hirshman's and Gerschencron's hypotheses. It was also tested whether focus of firms on subcontracting or direct exports has an effect on firm upgrading. The regression models did not score high in terms of this variable, but it was discovered that the more the firm invests and the higher its turnover, the better the prospects for upgrading (H6). Finally, neither of the two hypotheses related to dependency from buyers, suppliers and concentration on top export market, and the dependency from trade agents were validated as important factors affecting firm upgrading. The next two subsections further explain the importance of SSAB in Turkey and Bulgaria.

8.2.1 High SSAB in Turkey

Since the early 1980s, Turkish governments have paid increasing attention to the T/C industry. Major reason for that is the strengthened capacity of Turkish BAs which became very well organized and proliferated in the 1990s also to the regional level. The BAs have a clear strategy to support upgrading of the local firms, work closely with the governmental officials and promote the Turkish T/C industry abroad.

"You cannot do much without the government being involved", confirmed TCMA official in an interview. In the TCMA national strategy for the textile and clothing industry (2003), called UFUK (Horizon) 2010, there is a substantial part dedicated to the Turkish government. *"They have to do their homework too"*, clarified the Director General of TCMA. The organization has distributed the sectoral strategy to all 550 Turkish MPs and presented reports to all the ministers and governmental representatives. ITKIB and TTEA followed this and they developed separate strategies UFUK 2010. They made separate presentations to the government as noted in an interview with Akdeniz Asli, DEIK Business Council coordinator (30 September 2003, Istanbul), Esra Dogan, Research Department director of TTEA (16 October 2003 and 12 July 2004, Istanbul) and Öğuzhan Özben, Researcher at URAK (23 July 2004, Istanbul).

The TCMA has always informed and promoted their projects for the clothing industry to the legislative power because this is the only way for them to successfully cooperate with the government officials and be not only consultants but also direct participants in the policy-making. Such an example of cooperation was the Southeastern Anatolian project, which TCMA undertook in 2003 to bring clothing manufacturers to poor region. In fact, on February 06, 2004, the government adopted incentive regulation (Law 5084) for support of underdeveloped regions in Turkey (out of 81 regions, 36 were considered underdeveloped). In an interview with Ülkem Yaman, International Relations and Research department officer at TCMA (28 July 2004, interviewed by the author, Istanbul), it was clarified that only five months after the regulation came into force TCMA visited 33 of the underdeveloped regions to promote investments of garment

firms. “If garment firms go to Southeast Turkey (Anatolia), where most of these regions are found, than textile firms will follow them”, said Ms. Yaman.

“If the government did not realize, and they did not pass the law for incentives for our textile and clothing manufacturers, there is no other option to explore the opportunities which the Anatolian region offers for our manufacturers”, underlined the TCMA Director General, when asked about the impact of the law. That is why the BAs and the state authorities generally work hand in hand, strengthening and re-enforcing their capacity to help development of the sector.

The TCMA officials participate in the Governmental Economic Steering Committee, where their president is a member as well as in the sectoral council of TOBB (governmental export agency), where their president is also a member. They are also members of the Sectoral Association platform at TÜSIAD (without doubt, the strongest Turkish Business association). These memberships as well as the active participation in the internal discussions of these business organizations, serve as leverage for effective lobbying on the part of the sectoral agents in the T/C field. In addition, the TCMA Director General confirmed that it has never been difficult for the BAs to contact and work closely with the government in settling issues related to the domestic T/C industry.

The TTEA officials also highlighted the crucial importance of state support in this sector and the traditional cooperation between the BAs and the Turkish state for improvement of the environment of the T/C industry. Furthermore, ITKIB is the clearest example of state support for strengthening the capacity of the BAs. Granting financial support for activities, extending and expanding the role of ITKIB in regulating the sector seem to be among the most important tools of the state in this light.

Another form of cooperation, to be emphasized, is that between the textile and clothing BAs themselves. The interviews with representatives of the three most important BAs indicated that they work in close cooperation with each other. In case, for instance, there is a draft bill regarding the T/C industry, the BAs form a working meeting and present their position before the MPs. Moreover, at international forum, such as the ones of EURATEX and INTERCOLOR or the WTO meetings, the Turkish national BAs come up with joint positions. The international lobby power of the Turkish BAs gained strength with Turkey's entry into Customs Union with the EU. Three Turkish representatives (TTEA, TCMA and ITKIB) serve on the Board of EURATEX, which is the most important BA in the T/C field in EU. Moreover, in 2003, the deputy president of EURATEX, responsible for the clothing section, Mr. Umut Oran, is from the Turkish quota. In addition to that, the International Apparel Federation, based in London, and very influential in the international clothing field, has for a second term Mr. Oran as a president. Turkish BAs are always present with clearly formulated strategies and positions at international working meetings of the WTO, EU on T/C industry and trade.

The Turkish state supported the sector, introducing general and specific industrial policy to improve its competitiveness, as discussed in *Chapter III*. The state also extended and expanded the activities of the BAs to become equal partners in the project for local upgrading. Introducing the BAs as the main negotiators for textile quotas to the EU and the US market since mid-1980s, establishing the ITKIB, and involving BA representatives in policy-making in the T/C field are explicit signs of that. The collaborative efforts of state and BAs for support of local upgrading over an extended period of time, starting sometimes in mid-1980s, yields a case of *high* SSAB in Turkey.

8.2.2 Low SSAB in Bulgaria

Failure of the Bulgarian state to intervene and act in favour of the fastest developing industry of the economy between 1995 and 2003 and the passiveness of the BAs, who were not given a chance to participate in policy-making, resulted in low upgrading and high dependency of local firms. The BAs developed only as "paper tigers" while none of the Bulgarian governments since 1991 put the T/C industry as a priority sector and made efforts to expand and extend their functions.

The emergence of the T/C industry as a leading export sector of the economy after 1995 did not attract the attention of the state. The General Secretary of BCCI shared in an interview that as of the end of 1990s there was not even a proper department at the Ministry of Economy that deals with the textile and apparel industry. Therefore, there was no direct contact between the BAs and the state because, "There is no state official to talk to". (Vlaikov Georgi, 12 May 2003, interviewed by the author, Sofia)

Private firms are not interested in the BAs, as far as the latter neither provide marketing research and valuable information about the development of the sector, nor can they lobby the government for adoption of certain preferential policy. An anonymous interviewee, a manager from the clothing sector, stated: "These organizations are one-man show and the only thing they do is to occasionally attend working meetings with government officials, which yield no concrete result" (21 May 2003, interviewed by the author, Sofia). Interviews by the author with the Bulgarian T/C BA officials also confirmed this observation.[132]

Collective action is a serious problem which BAs are facing in Bulgaria. Without the support of the state, the local BAs tried to increase their capacity during the 1990s, but it

[132] Kolev Stefko, Director of BAKI (12 May 2003); Vlaikov Georgi, Sewing Branch General Secretary (25 June, 2003); AATEB representative (10 December 2003).

was not easy. Many entrepreneurs in Bulgaria seemed to be unaware of the role of BAs in the conditions of market economy and tended to ignore them as unnecessary and ineffective institutions such as the SIAs, which functioned in the times of the socialist economy. In addition to that, the clothing, knitting and textile business is very competitive and entrepreneurs were suspicious and found no interest to be members of BAs. After 2000, firm managers began to understand the benefits of participating in BAs. For instance, if a firm wants to raise an issue with the Ministry of Economy, it will have more weight if the issue is presented by a BA, representing member firms which employ over 50,000 workers. This is the reason why the BAs increased their role in trying to unite more firms under one umbrella in order to be able to present their demands more effectively before state authorities. By 2003, they did not manage to do so; neither did they participate in decision-making, affecting the sector.

The company managers who were interviewed in the author's survey acknowledged the lack of state support to boost their export performance and upgrading. They also expressed an opinion that BAs were poorly organized and ineffective. But, leading sector opposition is weak not only on the part of the firms, but also on the part of the workers. The small size of the firms and the employers' opposition against labour organizations makes unionizing very complicated for them. Collective bargaining agreements are rear, members of trade unions were discriminated or even fired, and workers' rights are often disrespected, as found by my own research and as argued by Vassileva V. (2001). The low rate of unionization and the fear of losing jobs due to the high competitiveness and unemployment rate makes collective action or political clout by T/C workers very difficult. In such circumstances the Bulgarian state was fairly free to act, as it was the

case in Turkey, where the local business enjoyed liberty from workers' strikes. Despite this, the Bulgarian government did not restructure the T/C industry by 2003. The lack of support for the sector on the part of the state and the lack of cooperation between the state and BAs over extended period of time yields a case of *low* SSAB in Bulgaria.

8.3 Final words

Turkey has managed to achieve industrial and firm upgrading in the past two decades, as proved in the dissertation. The export positions of developing economies, like Turkey, Mexico, Romania, etc., however, are threatened by the Chinese membership in the WTO and the abolishment of all kind of quota restrictions to textile trade from January 2005.

A year before the liberalization, China exported textiles worth €16 billion to the EU. As a result of the high imports, the European Commission has applied a safeguard clause that is prescribed in the WTO rules to limit the surge of textile imports from China. Thus, after consultations, EU and China have signed an agreement on 10 June 2005 to limit growth between 8 % and 12.5 % of 10 Chinese textile products until the end of 2008.

Various initiatives are underway in Turkey aiming at introducing additional non-tariff barriers or market safe-guards to Chinese exports based on customer's demands and standardisation schemes, undertaken by Turkish BAs and the government which act hand in hand. Moreover, Turkish leading textile and apparel trade groups, together with US ones, became initiators of the Global Alliance for Fair Textile Trade (the so-called *Istanbul Declaration*), signed on 3rd of March 2005. The Declaration called for an emergency meeting of the WTO in order to examine whether the quota phase-out could be extended until December 31st, 2007 or some other actions should be taken. This global initiative attracted over 120 representatives of textile and apparel groups from different

countries as of 5 October 2005.[133] It organized several campaigns to lobby the WTO to take effective measures. Although it did not reach its goal, the initiative revealed a new arena of future contest in global textile trade (i.e. international pressure on WTO free trade measures). It also demonstrated that Turkey was not only a simple participant and observer, but a major organizer and international lobbyist for protectionist measures against Chinese textile exports. In general, it is likely that Turkey has managed to move from European periphery to semi-periphery position as it substantially improved its leading export industry's position in the global economy, which has also been previously discussed by the author. (Evgeniev Evgeni 2006a, 2006b)

As far as Bulgaria is concerned, the trade liberalization activated the state to redirect its attention towards its leading export sector. This happened in 2004 when the state entered into partnership, through the Ministry of Economy, with the Gesselschaft für Technische Zusammenarbeit (GTZ). This cooperation gave birth to two national strategies - for the clothing and the textile industry. These strategies involved sectoral actors and public officials, national and international experts, foreign and local entrepreneurs into discussions and put forward concrete recommendations to the state and BAs on how to target local upgrading. The impact of these strategies awaits further analysis, as implementation is what is expected to follow. The preliminary observations of the author, however, are not that optimistic because it seems that the state *came too late*. (Evgeniev Evgeni 2004a, 2004b)

The Bulgarian T/C manufacturers are already facing more difficulties in coping with the international competitors because of the end of textile quotas to its major market (that of EU), but also due to the expected membership of Bulgaria to the European Union in

[133] For more information about the Istanbul declaration, www.fairtextiletrade.org/istanbul/declaration.html.

January 2007, which requires that local manufacturers comply with EU regulations and standards that are difficult to meet. Therefore, a downward trend of clothing exports and progressive decline of textile and clothing activities is expected in the near future.

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The thesis explored the kinds of state policy and state-sector cooperation, intervention and support that contribute to firm and industrial upgrading in peripheral economies. It made attempts to build understanding of the current barriers and possibilities for local upgrading. The analysis of the thesis is restricted to in-depth comparison of two developing economies and takes into account one particular industry and firms within that industry. As such, the subject might seem quite specialized, but it throws very significant light on issues related to the development of contemporary interdependencies and forms of linkages of economies from the core and the periphery and possibilities for firm and industrial upgrading.

On the one hand, the important implication of this thesis for future research is related to the empirical framework of sectoral, networks and firm analysis, which can be applied to study also other sectors of the economy. Moreover, the Unit Value Analysis application is innovative as the author joins the scholarly debate of how to study local upgrading in developing and third world economies by offering a tested methodological tool. A recent paper *"Global Implications of Unraveling Textiles and Apparel Quotas"* by Patrick Conway (2006: 15-16) offers a similar approach, as it looks at unit values of 40 high-risk countries at the aggregate level, but also at three specific product categories. For instance, Conway estimates that Bulgaria has decreased its export to the EU and US market combined by only 2.5 % in 2005 compared to 2004, while Turkey lost only 1.6 %.

The countries in focus perform slightly better compared to Romania (-6%), Mexico (-7.5%), Hungary (-11.1 %) or Serbia (-60.8 %). This is at the expense of beneficiaries from the textile trade liberalization, like India (22.3%) and China (50.3%). Conway's application is valuable, but limited, as it does not apply a comprehensive qualitative analysis of the exports, as this thesis does, in order to evaluate industry's export position.

By using unit value analysis methodology, Peter K. Schott (2004) studies product-level US trade data at the low/medium/high value level. Schott proves "high-wage countries use their endowment advantage to add features or quality to their varieties that are not present among the varieties emanating from low-wage countries". Thus, the scholar, by using UVA, concludes that unit value patterns are inconsistent with new trade theory models that have producer price varying inversely with producer productivity. The major finding of the paper is that "the degree of insulation afforded to workers in high-wage countries will depend upon the substitutability of high- and low-wage countries".

On the other hand, the thesis refers to the imperative issue of development today: it is not important how much you export, but what you actually export, as put by Ricardo Hausmann, J. Hwang and Dani Rodrik (2006) in a recent paper "*What You Export Matters"*. The authors create a quantitative index to study traded goods in terms of their implied productivity. They provide evidence that shows that countries that latch on to a set of goods that are placed higher on the quality spectrum tend to perform better.

Finally, the author tends to believe that the application of GVC analysis to peripheral states might instigate further research on the *institutional component* of the GVC analytical framework (state' and branch associations' capacity to help local upgrading) and employ it to other textile & clothing producer and market regions in the global world.

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www.kipas.com.tr, www.vratitza.com,
www.tanifashion.com/companyinfo.htm
www.rila-style.com; www.jenistyle.com,

Agencies :
www.investbg.government.bg,
www.detkib.org, www.uib.org.tr, www.aib.org.tr
www.gaib.org.tr, www.akib.org.tr,
www.egebirlik.org.tr, www.tekstilisveren.org.tr,
www.itkib.org.tr, www.tcma.org,
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Reports :
www.cleanclothes.org/companies/savina99-11.htm,
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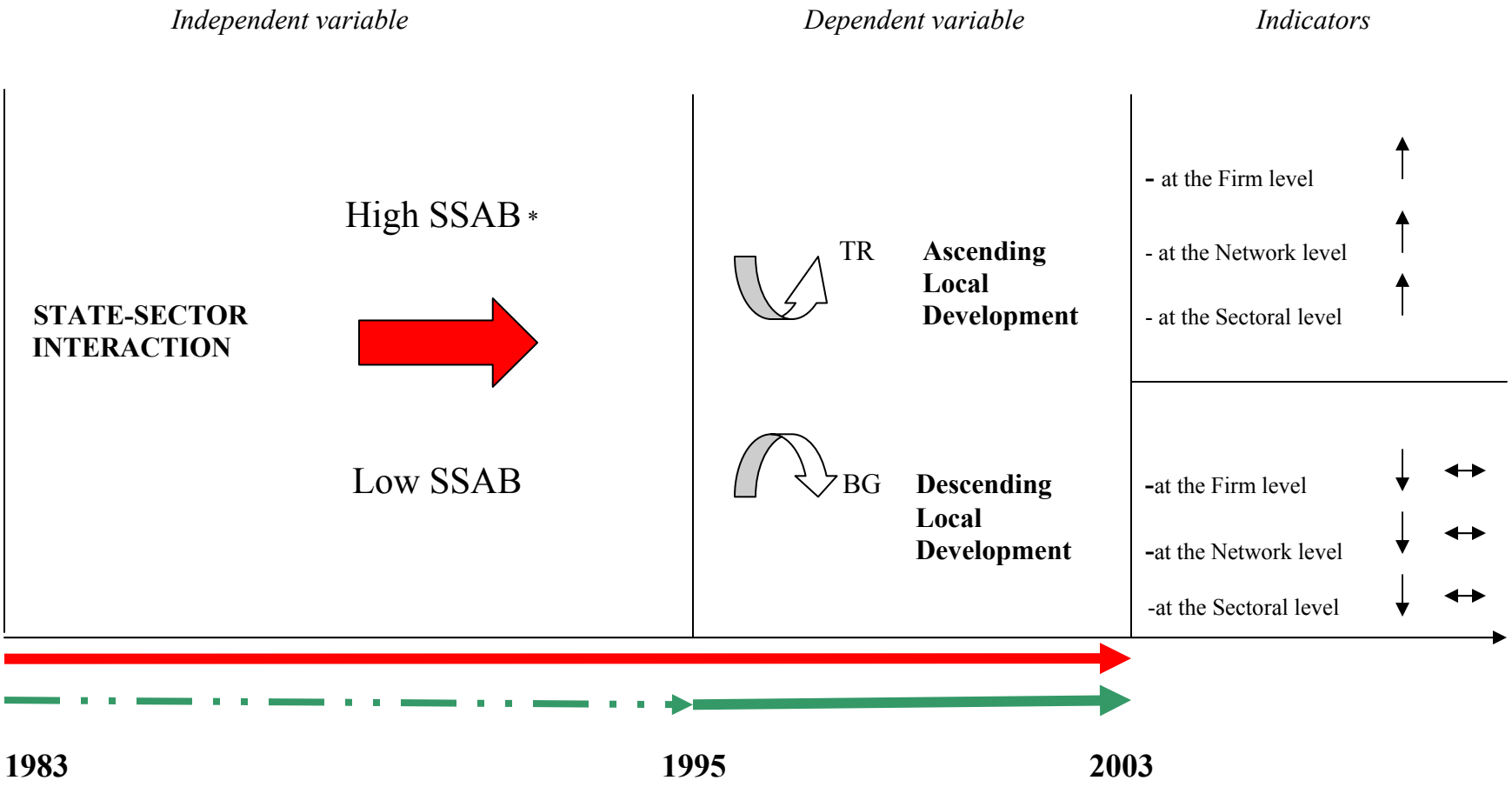
www.southtravels.com/middleeast/turkey/map.html.

APPENDICES

APPENDIX A. Model for T/C Development in the European Periphery



Source: Author's construction

* State-Sector Aptitude Building

Appendix B. Questionnaire

Firm Upgrading in Turkey and Bulgaria

Company name:……
Identify your position within the company:……..
Number of years of experience within the textile and clothing industry:…….

I. GENERAL INFORMATION

1. YEAR OF ESTABLISHMENT:

2. OWNERSHIP:
a) 100% state-owned
b) 100% private
c) mixed (please, specify the share of private/state ownership):……....

3. THE FIRM IS:
a) 100 % local
b) 100 % foreign
c) mixed (please, specify the share of local/foreign ownership)……

4. REGISTRATION OF THE FIRM:
a) Joint Venture
b) Management-Buy-Out
c) Limited Liability
d) Joint-Stock Company
e) Other:……

5. WAS THE COMPANY PRIVATIZED?
a) No
b) Yes (please, identify when:…….and specify the method of privatization: MBO…….%; Direct Sales…...%; Voucher:……..%; Other:……).

6. WHAT IS CURRENTLY THE NUMBER OF YOUR EMPLOYEES?
a) 10-49
b) 50-249
c) over 250

7. NUMBER OF YOUR EMPLOYEES:
a) At the end of 1980s:…….
b) 1995:……
c) 2000:……
d) 2002/03:……...

8. AVERAGE SALARY:

Bulgaria	Turkey
a) 60-109 USD	a) 110-219 USD
b) 110-159 USD	b) 220-299 USD
c) >160 USD	c) > 300 USD

9. TURNOVER OF THE FIRM:

Bulgaria		Turkey	
a) < 1 m USD	end of 1980s	a) <2 m USD	end of 1980s
b) 1-2.49 m USD	1995	b) 2-4.99 m USD	1995
c) 2.5-4.99 m USD	2000	c) 5-9.99 m USD	2000
d) > 5 m USD	2002/3	d) >10 m USD	2002/3

10. DO YOU HAVE YOUR OWN PRODUCTION FACILITY?
a) No
b) Yes (please, specify the location):…….

II. PRODUCTION AND INVESTMENT

1. WHAT PRODUCT/S DO YOU PRODUCE?

2. FIRM'S SPECIALIZATION?

a) textile.....%
b) apparel .....%
c) knitting……%
d) dyeing…….%
e) finishing/printing…..%
f) other:……

3. IDENIFY YOUR DEPARTMENTS AND NUMBER OF EMPLOYEES:

a) Statistical and Information Department
b) Logistics and Customs
c) Energy and Mechanical
d) Marketing:
e) Trade
f) Production
g) Design
h) Production Planning
i) Accountancy
j) Others:…….

4. THE ANNUAL INVESTMENT (FOR TURKEY) AND TOTAL INVESTMENT (FOR BULGARIA), WHICH THE FIRM MADE AFTER 1990 FALLS, IN THE FOLLOWING RANGES:

Bulgaria

a) <100.000 USD
b) 100.000 - 249.999 USD
c) 250.000 – 499.999 USD
d) 500.000 – 2.5 m USD
e) >2.5 m USD

Turkey

a) <200.000 USD
b) 200.000 - 499.999 USD
c) 500.000 – 999.999 USD
d) 1 m USD – 5 m USD
e) >5 m USD

5. DISTRIBUTION OF THE INVESTMENT:

a) Raw materials:……..%
b) New buildings:.....……%
c) Machinery:……..%
d) Others :.....%

6. USED RESOURCES FOR INVESTMENT:

a) foreign company's funds:…….%
b) local bank credits:……%
c) foreign bank credits:……%
d) profit reinvestment:…….%
e) other, please specify:…….

7. DID YOU DEVELOP NEW PRODUCT/S?

a) No
b) if yes, please specify:……..

8. DO YOU HAVE ISO CERTIFICATES (ISO 9000, 9002, 14000 OR BUYER'S AUDITS?

a) No
b) If yes, please specify what type and since when:……

9. DO YOU DESIGN YOUR PRODUCT/S?

a) yes, completely;
b) mainly we do;
c) mainly our foreign partner does;
d) no.

10. DO YOU HAVE YOUR OWN BRAND/S?

a) No
b) Yes (Please, specify how many) ……..

11. IF YOU HAVE YOUR OWN BRAND/S, PLEASE IDENTIFY WHICH MARKET/S THE FIRM ENTERS:

a) local
b) foreign
c) both

III. MARKETS

1. WHAT PERCENTAGE OF YOUR ANNUAL PRODUCTION (IN VALUE) IS FOR EXPORT?

a) End of 1980s:……..%
b) 1995:……...%
c) 2000:……..%
d) 2002/3:…..……%

2. PLEASE, INDICATE YOUR EXPORT MARKETS (SHARE OF TOTAL EXPORTS):

a) Bulgaria:……..%
b) France:……%
c) Germany ……%
d) Italy …….%
e) Russia…….%
f) Spain:…….%
g) Turkey……%
h) USA:……..%
i) Others, namely ……

3. WHAT PERCENTAGE OF YOUR EXPORT IS UNDER FULL-SUBCONTRACTING, SEMI-SUBCONTRACTING AND DIRECT EXPORT?

a) In late 1980s
- full:……...
- semi: ……
- direct export:……

b) 1995
- full: …….
-semi:…….
-direct export:……

c) 2000
- full:……...
- semi:…….
- direct export:……

d) 2002/3
- full:……..
- semi:……
- direct export

4. DO YOU HAVE YOUR OWN LOCAL SHOP?

a) No
b) Yes (please, specify the number of shop/s and location)….. ……..

5. DO YOU HAVE YOUR OWN SHOP ABROAD?

a) No
b) Yes (please, specify the number of shop/s and location) ……

IV. BUYERS

1. HOW HIGH IS THE SHARE OF THE TWO MOST IMPORTANT BUYERS IN YOUR EXPORT SALES?

a) >90%
b) 60-90%
c) 30-59%
d) <30%

2. SINCE WHEN DO YOU WORK WITH YOUR TWO MOST IMPORTANT BUYERS AND FROM WHERE DO THEY COME FROM?.....

3. DO YOU USE TRADE AGENTS TO CONNECT YOU WITH YOUR FOREIGN PARTNERS?

a) No
b) Yes, (please, specify from where they come from?.....

4. FOR WHICH FOREIGN BIG BRANDS DO YOU MANUFACTURE:…….

5. DO YOU FINANCE YOUR LOGISTICS WHEN YOU EXPORT?

a) yes, completely; b) mainly I do;
c) mainly my foreign partner; d) no

6. DO YOU PARTICIPATE IN LOCAL ORGANIZATION OF FIRMS FOR MARKETING AND DISTRIBUTION?

a) No
b) Yes

V. SUPPLIERS

1. WHAT IS THE PLACE OF ORIGIN OF YOUR RAW MATERIALS/TEXTILE INPUTS:

a) Bulgaria
b) Turkey
c) European Union
d) Arab world
e) United States of America
f) East Asia
g) Others:……

2. HOW HIGH IS THE SHARE OF YOUR TWO MOST IMPORTANT SUPPLIERS?

a) >90%
b) 60-90%
c) 30-59%
d) <30%

3. SINCE WHEN DO YOU WORK WITH YOUR MOST IMPORTANT SUPPLIERS?

4. DO YOU USE TRADE AGENTS TO PROVIDE YOUR RAW MATERIALS/TEXTILE INPUTS?

a) No
b) Yes (please identify from which country they come from)…….

5. WHAT IS THE PERCENTAGE OF THE SHADOW ECONOMY IN THE DOMESTIC TEXTILE AND APPAREL INDUSTRY?

a) >20 % b) 20-29 % c) 30-49 % d) 50-69 % e) >70 %

6. DO YOU TAKE PART IN LOCAL ORGANIZATION OF FIRMS FOR SUPPLY OF RAW MATERIALS/TEXTILE INPUTS?

a) No b) Yes

VI. INCENTIVES

1. HOW DO YOU EVALUATE THE SUPPORT FOR YOUR EXPORT ACTIVITIES FROM STATE AUTHORITIES?

a) very positive
b) positive
c) neutral
d) negative
e) very negative

2. IF YOU RECEIVED STATE SUPPORT, PLEASE IDENTIFY WHAT KIND:……

3. HOW DO YOU EVALUATE THE SUPPORT FOR YOUR EXPORT ACTIVITIES FROM BRANCH ASSOCIATIONS?

a) very positive
b) positive
c) neutral
d) negative
e) very negative

4. IF YOU RECEIVED SUPPORT FROM BRANCH ASSOCIATIONS, PLEASE IDENTIFY WHAT KIND AND FROM WHICH BAs:…… …….

5. EXPLAIN HOW DO YOU FIND THE FUTURE DEVELOPMENT OF YOUR FIRM?

……..

APPENDIX C. Map of Bulgaria

Source: www.investbulgaria.com/bulgarianMaps.htm

APPENDIX D. Map of Turkey

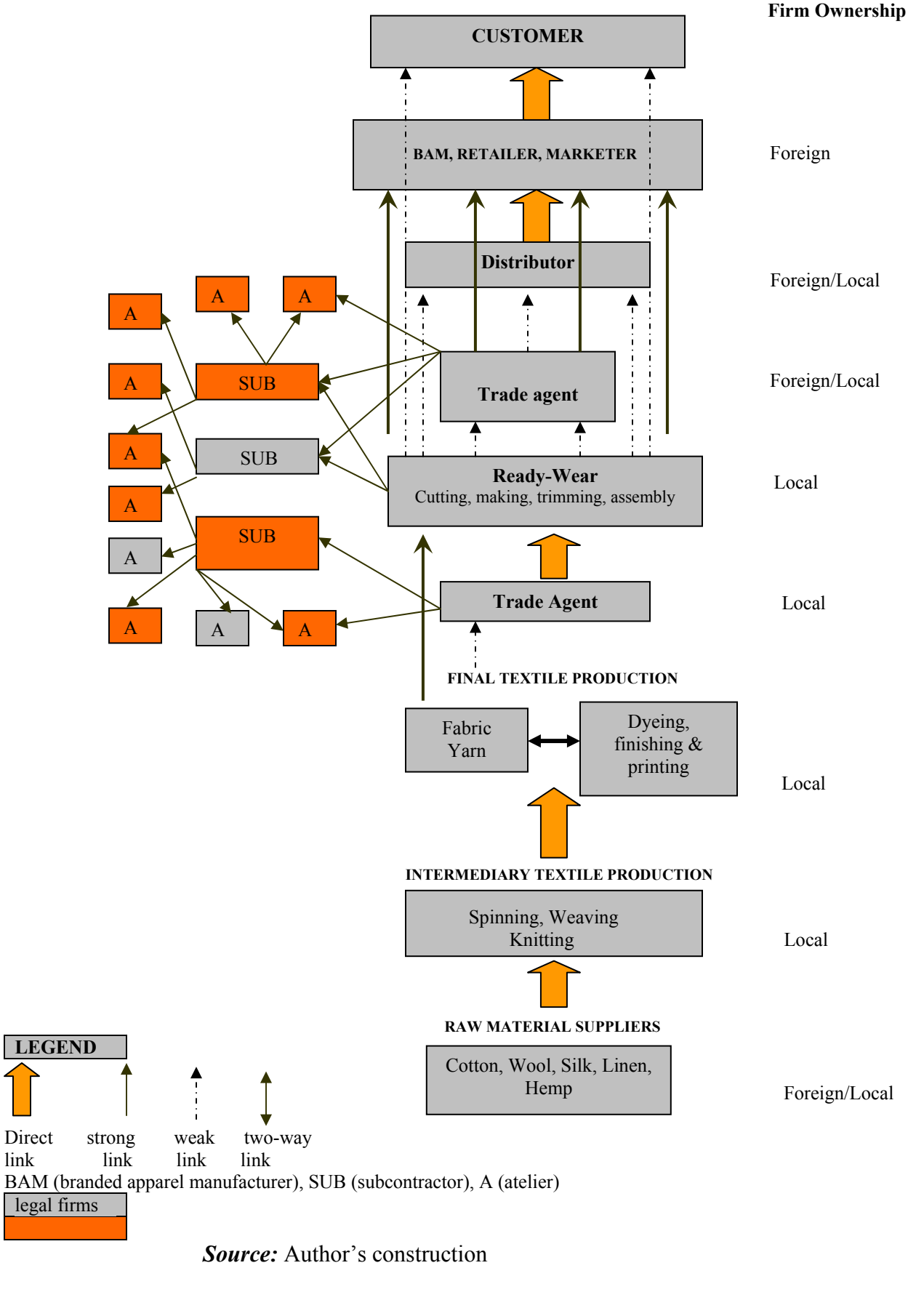
Source: www.southtravels.com/middleeast/turkey/map.html

APPENDIX E. Variables and Indicators

Variables	Indicators
Transnationalization	Firm export share of total production Firm export trend
Product upgrading	New products developed
Process upgrading	Bulgarian T/C firm investment Turkish T/C firm investment Investment in new buildings Investment in machinery Rank of investments (low/high) Majority share of investment distribution
Functional upgrading	Firm own brand Firm own shop Placement of own shop (home, abroad) Availability of marketing and design departments
Organizational upgrading	ISO standards and buyer's audits
Dependency on foreign buyers	Share of two most important buyers Firm biggest export market Firm concentration in the top export market Dominant firm contracts with foreign buyers in the following periods (late 1980s, 1995, 2000, 2002/3)
Dependency on suppliers	Raw materials' place of origin Share of firm two most important suppliers
Dependency on trade agents	Use of trade agents to connect with foreign clients Use of trade agents to connect with suppliers
Branch and State support	Attitude towards state support Attitude towards branch support Recoded branch support Recoded state support Recoded B&S support for Bulgaria Recoded B&S support for Turkey
Indexes	Index of small firms Index of large firms Index of dependency (clients, concentration in the top export market, suppliers) Index of full subcontracting Index of direct export
Others	Firm registration (MBO, liability co) Main form of privatization Firm employment trend Average salary (workers) Turnover of BG/TR firms and turnover trend Used resources for investment

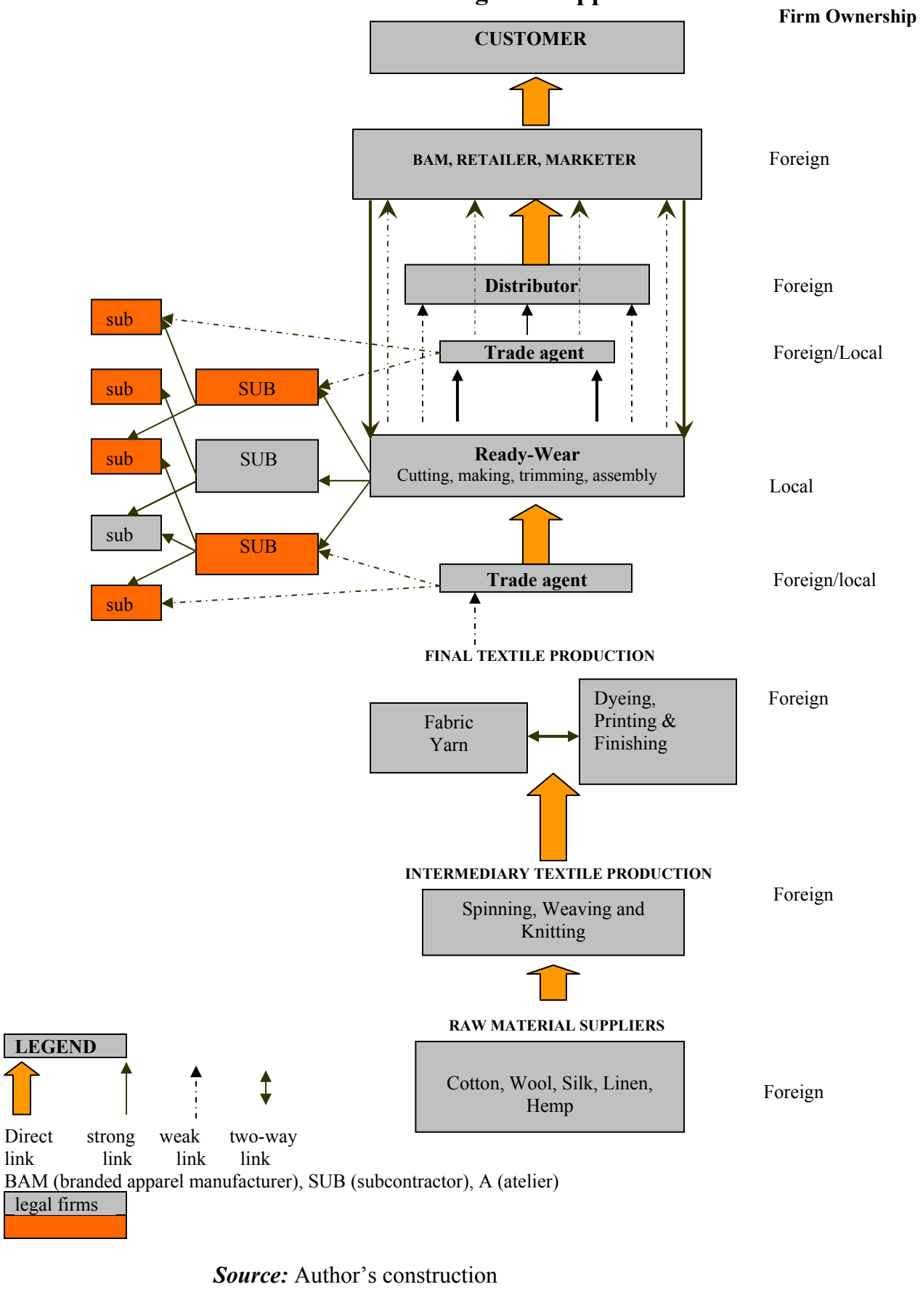
Source: Author's analysis based on survey results

APPENDIX F. Turkish Apparel Value Chain



Source: Author's construction

APPENDIX G. Bulgarian Apparel Value Chain



Source: Author's construction

APPENDIX H. Dependency indicators

Variable	Categories	Bulgaria	Turkey
I. Dependency on foreign buyers			
a) Share of two most important buyers N:55 BG firms; N:43 TR firms	>90 % 60-90 % 30-59 % <30 %	25 % 35 % 29 % 11 %	7 % 23 % 33 % 37 %
b) Firm concentration in the top export market N:59 BG firms; N:38 TR firms	>90 % 60-90 % 40-59 % <40 %	15 % 41 % 29 % 15 %	18 % 42 % 29 % 11 %
c) Dominant firm contracts with foreign buyers in the following periods:			
late 1980s N:20 BG firms (out of 20); N:23 TR firms (out of 28)	100 % subcontracting semi subcontracting direct export	35 % 15 % 50 %	39 % 22 % 39 %
1995 N: 46 BG firms (out of 47); N:32 TR firms (out of 37)	100 % subcontracting semi subcontracting direct export	57 % 17 % 26 %	31 % 22 % 47 %
2000 N:54 BG firms (out of 55); N:37 TR firms (out of 36+1 which did not show establishment year)	100 % subcontracting semi subcontracting direct export	65 % 15 % 20 %	8 % 16 % 76 %
2002/2003* N:58 BG firms (out of 59); N:38 TR firms (out of 43)	100 % subcontracting semi subcontracting direct export	64 % 12 % 24 %	8 % 10 % 82 %
II. Dependency on suppliers			
a) Share of firm two most important suppliers N: 48 BG firms; N:43 TR firms	>90 % 60-90 % 30-59 % <30 %	12 % 15 % 40 % 33 %	9 % 23 % 35 % 33 %
b) raw materials place of origin N: 53 BG firms; N:43 TR firms	Bulgaria Turkey EU Arab World USA East Asia others	15 % 17 % 53 % 2 % 2 % 9 % 2 %	0 % 77 % 16 % 0 % 0 % 7 % 0 %
III. Dependency on trade agents			
a) Use of trade agents to connect with foreign buyers N: 58 BG firms; N:43 TR firms	Yes No	66 % 34 %	30 % 70 %
b) Use of trade agents to connect with raw material suppliers N: 62 BG firms; N:43 TR firms	Yes No	40 % 60 %	26 % 74 %

Source: Author's survey database, N=Number of observations *firms were interviewed in 2003 and 2004, which respectively corresponds to last data for the database, namely for 2002 or 2003; BG=Bulgaria; TR=Turkey.

APPENDIX I. Upgrading indicators

Variable	Categories	Bulgaria	Turkey
I. Product upgrading			
a) New products developed N:57 BG firms; N:44 TR firms	Yes No NAP (in case of trader)	58 % 42 %	93 % 2 % 5 %
II. Process upgrading			
a) Bulgarian T/C firm investment (1990-2002/03) N:58 firms	<100.000 USD 100.000-249.999 USD 250.000-499.999 USD 500.000-2.5 m USD >2.5 m USD	28 % 29 % 12 % 22 % 9 %	--- --- --- --- ---
b) Turkish annual T/C firm investment (since 1990) N:41 firms	< 200.000 USD 200.000-499.999 USD 500.000-999.999 USD 1 m USD-5 m USD >5 m USD	--- --- --- --- ---	19 % 17 % 15 % 17 % 32 %
c) Investment in new buildings N: 41 BG firms; N:40 TR firms	0 % <30 % 30-59 % 60-90 % >90 %	44 % 17 % 27 % 12 % 0 %	15 % 33 % 30 % 10 % 12 %
d) Investment in new machinery and technology N:43 BG firms; N:41TR firms	0 % <30 % 30-59 % 60-90 % >90 %	0 % 5 % 37 % 23 % 35 %	17 % 22 % 34 % 17 % 10 %
e) Rank of the investments N:58 BG firms; N:41 TR firms	Very low Low Medium High Very high	28 % 29 % 12 % 22 % 9 %	19 % 17 % 15 % 17 % 32 %
f) Majority share of T/C firm investment distribution N:45 BG firms; N:41 TR firms	Raw materials New buildings Machinery Others	0 % 22 % 67 % 11 %	12 % 22 % 61 % 5 %
III. Functional upgrading			
a) Firm own brand N: 57 BG firms; N:41 TR firms	Yes No	56 % 44 %	76 % 24 %
b) Firm own shop N: 57 BG firms; N:44 TR firms	Yes No	39 % 61 %	52 % 48 %
c) Place of own shop N: 22 BG firms with shops (22 responded) N: 23 TR firms with shops (23 responded)	At home Abroad Both	91% 0 % 9 %	78 % 0 % 22 %
d) Availability of Design and Marketing departments N: 46 BG firms; N:44 TR firms	Both are missing Design is missing Marketing is missing Both are present	26 % 17 % 20 % 37 %	16 % 20 % 5 % 59%
IV. Organizational upgrading			
a) ISO standards or firm audits N:41 BG firms; N:42 TR firms	Yes No	34 % 66 %	62 % 38 %

Source: Author's survey database, N=Number of observations; BG=Bulgaria; TR=Turkey; NAP=non applicable.